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Arbitration and disputes arising out of public procurement contracts: incompatibility or regularity?

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Abstract

So far there is no unanimous answer to the question whether disputes arising out of public procurement contracts are arbitrable¹. Different national legal systems provide different answers. Irrespective of national laws, could disputes arising out of public procurement contracts be arbitrable in principle taking into account the related public interest and other specific features of public procurement contracts? Answer to this question is being searched in this article.

List of abbreviations

¹ The term “arbitrability” may have different meanings. Sometimes this term is used to define the existence and validity of the parties' consent to arbitration. This term is very broad and may cause confusion, therefore it is not widely used in international practice.(See FOUCHARD 312). This is why the term arbitrability will be used in this article exclusively in its narrow sense, to cover disputes capable of being resolved through arbitration.

Directive 2004/18/EC – Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts

ECJ – the Court of Justice of the European Union

GDP – gross domestic product

Public authorities – contracting authorities as defined in Directive 2004/18/EC, i.e. the State, regional or local authorities, bodies governed by public law, associations formed by one or several of such authorities or one or several of such bodies governed by public law

Keywords

Public procurement, arbitrability of public procurement contracts, public interest, rule of law

I Introduction

Public authorities actively participate in commercial relationships. Each year, European public authorities spend 18 per cent of GDP on goods, services and works.² Modern states usually have legislative basis designated to regulate public procurement procedures in order to protect public funds. For example, Directive 2004/18/EC regulates the publication and organisation of tender procedures at EU level.

Public procurement legislation usually provides regulations regarding public procurement procedures, for example, publication of public tenders, award criteria, etc. The scope of specific regulations usually ends up with conclusion of public procurement contract – performance of the contract usually falls out of scope of public procurement legislation.³ Public procurement contracts are usually performed under standard commercial practice, if no exceptions are provided in national laws (for example, with regard to change of the contract price, etc.).

Sometimes commercial relationships between public authorities and private entities, likewise entirely private relationships (i.e. relationships between two or more private entities), may end up with a dispute.

In order to re-establish the balance between the conflicting parties as quickly and as fair as possible, the dispute shall be solved effectively, transparently and

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<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1580&format=HTML&aged=0&language=EN&guiLanguage=en>

3 For example, please see UNCITRAL Model Law on Public Procurement, adopted by the General Assembly of the United Nations, Official Records of the General Assembly, Sixty-sixth Session, Supplement No. 17 (A/66/17), annex I.

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legitimately. This is applied to all disputes, including those arising out of public procurement contracts.

Some disputes may only be solved in court. The list of these disputes depends on national legislation.

If the subject matter of the dispute is non-arbitrable, the court may set aside the arbitral award or refuse the recognition or enforcement of the arbitral award. In order to have the possibility to forecast will the arbitral award be enforceable, it shall be clear whether the subject matter of the dispute is arbitrable.

For example, in Lithuania disputes arising out of bankruptcy, consumption agreements, employment matters, etc. are non-arbitrable. Disputes arising out of public procurement contracts are not explicitly mentioned in this list. If law prescribed that these disputes were non-arbitrable, there shall be no doubts regarding arbitrability of such dispute.

What shall happen to the dispute if applicable laws do not provide with a straight-forward answer? Could a dispute arising out of public procurement contract be arbitrable in its essence?

The arbitrability of public procurement contracts-related disputes shall be explored further in this article.

II Arbitrability of disputes arising out of public procurement contracts

Every time a person recourses its dispute to arbitration, the question of arbitrability arises. Two types of questions arise at this stage. First, is the subject matter of the dispute capable of being resolved by means of arbitration, and second, are the parties entitled to submit their disputes to arbitration.

In some legal systems, all public authorities (all public authorities usually fall within the category of contracting authorities) are prohibited from submitting their disputes, or at least the ones which are related to their domestic matters, to arbitration. As there are a few types of contracting authorities, different rules of becoming a party to arbitration may be applicable to each of them. Therefore the second question above (also known as “subjective arbitrability” or “arbitrability *ratione personae*”) will not be further examined in this article.

The first question regarding capability of the dispute to be solved by means of arbitration (also known as “objective arbitrability”, or “arbitrability *ratione materiae*”) is the key aspect of this article and shall be discussed further in details.

So far there is no unanimous answer to the question whether disputes arising out of public procurement contracts are arbitrable. Every national law determines which types of disputes shall be exclusively sent to the national courts and which can be referred to arbitration. This differs from state to state reflecting the

political, social and economic prerogatives of the state, as well as its general attitude towards arbitration.⁴

Case law of different countries provides different answers as well.

For example, Russian courts refused to recognize the arbitration clause in the contract between Russian state establishment and several state agencies and a German contractor as not enforceable and stated that commercial disputes are generally arbitrable and a specific and clear exclusion is necessary to render a commercial dispute non-arbitrable.⁵ Different decision has been reached by Brazilian courts – according to public sources, similar dispute has been directed to be solved in court.⁶

Lithuania had an example as well.⁷ After performance of public procurement procedures, public procurement contract regarding construction of wastewater treatment facilities was concluded between public authorities and private construction contractors. After two years of performance of the contract, the contractors requested the customer (public authorities) to increase the contract price. After failure to settle the dispute amicably, the parties went to Vilnius Court of Commercial Arbitration because the contract provided arbitration as the mechanism of dispute settlement. The arbitral tribunal ordered the public authorities to pay the extra amount requested. The customer (public authorities) applied to Court of Appeal of the Republic of Lithuania requesting to set aside the award issued by Vilnius Court of Commercial Arbitration arguing that disputes arising from public procurement were non-arbitrable under Lithuanian law. The Court of Appeal upheld the decision of arbitral tribunal.

The Supreme Court of the Republic of Lithuania stated that disputes arising from public procurement contracts are not arbitrable under Lithuanian law and that only the courts have a right to hear disputes arising from public procurement contracts. The Supreme Court grounded its decision on the main argument that although the list of non-arbitrable disputes in Lithuania does not include public procurement contracts, these contracts should be regarded as not arbitrable according to other provisions of Lithuanian law. The court stated that the Law on Public Procurement of the Republic of Lithuania provides that disputes with regard to public procurement procedures should be heard by courts. Therefore, according to the Supreme Court, this law shall be the *lex specialis* with regard to all matters arising from public procurement contracts. The court also stated that public procurement issues are related to the protection of public interest because of the need to ensure proper use of public budget, competition of suppliers and transparency of public procurement.

⁴ Lew, 199

⁵ <http://cisarbitration.com/2012/05/25/government-procurement-disputes-still-arbitrable-in-russia/>

⁶ <http://kluwerarbitrationblog.com/blog/2010/10/22/question-mark-on-the-arbitrability-of-disputes-arising-out-of-public-contracts-in-brazil/>

⁷ *UAB Kauno vandenys v WTE Wassertechnik GmbH* (3K-7-304/2011)

As it can be seen, no unanimous approach with regard to this question may be found in different national legal systems.

In order to find the answer to this question, the possible main reasons for classifying the public procurement contracts-related disputes as non-arbitrable shall be analysed. These main reasons may be the following:

- firstly, the public interest underlying in public procurement contracts;
- secondly, short terms provided for solution of public procurement-related disputes;
- thirdly, the demand of the decision to be in compliance with imperative national laws of the respective country.

The list of arguments set forth above may not be regarded as finite. There are no doubts that there may be more related arguments. However, let us analyse these arguments as the main ones, causing the exclusion of disputes related to public procurement contracts from the lists of arbitrable disputes.

A Public interest as the main feature of public procurement

The rationale of public-procurement-related disputes to be solved in court may usually be explained by the fact that public procurement is highly related to public interest.

In any legal society, it is usual to consider certain type of disputes not to be left to a private dispute resolution mechanism such as arbitration.⁸ Certain disputes may involve such sensitive public policy issues that it is felt that they should only be dealt with by the judicial authority of state courts.⁹

When the legislative body intends to leave those sensitive issues to be solved by judiciary body of the state only, different methods of achieving the aim may be applied.

One of them simply consists in excluding from resolution by arbitration disputes which are perceived as involving questions of public policy. There are two possible justifications for this solution. First, it may be considered inappropriate for private judges to rule on certain issues, such as those arising in divorce proceedings, even where there is an international element. The second justification is of an entirely different nature and betrays more of awareness towards arbitration: it is founded upon the idea that the chances of arbitrators reaching decisions that are socially acceptable are too uncertain to allow

⁸ .(See FOUCHARD 331).

⁹ (See Lew 188).

recourse to arbitration in sensitive areas. On this basis arbitrators might be prohibited from resolving disputes involving questions of antitrust law, for example.¹⁰

Other method entails excluding from resolution by arbitration all disputes where one of the parties has violated a rule of public policy by concluding the contract itself. Considering the fact that public procurement procedures are very strict and regulated in details, it would be difficult to believe that public procurement contract contravenes public policy. During the procedures of public procurement, the related documents are reviewed very thoroughly and multiple times (for example, before announcement of public procurement documentation – by contracting authority itself and by other responsible institutions, after announcement – by potential suppliers or even by judicial bodies if any dispute with regard to the public procurement procedures arise, etc.). Therefore the public procurement contract itself usually may not violate public policy.

As it can be seen from above, it shall be verified whether public procurement disputes contain the element of public policy. Usually, public procurement contracts are of purely commercial nature. However, use of funds of state budget may be considered to contain the element of public policy.

Either way, as it was confirmed by the ECJ, protection of public interest is no longer a prerogative of the state courts. Arbitrators are also enabled and, in some cases even obliged, to protect the public interest. For example, ECJ has stated a numerous times that the arbitral tribunal is obliged to apply mandatory provisions of EU law and it was confirmed by the EJC that arbitral tribunals are enabled to apply also provisions which consider the public policy of EU law.¹¹ The main rationale of the EJC is that arbitrators must take into account mandatory rules eventually applicable to the case by reason of their connection to the case.¹²

One more important issue is the confidentiality of the arbitral proceedings. Having stated that use of funds of state budget may be considered to contain the element of public policy, one shall ask whether dispute related to public procurement contract may be solved behind the closed doors. In private commercial disputes, confidentiality of the dispute resolution by means of arbitration is often taken to be one of the important advantages – arbitration is essentially a *private* process.¹³ In a dispute where one of the parties is public authority, society may ask for open proceedings.

¹⁰ .(See FOUCHARD 332)

¹¹ Nordsee Deutsche Hochseefischerei Gmb H v Reederei Mond Hochseefischerei Nordstern AG & Co KG; Elisa María Mostaza Claro v. Centro Móvil Milenium SL ECJ judgment of 26 October 2006, C-168/05; Asturcom Telecomunicaciones SL v. Cristina Rodríguez Nogueira EJC 6 October 2009, C-40/08; Ingmar GB Ltd. v. Eaton Leonard Technologies Inc ECJ, C-381/98,[2001].

¹² Conflict of Laws in International Arbitration, Franco Ferrari, Stefan Kröll, Walter de Gruyter, 2010 , p. 376

¹³ Redfern, para 1-53

B Difference between efficiency of procedures of court and arbitration

It is widely recognized that public procurement disputes shall be solved quickly in order not to freeze the procedures. There are cases when EU or other international funds are used for financing of the project, and therefore the disputes shall be solved in the most effective and rational manner.

The same is applied to the disputes related to public procurement contracts which are concluded after performance of the public procurement procedures. Such disputes require expedient procedure in order not to cause any inconveniences neither for the public authority, nor for the supplier.

Arbitration may well suit for this purpose. Arbitration relies on speed and cost-effectiveness for its survival. Very often what is quick is cost-effective.¹⁴

One may argue that the development of arbitration world-wide and the emergence of formalism in procedure have slowed down arbitration proceedings significantly. To overcome this problem expedited procedures or fast-track arbitrations have been introduced.¹⁵ Also, the parties may choose the dispute to be solved by sole arbitrator in order to save time for coordination of schedules, etc.

C Rule of law

When deciding the merits of a dispute, arbitrators must apply the law chosen by the parties or, in the absence of such a choice, will enjoy a certain freedom in determining the applicable law.¹⁶

The parties' freedom to choose the applicable rules of law does not extend to allowing them to reject the need for the contract to be governed by some rules.¹⁷ If faced with a contractual provision inviting them to apply no rule of law to all or part of the dispute which they are to resolve, the arbitrators will nevertheless be at liberty to apply the rules of law they consider to be appropriate, just as if the parties had simply expressed no choice at all.¹⁸

It may be seen from above that arbitrators may only choose the applicable law in case the parties failed to do so. From perspectives of protection of public policy, any dispute arising out of public procurement contract shall be adjudicated according to national laws of the state of the public authority. In case the

¹⁴ Redfern 6-46

¹⁵ Lew, 549, Redfern 6-43

¹⁶ Fouchard, 186

¹⁷ Jean-Flavien Lalive, *Contrats entre Etats ou entreprises étatiques et personnes privées – Développements récents*, in COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW, Vol. 181, Year 1983, Part III, at 49 in Fouchard 801

¹⁸ Fouchard, 801.

arbitrational clause fails to provide national laws of the state of the public authority as the applicable law, such dispute shall be declared as non arbitrable.

D Neutrality of the forum

It is internationally recognized that one of the main advantages of arbitration, as compared with litigation, is the neutrality of the forum. Parties tend to sign arbitration agreements or to include arbitration clauses in their contracts in order to ensure that any dispute arising from the contract will be settled by an unbiased and neutral forum. Neutrality of the forum is even more important in cases where one of the parties is a public entity. Thus, arbitration ensures equal opportunities for both parties to present their cases and to obtain an award, which would be enforceable, notwithstanding the fact that the other party to the dispute is a state or an entity controlled by a state.

For example, in Peru arbitration in such disputes is even obligatory as it is believed that such law may attract the entry of foreign capital in Peru.¹⁹

III Conclusion

Considering the fact that public procurement contracts have the element of public interest, one might conclude that the only competent organ for settlement of disputes arising thereof is national court. However, taking into account the commercial nature of public procurement contracts, the commercial-oriented approach of arbitrators, as well as efficiency of arbitration procedures and, most importantly, the rule of law as the guiding principle of all the arbitration procedures, arbitration shall not be avoided in public-procurement-contract related disputes. Contrarily – arbitration shall be promoted as effective way of settlement of disputes related to public procurement contracts as all public procurement contracts are of commercial nature.

In order to establish the wholly arbitration-friendly community, such disputes may not be crossed out of competence of arbitration courts.

¹⁹ Molina

Bibliography