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SOCIETY OF CONSERVATIVE LAWYERS

Procuring Economic Growth: An Overview of Procurement Law Reforms Essential to Recovery

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FOREWORD

It has been possible to produce this pamphlet due to the work of Natalie Etchells who is the Society's first Lyell Scholar. The Lyell Scholarship is named after the late Right Honourable Lord Lyell of Markyate QC who was Solicitor General between 1987 and 1992 and Attorney General between 1992 and 1997 becoming the longest continuously serving law officer for more than 100 years. Lord Lyell was Chairman of the Society of Conservative Lawyers at the time of his death in 2010. The Scholarship is funded by the legacy left to the Society by the late Pamela Thomas OBE who was closely involved with the Society for many years and served as its Secretary for more than twenty years. The Society would like to thank Simon Randall CBE for his hard work during the selection process for the Lyell Scholar and for the guidance and editing assistance he gave the author during the production of this pamphlet.

The need to improve the process of public procurement is well recognised. What Natalie Etchells identifies in this paper is the range of problems that exist, particularly in the wake of the financial crisis. These include the complexity of pre-qualification questionnaires, the administrative burden placed on public bodies by the obligation to have a lengthy EU-wide procurement process and the many difficulties that confront SMEs in the procurement process.

These issues are important not least because of the sheer scale of public procurement in the United Kingdom. £238 billion is spent on goods and services each year representing 15% of the UK economy. Natalie makes substantial proposals for reform which will make a valuable contribution to the debate on the way forward. These proposals reflect the underlying Conservative philosophy of creating a free and fair market and stripping away unnecessary bureaucracy. The Society of Conservative Lawyers very much welcomes her suggestions.

The Society of Conservative Lawyers is an association of lawyers who support or are sympathetic to the aims of the Conservative Party. Members hold a range of different views within those parameters and the views expressed in this paper are not necessarily held by all members of the Society or by the Conservative Party.

Foreword by Lord Faulks QC
Former Chairman of Research, Society of Conservative Lawyers

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February 2014

Introduction

It has been said of this area of law, at a fractious intersection between law and politics, that ‘no winners and only losers appear to exist’ with no one content with the current regime.

This paper discusses select contemporary problems in the public procurement process which the European Commission has addressed as the new procurement directive wended its bureaucratic way through the legislative hurdles, and suggests a range of options for practical improvement, with a focus on encouraging a longer-term perspective and simplifying the process for all involved.

This paper will provide an overview of four key issues: encouraging active participation in public procurement by Small and Medium Sized Enterprises (SMEs); the problem of simplifying pre-qualification questionnaires (PQQs); the effect of cross-border interests on UK procurement; and the establishment of a new regulator or ombudsman. The *Teckal* exemption will in addition be briefly addressed, but due to the complexity of the issues cannot be dealt with comprehensively in this paper. This paper will address the relevant parts of both the domestic and EU regimes for public procurement.

It should be noted from the outset that in order to promote growth public sector reforms both domestic and EU will need to be considered.

What is the relevance of public procurement during a recession?

Public procurement, whilst not a glamorous area of law, is essential to the provision of all government and local services, particularly as procurement itself has become an industry employing tens of thousands at costs running into billions.¹ Public procurement affects the purchase of goods, works and services by government or other public bodies and the regulations governing the process emanate from the European Commission. The interests balanced by public procurement are important: large sums of money, innovation and public administration.² Improving the efficiency of the procurement process will benefit society as a whole by reducing costs and time for the provision of goods, works and services, meaning that government and local authorities can do more with the available funds. This is of utmost importance in a time of austerity.

Without a long-term perspective both national and local government fails to innovate and add little value, effectively stagnating. It is vital to promote strategic involvement and meaningful contributions to economic recovery. The decline in investment since the global financial crisis justifies questioning the current role of public procurement in advancing economic recovery. The situation must be resolved with some urgency. It is considered by some that ‘radical short-term procurement strategic interventions’ are necessary in order to encourage recovery.³

1 *Jon Hughes and Professor Marc Day: Report on Public Procurement 2011*

2 *W.Stolwyk, “Public Procurement: Catch 22” – available at www.ssm.com*

3 *J G Murray, ‘Public procurement strategy for accelerating the economic recovery’ Research note (Improvement and Development Agency for Local Government (IDeA), Lisburn, UK) *Supply Chain Management: An International Journal* 14/6 (2009) 429-434, 429.*

The current situation

Following the financial crisis of 2007-2008 it is important to re-evaluate accepted or neglected areas within the governance of the state and how it interacts with the private sector to ensure that the most suitable approach is taken. This re-evaluation is essential in terms of perceived best-practice which may, in the short-term, be inappropriate and delay economic recovery.

There are more than 370 local authorities in England and Wales.⁴ This figure alone represents an incredibly complex situation for any procurement regime to manage. In a Local Government Association 2010 survey there were 141 responses on the European Commission's proposals to modernise EU procurement legislation. Two-thirds of respondents to the survey stated that procurement costs and administrative burdens had worsened as a result of the current European Directive 2004/18/EC incorporated into regulations in England, Wales and Northern Ireland.⁵ The European Parliament has just approved the new procurement directive which will shortly be presented to the Council of Ministers for approval. Fifty-four per cent of respondents believed that the simplicity of the procurement process had worsened. The procurement budgets of councils add a further layer of complexity to the regime, as most respondents had a budget of less than £50 million, but four respondents stated a team budget of more than £350 million for the 2010/11 financial year. The UK public sector currently spends £238 billion on goods and services a year, this represents approximately 15% of the UK economy.⁶

These figures serve to demonstrate both the significance of public procurement to the economy and the difficulties faced in designing an effective procurement regime.

There are numerous issues highlighted with UK procurement. The average public sector procurement costs around £46,000, compared to £19,000 in France,⁷ and the average completion time is 200 days. The threat of legal action further impacts councils, which can lead to risk averse procurement processes in some cases.⁸ However, it is evident that the need to reduce costs and the potential achieved through long-term perspectives are likely to be difficult to reconcile,⁹ and it is often forgotten that procurement is essentially an economic and commercial activity.¹⁰

Conclusions

This paper will conclude that priorities for procurement reform are:

- a) Reducing costs
- b) Simplifying the process
- c) Creating a level playing field for all including SMEs
- d) Pragmatism
- e) Long-term value creation

The recommended way forward will be increased flexibility in the tendering process, and a new ombudsman and/or a new procurement specific tribunal.

4 Local Government Association, *Research Paper, 'The impact of EU procurement legislation on councils', Local Government Group, December 2010, at p.2, available at <www.local.gov.uk>*.

5 *ibid* at 3

6 Cabinet Office, *Press Release, 'Supporting economic growth through public procurement', 26 April 2012*

7 Cabinet Office, *Press Release, 'Radical package unveiled to support business and promote growth', 20 November 2011*

8 Local Government Association, *Research Paper, 'The impact of EU procurement legislation on councils', Local Government Group, December 2010, at p.3, available at <www.local.gov.uk>*.

9 J G Murray, 'Public procurement strategy for accelerating the economic recovery' *Research note (Improvement and Development Agency for Local Government (IDeA), Lisburn, UK) Supply Chain Management: An International Journal 14/6 (2009) 429-434, 430.*

10 W.Stolwijk, 'Public procurement: Catch 22', p.2, available at <www.ssrn.com>.

The EU definition of an SME requires a headcount of less than 250 and a maximum annual turnover of £40 million.¹¹

The problems of SMEs have been well documented. The inability to access loans and cash flow difficulties are commonplace, and exacerbated by economic recession. Business failure may result in a consequential loss of revenue to local authorities with higher unemployment leading to greater demand on public services.

Furthermore, there is an innate prejudice by public sector bodies against SMEs and, despite comfortable words of support in the new draft directive, the process threatens to become more complicated and discouraging for SMEs.

What can be done to encourage SME participation?

The package of measures announced by Cabinet Office Minister Francis Maude MP is tailored to SMEs specifically and will include plans to streamline the procurement process.¹² The new approach is part of a long-term programme of reform.¹³ The programme is to include:

- a) Continuous improvement of the way in which the UK buys public goods and services by taking a more strategic approach; and
- b) A levelling of the 'playing field' for those UK based suppliers, who may previously have had difficulty accessing public sector tendering opportunities.

Other stated Government aims to address 'short-sighted decisions' include:

- a) Making it 40% faster to do business with the Government; and
- b) Collaborating with businesses at an earlier stage in the procurement process in order to include them in all possible opportunities.¹⁴

Whilst these concepts are encouraging there is no discussion of the practicalities of the implementation of these aims, at this stage they remain concepts. Heralding a new approach does not necessarily translate to the adoption of a new approach.

Further recent measures adopted to promote SMEs have included:

- a) The appointment of Stephen Allott as a new Crown Commercial Representative (CCR) for SMEs;
- b) The launch of SME product surgeries;
- c) Seeking to eliminate PQQs for all central government procurements under £100,000; and
- d) Allowing firms to submit their pre-qualification data once for all procurements in common commodities.¹⁵

The division of contracts into lots has been proposed in the new EU procurement directive. It was proposed specifically to encourage SME participation through a reconsideration of the structuring of opportunities.¹⁶ However, the Local Government Association is apprehensive of the possibility of resulting legal challenges.

11 *Recommendation 2003/361/EC*, available at <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:124:0036:0041:en:PDF>>; see further European Commission, Enterprise and Industry Publications, 'The new SME definition: user guide and model declaration' available at <http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf>

12 OGC, 'Procurement Policy Note- Package of announcements to support small businesses', Information Note 19/10, November 2010 and *Small Business: Great Ambition 2013*.

13 Cabinet Office, Press Release, 'Supporting economic growth through public procurement', 26 April 2012

14 Cabinet Office, Press Release, 'Radical package unveiled to support business and promote growth', 20 November 2011

15 Cabinet Office, Press Release, 'Government opens up contracts to small business', 11 February 2011.

16 Local Government Association Response 'EU proposals for procurement reform', February 2012, p.6, available at <www.local.gov.uk>

However, further guidance is necessary. Respondents to the Local Government Association survey said that clarity was needed around the use of local SMEs, particularly in terms of a policy decision either to encourage SMEs or whether they work under a ‘big is best’ agenda.¹⁷

Although Government might have wished to be more radical and adopt the Prime Minister’s proposal¹⁸ to exempt Europe’s entrepreneurial SMEs from more directives (perhaps including procurement), an initiative was agreed with European Union member states for time limited contracts for mutuals at the December 2012 Competitiveness Council. This was supported by the Irish Presidency (Press Release 2 May 2013).¹⁹

The policy note from the Cabinet Office 25 July 2013 confirmed that trilogue negotiations on the revised EU directives concluded in July in Brussels. This has now been agreed by the European Parliament. The key change in the proposed directive, which could be quickly transposed into UK regulations, is the ability of a public body to “reserve the award of certain services contracts to mutuals/social enterprises for a time limited period”²⁰

PQQs

The selection of suppliers is a crucial part of the procurement process. Pre-qualification questionnaires are used to reassure procurers that the supplier is suitable.²¹ They provide a structured means of capturing the required information for the selection of suitable suppliers. However, PQQs are not mentioned in either EU or UK law, although both the relevant directives and the domestic regulations permit contracting authorities to carry out a short listing exercise (except in the “open procedure”). This has given rise to the growth of increasingly formal and long PQQs.

Carrying out procurements with complex PQQs may be viewed as the Local Authorities ‘playing it safe’. It is effortless for contracting authorities to over-formalise the process. The extensive questions increase costs for bidders and are not always necessary.

The current situation is disadvantageous to smaller companies as they may have difficulty navigating the complex PQQs and it may be beyond their capacity to compete with larger companies under these circumstances.

17 *Local Government Association, Research Paper, ‘The impact of EU procurement legislation on councils’, Local Government Group, December 2010, at p.9, available at <www.local.gov.uk>.*

18 *EU Speech at Bloomberg 23 January 2013.*

19 *Government response to the Communities and Local Government Select Committee’s Report: Mutual and Co-operative approaches to delivering local services.*

20 *Cabinet Office: Procurement Policy Note – Further progress update on the Modernisation of the EU Procurement Rules July 2013*

21 *OGC, ‘Procurement Policy Action Note – ‘Mandated use of core pre-qualification questions in Central Government’, Action Note 20/10, December 2010, p.2, para 13.*

What can be done to simplify PQQs (for all parties to public sector procurement contracts)?

As part of its SME initiative the Cabinet Office has produced a simplified set of PQQs for use both above and below procurement thresholds. These simplified PQQs were mandated for use from 1 December 2010, with supplementary questions for specific projects or sectors. The standard is not compulsory, but it recommended, for the full public sector.

Discouraging local authorities from imposing additional questions for new SMEs is also important. Local authorities may seek to reassure themselves that a new SME supplier is suitable by asking more extensive questions, for example about industrial accident records and environmental policies.

Prior information notices may help to simplify the tendering process. The proposed introduction of the 'light' procedural regime for 'sub-central' authorities is a helpful development.²² The proposals permit the use of a prior information notice ('PIN') to suffice as the call for competition. This change will significantly improve efficiency as the publication of separate contract notices would no longer be necessary for certain types of procurement.

Cross-border Interests

The public procurement regime requires that opportunities above the OJEU thresholds are advertised EU-wide. Thus, there is scope for companies based elsewhere in the EU to win contracts and provide services and goods to the UK.

Current situation / Current problems

An assessment of the extent to which suppliers from outside the UK have submitted expressions of interest, submitted tenders, and been awarded contracts for tenders advertised by respondent local authorities was carried out by the Local Government Association (LGA).²³ The survey found that it is unusual for suppliers based in other EU countries, without a UK base, to be involved. 76% stated that they rarely or never receive expressions of interest from this type of supplier. 89% stated that they rarely or never received tenders from these suppliers. 91% stated that contracts are rarely or never finally awarded to these suppliers. Whilst these statistics are by no means comprehensive, as only 141 councils responded to the survey, it is important to acknowledge that a significant majority of those who did respond feel that there is little effect or productive contribution in advertising tenders beyond the UK and that the exercise incurs unnecessary costs.

The LGA presented evidence to the European Commission showing a lack of cross-border interest in procurement markets at low contract values.²⁴ The stated result of this was the incurring of unnecessary administrative burdens on public bodies in running lengthy EU-wide procurement processes, which receive little or no notice from those based abroad.

However, the awards to foreign businesses by the UK comprise 3% of the value of UK public procurement.²⁵ It is higher than that of either Germany (1.9%) or France (1.5%).

There are two additional issues. No account has been taken of inflation since the introduction of thresholds. There is also a feeling of unfairness about the regime, given that the Commission and other EU bodies may not have to follow the same procurement rules.

22 *Local Government Association Response 'EU proposals for procurement reform'*, February 2012, p.4, para 1.4, available at <www.local.gov.uk>

23 *Local Government Association, Research Paper, 'The impact of EU procurement legislation on councils'*, Local Government Group, December 2010, at p.13, paras 37-38, available at <www.local.gov.uk>.

24 *Local Government Association Response 'EU proposals for procurement reform'*, February 2012, p.2, available at <www.local.gov.uk>

25 J.G. Murray, 'Debate: Revolutionizing or recycling public procurement policy in the UK?' (2012) *Public Money & Management*, 32:3, 165-167, at 166.

What can be done to resolve the issues?

The need to raise thresholds was mentioned several times in the Local Government Association survey.²⁶ A more proportionate approach has been called for based on significantly raised thresholds. However, this may prove difficult to achieve as there could be a conflict with World Trade Organisation thresholds.

Increasing thresholds is certainly one method of dealing with the issue of cross-border interests, but it would not resolve the issue in its entirety. It is important to consider making the advertising process more flexible and to reconsider if cross-border tenders are suitable in all areas of supply of goods and services. A refinement of the areas which are subject to cross-border expressions of interest may also relieve the problem.

Establishment of an oversight body

Is additional regulation of procurement desirable?

The original draft of the new Directive required the establishment of a mandatory oversight body, independent from government.²⁷ The revised Directive now envisages that Member States will be required to actively enforce implementation and, in particular, monitor the success (or otherwise) of SMEs. However, it is also desirable to have some form of organisation to provide, as a minimum, advisory services to local authorities and SMEs. Currently there is no such separate organisation. It would promote the participation of SMEs in procurement exercises and provide necessary clarification to local authorities if a body with at least ombudsman status was established. Three options to remedy this situation are considered below:

- a) a new agency or regulator specific to procurement;
- b) an ombudsman; or
- c) a tribunal to hear grievances.

How can this be improved? - Evaluating the options

A new regulator?

A new agency with authority over procurement processes perhaps has an appealing facade of simplicity. However, the establishment of such an authority would incur very substantial expense and may add another layer of complexity to the procurement regime.

The Local Government Association was decidedly against a single independent oversight body and would not welcome a new public agency established specifically for police procurement, and argues that development in public procurement practices should be driven by the local government sector.

Furthermore, difficulties as regards conflicts of interests have been foreseen including the monitoring of the application of the rules and of the provision of legal advice to the contracting authorities.

An ombudsman?

An ombudsman, as opposed to a new agency, is a non-intrusive option. The ombudsman's role would most helpfully be in providing independent resolution of disputes or grievances. There is a need to encourage public sector contracts, make it easier to get SMEs involved and make the whole regime more accessible. It could also have the effect of reducing litigation costs if it works to resolve public-private sector grievances without the involvement of the courts or a new tribunal.

26 *Local Government Association, Research Paper, 'The impact of EU procurement legislation on councils', Local Government Group, December 2010, at p.8, available at <www.local.gov.uk>.*

27 *Local Government Association Response 'EU proposals for procurement reform', February 2012, p.11, available at <www.local.gov.uk>*

By analogy with financial services the ombudsman could be funded by the sector, rather than government, akin to the Financial Services Ombudsman. Additionally this would preserve independence from government influence.

A tribunal?

It is argued by the LGA that the national courts should continue to enforce procurement law. However, a specific tribunal may help to equip SMEs to deal on a more even footing with local authorities and avoid the discouraging, lengthy and expensive legal process. A useful model for developing this idea would be that of the German procurement tribunals.

Public procurement in Germany is a matter of concurrent legislative power, meaning that the Federal States (*Bundesländer*) can legislate provided that the Federation has not enacted a law itself.²⁸ In Germany the review system for public procurement applies only above the EC thresholds. There are public procurement tribunals as the first instance and the Court of Appeal (*Oberlandesgericht*) as the appellate instance.

At first instance at the pre-contractual stage the procurement tribunal may be addressed if a competitor wants to interfere with an ongoing procurement procedure. The decision has the legal character of an administrative act (*Verwaltungsakt*). The tribunal has the competence to require the contracting authorities to act in a specific way, for example an order to alter the proceedings or halt the awarding procedure. The Court of Appeal may choose to overrule the tribunal's decision or to confirm it. It may also remit the case back to the tribunal to decide again in light of the Court of Appeal's legal opinion.

After the conclusion of the contract the tribunals may rule that the contract is ineffective. However, the tribunals have no competence to decide on compensation, thus these claims must be brought to civil court.

An adaptation of this to suit the SME agenda could involve preferential costs rules to SMEs with, for example, reduced costs if successful.

Other selected issues

Localism Act 2011

The Community Right to Challenge ('CRC') provided for in the Act may be incompatible with the EU procurement regime. The CRC allows voluntary/community groups/staff co-operatives to challenge and require a Local Authority to run a procurement exercise to externalise the service.²⁹

At this stage it is unclear precisely what the effect and interaction will be. Concerns have been raised by lawyers about the interface between the two regimes. Questions raised included:

- a) Can an authority be a contracting authority and its staff a bidder for its own contract simultaneously?
- b) Under what conditions can an authority abandon a CRC-triggered procurement process or ignore the result?
- c) And, what standard of evidence is required to justify such decisions?

A growing number of authorities are taking on a commissioning role, encouraging the transfer of services to either voluntary/charitable bodies or locally created social enterprises/SMEs utilising the Localism Act's general power of competence. The public procurement rules in such a situation consequently interfere with the legitimate aspirations of elected local authorities although the recently approved EU procurement directive would enable an authority to negotiate direct with a mutual or social enterprise for a limited three year contract.

28 *Article 74 I No.11 Constitutional Law; Public Procurement Network, Italian Presidency, eds Tiziana Bianchi and Valentina Guidi, 'The comparative survey on the national public procurement systems across the PPN' at 81, available at <<http://www.publicprocurementnetwork.org/docs/ItalianPresidency/Comparative%20survey%20on%20PPN%20systems%20across%20PPN.pdf>>*

29 *Local Government Association Response 'EU proposals for procurement reform', February 2012, pp.5-6, available at <www.local.gov.uk>*

Teckal

For cases falling within the *Teckal* exemption, where the services are transferred to a wholly-owned entity, the need for a public procurement process is removed, with public bodies dealing directly with the private sector.

Some respondents to the Local Government Association's survey highlighted concerns over case law creating ambiguity in terms of what is and is not allowable in procurement practice.³⁰

Despite some uncertainty in the effect of case law, the LGA welcomes the proposed codification of the second limb of the *Teckal* test as adding to legal certainty.³¹

It is important for the Government to steer the EU procurement regime towards a nuanced and clear approach to the *Teckal* exemption. Clarification of *Teckal* has been incorporated in the new recently approved Directive with a changed 20% provision, but it does not necessarily allow for local variations.

Improvement of social, environmental and economic wellbeing

The new Directive (Article 67) contains some comfortable words stressing the importance for local authorities of issues in making decisions on letting contracts. This coincides with the coming into force of the Public Services (Social Value) Act 2012.³²

This legislation is important for SMEs in that it will require local authorities to focus on the broader issues of social, environmental and economic wellbeing preferring locally-based or smaller contractors.

30 *Local Government Association, Research Paper; 'The impact of EU procurement legislation on councils', Local Government Group, December 2010, at p.6, available at <www.local.gov.uk>.*

31 *Local Government Association Response 'EU proposals for procurement reform', February 2012, p. 4, available at <www.local.gov.uk>*

32 *Public Procurement Note 10/12 (Cabinet office) 20 December 2012*

Conclusion and Recommendations

It is apparent that as a minimum a clarification of many areas discussed in this paper is necessary. The way forward must take account of the need to simplify the procurement process, create a level playing field for all participants, take a pragmatic approach to the issues posed by the interaction between EU and UK law and create long-term value rather than short-term gains.

A package of ways to proceed is recommended as it is important that multiple options are employed concurrently to tackle the inter-dependent issues of the various market participants:

- a) A further, detailed examination of how procurement tribunals could be established in the UK and what powers they should possess;
- b) The establishment of an ombudsman to deal with or mediate disputes or grievances;
- c) A re-examination of the advice given by government on best practice, particularly as concerns PQQs and the pre-contractual element of the process;
- d) Review at the EU level of cross-border interests and consideration of greater flexibility in this area according to location or type of service/goods supplier or industry area taking into account the “light regime” incorporated in the new Directive;
- e) More comprehensive guidance from government for contracting authorities on the priority of promoting SMEs;
- f) Final approval to the EU Procurement Directive. The Government’s welcome proposal to provide a time limited window to exempt Europe’s social enterprises, public sector or employee mutuals from enduring procurement where local authorities have legitimate reasons for negotiating direct with such mutuals³³ has been incorporated in Article 77 of the new Directive. This involves three year contracts to bodies “based on employee ownership or participatory principles, or [requiring] active participation of employees, users or stakeholders”.
- g) Quick transposition of the Directive into UK regulations with considerable simplification.

33 *European Parliament Legislative Resolution of 15 January 2014*

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