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## ARTICLES

- Public Procurement within the Framework of a Transatlantic Trade and Investment Partnership  
*Zbigniew Raczekiewicz*
- The Government Procurement Chapter of the Trans-Pacific Partnership Agreement: An Assessment of its Potential Impact  
*Robert D. Anderson and Philippe Pelletier*
- Is There a Devil in the Details? Modification of Public Contracts in the EU and the US  
*Mari Ann Simovart*
- The World Bank's New Procurement Regulations  
*Jędrzej Górski*
- The Evolution of Small Business Preferences in the United States and Selected Lessons Learned for the European Union  
*William T. Kirkwood*
- Does Nigeria Really Need A Regulator for Public-Private Partnerships?  
*George Nwagwu*

## OPINION

- Brexit and the Trump Election: Finding a Way Forward for Transnational Procurement  
*Christopher R. Yukins and Michael Bousher QC*

# The Exclusion of an Economic Operator Based on Significant or Persistent Deficiencies in the Performance of a Prior Public Contract

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*Among the several themes introduced by the new European directives, the present article focuses on an interesting innovation related to the possibility of exclusion of economic operators which are considered unreliable taking into account the execution of past contracts. That provision raises a number of issues, some of which we will herein briefly analyse.*

## I. Legal Framework and General Considerations

The new European directives<sup>1</sup> on public procurement were published on 28 March 2014. The respective transition to the national framework<sup>2</sup> is still in preparation in several Member States of the European Union.

Following its publication, there are numerous themes that necessarily imply a previous reflection from the national legislators in order to proceed with its correct and strict transposition, taking into consideration not only the imperative provisions but also the adaptation to the legal and factual reality in force – contractual and pre-contractual – arising from the Portuguese Public Contracts Code (hereinafter referred to as PCC) and the complementary legislation.<sup>3</sup>

Within the several amendments and innovations introduced by the new Directives on Public Procure-

ment, we are hereby essentially addressing a provision that constitutes, in our opinion, a clear and interesting innovation considering the previous Directives on this theme: the new grounds of exclusion of proposals, notably the specific ground foreseen in Article 57 (4) (g) of the Directive 2014/24/EU.<sup>4</sup>

The said provision foresees the following:

4. Contracting authorities may exclude or may be required by Member States to exclude from participation in a procurement procedure any economic operator in any of the following situations: [...].

(g) where the economic operator has shown significant or persistent deficiencies in the performance of a substantive requirement under a prior public contract, a prior contract with a contracting entity or a prior concession contract which led to early termination of that prior contract, damages or other comparable sanctions; [...].

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1 The new Directives are the following i) Directive 2014/23/EU, regarding the award of concession contracts (which constitutes a novelty); ii) Directive 2014/24/EU, regarding public contracts (which revokes Directive 2004/18/EU); and iii) Directive 2014/25/EU, regarding public contracts signed by entities operating in the water, energy, transports and postal services (which revokes Directive 2004/17/EU).

2 In Portugal, the working group created for this purpose was appointed by Resolution no. 2969/2015, of 24 March 2015 of the Cabinets of the Minister of the Presidency and Parliamentary Affairs, the Minister of Economics, the Secretary of the State and Treasury and Secretary of the Public Administration and Infrastructures, Transports and Communications.

3 In Portugal, after the entry into force of the PCC, the contracting authorities, the economic operators and all subjects dealing with the said Code have faced several obstacles and difficulties that have been more or less surpassed. Therefore, we do consider that the adaptations to be executed in the PCC shall be just simple adaptations (in some situations with a wider range) of the European legal provisions.

4 This possibility of exclusion is part of the list of grounds of optional possibilities of exclusion foreseen in Directive 2014/24/EU. In this situation, the contracting authority shall definitively decide if the competitor shall be excluded based on the said ground. Hereto regarding, please confer Pedro Gonçalves, *Direito dos Contratos Públicos* (Almedina: Coimbra 2015), 248, in collaboration with Carla Machado and José Azevedo Moreira. Please also confer S Arrowsmith, *The Law of Public Utilities Procurement* (3<sup>rd</sup> Edition, Sweet & Maxwell 2014), 1238.

Paragraph 101 of the said Directive put forward this possibility in a moreover dense form, as follows:

Contracting authorities should further be given the possibility to exclude economic operators which have proven unreliable, for instance because of violations of environmental or social obligations, including rules on accessibility for disabled persons or other forms of grave professional misconduct, such as violations of competition rules or of intellectual property rights. It should be clarified that grave professional misconduct can render an economic operator's integrity questionable and thus render the economic operator unsuitable to receive the award of a public contract irrespective of whether the economic operator would otherwise have the technical and economical capacity to perform the contract.

The said Paragraph also warns that: '[i]n applying facultative grounds for exclusion, contracting authorities should pay particular attention to the principle of proportionality. Minor irregularities should only in exceptional circumstances lead to the exclusion of an economic operator. However repeated cases of minor irregularities can give rise to doubts about the reliability of an economic operator which might justify its exclusion.'

Thus, the national legislator shall foresee the possibility of exclusion of a certain competitor or contestant based on grounds related to its (eventual lack of) unreliability arising from significant or persistent deficiencies in the performance of prior public contracts.

All of this shall take into consideration the respect not only for the principle of proportionality (as expressly foreseen in the above referred Paragraph) but also - and obviously - for all fundamental principles of public procurement (for example, and hereto regarding, the principle of competition and the principle of equality).

Bearing in mind its generic wording and its indicative nature,<sup>5</sup> the discussion on this matter has raised several issues already analysed by European and Portuguese authors. However, and considering the na-

tional framework, it is crucial to proceed with a more profound reflection.

## II. Background: The *Forposta's* Judgement

Prior to the identification and analysis of the main issues raised by the wording of the provision at hand, it is important to mention that this theme has been subject to a former discussion and approach at the national and international level.

First of all, and as below referred, several national frameworks already foresee a provision of this nature within the respective legislation.

Regarding this matter, it is important to highlight for its significance the *Forposta's* Judgement,<sup>6</sup> which led to a serious reflection on the inclusion of a provision of this nature in the new Directive on Public Procurement.

The main issue relates to a request within a specific procurement procedure that opposes two competitors who have already been excluded in the post-award phase based on Article 24 (1) (a) of the Polish Public Contracts Code, which foresaw the automatic exclusion of economic operators 'with which the contracting authority concerned annulled, terminated, or renounced a public contract owing to circumstances for which the economic operator is responsible, where the annulment, termination or renouncement occurred in the three-year period before the procedure was initiated and the value of the non-performed part of the contract amounted to at least 5% of the contract's value'.

The competitors mentioned that this provision infringed Article 45 (2) first paragraph (d) of the Directive 2004/18/CE, since its scope was wider than the European provision, which would only establish a "serious professional misconduct" (without committing the serious misconduct as referred by the competitors).

Thus, it was necessary to understand if the national provision was in conformity with the European provision (provided that the national legislator acknowledged that the referred national provision was based on the European one).

More precisely, the following two questions were considered:

(i) Can Article 45 (2) first paragraph (d) of the Directive 2004/18/EU, which states that any econom-

5 Still, please note that the United Kingdom transposed this provision of the Directive *ipsis verbis* in its *Public Contract Regulations*, which have entered into force on 26 February 2015 [cf. Regulation 57, no. 8, (g)].

6 C-465/11 *Forposta* [2012] ECLI-801.

ic operator may be excluded from participation in a contract where that economic operator has been guilty of grave professional misconduct proven by any means which the contracting authorities can demonstrate, be interpreted as meaning that it is possible to regard as grave professional misconduct a situation in which the contracting authority concerned annulled, terminated or renounced a public contract with the economic operator concerned due to circumstances for which that operator is responsible, where the annulment, termination or renouncement occurred in the three-year period before the procedure was initiated and the value of the non-performed part of the contract amounted to at least 5% of the contract's value?

(ii) If the preceding question is negatively answered – if a Member State is able to introduce grounds for excluding economic operators from participation in a procedure for the award of a public contract, which it considers to be essential for the protection of the public interest, the legitimate interests of the contracting authorities and the maintenance of fair competition between economic operators, is it possible to consider as consistent with the principles and provisions of the European Union law a situation involving the exclusion of economic operators with which the contracting authority concerned annulled, terminated or renounced a public contract owing to circumstances for which that economic operator is responsible, where the annulment, termination or renouncement occurred in the three-year period before the procedure was initiated and the value of the non-performed part of the contract amounted to at least 5% of the contract's value?'

The Court of Justice of the European Union answered negatively to both questions, highlighting that the provisions and principles of the European Union law, notably the protection of the public interest and the legitimate interests of the contracting authorities, do not justify that a national regulation enforces a contracting authority to exclude an economic operator in a situation such as the one above referred.

Notwithstanding the said ruling on the illegality of the Polish provision,<sup>7</sup> the Court of Justice of the European Union considers that 'a judgment which has the force of *res judicata* is not required in order

to prove professional misconduct, within the meaning of point (d) of that subparagraph', as well as that the 'the failure of an economic operator to abide by its contractual obligations can, in principle, be considered as professional misconduct'.

Giving the above said, and as noted by Diogo Duarte Campos,<sup>8</sup> the judgment at hand is 'particularly important provided that it seems to open the possibility to the Member States to expand the existing restrictions [...]; but it also seems that the Court does not consider absolutely necessary to have a *res judicata* judgment to exclude an economic operation from a public contest due to the infringement of contractual obligations'.

Article 57 (4) (g) of the Directive under analysis adopts (and clarifies) the conclusions of the judgment at hand by foreseeing the possibility of exclusion based on deficiencies (several, minor or an isolated one) in the contractual performance of an economic operator.

### III. A Provision of this Nature: an Old Demand

Mário Esteves de Oliveira and Rodrigo Esteves de Oliveira<sup>9</sup> did approach this theme in a more reflexive way (and within activities that are not subject to any regulation or specific supervision, which are the situations that may raise more doubts)<sup>10</sup> and concluded that in specific cases – and if duly fulfilled a set

7 The illegality of the Polish provision is also related to the fact that the Court of Justice of the European Union considered, in the Judgment under analysis, that the verification of a serious misconduct shall be performed by the contracting authority bearing in mind the individual and specific situation of the economic operator, a circumstance that did not occur in the Polish law, since the said legislation implied the automatic exclusion of the operator.

8 Summary of the *Forposta's* Judgment in *Revista dos Contratos Públicos*, no. 6, CEDIPRE, 2012 page 135. Please note that the Author, when preparing the summary at hand, anticipated its significance to the discussion of the review of the Directives in course at that time.

9 M Esteves de Oliveira and R Esteves de Oliveira, in *Concursos e Outros Procedimentos de Contratação Pública* (Almedina 2011), 518, (with the participation of the Signatory).

10 Regarding the activities subject to specific supervision and regulation, 'law already foresees that prior illegal conducts of the competitor in the pre-contractual procurement procedure shall be communicated by the contracting authority and analyzed and punished by the legislator, by InCI in case of contractors of public works (...), which solves part of the situations that could be raised herein'. M Esteves de Oliveira/R Esteves de Oliveira (n 9), 519.

of strict requirements – the contracting authorities shall not be obliged to sign a contract with an operator with whom it had a negative contractual or pre-contractual experience.<sup>11</sup>

We do agree with the underlying principle of the position adopted by the referred authors. Although the said position was brought up prior to the publication of the Directive (and, of course, of the provision at hand), it is our understanding that the possibility of exclusion of an economic operator in the referred circumstances should and shall be established. However, without the transposition to the national framework of the referred provision, it will not be possible to a judge or a jury to exclude an economic operator based on the said ground.

The following question could be asked: besides the grounds legally foreseen to exclude (or prevent from participating) a specific competitor, is the contracting authority competent to foresee other grounds (such as the ones herein under discussion)? Our answer is surely negative since that we are facing a procedural piece (for example a procedural program) which has the nature of regulation – and not law – and regulations cannot establish additional grounds for exclusion.<sup>12</sup>

Regarding this specific issue Miguel Assis Raimundo<sup>13</sup> states that within the national law this issue cannot be raised provided that in some situations the procedural pieces are approved by law, such as concession contracts. Still, and as referred by the author, the possibility of establishing the said pro-

vision (considering other circumstances or constraints)<sup>14</sup> would always be an exceptional situation.

Anyhow, our conclusion is that, taking into consideration the current legal framework, it is not possible to foresee general grounds and constraints (and/or based on imperative provisions of the Directives) in procedural pieces.<sup>15</sup>

Notwithstanding, and as above referred, this is an issue of extreme relevance that shall be addressed considering the national pre-contractual and contractual reality<sup>16</sup>

At the international level, several Member States have reflected this concern in the respective legislation, as follows:

In Spain, and according to number 2 of Article 60 of *Ley de Contratos del Sector Público*,<sup>17</sup> it constitutes an impediment to the situation where an economic operator failed to comply with essential clauses of a contract (due to causes imputable to it) and such failure lead to the termination of the contract signed with a contracting authority or to the application of penalties or the payment of an indemnity for the damages caused.

In France, notably within the Courts, it has been accepted that there is the possibility of exclusion of an economic operator for serious deficiencies in previous contracts if the said economic operator cannot demonstrate that the acts and procedures that lead to the said deficiencies were duly adjusted.<sup>18</sup>

On the other hand, the US law foresees since its reforms executed in the 90's that in contracts of an

11 The Authors also defend that 'in these situations, if there exists a more than justified concern or fear of repetition of the said experience or that the relationship between the contracting authority and the economic operator – if awarded – would be impossible – in a way the contracting authority would be prevented from intervening in the procedure through the application of article 48 of the Portuguese Administrative Procedure Code – there are grounds to, notwithstanding the silence of the law, assume the possibility of interdiction from participation of the said economic operator on the pre-contractual procedure'. *M Esteves de Oliveira/R Esteves de Oliveira* (n 9), 520.

12 Regarding the definition of the principle of legality and the relation between regulation and law, please confer Freitas do Amaral, *Curso de Direito Administrativo*, (2<sup>nd</sup> edition, Vol. II, Almedina: Coimbra 2011), 49 ff. and 192 ff., respectively.

13 M Assis Raimundo, 'A formação dos Contratos Públicos - Uma concorrência ajustada ao interesse público' (Associação Académica da Faculdade de Direito de Lisboa: Lisbon 2013), 868.

14 As it would be the situation whereas a Member States would be free to establish other impediments besides the ones foreseen in the Directives. Please note that currently it is understood by the Courts that the Member States may establish those impediments in

several situations but not in situations as the one under analyses with regards to imperative provisions of the Directives. Regarding this matter, please confer Rodrigo Esteves de Oliveira, 'Restrições à Participação em Procedimentos de Contratação Pública' (2009) *Revista de Direito Público e Regulação*, Cedipre, 29-30; C-226/04 and C-228/04 *La Cascina and Others* [2006] ECLI-94.

15 Please note that regarding specific impediments related to the procedure itself, this possibility may be considered. In a more detailed way, please confer *Assis Raimundo* (n 139), 873 ff.

16 In this regard, *Assis Raimundo* (n 139) defends as a good solution the possibility of establishing as an impediment the fact that the economic operator was judicially convicted (final judgment) or was issued an administrative and sanctioning resolution for the improper performance on previous contracts.

17 *Real Decreto Legislativo* no. 3/2011, of November 14 (with the wording given by *Ley* no. 40/2015, of October 1).

18 Please confer Judgment of *Cour Administrative d'Appel de Marseille*, of Junho 23 2014, procedure no. 11MA02487, available at <<http://www.citia.fr/7.aspx?ProdID=b94e3036-903b-4519-92cd-e72a2342bf7d&CatID=3739da99-5458-446e-a410-4420b8abbf16&sr=0&page=7>> Last accessed on 27 July 2016.

amount superior to US\$100,000 it shall be taken into consideration the performance of the economic operator in previous contracts, preventing the "users" to handle with a poor contracting party.<sup>19</sup>

#### IV. Article 57 (4) (g) of the Directive – General Considerations: a Practical, Doctrinal and Legal demand

As above referred, there are several issues that may be raised in what concerns the national transposition of this possibility of exclusion foreseen in the Directive.

First of all, it is our understanding that the provision at hand shall be transposed to and processed in the national legal framework.<sup>20</sup> This is in fact a former demand which was never described and developed in the national legislation, perhaps due to a lack of audacity, provided that it may end existing doubts and may affect several sensibilities which are hard to surpass. This may also be the reason why the European legislator has left to the Member States the responsibility of proceeding with transposition of this provision, establishing its operating terms and conditions by the contracting authorities.

We do consider that the transposition of this provision may put at risk different principles and national regulations already assimilated by the interested Parties, which may be in conflict with the said provision. However, we also do consider that it is advisable to take the risk and try to counterbalance – in a reasonable and pondered way – these principles and provisions with innovative ones that reflect (or shall reflect) the contractual and pre-contractual reality in specific cases.

We believe that this reality was the basis of the thought of the European legislator when foreseeing the possibility of exclusion of an economic operator due to the verification of significant or persistent deficiencies in the performance of a prior public contract that may damage its reliability.

It is of general knowledge of all entities that handle pre-contractual procedures and public contracts (whatever nature – public works contracts, service acquisition contracts, goods acquisition contracts and others)<sup>21</sup> that in several situations the contracting authorities are forced to contract with economic operators with whom they had damaging experiences due to the fact that they submitted the best pro-

posal in, for example, a public tender. Although the said contracting authorities already know that the contract may be defectively executed due to the deficiencies, gaps and conflicting behaviour of the economic operator (which may lead to a procedural or judicial dispute), there is a legal obligation to sign the contract at hand with such an operator to the following years.

Therefore, it is our understanding that this possibility of exclusion is opportune, fair and reasonable,<sup>22</sup> provided that the contracting authorities<sup>23</sup> make a fair and correct use of the same.

In order for this possibility of exclusion of an economic operator to be correctly applied, the national legislator shall, *prima facie*, ponder and analyse the best way to proceed with its transposition, taking into consideration not only the principles and provisions already rooted in Portugal but also the practical use in the future of the said possibility of exclusion by the contracting authorities.

#### V. Conclusion

Giving all the above mentioned, it is easy to conclude that the possibility of exclusion of an economic operator is a necessary and revolutionary provision that shall be transversal to all legal frameworks of all Member States of the European Union.

In what concerns the national legal framework, the main issues will involve the transposition proce-

19 Regarding this provision, please confer S L Schooner, D I Gordon and J L Clark who highlight the following: 'The introduction of contractor past performance as a mandatory evaluation criterion for all procurements over \$100,000 empowered the end user and reduced the likelihood that government buyers could effectively foist a poor performer on the user. This requirement reflected the idea that it was better to pay more to obtain a contractor with a good track record because of the likely increased odds of user satisfaction'. S L Schooner, D I Gordon and J L Clark 'Public Procurement Systems: Unpacking Stakeholder Aspirations and Expectations' (2008) George Washington University Law School, 7.

20 It is not possible to grant to the same a vertical and direct effect (due to the fact that it is not sufficiently clear, precise and unconditional).

21 Kindly note that Directive 2014/25/EU (Concessions Directive) foresees in Article 80 (1) that the Member States may demand the exclusion grounds established in Article 57 (4) of Directive 2014/24/EU.

22 Please confer *Gonçalves* (n 4), 255, who agrees with this option of the European legislator, although appealing to prudence in its application.

23 And also in "improper" cases, the fair and correct use from other entities, such as the courts.

dure by the national legislator and, afterwards, its practical use by the contracting authorities and, of course, the courts' sensibility to assess the (in)valid-

ity of the said practical use in situations where the principles that guide the public procurement activity may be offended.