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The 'Fiasco' of the West Coast Rail Franchise and the European Public Procurement Rules

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Preliminary

For the past two decades the carriage of rail passengers has been done by private operators to whom concessions have been given to run the services (rail franchising). A report in January 2013 by Richard Brown confirmed the overall success of this policy despite a recent procurement failure (the West Coast Line Rail Franchise), which is the subject of this article. Brown says "Having examined the position, I share the Government's view... that the rail industry works, and that there is no credible case for major structural change.... Since privatisation, Britain's railways are successfully carrying more passengers, more safely, on many more and newer trains, more of which arrive punctually and with greater levels of passenger satisfaction."

Rail franchising is of interest to the author[1] because it is affected by the operation of the European directives on public procurement. She has practised in this area of law, originally as a local government lawyer, since the early 1990s. The author has published academic articles and responses to EC Commission consultations papers since then sharply critical of the legislation, in particular the enforcement regime introduced in 2009, which has made it virtually impossible to run a challenge-free public procurement. The rate of challenge has dramatically escalated since 2009 though the disruption and expense rarely hits the headlines. The procurement challenge to the West Coast rail franchise tendering exercise however grabbed public attention and might help focus attention on whether the European procurement regime provides value for money.

Virgin Rail was the incumbent supplier for the West Coast line. In July 2010 the government launched a consultation on rail franchising policy, considering alternative mechanisms for managing risk within a revised franchise contract. At about the same time it considered but declined an offer from Virgin to extend its rail franchise by two years until March 2014. Instead it went out to tender on what was to be the largest contract it had ever tried to let, at a time when cuts were being made in departmental staffing. Virgin challenged the award to First Group in August 2012. The provisional award was cancelled two months later and Virgin was confirmed as the service provider in the interim until November 2014.

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[1] Rosemary Boyle is an in-house commercial lawyer for the University of Cambridge, which, thankfully, is not subject to the European public procurement directives, though it generally tenders its contracts on a voluntary basis, broadly in line with but not subject to the directives. The views expressed in this article are personal, not the views of her current or former employers. Rosemary has advised on complex procurement and other contracts since the late 1980s, including IT procurement and outsourcing of services. She also advises on intellectual property law.

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Introduction: European public procurement law

Most public procurements in every member state of the European Union (even a services contract if it costs more than £40,000 per year) have to be advertised in the Official Journal and let in accordance with a very thick legislative rule book[2]. The public procurement directives are an internal market measure[3] intended to promote cross border trade and freedom to provide services. Detailed rules are designed to ensure that every stage of the process is transparent, beginning with an advertisement in the Official Journal, and bidders are treated equally. Every possible loophole is blocked. This results in detailed and complex legislation, which is also unfortunately unclear. Contracting authorities have to give advance notice of awards, and disappointed tenderers have powerful rights to challenge the award. If legal proceedings are brought, the award is automatically suspended.

Some services, known as 'Part B' services, are not thought to be of cross border interest, so are only minimally regulated. Part B services do not need to be advertised in the Official Journal. The strict requirements for Part B services are simply that contracting authorities must treat all bidders equally in accordance with the Treaty of Rome, ensure the specifications are not discriminatory and publish a contract award notice. Normally contracting authorities advertising in this way do not intend to be bound by the full gamut of the EU procurement rules, though in at least two cases it was argued that a contracting authority advertising on this basis was said to have submitted to the jurisdiction of the regime so that the rules could be enforced against it. So far the Court of Appeal has not accepted that argument, in the absence of any clear mutually agreed intention. The Court of Appeal was however prepared to accept that there was an implied contract imposing an obligation on the contracting authority to consider the tender in good faith. Although the court agreed that general principles of EU law (relating to transparency and equality) can apply to contracts not fully subject to the EU legislation, it refused to go further on the ground this would be an illegitimate attempt to expand the reach of EU law. [4]

The fact that a contracting authority in good faith prefers one bid over another or constructs its financial model for award in one way rather than another should not be a ground for challenge in itself. Nor, in the author's view, should it be a ground for challenge that the winning bid did not provide the best value - because otherwise it would be impossible ever definitively to make an award. Moreover, in the author's view, bearing in mind the purpose of the directives as an internal market measure, public procurement value for money is not within the jurisdiction of EU procurement legislation; this is a matter for Member States. Rather, some actual breach of the rules must be shown; and the courts should respect purchaser discretion and not go on a hunt for a breach to enable them to review decisions which are really judgments about value for money. [5]

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[2] *The Public Sector Directive 2004/18/EC* ("the Directive"), implemented in England and Wales in the *Public Contracts Regulations 2006* ("the Regulations"). On 11 December 2012 the Council of Ministers put forward a proposal to replace this directive (Proposal 16725/1/12, 2011/0438 COD)

[3] Authority derives from Treaty on the Functioning of the European Union, and in particular Article 53(1) (mutual recognition of qualifications), Article 62 and Article 114 (harmonisation to promote the internal market)

[4] *JBW Group Ltd v Ministry of Justice [2012] EWCA Civ 8*).

[5] If a 'best value requirement' is felt appropriate, this should be a matter for national not European legislation: See the discussion at p31-5 in *Social and Environmental Policies in EC Procurement Law*, Editors Arrowsmith and Kunzlick, CUP 2009, where the potential for confusion is traced back to the Commission's desire to assert value for money considerations as a benefit of EC procurement policy. "Value for money is not per se an objective of the EC regime." However judges have been tempted to stray into this area. See for example in the case of *Henry Bros (Magherafelt) Ltd and others v Department of Education for Northern Ireland (No.2)* [2008] NIQB 105, where Coghlin LJ was unimpressed by the contracting authority's external specialist

The West Coast 'rail fiasco'

The UK rail franchise programme was advertised in January 2011 in the Official Journal as a 'Part B' service on a voluntary basis.

Between July and October 2012 Sir Richard Branson of Virgin Rail, a bidder in the UK rail franchise programme, stopped the Department for Transport (DfT) £5.5 billon West Coast rail franchise decision 'in its tracks'. This article looks at what has been said went wrong with the procurement, and the legal consequences; and also takes the opportunity given by this high profile bid challenge to consider what is the purpose of a public procurement regime and question whether the current procurement regime, implemented in the Public Contracts Regulations 2006 ("the Regulations"), is the appropriate way to regulate public procurement. It concludes that the European procurement regime needs radical reform.

The Procurement Process is cancelled

The publicity message in October 2012 when the award was overturned was that Richard Branson had saved the taxpayer from an expensive mistake: the procurement officers 'got their maths wrong', despite the fact that an 'independent' report (from the Virgin team) had pointed this out before the award. 3 senior civil servants were suspended though later re-instated (one later brought a successful legal challenge against the DfT); the Minister apologised and commissioned 2 reports (one on the award process and one on the wider franchise programme[6]); the National Audit Office (NAO) also investigated; and initially it seemed that bidders were to be refunded their bidding costs[7].

Meanwhile the chief executive of First Group, which had been named as preferred bidder, commented: "The issues could have been remedied another way and that's really what we are trying to understand." It is however hard to remedy EU procurement breaches retrospectively. In the end the DfT paid up all round. It paid £5m to FirstGroup for preparatory work before the competition was scrapped. This payment was part of £46m to refund bid costs of the companies that pitched for the lucrative contract and further £9m of other costs. Add to this the initial costs of tendering and of re-tendering and the cost of the 3 inquiries and it is appropriate to ask if this outcome really was a good one for the public purse; and how public procurement challenges should be handled.

The main sources for finding out what happened are the NAO report[8] and the Laidlaw report commissioned by the DfT (which cost £3.5m[9]) both published on 6 December 2012. The NAO and Laidlaw agreed that there had been errors, errors described by Patrick McLoughlin, transport secretary (apparently not involved in the decision making) as "completely unacceptable". The NAO concluded that swingeing cuts at the DfT,

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professional advisers' evaluation model on price and accepted instead the claimants' contention that there were errors in the procedure for determining which tenders were the most economically advantageous. See also Morrison v Norwich City Council 2010 EWHC where Arnold J was prepared to grant an injunction because it was arguable that the contracting authority had *not done enough* to investigate whether the winning bidder was abnormally low, even though Regulation 30(6) of the Regulations gives contracting authorities the right to reject an abnormally low tender, subject to giving bidder a right to justify its tendered price. But it does not require rejection.

[6] The Brown report referred to above, January 2013, available from the Department for Transport website.

[7] There were second thoughts on this, reported in the Daily Telegraph Business section on 1 Feb 2013. The four train companies who bid were reported to be 'furious' that they would not be compensated for their £40m bidding costs. "The Government defended its position by pointing to a clause in the Great Western tender document, stating "it will not be responsible for the costs or expenses" of any bidder.'

[8] The NAO report is available on the NAO website and the Laidlaw report can be downloaded from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/29866/report-of-the-laidlaw-inquiry.pdf

[9] per Simon Burns the Transport Minister on 18 December 2012 (London Evening Standard report)

together with rushed implementation of changes to rail franchising policy, lay at the heart of what went wrong. There was the usual rush that occurs when serious money is at stake to blame everyone else and take the high ground if not implicated. Rail union RMT was on the chase, estimating that the final bill could top £100m; and the Labour chairwoman of the Public Accounts Committee commented that the procurement was a 'first class fiasco' and it was 'bewildering' that the department thought the FirstGroup bid was deliverable. The final report, issued on 23 January 2013 by Committee chair, Labour MP, Louise Ellman was equally critical. Although 3 Conservative MPs refused to join in, the committee criticised the ministers at the time for giving insufficient oversight. The committee also ventured the opinion that "There remain concerns that officials manipulated the outcome of the competition to ensure First Group got the contract" and recommended the Department investigate further.

Mr Rutnam, permanent secretary at the DfT, told the Public Accounts Committee that at least some of the failure was attributable to not spending enough on external consultants. Basic organisational issues seemed to drift too. It would seem that a lot of the procurement was conducted without clear oversight: until March 2012 it was not clear who was the senior DfT officer in charge of the project.

No-one seems to doubt that mistakes were made. In the immediate aftermath of the decision in October 2012 to cancel the award, a senior DfT official decided to write to bidders saying there had been flaws in the process. And the NAO concluded: 'It is clear that the Department's conduct in the InterCity West Coast franchise competition was not value for money. It is likely to result in significant cost for the taxpayer, the full value of which is unknown at present.' The Transport Select Committee agreed.

What happened?

The bare facts are: The contract award committee approved the award on 25 July 2012. Virgin complained to the Minister on 23 July, before the award, and again on 10 August 2012. The award was confirmed on 14 August 2012. Virgin filed judicial review proceedings and parallel proceedings under the regulations on 28 August 2012. The award was cancelled on 3 October 2012.

The first thing to notice is that the DfT budgeted £1.9m for advice on the procurement and retained Eversheds and Atkins (legal and technical advice). There seems however to have been a question mark over how financial advice was provided.

Laidlaw's primary focus was 'flaws related to the process' by which the DfT determined the level of the subordinated loan facility (SLF) which bidders were required to put up against the risk of them walking out on the contract.

On 19 June 2012 the contract award committee agreed indicative levels which the two leading bidders, Virgin and First Group, were told about. These indicative levels were based on an initial assessment. On 27 June, the committee approved final values for all bidders: FirstGroup was required to put in place an SLF of £190m for a bid that envisaged returning £13.3bn to the taxpayer by the end of 2028 based on annual revenue growth of 10.4% a year. Virgin was required to pledge an SLF of £40m for its offer to pay £11bn, based on 8.5% annual growth. Virgin said that FirstGroup should have been asked to put up £600m.

The SLF sought to guard against a risk that bidders offered large premiums to the DfT based on over-optimistic projections of revenue growth. If the franchise is profitable, the risk to bidders from not achieving these projections reduces over the contract, as should they default they will have already generated considerable profit. The DfT had reviewed the fact that in the past franchises the subordinated loan facility was typically small and

felt that it needed to change the way the SLF was calculated to ensure that West Coast bids would be resilient to an economic downturn.

In November 2011 financial advisers Grant Thornton had helped the DfT analyse the impact of using the GDP mechanism to calculate the SLF, using bidders' risk adjusted costs and revenues, and how the size of the subordinated loan facility would change under various scenarios. Grant Thornton's report illustrated that the size of the SLF was sensitive to the parameters the Department set and the margin bidders sought.[10] In particular it was 'sensitive to the risk adjustment the Department applied, and riskier bids could require a commercially unviable subordinated loan facility'. Also the DfT risked overcompensating bidders in a downturn[11].

Grant Thornton has also advised earlier on the options available to the DfT to improve the financial robustness of rail franchises generally and later, during the West Coast project, it discussed procurement stress testing and mitigation criteria for the West Coast bid evaluation with the DfT and Atkins. However it does not seem they were instructed extensively on the West Coast award process.

The development and release of the SLF model to bidders was not entirely smooth. The NAO report states 'The Department did not have a method to calculate the subordinated loan facility when the Tender was released [in January 2012], and decided to use its GDP resilience model as it did not have time to develop a bespoke tool[12]' though it would seem that the use of the GDP model was discussed earlier with Grant Thornton. The Department informed bidders of the new SLF policy but not its method for calculating it. In response to bidders' requests for transparency, the Department issued guidance on 24 February stating that the subordinated loan facility would be calculated using the GDP resilience model. Why did it not give the full detail? The NAO report says 'The Department did not give bidders the model because it simplified cost and revenue models and contained assumptions about operators' behaviour which it did not wish to share.' 'Instead [the Department] issued a generalised set of results from the GDP resilience model that set out the likely size of the subordinated loan facility under various circumstances, called a "ready reckoner". This provided some more information, but bidders still could not calculate their subordinated loan facility as they did not know the risk adjustments the Department would apply.' Following the issue of the SLF Guidance, in March 2012 the West Coast Project Team also provided bidders with guidance in relation to the DfT's approach to risk adjustments in a document headed: "ICWC - Supplementary guidance on the risk adjustment process for financial compliance when sizing of [sic] the Subordinated Loan Facility" (the "Risk Adjustment Guidance"). According to the Laidlaw Report the SLF[13] and Risk Adjustment Guidance[14] was produced by DfT officials and Atkins, with input from the West Coast Project Team and a DfT Deputy Director. It was shown in draft form to a DfT internal lawyer and Eversheds.

In summary there seems to have been a sensible decision to learn from past experience and seek for this franchise a higher SLF; an attempt to determine how to do that with some input from Grant Thornton; and an attempt to give a certain amount of information to bidders about how the Department would go about calculating the SLF for bids. Atkins provided support to the DfT on the financial evaluation, including examining First Group's forecast revenue growth, whether the DfT's own passenger revenue assumptions

[10] Source: NAO report para 4.8
[11] NAO report para 3.9 if for example passenger demand was lowered than estimated by the Department
[12] Para 4.9
[13] Paragraph 4.12
[14] Paragraph 4.20

were likely to be an underestimate and determining and applying various other risk adjustments, such as the effect on passenger growth of increased bus and coach costs. The Department used Atkins work in determining the risk-adjusted revenue and costs needed to calculate the subordinated loan facility. Atkins did not advise on SLF sizing methodology, or determining the SLF levels. It is not clear therefore if, apart from the input from Grant Thornton, the application of the SLF methodology was one on which detailed financial advice was given.

It became apparent, at some point in the process, that there was a mistake in the SLF model. The nature of this mistake is explored in the Laidlaw report. He commissioned an analysis by Ernst and Young[15] who found there were two flaws, which 'meant that the SLF numbers generated by the DfT's GDP Resilience Model and, by inference, the Ready Reckoner were substantially understated':

> (a) There may have been a mathematical error in the GDP Resilience Model. Inputs for this had to be in nominal terms, which were then deflated by reference to the Retail Price Index to establish the parameters on which the model operated. However the output of the calculations was not re-inflated when sizing the SLF requirement. Laidlaw suggests that as a result the SLF levels were understated by a factor of approximately 50%, though a footnote suggests that this figure is not totally certain.
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> (b) There was a mathematical inconsistency between the published elasticity factor in relation to passenger revenue of 1.8 and the target default rate of 4.4% (a 4.4% chance of contract failure). This would have confused or misled bidders. The SLF evaluation actually applied an elasticity factor of 1.4, rather than 1.8 as published. If the published rate had been used the default rate would have been much worse – 30%. Note though that this criticism is about inconsistency not that the choice of 1.4 was itself incorrect: As the NAO commented 'The Department used the latest data to derive a factor of 1.4 in the GDP mechanism and in sizing the subordinated loan facility. This reduced the risk it would overcompensate bidders in a downturn and that the subordinated loan facility would be unaffordable to bidders'.[16] It would seem that the calculation of the SLF and its relation to reality was to some extent theoretical, an art, balancing different types of risk, rather than simply the application of mathematical science.

There was another problem: The NAO report noted 'Bidders' models were complex and were derived using different methodologies, making assessment challenging.' In other words, evaluation wasn't an easy task. It also suggests to the author that the response document was not sufficiently well structured, since its aim should have been to produce easily comparable bids.

The final recommendation to the contract award committee is reported by Laidlaw as follows: 'The ICWC [West Coast] Project Team email on 7 August 2012 included the following statement: 'The four bids have been assessed by DfT officials and external technical consultants, Atkins. Costs and revenues proposed in bidders' financial submissions were all subject to a rigorous risk adjustment process. The outputs from this adjustment then informed the levels of subordinated loan facility (SLF) required for all bidders.'[17]

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[15] Laidlaw para 5.12

[16] NAO 4.18

[17] Source: the Laidlaw report

What later emerged as a key issue was whether the contract award committee which made the final decision could exercise any discretion in setting the SLF. An in-house lawyer, presumably a procurement specialist since otherwise it would have been negligent to advise, told officials that they could use discretion. However Eversheds later disagreed and warned that DfT *may* have "exercised a discretion in sizing the SLF ...that was inconsistent with the SLF guidance" and there was "inconsistency between the way in which risk adjustments had been made to the various bids". The Laidlaw report identifies that there seems to have been some disagreement between Eversheds and the DfT about how firmly that advice was given; in the end Eversheds was criticised for not following up on the point. Let lawyers beware, not least about the need to ram home unwelcome but important advice. The NAO report says: 'This information appears not to have been formally escalated within the DfT by any of the participants.'

The NAO report was blunter than Eversheds about the application of discretion: "The Department asked Virgin for a subordinated loan facility of £40 million when its calculations showed none was required, while it reduced the total capital required from First Group from £252 million to £190 million, after taking account of £10 million equity included in the bid.[18]" This sounds like manipulation of the figures but could have been a practical judgment of how risk ought ultimately to be balanced.

It was clear before the award decision was made that Virgin was likely to challenge. The DfT refused criticism of its processes from Virgin. It did so on the basis of heavy weight advice: On 31 July 2012 leading and junior counsel were asked to advise, which they did, together with Eversheds and the DfT's internal lawyers. Counsel were told there was a potential issue about the manner in which the SLF requirements had been determined by the DfT. In short the problems with the SLF model and its application, including the error, were considered by advisers[19]. It would seem very unlikely that the DfT would have confirmed the award if they had been advised at this point not to do so. On 14 August 2012 officials briefed the Minister of State, giving reassurance that Virgin's assertions did not affect the decision to award the franchise to First Group; the award was confirmed.

It seems that PwC were also asked to assist with the preparation of the defence.[20] PWC examined how a number of factors would have influenced the size of the subordinated loan facility that Virgin and First Group were asked to provide, including passenger demand, the choice of elasticity factor, and over what period the SLF calculation was made. According to the NAO PWC identified "an undetected error in the model"[21]. It may be though that this investigation was not done until after the award was confirmed and the launch of the judicial review proceedings[22].

On 28 August 2012 Sir Richard launched the exocet of judicial review proceedings. As a result the contract was not signed as intended on 29 August. On 3 October 2012 the DfT cancelled its provisional decision to award the franchise to First Group. The DfT announced the two independent reviews and put three outstanding franchise competitions on hold.

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[18] NAO Report Para 4.25

[19] Laidlaw Report para 4.113 "As part of the defence preparation.....it was recognised that likely areas for challenge would include the DfT's mechanism for determining levels of required SLF and that there were potential concerns over the manner in which the SLF requirements had been calculated.

[20] NAO Report para 5.4 "an undetected error in the model... was highlighted in work the Department had commissioned from PricewaterhouseCoopers (PwC) in preparation for its legal defence".

[21] NAO Report para 5.3

[22] The PwC report was given in a redacted from to the Transport Select Committee. The date of the report is not given. The minutes of the oral evidence annexed to the report of the says suggest the PWC work on the model was not done until September (Q921, footnote 2). http://www.publications.parliament.uk/pa/cm201213/cmselect/cmtran/537/121218.htm

The author has not been able to work out what happened between 28 August and 3 October, and what caused the DfT in this period to change its mind about the award. There are several possibilities: Did officials ask counsel to give the answer they wanted. Or was carefully considered legal advice not to proceed ignored? Or was it that, sometime in September or October 2012, counsel's reassuring advice (which included a consideration of the SLF) was simply torn up? A further twist is the advice the Department obtained from PWC. If the PWC advice was only sought once the judicial review proceedings had been launched, it may be that counsel's advice was then reconsidered. If so, it begs the question why PWC advice was not obtained earlier?

An intriguing question is what counsel and PWC actually advised. Counsel's advice is not discussed in any of the reports. The PWC report by contrast was produced to the Transport Select Committee but not in any meaningful form. The Select Committee report says that the PwC report was sent to the committee "on a confidential basis, with numerous redactions... [which] make it hard to follow".[23]

Laidlaw does not mention the PWC advice in his report at all. One wonders how it compares with Ernst and Young report, which Laidlaw reports as undermining the SLF calculations. Curiously, the NAO report[24] says specifically that PWC did not advise the Department on how their findings affected the decision to award the contract. This seems odd if the report was commissioned as part of the legal defence preparations. Did PWC not offer a view about how fundamental the mathematical error was?

What was the legal failure?

Even if mistakes were made and the wrong award made in terms of value for money, this does not mean that as a matter of law the award had to be cancelled. The legal question is did the mistakes constitute breaches of the procurement rules?

Right at the beginning of its report the NAO laid out (and presumably endorsed) a summary of Laidlaw's findings; three matters cited could in principle have founded a challenge under procurement law: First, 'there was a lack of transparency. The Department did not give bidders enough information on which to base their bids... the Department felt unable to release the model to bidders although it did provide a simplified tool (the 'ready reckoner'), to help them develop their bids.' Secondly, 'the Department did not follow its own published guidance.' Thirdly, the NAO concluded there was inconsistency and inequality: 'The amount of capital that the two final bidders were asked to put into their bids was understated and inconsistently determined. The Department applied judgment to decide the subordinated loan facility required from the two leading bidders, and in doing so treated them inconsistently.' 'It was using the tool to calculate a subordinated loan facility that could have ruled bidders out of the competition due to its size and was therefore open to challenge.' The NAO also found that 'there was inconsistency in the use of elasticity factors in the bidding process' and criticised the documenting of clarification questions and answers and raised doubts about whether answers were consistent and communicated to all bidders.

In summary, one criticism was that the DfT did not follow 'its own rules' when evaluating the SLF. The other set of criticisms were about lack of transparency and unequal treatment.

What are we to make of the criticism about the use of discretion in the light of the history set out above? It seems that it was the publication of the SLF Guidance and ready

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[23] Q921, footnote 2 http://www.publications.parliament.uk/pa/cm201213/cmselect/cmtran/537/121218.htm

[24] NAO report para 5.4 "PwC did not advise the Department on what decision it should have made".

reckoner which – perhaps - removed the DfT's right otherwise to make a discretionary judgment about the level of SLF. The NAO report commented: 'While the tender stated that the Department would 'determine' the size of the subordinated loan facility, the guidance it subsequently issued stated that it would use the GDP resilience model to do this....[25].' 'When it approved the final values of the subordinated loan facility on 27 June 2012 the contract award committee applied discretion, which it thought it was entitled to do, to the numbers produced by the "ready reckoner.'

A point to remember is that Eversheds saw a draft of the guidance before it was issued (though it does not emerge from the reports whether or not Eversheds were specifically asked – or thought it was appropriate – to advise on the disadvantage of issuing the guidance notes, given that this might have the legal effect of fettering the Department's discretion). Equally the legal team, of which Eversheds was part, provided the analysis which gave the Department confidence to proceed with the award to First Group, despite the challenge from Virgin and despite any concerns about the SLF guidance. The criticism in relation to the SLF then does not seem to the author as straightforward as presented in the reports.

Any DfT failure to follow its own rules was primarily a failing under English law (a first instance decision in the High Court established the principle that failure to follow any published rules is a breach of a quasi contractual obligation owed to bidders[26]) rather than a breach of European law. However inconsistency in applying the evaluation model could amount to a breach of the Treaty of Rome requirement to treat all bidders equally.

West Coast Lessons

A striking feature of this saga is that a high value commercial contract, which could have attracted a bidder from outside the UK, was only a Part B service. As a result, Sir Richard's threatened challenge probably rested on an English High Court decision and general principles of EU law (relating to transparency and equality)[27], rather than the detailed and innumerable possibilities for challenge under the Regulations. This may have been a factor in the DfT's legal advisers' minds when considering the risk of a Virgin challenge. Had Sir Richard had the full procurement legislation at his disposal, his task would have been much easier. Indeed he would have been in this – for him – happy position had the Council of Ministers' proposal published on 11 December 2012, been legislated earlier. This proposal would make service concessions (including franchises such as the West Coast franchise) subject to detailed regulation, on the same footing as other public procurements[28]. Whether or not that is a good thing, depends on how good the underlying regime is, a point to which we will shortly return.

An immediate lesson that can be drawn is that, even without the pitfalls created by the EU procurement rules and the possibility of bid challenge, running these vast and complex procurements, is a risky business and very expensive. I am not arguing in favour of nationalisation or in-house provision but I do wish to point out that the difficulty of actually delivering outsourced services on the scale wanted by modern politicians is rarely discussed. The UK government and health service have a string of failed IT projects for example and I have long wondered if part of that failure is due to the ambitious nature of the procurements – huge needs are gathered up and addressed in one contract. The LIBRA PFI (magistrates courts systems) was one of many such ambitious and failed projects. The NAO reported in 2003 that this was 'one of the worst PFI deals'

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[25] NAO report para 4.26

[26] *Blackpool & Fylde Aero Club v Blackpool Borough Council [1990] EWCA Civ 13)*

[27] *JBW Group Ltd v Ministry of Justice*

[28] 16731/12, 2011/0437 (COD)

it had ever seen. It was actually an attempt to rescue an earlier failed project: Some years before a Home Office civil servant had decided, with ministerial backing, to commission a bespoke software development, even though there was an existing working system owned and liked within the magistrates courts' service. The bill for this failure was £45m. The NAO perhaps could have kept a better eye on the LIBRA project (run by the Lord Chancellor's Department), having been alerted to the odd Home Office decision to proceed with the earlier project. It is easier to spot mistakes in hindsight rather at the time, even if you have been forewarned. The Transport Select Committee said of the West Coast Franchise failure "We strongly suspect that there are lessons for ministers in terms of more realistically matching policy ambition to departmental capacity and resources." Perhaps this will be the start of some re-thinking about ambitious procurement goals by government and the NAO?

Finally one might ask if it was a good thing that Sir Richard Branson was able to challenge the West Coast rail franchise award? Well not for First Group, which saw its share price fall. A lot rides on these multi-billion pound deals and suppliers as well as the contracting authorities suffer if an award is challenged or cancelled. It is of course obvious from looking at major problems with major central government procurements in the past that procurement rules and the possibility of bid challenge are a necessary and healthy part of the major public procurement activity. It is not so long ago that the construction of the New Parliamentary Building was awarded specifically on a 'buy British' rather than 'best value' basis. But this does not by any means lead to the inevitable conclusion that the European procurement rules as we have them - and lawyers - are the best way to provide a counter-balance to reduce the risk of poor decisions or decisions which breach the UK's international free trade obligations, or the best way to deter corruption of a soft or flagrant kind. That is especially questionable if the rule book is thick and unclear or if the contract is a relatively low value service contract (a consideration of £40,000 per annum brings the contract within the scope of the rules).

EU Procurement Rules – a nightmare

Contracting authorities like to think they are relatively safe when dealing with Part B services. The DfT was perhaps unlucky to find itself credibly threatened on a Part B service procurement. The fact that this case hit the headlines gives us the opportunity to consider the sudden growth in procurement challenges over the last few years and the fact that now it is relatively easy, if expensive, to challenge a procurement which is fully subject to the Regulations. If the current proposal goes through it will also be easy to challenge the award of service concessions.

It is perhaps a too well-kept secret that from the word 'go' the EU (then EC) procurement rules were clunky, complex and unclear. One long-running effect of the complex and unclear procedures is that it is extremely hard for small and medium enterprises (SMEs) to win any public contract work, even though SMEs are regarded increasingly as critical in supporting the drive to emerge from recession. The EU Commission Procurement Directorate, fairly divorced from the actual reality of purchasing, has long been complacent about the deficiencies of their legislation. In their 1996 Green Paper, the Commission opined that the rules were fine, that all that was needed was a period of consolidation and robust enforcement procedures. This complacency attracted widespread and detailed criticism which (surprisingly, given the difficulties of getting EU law amended) actually resulted in a serious wrangle to improve the rules.

The Commission got the stringent enforcement regime it wanted in 2004 via the Remedies Directive, in return for merging 3 sets of parallel rules (for public works, supplies and services) and providing some procedures which purported to be more flexible. In fact the 2004 consolidation failed to address fundamental criticisms of the

rules. The same criticisms as were being made prior to the 1996 Green Paper were still being made in response to a further EU Commission Green Paper in 2011, when the Commission, still complacent, suggested extending the ambit of the regulation and imposing obligations on contracting authorities to use public procurement to achieve other societal goals. The torrent of criticism which greeted the 2011 Green Paper[29] saw off some of the worse suggestions but did nothing to alleviate the real problems. Despite the criticism, on 11 December 2012 the Council of Ministers published a proposal 'to modernise' public procurement[30], adopting a minimally adapted Commission proposal. Announced as 'major overhaul', the proposal purports to address 'the degree of flexibility that should apply in the use of competitive procedures with negotiation, the application of a lighter regime for certain categories of services (social, cultural, health, etc.), the wide use of e-procurement and the supervision and monitoring of procurement procedures'. The declared aim is to make procurement procedures simpler and more flexible, to provide better access to the market for SMEs, and to promote sound procedures and enable contracting authorities to pursue societal goals. The result in fact is somewhat different: an even longer regulation weighing in at 357 pages, of which the first 50 pages constitute Recitals before the provisions begin. The 'new flexibility' consists in a new variant of the complex and cumbersome competitive dialogue procedure and a new procedure (equals more regulation) for 'innovation partnerships', rather than the much needed simplification and lightening of the procedures.

There isn't much help for SMEs either: Three of the Recitals exhort contracting authorities to do more to help SMEs; one provision allows the Commission to ask Member States to report on the level of SME participation in public procurement. Two provisions might help: One seeks to encourage - or perhaps compel - contracting authorities to break contracts down into smaller lots, so SMEs can cope with them. There is also some attempt to think about whether the paperwork to qualify to be invited to bid could be standardised; and whether the requirement to support statements with evidence could be deferred until award. (Whether either of these ideas will make practical sense for a contracting authority, and so promote a good outcome for the money spent, remains to be seen. It sounds like more expense, confusion and impracticality for purchasers.) The Commission has failed to take on board or do anything much about the fact that SME participation is hindered by the complexity of the rules. A radical slimming down and streamlining is required to enable SMEs to compete productively in public tenders. There is absolutely no sign of the much needed simplification in the 'major overhaul'. The politicians who wield the power are asleep.

So at the start of 2013 the complexities and uncertainties of the regime remain a huge drain on public sector budgets and effort. This is unaffordable when severe austerity measures and cuts in public spending are required across the Union. Under the EU rules the courts have looked at questions of value for money, which are a national government responsibility. Worse the rules which were meant to promote cross border trade have been an almost complete failure (though they have opened up some markets in some countries where competition was not properly pursued). SME participation remains difficult.

One area particularly ripe for re-consideration was not mentioned in the 2011 Green Paper: the enforcement rules embodied in the Remedies Directive. Prior to that Directive, the procurement rules could be a nuisance but a way through could be found. Now if a supplier loses a tender (particularly if the margin on award is close, as it easily

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[29] See for example *EU Procurement Green Paper On The Modernisation Of EU Public Procurement Policy*, Rosemary Boyle, Public Procurement Law Review 2011 Issue 5, NA 171.

[30] Press release of the 3208th Council meeting 10-11 December 2012

can be), there is no point in the supplier not challenging the award and triggering an automatic suspension of the contract. Any well-advised bidder will be able to find some ground for challenge, particularly if the courts are prepared, as they should not be, to entertain a challenge on grounds of value for money.

It is of course hard at first sight to argue against there being an enforcement regime. Surely it is logical and reasonable? Rights without remedies are pointless? The problem however is that the Remedies Directive builds on unclear legislation; even the enforcement provisions are unclear (for example it is a ground for challenge that the purchaser has not provided 'sufficient' information about the award decision); they include no threshold of any kind for challenge; and they provide a draconian set of sanctions, which could result in the contracting authority paying compensation to the claimant and the successful bidder and then having to fund another procurement process. The current regime is not the way to regulate public procurement, even if that regulation were delivering significant cross border trade and giving SMEs lots of scope for activity, which it certainly is not.

The current rules are a nightmare for purchasers, successful bidders and SMEs. Professor Arrowsmith, the leading academic authority on the rules makes no bones about this when lecturing: she says the rules are often not clear and the key question is what is the contracting authority's appetite for risk?[31] Successful regulation means setting out clear rules to guide people into sensible and achievable action. Not the opposite. It is now virtually impossible to run a risk-free procurement. Even the Commission cannot avoid challenge on its own procurement exercises! Challenges are also made successfully against professional public purchasing consortia and contracting authorities whose procedures have been vetted by specialist external lawyers and QCs. Public purchasing should not be a legal minefield, especially for lower value procurements.

One might say that the only major cross border market creation we have seen is in legal services: A huge legal services industry has been created in the last 20 years across Europe as a direct result of the increasingly detailed and unclear regulation. With lots of money riding on huge public contracts, court proceedings are inevitable. Most of the proceedings are launched, as in the case of the rail franchise, by national bidders against their national government. From a practical perspective national procedures are not a concern of Europe or the internal market.

The need for radical reform

Public procurement is big business. Who should decide how public money is spent, and who should review spending decisions, are major public questions, which are not being given serious attention. Important questions are not being asked about whether the current procurement regime is fit for purpose and they are likely to be buried under the onward march of Richard Branson to the decision he wants on the rail franchise. In particular should the legal rules at European level be limited to meeting international trade obligations? This would simply require that it must be possible to see how decisions have been taken and to challenge 'buy local' decisions.

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[31] See also Achilles' Newsletter 08 April 2011 promoting its advice service, for which Prof Arrowsmith provides the legal updating: "Purchasing within EU procurement is an increasingly risky business, with the number of cases being taken to court rising year-on-year. To *reduce* the risk of non-compliance to your organisation, you need to be able to understand when legislation applies to your contract, and how to apply it and access to an expert in the field of EU who can answer your questions, *without breaking the bank*" [italics are the author's emphasis].

Public purchasing has become more professional over the last 20 years. Clearly some procurement rules are necessary and 27 bilateral treaties across Europe are not the way to achieve it.

I have spent most of my working life as an in-house lawyer trying to help procurement professionals get the best deal by designing clear, competitive processes, which insist on comparable bids. I am totally committed to thoughtful processes, carefully done and the best outcome for public money spent, irrespective of who that purchaser is, provided they act in a competent and lawful way. But I question the value for money of the EU compliance overhead which has become ever more voracious. We need good, highly regarded and well-paid procurement professionals, not a huge legal services industry and over-mighty bidders. As things currently stand the rules mean that procurement professionals have to focus on compliance rather than defining smart bidding processes which put maximum pressure on bidders to ensure that the weaknesses as well as the benefit of their bids are exposed and compared.

At a conference organised in autumn 2012 by the British Comparative Law Association, a US commentator asked what the EU legislation was seeking to achieve; why it was litigated before the general courts; and why small procurements were as regulated as large ones. It would do a great deal to improve public procurement if the rules were vastly simplified and if enforcement was not done through the courts but, as in the US, via specialised procurement tribunals, to which, ideally lawyers should not have access. We do (or at least did) have an administrative procedure for bid challenge which was cheap and effective: A couple of years ago the author halted a government department procurement with 2 pages of argument, by invoking the 'supplier feedback service' operated by the now defunct Office of Government Commerce. Success rested on a somewhat technical procedural argument based on a recent bit of European case law. But that is another story...

Conclusion

The West Coast rail franchise shows that public procurement issues can get national public attention and political interest. The 'rail fiasco' may falsely create the impression that the current rules are a good thing. They are not. They do not strike the right balance between incentivising purchasers to follow the rules and giving scope for innovative – or even effective – purchasing. The requirements should be manageable, affordable and crystal clear. Purchasers should not be more concerned about compliance than purchasing outcomes. Rule complexity should not create doubt about what counts as compliance. Suppliers should be more concerned about delivering good contracts, not funding lawyers to challenge every opportunity lost. The incentivising of suppliers to mount challenges needs to be scaled back. There should be a value or materiality threshold before a contract is suspended or a case is allowed to come before the court. There is now an urgent need to re-examine and re-balance the value for money of strict enforcement against the efficient use of public sector resources to achieve public sector spending goals. Even if there was not a crisis in public sector funding, this would be necessary. The enforcement regime did not pass an affordability test when it was introduced. In the current economic climate it is mad. Too many, and probably most, public procurements are currently susceptible to challenge. The focus when reforming the public procurement regime should be: will these rules motivate suppliers to bid across borders, facilitate the involvement of SMEs, and leave enough head room for procurement professionals and suppliers to deliver value to the organisations and the public they serve? Is it too late for those who govern Europe to take these questions seriously?

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