

TRANSPARENCY AND GOOD GOVERNANCE IN PUBLIC SECTOR PROCUREMENT

This paper was submitted for a Master of Laws subject, Comparative Administrative Laws. It has been re-edited following submission.

Judicial review concerns pursuit of appropriate process.¹

1 INTRODUCTION

Despite twenty years of public sector reforms and the corresponding reduction of the state sector, the purchasing power of central and local government, and their respective agencies, remains an important part of the New Zealand economy.

Core government expenditure² for the 2004 year is forecast to be \$35,367 million, which represents 26.39% of GDP for the same period, of \$134,034 million³ (compared to 11% of European Community GDP in 1996, the most recent figures available⁴). The most recent figures for local government expenditure⁵, for the 2002 year, total \$1,779 million⁶. Based on these figures, procurement procedures adopted at all levels of government, and the policies reflected in them, have real significance to a wide range of interest groups.

The public generally has an interest in how its money is spent, and more particularly in the services provided by government and in the development, operation and maintenance of essential infrastructure.

Suppliers, and the market generally, also have an interest in participating in publicly funded procurement projects, and in ease of entry into, fair dealing within and exit from such projects and supply relationships.

For the government itself, the primary consideration should be achieving policy objectives at the best value for money, and all that entails. The size of the public purse, and its

¹ *University of Auckland v Tertiary Education Commission* (unreported) HC, Auckland, 5 April 2004, (CIV2004-404-1304) Williams J at para 67.

² Including core government functions, health, education, defence, law and order, and by companies (Crown Research Institutes, State Owned Enterprises, Crown Owned Companies and Crown Entities), but excluding expenditure on welfare payments and national superannuation.

³ 2004 Budget Economic and Fiscal Update, and *New Zealand Treasury*.

⁴ Europa – website for the European Union europa.eu.int

⁵ Including LATEs and council owned and council controlled companies.

⁶ *Statistics New Zealand*.

impact on the local economy, however, provides an opportunity, if not a temptation, for governments to use procurement to pursue non-commercial objectives unconnected with the subject matter of the procurement; what Sue Arrowsmith refers to as *secondary objectives*⁷. These can take the form of discriminatory practices (for example, to right historic wrongs to Māori, or to prefer local suppliers) or of advancing social or environmental policies. Inevitably, secondary objectives blur the primary concern of value for money.

This paper examines the policies surrounding public sector procurement and the requirements for transparency and good governance, the constraints on public sector procurement, and whether there is a case for the law to impose higher standards on such expenditure due to its public nature.

2 TRANSPARENCY AND GOOD GOVERNANCE

A Transparency

1 Generally

Literally, *transparency* carries with it concepts of openness, translucence or pellucidity; shedding light on the dark corners of government decision making practices.

The report of the APEC Government Procurement Experts Group (GPEG) on the Non-Binding Principles on Government Procurement⁸, which have been endorsed by the New Zealand Government, identifies six principles for adoption:

- (1) transparency,
- (2) value for money,
- (3) open and effective competition,
- (4) fair dealing,
- (5) accountability and due process, and
- (6) non-discrimination.

Transparency is defined by the following statement of general principle:

The general principle is that sufficient and relevant information should be made available to all interested parties consistently and in a timely manner through a readily accessible, widely available medium at no or reasonable cost. This general principle is applicable to all aspects of [government procurement], including the

⁷ *The EC procurement directives, national procurement policies and better governance: the case for a new approach* (2002) 27 E.L.Rev. Feb.

⁸ 2 September 1999, available from the APEC website on www.apecsec.org.sg

*general operational environment, procurement opportunities, purchase requirements, bid evaluation criteria and award of contracts ...*⁹

Going through the motions of publication (say through a local gazette) is clearly not sufficient. The information must be sufficiently detailed, complete and relevant to enable informed decisions. It must be provided to all interested parties in a timely fashion. Transparency, under this principle, promotes ease of entry and militates against discriminatory practices.

The assumption in the general principles is that requiring the same levels of transparency in relation to bid evaluation criteria and award will also reduce discriminatory and other undesirable practices. Certainly, evaluation criteria should be clearly specified and should be clearly related to the objectives of the procurement, and should be applied fairly and even-handedly. It does not follow, however, that these goals are best achieved by disclosing this information to prospective suppliers. Certainly, they need confidence in the process, but that can be achieved in other ways.

Exceptions to the disclosure requirement are then identified by the GPEG; commercially sensitive information, prejudice to fair competition between suppliers, impeding law enforcement, public interest or compromising economic security.

The GPEG then reduces the general principle of transparency to a number of distinct elements:

- (a) *General operational environment* – publishing the rules of participation and ensuring all relevant laws, judicial decisions and administrative rulings available and transparent. This is less of a concern in those Pacific Rim countries where the rule of law is well established.
- (b) *Procurement opportunities* – encouraging wider participation. Wide publication must be accompanied by confidence that the contract is genuinely available for award and sufficient time for potential participants to understand the contract requirements and to prepare and submit bids. This is frequently more than government procurement bodies allow.
- (c) *Purchase requirements* – to ensure that only participants who genuinely can meet the requirements respond, and to ensure that bids are responsive. This can lead to over specification, or to discriminatory practices (eg, specifications which exclude viable alternatives). The GPEG recommends the use of performance/functional/operational requirements, rather than direct specification. At operational levels, there can be considerable resistance to performance specifications as they usually have a preference for uniformity.

⁹ See para 3 of the GPEG report

There is also the potential for unquantifiable and unmanageable risks to be assigned.

- (d) *Bid evaluation* – criteria should be transparent, and evaluation strictly in accordance with them. In the GPEG's view, this is to ensure fairness and integrity.
- (e) *Award* – demonstrating accountability. This would include publishing the name of the supplier and its price, and debriefing.
- (f) *Due process* – availability and avenue for complaints.

It is also assumed that, when the information is made available, it will be considered in all its context and will be understood by all those to whom it is provided.

It is to be expected that those with an interest in the process will request the information, review it and hold procuring bodies accountable for their processes and their decisions. What is sometimes overlooked, however, is that the various players will provide or request information, not in the context of ensuring good governance, but to advance their own interests.

The purchaser is primarily interested in achieving its objectives at the best value for money. To achieve this the procuring government body will want to ensure that the best available suppliers are appointed and that value for money and certainty about price and quality, will be achieved. It is critical, therefore, for procuring bodies to motivate suppliers to be focussed on providing the best offer they can, and for the purchaser to retain control of the process to this end. The last thing it wants is to enter into debates with suppliers about the process, its fairness and legality.

Suppliers, conversely, will want to ensure that opportunities to supply aren't missed, that they understand the process and the requirements, and that they can have confidence in the process. While they will want to be assured that the process is fair and free from corruption and that all bids will be considered on equal terms, their ultimate concern is to win the supply contract. Any concerns they have about the legitimacy of the process will be secondary.

There are a number of difficulties with providing suppliers with full details of the evaluation criteria, how it is to be applied and details of the award, as proposed by the GPEG.

Supplying evaluation criteria can have the effect of deflecting suppliers away from preparing the best bid, to meet the contract requirements, towards a bid which will achieve the best score, which may not be the same thing, and in complex projects, usually isn't. Transparency at such a level opens the evaluation process to scrutiny, not by superiors in the procurement chain, ultimate beneficiaries of the supply or to independent scrutineers who are all in the best position to ensure compliance, but to parties with the biggest vested interest in the outcome.

Similarly, providing details of award with debriefings inevitably results in bidders re-examining their bids against the successful bid. In general terms, this is a productive

exercise. However, when coupled with fully disclosed evaluation criteria and processes, this also invites a critical examination of the bid process¹⁰ and, frequently, challenge.

While the evaluation and award processes should be robust, even the best processes do not deal with all opportunities thrown up during tendering. High degrees of flexibility are necessary in the bid evaluation process to enable the purchasing body to select the best value for money option. This flexibility is best provided by reducing the rigidity of evaluation criteria, and is certainly not helped by full publication.

For significant procurement projects, the expectation is that the selection process will be contested; usually by competitive tender¹¹. Purchasing by competitive tender pits prospective suppliers against each other on a number of assumptions. Foremost is the expectation that bids will be kept confidential as between bidders, and that the purchasing authority will run a fair and even-handed process with the best bid prevailing.

For bidders this is a fundamentally unfair process. Bid preparation has become lengthy, complex and expensive, with no certainty of success and no prospect of recovery of bid costs. Those costs must be carried by the bidders and profitability assured either through claims or variations post award. The Australian practice of bidders entering into arrangements to increase their bids by an agreed amount or percentage, which is then shared among the unsuccessful bidders following award, does not seem to have become established, or caught on in other jurisdictions.

In practice, more complex projects where bid costs are high will inevitably have a time consuming and usually unproductive challenge to the bid process. Complete disclosure of bid evaluation criteria and internal processes only exacerbates this problem.

Having suppliers compete for projects also allows opportunistic purchasers to capitalise on the competitive process and force bidders to accept risks which they ordinarily would not and which they are unable to price or to manage. Following award, the relationships become more adversarial, with contractors who may feel put upon during the tender process seeking every opportunity to recover profits lost, and to shed risks imposed on them, in the bid process.

For truly transparent processes, the information bidders most desperately want is details of other bidders and their prices. The increasingly popular alternative to simply complying with process rules and submitting conforming bids is to seize the initiative by unsettling the competitive process through legal challenge on the basis of procedural unfairness. It would be hard to argue that these challenges were launched in the name of increasing accountability. While transparency may discourage corrupt, underhand or proscribed practices by the threat of legal challenge, it is submitted that such challenge will only come from other bidders when they see advantage for themselves. The over provision of information about bid evaluation and award (which ultimately does not improve the quality of bids received) creates problems of its own, which work against the purchaser achieving value for money, and arguably don't improve accountability.

¹⁰ See discussion of the *Pratt Contractors* line of cases on p19 following.

¹¹ See discussion on "*Procurement : A Statement of Good Practice*" issued by the Controller and Auditor-General in June 2001 on p 18 following.

Ultimately, procuring public bodies are first accountable to their superiors, and then more generally to the public at large. That accountability is achieved through setting and applying proper procedures and through supervision by superiors, oversight by public watch dogs like the audit office and the Ombudsmen and last, and it is submitted least effectively, by challenge by disaffected bidders.

Transparency as a tool for ensuring accountability, while achieving value for money, therefore has its limits.

2 Statutory obligations for disclosure

In private law, the obligations for disclosure are restricted to limited legislation (for example, the Privacy Act 1993), the terms of contract, duties in tort, prohibitions against deception and in discovery during the litigation process.

For public bodies, the starting point for disclosure is the Official Information Act 1982, for central government, and the Local Government Official Information and Meetings Act 1987, for local government.

The Official Information Act includes in its purposes¹², increasing the availability of information to the public to enable more effective participation in the making and administration of laws and policies and to promote accountability, “*and thereby to ... promote good governance of New Zealand*”. Again, the assumption being that providing information would inexorably lead to good governance. The principal of availability outlined in section 5 is that “*information shall be made available unless there is good reason for withholding it.*”

Good reasons for withholding are identified in sections 6, 7, 9 and 10 and include, in section 9(2), to:

- (b) *Protect information where the making available of the information –*
 - (i) *would disclose a trade secret; or*
 - (ii) *would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information ...*
 - ...
 - (i) *Enable a Minister of the Crown or any Department or organisation holding the information to carry out, without prejudice or disadvantage, commercial activities; or*
 - (j) *Enable a Minister of the Crown or any Department or organisation holding the information to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations); or*
 - (k) *Prevent the disclosure or use of official information for improper gain or improper advantage.*

¹² See section 4 of the Official Information Act 1982.

For local government, the Local Government Official Information and Meetings Act mirrors the principles¹³ and expresses the exceptions quoted above in identical terms¹⁴.

Where information is withheld for reasons identified in section 9(2) of the Official Information Act¹⁵, such reasons are not conclusive, and the withholding will not be automatically upheld in any subsequent scrutiny. Under section 9(1), disclosure can still be “*outweighed by other considerations which render it desirable, in the public interest, to make that information available*”. No guidance is provided in either Act as to when public interest might outweigh the reasons for withholding, other than the general principle of availability.

There has been considerable judicial discussion on how that balancing process is to be done; most usefully by Jeffries J in *Wyatt Co (New Zealand) Ltd v Queenstown-Lakes District Council*¹⁶. That case involved the request by a local newspaper under the Local Government Official Information and Meetings Act for copies of a consultant’s reports, which were prepared at the Council’s request. The reports were covered by a contractual undertaking of confidentiality between the Council and Wyatt, the consultants.

In weighing the claim that Wyatt would be commercially prejudiced by disclosure against the local paper, Mountain Scene’s desire to publish, Jeffries J observed at p 190:

It cannot be denied that some of the information recommended to be released by the Chief Ombudsman will reveal matters which Wyatt wants to keep entirely secret. The Official Information Act was passed in 1982 following an exhaustive investigation into the subject in New Zealand, which also reflected the same movements elsewhere in the world. Cook P in Commissioner of Police v Ombudsman at p 391 was prepared to regard that Act as correctly described as a constitutional one. In 1987 the Act under consideration was passed extending the right of the public to know and must similarly be regarded as of constitutional significance. Governments of different political philosophies have endorsed the principle of freedom of information so as to express support for the concept that knowledge and information about the conduct of public affairs, and the application of public money, in a democratically governed country are essential to its right to be so described. The Courts must zealously support those quite sweeping legislative intentions. It is fundamental to the Act that the public are to be given worthwhile information about how the public's money and affairs are being used and conducted, subject only to the statutory restraints and exceptions.

It is interesting to note the ease with which the Court was prepared to overrule the grounds for withholding. Wyatt had a real desire, based on the impact to its business of disclosure, to ensure that its involvement with the Council was not disclosed. Whether or not this view was rational, and clearly his honour was not impressed by the reasons¹⁷, Wyatt went to

¹³ See section 5.

¹⁴ See section 7(2)(b), (h), (i) & (j).

¹⁵ Section 7(2) of the Local Government Official Information and Meetings Act.

¹⁶ [1991] 2 NZLR 180

¹⁷ Also at p 190.

some lengths to ensure confidentiality by including a confidentiality clause in its appointment, entering into lengthy correspondence with the Council in relation to the disclosure and taking the proceedings in question. Rational or otherwise, it was Wyatt's assessment that confidentiality was important to it and it contracted on that basis. Notably, the confidentiality was Wyatt's, rather than the Council's.

The public interest, conceivably nothing more than prurient, was sufficient for his honour to observe:

There cannot be allowed to develop in this country a kind of commercial Alsatia beyond the reach of a statute. Confidentiality is not an absolute concept admitting of no exceptions ... It is an implied term of any contract between individuals that the promises of their contract will be subject to statutory obligations. At all times the applicant would or should have been aware of the provisions of the Act and in particular s 7, which effectively excludes contracts on confidentiality preventing release of information.¹⁸

The balancing of demands for commercial confidentiality against public interest in terms of ss 9(1) and 7(1) of the Acts seems heavily weighted in favour of disclosure. There is no doubt, however, that His Honour is correct that ss 9(1) and 7(1) of the Acts require the Court to balance the interests, and confidentiality clauses in contract will need to be justified if withholding is to be upheld. The ease with which Wyatt's concerns were discarded is, however, surprising.

The issue was also specifically raised in relation to the conduct of tenders in the case of *Gregory v Rangitikei District Council*¹⁹. The District Council had resolved to sell some surplus land. There was on record an undertaking to first offer the land to an adjoining owner, which the District Council felt some moral obligation to honour. In the event, the land was offered for sale by tender, and the adjoining owner participated in that tender round. The tender procedures were relatively simple, and included the phrase "*Highest or any tender not necessarily accepted*". The reserve was not met, and the highest bidder, Gregory, sought the opportunity to negotiate for the purchase.

In the following interregnum, pressure was brought to bear at a political level for the direct sale to the adjoining owner, Roberts, in accordance with the earlier undertaking. The District Council advised Gregory by letter:

At the present time ... the Council has decided to retain the property but may decide at some future time to sell the property by such means as it thinks fit.

This statement was misleading, as negotiations were underway with Roberts, which ultimately lead to the sale of the property.

The plaintiff sought reasons from the District Council for its decision to decline all tenders, its plans for the future of the land and copies of all minutes, records, reports and recommendations in terms of the Local Government Official Information and Meetings Act.

¹⁸ At p 191.

¹⁹ [1995] 2 NZLR 208

The council declined in terms of s 7(2)(h) & (i), on the grounds of prejudice or disadvantage to carrying out its commercial activities and commercial negotiations.

The public interest in disclosure in that case could be expressed in reasonably compelling terms, including confidence in the sales process and accountability. The grounds for withholding by the District Council were not strong, save in relation to the amount of the reserve, and the tender round had been cancelled. Timely disclosure might also have revealed that, contrary to what had been advised to Gregory, the District Council was in discussion with Roberts for the sale of the property by private treaty. Regrettably, the issue was not specifically considered by the Court in that case.

3 Limited Disclosure – the alternative approach

It is unfortunate that the principle of availability in the legislation, and transparency in the APEC procurement principles, do not allow for context, nor do they recognise that the roles and interests of the parties may favour accountability at the hands of internal mechanisms, public watch dogs and the democratic process.

If the roles and interests of each participant is considered in context, there are limits on the amount of information which needs to be disclosed, and how well due process will be served by that disclosure. There is no assurance of increased accountability, for example, if bid evaluation criteria are disclosed to purchasers. That is an issue for internal supervision and the ombudsmen and/or audit office review. Conversely, if that information is disclosed, there is the risk that bidders will become focussed either on achieving the highest evaluation score, rather than providing the best solution to the procuring body's specification for the supply, or unseating the preferred bidder, by challenging the process.

B Good Governance

1 Primary Objectives

The primary objectives of government bodies, at a policy level, must be to achieve its policy objectives, at the best value for money and with certainty of price, quality and timing of delivery.

Implicit in this is the avoidance of barriers to efficiency; for example, corrupt practices, overly complex approval and procurement procedures, complex bid requirements resulting in unnecessary bid costs and intrusive compliance costs. To this, GPEG adds open and effective competition, fair dealing, accountability and due process and non-discrimination.

The GPEG defines value for money with the following general principle:

The general principle is that [government procurement] practices and procedures should be directed to achieving the best available value for money in the acquisition of goods and services to deliver, or support delivery of, government programmes.

The test of the best available value for money is a comparison of relevant benefits and costs on a whole of life basis. Purchase price alone is not an adequate indicator of total relevant costs. The lowest-priced compliant offer does not necessarily

*represent best value for money. Benefits in terms of savings to taxpayers and suppliers may also be obtained through improvement in the procurement process and management.*²⁰

From this useful general statement, the following detailed elements are extracted:

- (a) *Assessment of need* – accurately identify desired outcomes from the procurement activity
- (b) *Selection of appropriate procurement method* – open and competitive tendering the preferred method, though alternative methods may be used because of strategic importance, complexity and/or cost, complexity of the marketplace, urgency, compatibility and/or existence of a sole source of supply.
- (c) *Evaluation of suppliers and their offers* – to identify best value for money. This will include benefits and costs on a whole of life basis, competence, viability and capability of suppliers, compliance (fitness for purpose) and time frames, risk assessment, avoidance of cost and comprehensive contract terms.
- (d) *Procurement function itself providing value for money* – costs to buyers and suppliers arising out of the process should be minimised.

While there is reference to whole of life cost, and risk, it is worth noting that the principles deal almost exclusively with the bidding process, rather than with the entire procurement process. In contracts for the supply of over the counter items, this is less of an issue as quality and performance will be covered by whole of life cost and after-sale warranties and service.

For contracts which have ongoing relationship issues, or design, specification, construction, operation and maintenance contracts adopted for more complex procurements (for example the construction of significant items of infrastructure), then a large part of the value for money assessment will depend on the quality of that relationship, and additional costs incurred following award.

If an overly rigorous, and opportunistic, tender process has preceded award, then the contractor may feel motivated to recoup bid costs, recover profit negotiated away during the tender process and shed risk imposed by the procuring body. The contractor will also seek to reduce costs to the minimum. Price certainty, quality and certainty of delivery then come under pressure. While good contract management and a sound contract may assist, these are no substitute for a contractor willingly and competently performing under a contract that ensures that it is profitable for it to do so.

A product of the style of new public management also favoured by successive Governments in New Zealand over the last 15 years is capture; monopoly or monopsony. Where specialist expertise is increasingly outsourced, formerly in-house business units are

²⁰ Paras 16 & 17 of the GPEG report.

forced to undergo theoretical competition (against benchmarking), where there is no realistic alternative supplier. As with monopolistic suppliers, where suppliers have a single source of sale (monopsony) then buyer and seller become captive to each other.

While this can provide benefits in terms of dedication of service and development of expertise, it does not promote value for money, and benefits in privatising what was formerly in-house expertise looks like an accounting exercise.

The balance of the core elements of the GPEG's Non-Binding Principles on Government Procurement are uncontroversial and, for the sake of completeness, are as follows:

Elements of Open and Effective Competition

34. *The general principles are that the [government procurement] should be open and procurement methods should suit market circumstances and facilitate levels of competition commensurate with the benefits received.*

Elements of Fair Dealing

44. *The general principle is that the procurement system should be designed and buyers should conduct themselves in ways such that procurement activities are conducted in a fair, reasonable and equitable manner and with integrity.*

Elements of Accountability and Due Process

60. *The general principle is that government procuring agencies and individual procuring personnel should be, and are seen to be, accountable to their governments, the end users, the public and suppliers for the efficient, cost-effective and fair conduct of their procurement; and that mechanisms for scrutiny of the procurement process and avenues/channels for review of complaints should be available.*

Elements of Non-discrimination

70. *The general principle is that procurement laws, regulations, policies, administrative guidelines, procedures and practices should not be prepared, adopted or applied so as to afford protection/favour/preference to, or discrimination/bias against, the goods, services or suppliers of any particular economy/economies. **The use of discriminatory practices in government procurement undermines the competitive process and thus the ability of member governments to achieve the best possible value for money.***

Emphasis is added to the last statement to highlight the approach taken by the GPEG, that a pure market, free of government intervention, will result in the best value for money. Objectively, this has to be true if all participants follow the same approach. This does not mean, however, that government policies will be advanced, or its secondary objectives achieved, if these principles are complied with.

While the principles have been endorsed by the Government, they are, by their own terms, non-binding principles and for guidance only.

2 Secondary Objectives

In her paper on The EC Procurement Directives²¹, Sue Arrowsmith highlights the differences between the objectives of national systems of procurement (principally value for money and adopting efficient processes) and supranational objectives (in the case of the EC, the elimination of discriminatory practises and the promotion of the Single Market). She goes on to observe:

Government procurement systems also, however, implement non-commercial objectives. One is integrity, a concept covering, but not confined to, absence of corruption. Integrity of course has an impact on value for money, but is also pursued for other reasons, such as to remove sources of funding for criminal organisations or to avoid political scandal. Another objective of some national systems is equality of access – for example, purchasers may rotate invitations to tender to give all suitable firms equal access. Accountability is another objective: governments generally seek to ensure that citizens can see how business is conducted. Finally, governments also often use procurement to promote industrial, social or environmental policies unconnected with the subject matter of the contract (“secondary” objectives). For example, they may award contracts only to firms that employ disadvantaged ethnic groups.²²

In New Zealand, typical secondary objectives would be support for regional development and preference for local supply, promotion of the principles of the Treaty of Waitangi (now in some disarray, along with the Government’s now defunct *Closing the Gaps* initiative) and strengthening free trade agreements. To an extent the government’s requirements for transparency and primary objective of value for money arise out of secondary objectives to secure free trade arrangements.

As with the EC model, promotion of these objectives can often result in conflict with New Zealand’s international commitments of freedom of entry into government procurement and against discriminatory practices²³. Unlike the EC, however, New Zealand is not, as yet, subject to the jurisdiction of any supranational courts on the enforcement of such commitments.

3 PUBLIC PROCUREMENT

A Supranational Obligations

The development of the European Union from a Common Market to a supranational system of government, complete with its own directly elected parliament, council of ministers, courts, executive government and, shortly, constitution, has seen a gradual transfer of the sovereignty from national parliaments to the EC and a reduction in the

²¹ See footnote 6 on page 2 above.

²² (2002) 27 E.L.Rev. Feb. at p 6

²³ See discussion on the *ANZ Government Procurement Agreement* and the *Agreement between New Zealand and Singapore on a Closer Economic Partnership* at p12.

ability of national governments to pursue policies in the (perceived) best interests of their respective citizens.

The example of the EU has led to considerable growth in free trade agreements, and trade blocks, like the 1983 Closer Economic Relations Agreement (CER) between Australia and New Zealand, the 2001 Closer Economic Partnership agreement (CEP) between New Zealand and Singapore, and CEP and free trade agreements are currently under negotiation with Thailand, Hong Kong, Mexico and the People's Republic of China. New Zealand and Singapore are also in negotiation to extend the Singapore CEP to include Chile (P3 CEP).

The CEPs are focussed on trade liberalisation, but the Government prefers to use the agreements to encourage wider economic and investment relationships. Ideally, the CEPs are comprehensive and consistent with WTO (note, not AGP) provisions and APEC goals and principles²⁴.

New Zealand has not joined the plurilateral World Trade Organisation Agreement on Government Procurement (AGP), as *"it has been judged that AGP membership would entail a prescriptive approach to purchasing procedure at odds with New Zealand's deregulated and decentralised public sector management regime, and would be likely to increase administrative and transaction costs."*²⁵ There was agreement, however, at the Doha round in November 2001 to explore a multilateral agreement on transparency of procurement policies and practices and expanding the WTO General Agreement on Trade in Services to include government procurement of services. The view of the Government generally is that *"New Zealand's unrestricted open market approach is compatible with normal WTO principles of non-discrimination and transparency"*²⁶.

There are 36 members of the WTO AGP²⁷; representing most of the developed world, with 9 countries negotiating for accession and 19 observer states (including Australia).

For the purposes of comparison, there are a number of other international approaches to government procurement, including:

- the European Union Directives covering works contracts, supply contracts, service contracts and procurement by utilities. Together these Directives comprise a comprehensive body of law, setting out prescriptive forms and procedures for Member States. The first priority of these Directives is to promote the Single Market, and to avoid discriminatory practices.

²⁴ see statement on MFAT website at www.mfat.govt.nz/foreign/tnd/ceps

²⁵ *Government Procurement in New Zealand – Policy Guide for Purchasers* published by the Ministry of Economic Development, Regulatory and Competition Branch, July 2002 at p 23.

²⁶ *Ibid* at p 24.

²⁷ Canada, European Communities (including its 25 member States: Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, United Kingdom), Hong Kong China, Iceland, Israel, Japan, Korea, Liechtenstein, Netherlands with respect to Aruba, Norway, Singapore, Switzerland, United States.

- the World Bank Guidelines for Procurement for use in projects financed in whole or in part by loans from the International Bank for Reconstruction and Development (IBRD) or credits from the International Development Association (IDA). These guidelines are also prescriptive, and the priority is to avoid corrupt practices.
- the UNCITRAL Model Law on Procurement of Goods, Construction and Services. The Model Law and Guidelines to Enactment also follow a detailed and prescriptive approach to procurement, expressing as their objectives the maximising of economy and efficiency, encouraging participation in procurement, promoting competition, fair and equitable treatment, fairness and public confidence and achieving transparency. The Model law has been adopted, or inspired legislation, in 18 countries²⁸; typically countries without a history of representative democracy, or the rule of law.

Our particular concern is with those agreements to which New Zealand is signatory.

1 ANZ Government Procurement Agreement (ANZGPA)

Among the agreements arising out of CER²⁹ is the *Australia New Zealand – Government Procurement Agreement 1991*³⁰ (ANZ GPA), under which the Australian Commonwealth, the individual States and Territories and the Government of New Zealand:

*Recognise the benefits to Australian and New Zealand (ANZ) industry and to government purchasing bodies of treating Australia and New Zealand as a single market for government procurement in accordance with the objectives and principles of the Australian and New Zealand Closer Economic Relations Trade Agreement.*³¹

Under clause 2 of the agreement, the respective Governments are to (among other things) provide equal opportunities to each others' suppliers, and treatment no less favourable, than accorded to domestic suppliers, to promote opportunities for competition on the basis of value for money and to avoid purchasing practices biased against foreign suppliers.

The agreement applies to "*Government procurement*", which is principally by government departments and bodies controlled by the respective Governments. Local authorities and bodies corporate are excluded, however, the parties agree to use their "*best endeavours to encourage wider application of the Agreement, consistent with good commercial practice*"³²

Under clause 4, the parties agree that they "*will not use amongst themselves any form of procurement practice which:*

²⁸ Albania, Azerbaijan, Croatia, Estonia, Gambia (2001), Kazakhstan, Kenya, Kyrgyzstan, Malawi (2003), Mauritius, Mongolia, Poland, Republic of Moldova, Romania, Slovakia, Tanzania, Uganda, and Uzbekistan.

²⁹ Pursuant to Article 11 of the Australia-New Zealand CER Agreement.

³⁰ Last revised in August 1997, and available for download from www.mfat.govt.nz/foreign/regions/australia/tradeeconomic/governmentprocurement.html

³¹ Introduction to the ANZGPA.

³² Definition of *Government Procurement* in clause 1(e).

- *discriminates against*
- *is biased against*
- *or has the effect of denying equal access or opportunity to*

any ANZ supplier.”

Exemptions and compliance under the agreement are ultimately dealt with by the responsible Ministers.

While the objects and principles underlying the agreement are less thorough in their expression than the GPEG statement, the approach is consistent.

2 NZ-Singapore CEP

The Agreement between New Zealand and Singapore on Closer Economic Partnership was entered into on 1 January 2001.

Part 8 of the agreement provides for the establishment of “*a single New Zealand/Singapore government procurement market*”, achieved (among other things) by “*committing to implement the APEC Non-Binding Principles on Government Procurement*”³³.

The agreement applies to government procurement above 50,000 national currency equivalents (which in 2002 dollars, equates to NZD 134,500). As with the ANZGPA, the agreement applies only to government procurement with a best endeavours obligations to extend the application to local government and others.

Article 53 contains a particular prohibition against the imposition, seeking or consideration of *offsets*, which are defined in paragraph 2 as being “*measures used to encourage local development or improve the balance of payments accounts by requiring domestic content, licensing of technology, investment, counter-trade or similar requirements.*”

As with the ANZGPA, complaints are dealt with by the respective responsible Ministers³⁴.

On that basis, under both agreements, the Government is therefore constrained from using its procurement expenditure to pursue secondary objectives, if it has the effect of discriminating against suppliers from Australia or Singapore.

³³ See Article 46.

³⁴ See Article 54.

B Government Procurement Policy

The New Zealand Government procurement policy is set out in the publication *Government Procurement in New Zealand – Policy Guide for Purchasers*³⁵, which is to be read with the Auditor-General's publication *Procurement – A Statement of Good Practice*³⁶.

The policy guide sets out general guidance for procurement, rather than prescriptive rules and procedures, and provides for notification of procurement opportunities on the New Zealand Industrial Supplies Office (NZISO) website. The guide is mandatory for all government departments³⁷ and other taxpayer-funded agencies. State-Owned Enterprises and local authorities are encouraged to follow the same approach.

The policy guide sets out five principles for procurement³⁸:

- *best value for money over the whole of life;*
- *open and effective competition;*
- *full and fair opportunity **for domestic suppliers**; (emphasis added)*
- *improving business capabilities, including e-commerce capability; and*
- *recognition of our bilateral obligations to Australia (Closer Economic Relations) and Singapore (Closer Economic Partnership), and our trade policy interests in open and transparent government procurement markets.*³⁹

The policy guide goes on to confirm that the "*Government has also endorsed the 1999 APEC Non-Binding Principles on Government Procurement*".

It's not clear if that endorsement is to adopt the principles where practicable, or to confirm their non-binding nature. Despite this endorsement, the Government's five stated principles repeat only two of the Non-Binding Principles (value for money and open and fair competition), and overlook transparency, fair dealing, accountability and due process, and non-discrimination. The Government's list then introduces the new concept of full and fair opportunity **for domestic suppliers** and e-commerce capability.

The last principle does explicitly recognise the commitments under the CER & CEP agreements, but it is not entirely clear how this sits with the preceding principles. Presumably, any policy to promote full and fair opportunity for domestic suppliers would mean competition with international supplies.

³⁵ Available from the Ministry of Economic Development, Regulatory and Competition Policy Branch, last revised in July 2002. This document was interestingly first issued as *Government Purchasing Guidelines : Opportunity for Local Industry* in September 1991.

³⁶ Published June 2001, and available from www.oag.govt.nz

³⁷ Defined as "Departments of Public Service" in the First Schedule to the State Sector Act 1988 (rather than "Government departments", as provided in the footnote on p 4 of the policy guide) plus the NZ Police and the NZ Defence Force.

³⁸ Adopted following a policy review in April 2001. See Cabinet Minute *Government Policy Review CAB Min (01) 11/18*

³⁹ See p 5 of the policy guide

The policy guide then tries to tread a fine line between imposing an obligation and encouraging procurement bodies to use domestic suppliers in pursuit of the stated secondary objective of sustainable industry and regional development. The policy stops short of requiring “offsets”, stating that it does not:

impose on purchasing agencies a requirement to use their purchasing as a direct lever for industry or regional development, eg through domestic price preference or mandatory “offsets” (requirements on government buyers to obtain commitments from overseas buyers (sic) to assist domestic industry)⁴⁰,

but then goes on in the related footnote to state:

Purchasing agencies may nevertheless wish to consider commercially viable offsets which support their agency goals – see Annex: “Informal Voluntary Offsets Policy”, page 28.⁴¹

The Annex then further defines *offsets* as:

a benefit or contract for manufacturing and/or services which is awarded to a New Zealand firm. An important feature of an offset may be the inflow of new or improved technology to New Zealand.⁴²

and then explains how an offset might work in practice. The final paragraph of the Annex then states:

It should be noted that under Article 11 of the CER Trade Agreement, New Zealand and Australia have agreed not to require offsets in relation to Australian and New Zealand content in government purchases. Under the CEP Agreement, New Zealand and Singapore have agreed not to impose, seek or consider offsets in relation to government procurement from New Zealand or Singapore suppliers.⁴³

The Annex rather unhelpfully omits the obligations not to discriminate in both trade agreements and in the APEC Non-Binding Principles, and the best endeavours undertaking to extend the application of the approach to other government bodies. These statements sit rather uncomfortably together. If it is intended that Australian and Singaporean suppliers would not be covered by this preference, it is not at all clear how this would work in practice.

The policy guide then redefines value for money by requiring its agencies to “purchase from internationally competitive domestic suppliers⁴⁴”. The guide then lists 11 potential commercial and practical advantages in purchasing locally, and finishes with the statement:

⁴⁰ Ibid.

⁴¹ See p 5, footnote 3 of the policy guide.

⁴² See p 28 of the policy guide.

⁴³ Ibid.

⁴⁴ See p 7 of the policy guide.

In general, it will often make good business sense, in terms of value for money and a reliable supply base, that goods and services should be sourced from local suppliers where the necessary standards of competitiveness, quality and availability are met.

Which is a fairly clear mandate for preferring local suppliers. Then follows the rather disingenuous disclaimer:

The Government's procurement policy does not give preference or weighting to local content in itself. Similarly, there should be no discrimination on the basis of ownership of a supplier or preference for domestic equity in itself. Having given domestic suppliers full and fair opportunity and assessed any commercial and practical value for money advantages associated with local supply, agencies should buy from the best source available, according to their own judgement of all costs and benefits.⁴⁵

It is hard to imagine how the policy guide could be seen as doing anything other than promoting discriminatory practices. It identifies providing full and fair opportunities for local suppliers as a core policy, identifies industrial and regional development as secondary objectives, includes supporting domestic suppliers as value for money considerations, requires purchase from *the best source available*, but only after considering advantages of local supply and provides guidance on implementing offsets, albeit on a voluntary basis.

The effect of the policy can only be to *afford protection/favour/preference* (in terms of the APEC principles) and, if it falls short of discriminatory, certainly would not be encouraging a single market or using *best endeavours to encourage wider application of the Agreement, consistent with good commercial practice* in terms of the CER and CEP agreements.

There is no indication that either Australia or Singapore have challenged the policy guide on this basis.

C Audit Office Guidelines for Procurement

Consistent with the non-prescriptive preferences of the Government's policy guide, the Auditor-General's publication *Procurement – A Statement of Good Practice*⁴⁶, the statement of good practice provides guidance on managing procurement, including the preparation of all documentation and the procurement process itself.

Part 1 of the statement outlines overriding considerations, Part 2 covers the procurement process and Part 3 provides further discussion on a number of issues, including engaging consultants, syndicated procurement, outsourcing, contracting for the construction of physical works, sole source and monopsonistic procurers and e-commerce.

Like the policy guide, the statement of good practice is mandatory for *public entities* as defined in the Audit Act 2001, and for Transit and Transfund under their respective

⁴⁵ See p 7 of the policy guide.

⁴⁶ Published June 2001, and available from www.oag.govt.nz

enabling legislation.⁴⁷ Local authorities and entities under their control are not covered by the statement.⁴⁸

The statement generally follows through the detail of the issues covered under the APEC Non-Binding Principles, rather than any secondary considerations.

Procuring bodies are helpfully advised, in the section of Part 1 dealing with Legal Considerations, that they may have public law obligations, and that:

Such obligations may apply even when the entity is carrying out commercial functions, such as competitive tendering. A public entity should always take account of the risk that its procurement actions and decisions could be subject to judicial review or complaint to an Ombudsman.

A public entity's fundamental public obligation is always to act fairly and reasonably. This may impose a higher standard of conduct than that which applies in the private sector.

Public law obligations could apply to any aspects of a procurement process – including the pre-selection of potential tenderers.⁴⁹

The extent of such private and public law obligations is not, regrettably, without some doubt.

4 LEGAL CONSTRAINTS ON PROCUREMENT

A Generally

Legal constraints and obligations will, perforce be the subject of the law of contract, which makes no distinction between private and public law issues. The critical issues for public sector procurement, however, concern the process of procurement rather than contract delivery and performance.

1 Agreements to Agree

Applying the accepted contractual analysis of invitation to treat, offer and acceptance formulated in the *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd*⁵⁰, the Courts have been reluctant to imply any obligations to pre-contractual negotiations until relatively recent times. The increased complexity of tender procedures and the expense of due diligence investigations have meant that the obligations of the parties to each other have required further examination.

⁴⁷ See Part 1 of the statement, on p 6.

⁴⁸ Under Scope on p 4 of the Introduction to the statement.

⁴⁹ See p 8 of the Statement of Good Practice.

⁵⁰ [1953] 1 Q B 401

While it remains the case that agreements to agree are unenforceable due to lack of certainty and the inability of the Courts to enforce them⁵¹, it has increasingly become accepted that obligations may be acquired in contract before a formal contract has been entered into. In the case of *Fletcher Challenge Energy Ltd v Electricity Corporation of NZ Ltd*⁵², Fletcher Challenge and ECNZ entered into a heads of agreement for the supply of gas. The heads of agreement were brief, considering that the supply could relate to a value up to \$1.8 billion, and included a provision under which the parties were to “use all reasonable endeavours to agree a full sale and purchase agreement within three months of the date of this agreement”. A formal agreement was never achieved and Fletcher Challenge brought proceedings claiming that ECNZ was in breach of its *reasonable endeavours* obligations.

The High Court held that the parties intended to be bound, taking the following factors into account:

- (a) the importance and complexity of the transaction;
- (b) the degree of formality/informality and the terminology of the agreement (eg was there a signed agreement, an exchange of correspondence or only an oral exchange);
- (c) the amount of detail settled by the agreement;
- (d) the parties’ previous dealings and their conduct at the time of and following the agreement;
- (e) actions taken in reliance upon or part performance of the agreement; and
- (f) the fact that the agreement is one of a series of inter-related agreements between the parties.

The majority of the Court of Appeal held that it was not concerned by the lack of essential terms, commenting:

Something should be said about the place that the controversial decision of the House of Lords in May and Butcher Ltd v The King [1934] 2 KB 17 has in the modern law of contract. We take the view that this case is no longer to be regarded as authority for any wider proposition than that an “agreement” which omits an essential term (or, as Lord Buckmaster called it, “a critical part”), or a means of determining such a term, does not amount to a contract. No longer should it be said, on the basis of that case, that prima facie, if something essential is left to be agreed upon by the parties at a later time, there is no binding agreement. The intention of the parties, as discerned by the Court, to be bound or not to be bound should be paramount. If the Court is satisfied that the parties intended to be bound, it will strive

⁵¹ *Walford v Miles* [1992] 2 AC 128

⁵² [2002] 2 NZLR 433 (CA)

to find a means of giving effect to that intention by filling the gap. On the other hand, if the Court takes the view that the parties did not intend to be bound unless they themselves filled the gap (that they were not content to leave that task to the Court or a third party), then the agreement will not be binding.

On its own facts we respectfully doubt that May and Butcher would be decided by Their Lordships in the same way today. We are now perhaps more accustomed to resort to arbitration in order to settle even matters of considerable importance to the contracting parties. We find curious the notion that, in a commercial contract where price is left to be agreed, a reasonable price cannot be fixed and that, even where there is an arbitration clause, that clause cannot be used to determine the price because “unless the price has been fixed, the agreement is not there” (p 20).

We agree with Professor McLauchlan (“Rethinking Agreements to Agree” (1998) 18 NZULR 77 at p 85) that “an agreement to agree will not be held void for uncertainty if the parties have provided a workable formula or objective standard, or a machinery (such as arbitration) for determining the matter which has been left open”. We also agree with him that the Court can step in and apply the formula or standard if the parties fail to agree or can substitute other machinery if the designated machinery breaks down. This is generally the approach taken by this Court in Attorney–General v Barker Bros Ltd.⁵³

The Court also observed in relation to the enforceability of best or reasonable endeavours undertakings that:

Where the objective and the steps needing to be taken to attain it are able to be prescribed by the Court, a best endeavours or reasonable endeavours obligation will be enforceable.⁵⁴

The majority did not agree, however, that the prerequisites for a binding agreement had been made out, and the heads of agreement did not comprise a binding agreement in this case.

The Fletcher case illustrates that there are circumstances in which parties can be required to enter into a more detailed agreement pursuant to an earlier agreement, but what is required is an objectively measurable standard against which conduct can be tested to determine whether or not there has been a breach.

By way of example, it may be that a supplier offers an attractive long-term maintenance contract during the tender process in order to improve the whole of life cost assessment of its bid. The basic terms of that arrangement may be provided to enable a costing to be done, with the commercial terms to be agreed at a later date. If it is found that the parties intended to enter into a binding agreement, the Courts will do their best to give effect to the agreement⁵⁵.

⁵³ Supra at p 446, paras 60 to 62.

⁵⁴ Ibid at p 458, at para 115.

⁵⁵ *Queensland Electricity Generating Board v New Hope Collieries Pty Ltd* [1989] 1 Lloyd’s Rep 205

2 Estoppel

In the landmark case of *Waltons Stores (Interstate) Limited v Maher*⁵⁶, the terms of a contract for the construction and leasing of a new building were substantially settled, but both parties understood that the contract would not have binding effect until a formal exchange of documents had taken place.

Solicitors acting for Waltons Stores sent a draft contract to Maher's solicitors and in a subsequent telephone conversation, the solicitors for both parties agreed on certain amendments. The Waltons Stores' solicitors indicated that the amendments were subject to client approval and sent an amended draft later that day along with a covering letter which stated "we shall let you know tomorrow if any amendments are not agreed to".

Waltons Stores did not make contact with Maher for a further two months, at which time they wrote to say that they did not intend to proceed with the contract. By this time, Maher had already demolished the existing building and completed 40% of the new building. Maher had forwarded a signed copy of the amended contract to Waltons Stores a few days after the telephone conversation and, not having heard anything further to contradict Waltons Stores' earlier encouraging statements, had proceeded with the works.

Waltons Stores were aware that Maher was proceeding with the works. On appeal, the High Court of Australia did not accept Waltons Stores' reliance on strict legal principles of contract. It held that the defendant had represented by conduct that it would enter into a lease and it was therefore estopped from denying that such an obligation existed.

For equitable estoppel to be successful, the plaintiff must have relied on the defendant's representation to its detriment and the defendant must have committed some form of unconscionable conduct. In the *Waltons Stores* case, the detriment was that construction work on the property in question had already begun. The High Court of Australia suggested that unconscionability may exist where the detriment has been suffered by the plaintiff in circumstances where there was a relationship of responsibility between the parties. The factors which will be relevant in finding such a relationship will be the conduct of the party in creating or encouraging the belief that a promise would be fulfilled, the reliance on this by the other party, and knowledge of that reliance.

3 Good Faith

In an illuminating dissenting judgment in 2001⁵⁷, Thomas J canvasses the unhappy history of obligations to observe good faith in long term or relationship contracts:

Classical contract law is based on certain implicit paradigm cases, the most common of which is the contract for an identified commodity between two strangers operating in a perfect spot market. Contractual principles provide a relatively rigid offer and acceptance format and are intolerant of such issues as indefiniteness, agreement to agree, and agreements to negotiate in good faith. Principles of classical contract law like the bargain theory of consideration, the objective theory of

⁵⁶ (1988) 164 CLR 387

⁵⁷ *Bobux Marketing Ltd v Raynor Marketing Ltd* [2002] 1 NZLR 506

*interpretation, and the rule that silence is not acceptance are particularly apt for contracts of this kind.*⁵⁸

Taking no prisoners, His Honour goes on to observe:

*Despite its tradition, however, the law of England, and by derivation the law of this country, could not forever ignore the fundamental weakness of the classical conception of contract law. The formalistic approach was overtaken by the good sense of those Judges who recognised that the function of the law of contract is to provide an effective and fair framework for contractual dealings based on achieving the reasonable expectation of the parties. See J Steyn, "Contract Law: Fulfilling the Reasonable Expectations of Honest Men" (1997) 113 LQR 433 at p 434. The fundamental flaw of the classical conception of contract law was its empirical premise that most contracts are discrete. That premise is false. Most commercial contracts are in fact relational contracts. The great bulk of contracts either create or reflect relationships. It is discrete contracts that are unusual, not relational contracts.*⁵⁹

In Thomas J's view, relationship contracts are predicated on mutual trust and confidence, and therefore subject to an obligation to act in good faith⁶⁰. While his is a dissenting judgment, his comments on implying a duty of good faith in relationship contracts carried great force.

B The Process Contract

The concept of the collateral, preliminary or process contract to cover the formal pre-contract negotiation period was considered and accepted in New Zealand in two cases, both in the High Court in Palmerston North, within days of each other. Interestingly, neither case cites the other.

The first (delivered on 2 December 1994) was *Gregory v Rangitikei District Council*⁶¹ and the second, *Pratt Contractors Ltd v Palmerston North City Council*⁶² (delivered on 13 December 1994).

1 The Gregory case

The facts of this case have already been canvassed in outline.⁶³ The District Council put a cottage and adjoining land which were surplus to requirements up for sale by tender. The reserve was not met, so the District Council entered into direct negotiations with the adjoining owner, under a misapprehension over its obligations under an earlier undertaking.

⁵⁸ Ibid at p 514, para 33.

⁵⁹ Ibid at para 35.

⁶⁰ Ibid at para 44.

⁶¹ [1995] 2 NZLR 208

⁶² [1995] 1 NZLR 469

⁶³ See page 9, above.

While these steps were under way, the council through its solicitors pursued a consistent policy of non-information. By 27 May 1992 at the latest the plaintiff had heard “negotiations” with Mr Roberts [the adjoining owner] “are taking place”. The question of compliance with s 230 was raised. Information and copies of resolutions were demanded. The council, through its solicitors, simply maintained all was in order and declined information, pleading commercial sensitivity.

The property was sold to Roberts, and Gregory issued proceedings against the District Council.

Gregory's claim was under five heads:

- (1) *Contract* – the process contract adopted in the English case of *Blackpool & Fylde Aero Club v Blackpool Borough Council*⁶⁴.
- (2) *Breach of statutory duty* – the sale was subject to the obligation to publicly notify in terms of s 230 of the Local Government Act 1974, which the District Council failed to do.
- (3) *Negligence* – based on a series of failures, including the failure to publicly notify in terms of s 230.
- (4) *Section 9 of the Fair Trading Act 1986* – misleading and deceptive conduct.
- (5) *Breach of obligations involved within a statutory power of decision* – judicial review.

The first claim was made on two alternatives. The first was that the invitation to tender was an offer, and submission of the tender an acceptance. The contract, it was submitted, was a unilateral contract to accept the highest bid, which would be followed by a bilateral contract for sale. The difficulty with this argument was that the invitation contained the qualification that the *highest or any tender not necessarily accepted*. Relying on a Canadian decision⁶⁵, counsel for Gregory argued that the qualification was boilerplate which should not be given any weight, otherwise it would vitiate any tender contract, allowing arbitrary decision making.

McGechan J declined to follow this approach, observing:

Parties at arms length may contract in a way which allows the arbitrary, abnormal, or even downright stupid. The disdain for the “arbitrary” is a valid interpretative approach, in deriving intentions, but goes no further. If, to the contrary, the Canadian Court intended to lay down some wider rule, I respectfully decline to

⁶⁴ [1990] 3 All ER 25

⁶⁵ *Canamerican Auto Lease & Rental Ltd v Canada (Minister of Transport)* (1987) 37 DLR (4th) 591.

*follow. There is no suggestion such is needed under commercial provisions prevailing in New Zealand, and freedom of contract should be allowed.*⁶⁶

The second contract formulation was that the District Council warranted that the property was for sale and that Gregory's tender would be considered. This comprised an offer, which was accepted by the submission of a tender. The breach was by selling the property otherwise than by tender. Based on the *Blackpool case*⁶⁷ and subsequent formulations of the process contract approach, Gregory was on more fertile ground.

The qualification that the highest or any other tender might not be accepted remained insuperable for the Court, and at best, the obligation was to consider; not to accept. Helpfully, however, the Court accepted that the process contract approach was a valid way of considering pre-contractual, or tender relationships.

The second cause of action was based on the failure by the District Council to advertise the sale by private treaty in terms of s 230 of the Local Government Act 1974. The District Council relied on the earlier notification for the sale by tender as authority for the subsequent sale by private treaty.

McGechan J found that "*the s 230 resolution authorising sale by way of tender did not authorise the private sale which occurred ... The private sale was unauthorised.*"⁶⁸ However, such a breach did not give rise to private rights of action for breach of statutory duty as the obligation to publicly notify was for accountability, or as an early warning system, rather than protecting a particular class of purchasers. The second ground failed.

The third cause of action, in negligence, required the establishment of a duty of care to Gregory, breached by the District Council by failing to notify in terms of s 230 and deceptively and deliberately, without notice to Gregory, negotiating the sale to Roberts. Despite having already held that a breach of statutory duty could not be established because of the lack of a proximate relationship between Gregory and the obligation to advertise under s 230, the Court found in favour of Gregory on this point.

The fourth cause of action, involving a detailed consideration of the application of s 9 of the Fair Trading Act 1986, was also established. McGechan J made a number of observations which are useful.

Summarising the position of the District Council on the need for transparency:

It may be the plaintiff would have liked greater candour, but in commercial negotiations council was not required to put all its cards "face up on the table". There must be many occasions where publication of all facts is not in the council's best interests. Further, plaintiff was not influenced by the conduct concerned. If the conduct was misleading or deceptive (denied) "it made no difference to the outcome – it did not influence the plaintiff in any meaningful way". If the plaintiff has been "aware that a sale to Mr Roberts was in process", "he had no right to anything. He

⁶⁶ [1995] 2 NZLR 208 at 221

⁶⁷ See p 26 above.

⁶⁸ Ibid at p 226.

could not have forced a sale to himself". If there were complaint about the tendering process, plaintiff could have commenced injunction proceedings; but if there was merit council would have re-advertised, free then to sell as it wished.⁶⁹

Finding that the District Council intentionally kept the negotiations with Roberts secret:

I consider that secrecy in itself was deceptive. Having created a clear impression that council would sell, if at all, by tender, it was deceptive and misleading for council to proceed to sell by private treaty, without disclosure to tenderers. Council should have notified those concerned its intentions had changed... [that it did not do so] ... was ... a plain untruth. It was misleading and deceptive... The correct statement was that council deliberately did not say so. I am not persuaded by any policy argument that council in a commercial situation was not required to put its cards face up on the table.⁷⁰

The fifth (and final) cause of action was for judicial review of statutory powers of decision on the basis that the District Council:

- (a) failed to act fairly and/or reasonably,
- (b) failed to give effect to Gregory's legitimate expectation that his tender would be given genuine consideration, that the council would negotiate in good faith with him as highest bidder and that he would be given the opportunity to match any bid by Roberts,
- (c) should not have given preference to Roberts without approaching Gregory,
- (d) did not act in good faith, and
- (e) failed to comply with s 230.

The District Council denied it had duties under (a), (b) and (c), accepted the duties under (d) and (e), but denied breach. McGechan J accepted that the sale of the property was the exercise of a statutory power of decision, though he declined to grant the declarations sought as the property had by then vested in Roberts.

In reaching this conclusion, McGechan J was heavily influenced by comments made by the Privy Council in *Mercury Energy Ltd v Electricity Corporation of New Zealand*⁷¹. In that case, ECNZ terminated a transitional contract with Mercury Energy to supply electricity. The Court of Appeal had already formed the view that the decision to terminate was not the exercise of a statutory power or right, but a general commercial right to conduct its affairs in common with any other company in accordance with the law of contract.

Their Lordships observed that:

Judicial review was a judicial invention to secure that decisions are made by the executive or by a public body according to law even if the decision does not

⁶⁹ Ibid at p 232.

⁷⁰ Ibid at p 234.

⁷¹ [1994] 2 NZLR 385

*otherwise involve an actionable wrong ... The Corporation carries on its business in the interests of the public. Decisions made in the public interest by the Corporation, a body established by statute, may adversely affect the rights and liabilities of private individuals without affording them any redress. Their Lordships take the view that in these circumstances the decisions of the Corporation are in principle amenable to judicial review both under the Act of 1972 as amended and under the common law.*⁷²

The *Gregory case* is helpful for its acceptance of the process contract approach to tender relationships and its discussions of the application of s 9 of the Fair Trading Act 1986 and of the availability of judicial review in relation to the commercial activities of public bodies.

2 The Pratt Contractors cases

By way of background, Pratt Contractors Ltd, a civil contractor, wanted to increase the size of its road contracting business. Unfortunately, State roading contracts are run by Transit New Zealand Ltd, which has a very prescriptive approach to procurement and contracting practices. At that time a weighted attributes methodology was preferred for scoring tenders, with significant weighting for qualitative attributes.

As Pratt Contractors had limited qualifying experience, its score was always going to be low until it had completed a significant project. For Pratt to have any prospect of success, it would need to ensure that its tenders were low and compliant to make up for its poor score on previous contracts; lowballing.

(a) *Pratt Contractors Ltd v Palmerston North City Council*⁷³

This project was for the construction of a fly-over in Palmerston North.

Tender evaluation was initially by a pass/fail assessment of compliance, followed by the selection of the lowest tender. Four tenders were considered, and Pratt Contractors' was the lowest compliant tender.

In common with accepted practice, another tenderer had submitted an alternative tender, with its conforming tender, which proposed designed changes which would result in a \$250,000 saving. That alternative tender was considered and accepted by the Council.

The invitation to tender documents prohibited non-conforming tenders. Somewhat confusingly, the invitation to tender included the statement "*The Principal shall only enter into a contract for the non-excluded tender with the lowest price*" and the now stock phrase that "*the Principal is not bound to accept the lowest or any tender he may receive*".

Pratt Contractors sued in contract. In light of the express promise to accept the lowest price, Gallen J found that the Council had breached contractual obligations owed to Pratt when it accepted the non-conforming tender. The Court found an express unilateral contract based on an offer which was accepted by submission of the tender fulfilling the criteria.

⁷² Ibid at p 388.

⁷³ [1995] 1 NZLR 469

Unlike McGechan J, who had issued his decision in the *Gregory* case in the same court some days earlier, Gallen J ducked the qualification (about the lowest or any other tender not necessarily being accepted) and held that those provisions simply mean that it was open to the Council not to award the contract at all; however, if it chose to award the contract, it had to do so in accordance with its stated procedures. This restated the purpose of the process contract, which was to ensure proper consideration and evaluation of the tenders, rather than set any rules for the award of the second contract.

These cases are hard to reconcile on this point.

There are other problems with this first *Pratt* case. Pratt claimed, among other things, loss of business for contracts which would flow from its qualification for future Transit contracts and for lost profit on this contract. The first claim was disallowed, on the basis that it was too speculative, but the second, for a considerable sum, was allowed. The problem with this award is that the contract was only a process contract, under which the City Council was bound to consider tenders in accordance with its published tender rules. To award lost profit on the entire project, the Court had to find that the contract would inevitably be awarded to Pratt Contractors, and that they would actually make a profit.

This case remains significant, however, as the first case to find that a process contract existed and had been breached.

(b) Pratt Contractors Ltd v Transit New Zealand Ltd

Transit sought tenders for realigning State Highway 1 at Vinegar Hill, near Hunterville. At this stage, Pratt Contractors had a history of lowballing its tenders, then seeking to recover its costs and make a profit on contract claims. Some of its contracts had been plagued by dispute.

Pratt Contractors' was again the lowest priced tender of the eight received (by over \$ 1 million).

Tenders were to be assessed on a weight attribute method of scoring developed by Transit, under which price was accorded a score of 70%, with the balance being qualitative assessments (track record, experience, skills, resources, management skills and methodology). Transit also appointed a tender evaluation team, which included a consultant with previous experience of dealing with Pratt Contractors. Pratt was aware of this and sought, and was given, assurances he would be fairly deal with.

During the assessment, Pratt Contractors tender failed on technical skills and resources, due to Pratt's track record and financial viability. This latter point was to have been addressed by a bond, but Pratt had produced a letter from its bank which provided only that it would consider such a request, rather than undertaking to provide it. In a departure from Transit's standard practices, the tender evaluation team took this as less than comforting, and recommended to Transit that Pratt should be excluded.

Transit's project manager found the saving on Pratt's tender too attractive, and in discussion with Pratt, resolved the financial viability and resourcing issues. Transit was prepared to take a chance with Pratt. By this time, however, the tender validity period had expired.

Transit asked all tenderers to confirm their tenders and to keep them open for a further period. Two tenderers refused. Transit then terminated the tender round and sought resubmissions.

Pratt submitted two tenders – the second \$500,000 higher than the first to deal with concerns raised by the tender evaluation team about productivity. These concerns had been discussed between Pratt and Transit during the first tender round. When the evaluation team enquired which tender was to be considered, Pratt advised that the second, higher bid, should be considered.

In the second round, Pratt Contractors did not achieve the best score, and the contract was awarded to another tenderer. As an aside, Pratt then went out of business. Pratt's liquidators sued alleging breach of contract on the basis of bias and unfairness in evaluating the tenders, misevaluation of the tenders and wrongful disclosure of price prior to completion of the evaluation of non-price attributes.

Goddard J in the High Court⁷⁴ held that the preliminary contract required Transit not only to comply with the method of selection in the tender documents but also with its own internal procedural rules, which it had failed to do. She also held that the contract included implied terms as to fair dealing and good faith, stating (at paragraph 104):

There is no dispute in the present case that the tendering process is a process contract, and subject to the duties and obligations imposed by its terms and conditions, and also subject to a general implied obligation to act in good faith. It is clear that the common law envisages that tenders will be evaluated in a fair, transparent and commercially competitive way.

Looking at the tender evaluations, her Honour found that the first tender round was so tainted by the real risk of bias that it was irrelevant that Transit had the right to reject all tenders. Members of the tender evaluation team had been involved in previous dealings with the plaintiff that had resulted in dispute. The history of their relationship dictated that any situation of possible bias or antipathy be dealt with squarely and in advance of the evaluation commencing. Past experience on the part of the evaluators is a desirable factor, but Transit should have alerted the evaluation team from the outset that apparent bias was a live issue so as to put them on notice of the need to disqualify themselves or guard against it, and to be very open in their dealings.

Transit appealed.⁷⁵

The Court of Appeal departed from the finding of the High Court, and held that Transit's internal rules were not incorporated, and there was no obligation on Transit's part to eliminate the risk of bias. By the time the first tender round had been terminated, in the Court of Appeal's view Transit had complied with its procedural obligations under the

⁷⁴ *Pratt Contractors Ltd v Transit New Zealand Ltd* (unreported) HC, Wellington, CP221/97, delivered 6 September 2000

⁷⁵ [2002] 2 NZLR 313

contract⁷⁶. The second tender round was therefore properly conducted. The appeal was allowed.

Pratt then appealed to the Privy Council⁷⁷.

Summarising the issue, Lord Hoffman observed:

At the centre of the dispute lies the question of the extent to which the procedure for competitive tendering should be judicialised. Tenderers naturally want to be judged independently on their merits by an impartial selector and given the opportunity to rebut any suggestions of demerit which they regard as unfair. The parties who invite tenders, even if they are public authorities like Transit, want to be able to choose in what they consider to be their best commercial interests and not be hobbled by quasi-judicial procedural rules.⁷⁸

Their Lordships agreed that the Transit manuals were not incorporated into the tender contract, which is to be interpreted on its own terms. The sole implied term which their Lordships were prepared to accept in this contract was a duty to act fairly and in good faith.

There being no actual finding of bad faith on the part of the Transit project manager or the tender evaluation team, Lord Hoffman observed:

It is nevertheless necessary to identify exactly what standard of conduct was required of [the Tender Evaluation Team (TET)] in making its assessment. In their Lordships' opinion, the duty of good faith and fair dealing as applied to that particular function required that the evaluation ought to express the views honestly held by the members of the TET. The duty to act fairly meant that all the tenderers had to be treated equally. One tenderer could not be given a higher mark than another if their attributes were the same. But Transit was not obliged to give tenderers the same mark if it honestly thought that their attributes were different. Nor did the duty of fairness mean that Transit were obliged to appoint people who came to the task without any views about the tenderers, whether favourable or adverse. It would have been impossible to have a TET competent to perform its function unless it consisted of people with enough experience to have already formed opinions about the merits and demerits of roading contractors. The obligation of good faith and fair dealing also did not mean that the TET had to act judicially. It did not have to accord Mr Pratt a hearing or enter into debate with him about the rights and wrongs of, for example, the Pipiriki contract. It would no doubt have been bad faith for a member of the TET to take steps to avoid receiving information because he strongly suspected that it might show that his opinion on some point was wrong. But that is all.⁷⁹

⁷⁶ Ibid at para 112.

⁷⁷ Privy Council Appeal No 84 of 2002

⁷⁸ At para 3.

⁷⁹ Ibid at para 47.

Their Lordships would not be drawn on the more general obligation to perform any contract fairly⁸⁰, stating only that this was a *somewhat controversial question* which did not need to be addressed as it had been accepted by the parties that the duty existed in the present case.

While the determination falls short of clarifying whether or not there is a general obligation on the parties to act in good faith in all contracts as a general principle, it does provide good guidance on the issue of bias and the conduct of tender evaluation teams.

3 Good Faith

The circumspect approach of the Courts to implied terms of good faith is reflected in the case of *Fullers Cruises Northland Ltd v Auckland Regional Council & Fullers Cruises Ltd*⁸¹, in which Paterson J commented:

... while the ARC was obliged to act fairly, it was not precluded from acting in its own interests. In this respect, an implied term to deal fairly does not prevent a party calling tenders acting in its own interests and rejecting all tenders if it has a right to do so under the terms of the process contract...

*The standard by which fairness and equal treatment must be judged is an objective one. The standard requires, inter alia, a party such as the ARC to act in accordance with the terms of the RFTs and the associated tender documents before awarding a contract as part of the tendering process.*⁸²

This approach was also followed in the case of *Onyx Group Ltd v Auckland City Council*⁸³. This case involved the award of rubbish collection and recycling contracts. In response to an argument that the process contract included an obligation to act in good faith, O'Regan J stated:

The Council has a duty to deal even handedly with each tender, but it is entitled to look out for its own interests. There is no reason for a duty to act fairly and even-handedly to override express terms in the RFT, which give the Council a broad discretion as to how to approach the tender evaluation process. Adopting that approach, I find that the duty to act fairly does not limit the express provision of [the RFT], which entitle the Council at its sole discretion, to reject or evaluate non-conforming tenders. Once the Council has decided to evaluate a non-conforming tender, it must do so against the others also being considered whether they are conforming or non-conforming, on a fair and even handed basis, but any duty on the part of the Council to act fairly does not prevent it from exercising the option it has reserved to itself ...

⁸⁰ See *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1, 36-37.

⁸¹ (unreported), HC, Auckland, CP438/96, 4 June 1999, Paterson J [1999] BCL 693

⁸² *Ibid* at p 45.

⁸³ (unreported) HC, Auckland CP387-SD01/01, 2 September 2003, O'Regan J [2003] BCL 923

5 CONCLUSION

Government procurement represents an important part of the economy; not only because of its relative size, but also due to the public interest in how and how well it is expended in maintaining services and infrastructure, and as a policy tool. The primary concern for procuring bodies should therefore be securing value for money, with government policy makers setting secondary objectives.

A critical element in obtaining value for money is ensuring transparency in the procurement process and good governance throughout the process of appointing a supplier and delivery. From a practical perspective, however, there is real potential for conflict when extending the principles of transparency to all levels of procurement, without recognising the tensions inherent in the process of competitive tendering, and the fact that all parties will pursue their own best interests.

This is probably more a product of the traditional preference for competitive tendering as a method of selection, rather than anything inherent in the procurement process. Value for money, and good governance, may be better secured by ensuring that suppliers are not distracted from delivering the best bid they can, procuring bodies focus on value for money objectives, and supervision and accountability is dealt with through internal reporting lines and independent oversight by the officers of the Auditor-General and the Ombudsmen; at least until an alternative method of procurement finds favour.

The New Zealand Government has endorsed best practice principles for procurement, but has also taken the opportunity to promote secondary objectives through the process. From a political perspective, it is appropriate for governments to promote such objectives at the political level; not, however, in the fine print of internal procurement guidelines. The Government's Procurement Policy Guidelines appear to be a thinly veiled attempt to subvert the procurement process, and are also in conflict with New Zealand's international commitments to Australia under CER and Singapore under CEP.

In terms of legal constraints, the Official Information Act, and its local government equivalent, provides for high levels of disclosure, placing availability of information above traditional principles of contract, and commercial confidence. This puts public sector procurement on a far higher level of accountability than in the private sphere.

The Courts have not been persuaded that such clear recognition of public interest is warranted. Accountability of public bodies is still firmly in the sphere of the laws of contract, along with private law issues. Increasingly, there is an appetite for imposing general obligations of good faith and fair dealing, not just on public bodies, but as a matter of general contract law. This is proceeding, however, on a case by case basis, and remains subject to the explicit wording of the contract.