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PRIME MINISTER

DHSS LOCAL OFFICE PROJECT

1. I have advised on the justification for single tender procurement under EEC and GATT rules. My advice was favourable. I attach a copy at Annex A.

2, Central to that advice was the premise, expressed at paragraph 4(ii), that

"although the LOP computers will at first operate independently of these other DHSS systems, it is settled Ministerial policy that all the DHSS computer systems (i.e. those listed above and LOP) will be progressively linked, so that eventually an entirely integrated data-base will be created and the main frame machines will be capable of running the software from other machines within the system".

The premise derived from my Instructions from DHSS, viz. 'The Department's strategy is firmly committed to the convergence and integration of all benefit systems in what has been described as the "whole person approach"', a passage which now appears at paragraph 5.3 of Norman Fowler's paper to E(A).

pp. — 3. I have seen his minute to you dated 19 July covering his paper. At page 3 it is stated that :

"it must be recognised that future plans for integration are not as persuasive a justification as immediate technical requirements."



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4. I have also seen a copy of a Treasury letter to DHSS dated 19 July (Mr Watson to Dr Spackman) containing the following passage :

"I do not therefore believe that we can at this stage say that it is Government policy to go to the level of integration which your paper now appears to envisage; we must limit ourselves to what is in fact the position, that we wish to keep open this possibility provided that it proves cost-effective when we are clearer about the precise costs and benefits. It may well be that if the Law Officers have not understood this point they will wish to consider whether their legal opinion remains as stated to date."

5. I must make it clear that my advice as to the prospects of bringing ourselves (in the event of challenge) within the relevant exceptions contained in Council Directive 77/62, so as to justify the use of a single tender procedure, was given upon the premise to which I have referred. If the true position as regards the Government's policy is as described in the Treasury letter the prospects are very different. It is probable that we would fail.

6. It is difficult to envisage with precision any intermediate position between "settled Ministerial policy" and "keeping open the possibility". If, however, there is one, and we in fact occupy it, I would need to know what it is before being able to assess the legal consequences.

7. I am copying this minute to Members of E(A), Sir Geoffrey Howe, Norman Fowler and Sir Robert Armstrong.

A.M.

24 July 1985

Law Officers' Department

P36 6020 (GTN 2921)

~~MS-744X~~

Communications on this subject should
be addressed to

THE LEGAL SECRETARY
ATTORNEY GENERAL'S CHAMBERS

ATTORNEY GENERAL'S CHAMBERS,
LAW OFFICERS' DEPARTMENT,
ROYAL COURTS OF JUSTICE,
LONDON, W.C.2.

Our Ref: 400/85/153

Your Ref: A85/15L/JRJB

J R J Braggins Esq.
The Treasury Solicitor
Queen Anne's Chambers
28 Broadway
London SW1H 9JS

10 July 1985

Dear James,

PROPOSED LOP COMPUTER PROCUREMENT BY DHSS

1. The Solicitor General has seen your letters to Michael Saunders dated 18 and 19 June 1985 and your subsequent letter to me dated 3 July 1985. He has also seen the letter from Dr Spackman of DHSS of 4 July 1985 enclosing the latest draft of the paper for E(A). He has asked me to write setting out his advice and views.

2. Your letter of 18 June poses four specific questions which arise in the context of a proposal by DHSS to purchase, by way of single tender, ICL main frame computers for their Local Office Project (LOP). In general, they can be summarised as asking whether use of a single tender procedure is justified by virtue of the exceptions contained in Article 6(1)(b) or 6(1)(e) of Council Directive 77/62, as amended by Council Directive 80/767 ("the Directive"), or under Clauses V.15(b) or V.15(d) of the GATT Procurement Agreement ("the Agreement"), and what would be the consequences of any legal challenge to the single tendering procedure.

Is the single tender procedure justified?

3. The Solicitor General wishes first to set out his understanding of what appear to be the relevant facts in the light of which his advice is sought. The proposed paper for E(A) contains a great deal of information about the current state of computing within DHSS, the requirements of LOP and the overall

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operational strategy of the Department, but if the exceptions to the Directive and the Agreement are to be invoked certain features have special relevance.

4. These basic facts are as follows :

- (i) DHSS already has ICL main frame computers running ICL software to process the following benefit schemes, namely child benefit, retirement pensions, insurance contributions, and disablement benefits.
- (ii) Although the LOP computers will at first operate independently of these other DHSS systems, it is settled Ministerial policy that all the DHSS computer systems (i.e. those listed above and LOP) will be progressively linked, so that eventually an entirely integrated data-base will be created and the main frame machines will be capable of running the software from other machines within the system.
- (iii) It is not technically possible to achieve the degree of integration and compatibility mentioned (ii) above unless all the main frames and software are supplied by the same manufacturer. A mixed system comprising in part ICL machines and in part other machines could not achieve this.
- (iv) As all the main frame computers currently operated by the DHSS are ICL machines, to use any other machines in LOP would necessitate changing all the existing machines and software if the degree of integration and compatibility mentioned in (ii) above is to be achieved. Such an operation is not cost-effective from a DHSS point of view either in terms of cost or in terms of the additional time that will be required to modify the software and data-base. It would not be economic for any of ICL's competitors to supply the computers for LOP on the basis that they would have to meet the consequential costs of thus adapting the software and data base. It makes more technical and financial sense to use ICL machines.

*In which case
ICL should be
able to win in
open tender*

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- (v) If ICL machines are used, further integration with the National Unemployment Benefit System (which is operated by DHSS for the DOE on ICL main frame computers) and the tax system will be possible because they also utilise ICL main frames.

5. The conclusion to be drawn from these facts is that unless the entire system of DHSS computers is replaced (e.g. by IBM main frames), together with all the appropriate conversion of the necessary software and the data-base, the only way in which the Department's overall requirements can be met is by the provision of ICL main frames for LOP.

6. The purpose of both the Directive and the Agreement is to ensure that suppliers can compete for public supply contracts on equal terms. To this end, they require that save in specified circumstances all such contracts must be subject to the tendering procedures laid down. There are exceptions but, because these constitute exceptions from the general rule, it is likely that any court considering them will construe them narrowly. It is to be noted that you have not been able to find any cases decided by the European Court of Justice relating to any of the exceptions contained in Article 6 of the Directive.

Exceptions based upon technical reasons or the protection of exclusive rights:

7. The exception in Article 6(1)(b) is available where the goods can only be manufactured or delivered by a particular supplier, either for technical reasons or for reasons connected with the protection of exclusive rights. The Solicitor General considers that there are persuasive arguments in favour of both of these exceptions in the circumstances of this case. It can be said that the requirement to merge the appropriate DHSS data-bases to obtain an integrated system, and the requirement to be able to run existing ICL software on the new machines, mean that technically there is no other manufacturer which could manufacture or deliver the equipment which is needed. Put in these terms, the requirement might even meet the narrow construction test proposed in paragraph 8 of your letter to Michael Saunders of 18 June in the sense that only ICL can manufacture a computer which is architecturally compatible with the existing computers and hence ultimately able to form part of a common pool of computer resources. Another manufacturer

seeking to provide an appropriate machine could only do so by infringing the exclusive rights of ICL and such a consideration brings the case within the second limb of Article 6(1)(b).

8. Furthermore, even if it were theoretically possible to acquire non-ICL main frames for LOP, the requirements for ICL based software to be able to run on the LOP computers and the objective of merging the data-bases would mean that this could only be done with ICL software. Again, the use of the exception could be supported by reason of the protection of exclusive rights.

9. The weakness in these arguments lies in the fact that, in reality, a particular machine is being selected but there is no opportunity whatsoever for a competitor to present a tender. The question, therefore, is whether it is permissible to draw the specification in such a way that only one firm can meet it. Article 7 of the Directive applies to all tendering procedures covered by the Directive, including single tender (see Article 4). Article 7(2) prohibits the specification containing technical specifications which have the effect of favouring or eliminating certain undertakings or products. However, the requirements of this Article do not apply if such specifications "are justified by the subject of the contract", and the argument here would be that the specific requirement that the LOP system can be fully integrated with the existing DHSS systems means that this provision can be invoked. This constitutes an objective and proper reason both for drawing the tender in such a way that only ICL are in fact able to meet it; but it is important that the Department should be able to demonstrate that these requirements are genuine, and not merely a method of ensuring that ICL are awarded the contract. The Solicitor General understands from the papers he has seen that this is the case.

10. As for the exemption in Clause V.15(b) of the Agreement, although this does not contain any reference to technical reasons (and in that sense is narrower than the Directive) it is available "for reasons connected with the protection of exclusive rights". As indicated in relation to the Directive, there are arguments in favour of this exception being able to apply. In addition, this Clause adds a further requirement to that in the Directive, namely not only must the goods be able to be supplied by a particular supplier but that "no reasonable alternative or substitute exists". The Solicitor General does not

consider that this detracts from the strength of the available argument.

The exception based upon compatibility with an existing installation:

11. The exception in Article 6(1)(e) is available where the goods are to be delivered by the original supplier because they are a replacement or extension of an existing installation, and to purchase elsewhere could lead to the purchase of equipment with different technical characteristics resulting in incompatibility or disproportionate technical difficulties in operation or maintenance. If this exception is to apply here, it has to be established that the LOP main frames constitute "an extension of an existing installation". This gives rise to two questions: first, is the existing body of DHSS computers an installation; secondly, is it intended as an extension when integration, although firm policy, is still some little time in the future?

12. The Solicitor General thinks that this exception is less easy to rely on. LOP is undoubtedly capable of operating as a free-standing project, and in the light of the current organisation of DHSS and the way in which benefits are distributed, it is a separate system. This means that whilst it is capable of being integrated, and will be integrated in due course, arguably it is not being purchased as a component of an overall system; it is an independent installation which in due course will be merged with other DHSS installations. If the fact that a computer drew information from other computers meant that it could be regarded as an extension of such computers, this exception could become unjustifiably wide.

13. A further difficulty in regarding the existing DHSS main frames as an installation is that they would at some point (i.e. when the Operational Strategy was adopted) have changed their status from independent installations to a system constituting one new installation. No other manufacturer would have had any chance of tendering for any part of that system, and hence one of the objectives of the Directive would have been avoided.

14. It is, however, possible to regard the LOP computers not as independent installations but as part of a system which in due course would embrace all the DHSS computers all of which, as indicated above, would have to be compatible

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with those installed in LOP. It seems that those adopting the Directive did not have in mind the possibility that a number of similar computers could be linked in the way here proposed to form a unified system. Although the Solicitor General thinks that article 6(1)(b) of the Directive is wide enough to embrace the current DHSS proposal, he thinks that had the Community legislators contemplated something similar to the current proposals, they would have been more likely to place it expressly within the scope of Article 6(1)(e). The purpose of that Article is to avoid the necessity for the open tendering procedure where the technical characteristics of the existing system make it practically impossible to instal equipment manufactured by any one other than the original supplier. It would be a perverse interpretation of Community legislation which led to the result that purchasers were forced to scrap all their existing machines and purchase an entirely new system. Assuming there is no evidence to the contrary as to what the intentions of the legislators were in this connection, the Solicitor General thinks there is an attractive and very respectable argument for construing the exception in the light of the technological developments so as to apply also to this kind of situation; such an argument might well find favour with the European Court.

15. As for the exemption in Clause V.15(d) of the Agreement, the qualifying conditions are so close to those in the Directive that the same conclusion follows.

Effect of legal challenges:

16. However strong the case in favour of single tendering, it is still possible that a competitor will himself take legal proceedings against the Department or will complain to the Commission causing them to take proceedings under Article 169 of the EEC treaty. The Solicitor General thinks it is very likely that, if a competitor of ICL were minded to take proceedings on the basis that the DHSS has failed to comply with the Directive, the European Court of Justice would regard the Directive as being of direct effect. He thinks that the Court would regard this as a case of vertical direct effect, given that a company would be complaining about the disadvantage it had suffered as a result of the failure of a Member State to carry out its Community obligations. That failure is either the failure to legislate (which, the European Court would be likely to hold, can be invoked as against the Government acting as a purchasing authority)

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or the failure to proceed by way of open tender. The fact that that might have an effect upon a third party would not constitute a finding of horizontal direct effect. It would merely be a consequence of the application of vertical direct effect.

17. As to the remedy which the Court might be asked to provide, the Solicitor General thinks that the most likely is a declaration. He doubts whether damages would be available since a competitor could not prove that he would have been awarded the contract following an open tender. It is possible that the judicial review procedure might be used in an attempt to quash the decision to proceed by way of single tender and the award of the contract to ICL on that basis and to direct the Department to re-tender in accordance with the terms of the Directive. That would require the Department to re-tender and to disentangle the commitment it would have already made to ICL.

18. The Solicitor General considers that the remedy a competitor would be most likely to pursue is that of a declaration. The scope of the declaration requested is a matter for speculation but could range from a mere statement that the Department had failed to proceed by way of open tender, as required by the Directive, to a specific finding that any contract entered into with ICL was void. However the declaration was expressed, given the requirement of Community law that remedies provided by the domestic courts should be available for the purpose of ensuring observance of directly effective Community provisions, the consequence is likely to be the termination of any contract already entered into and a requirement to re-tender.

19. These consequences are serious but depend upon a competitor being able to convince the Court both that the Directive is directly effective (which it probably is) and that the DHSS have not acted within any of the exemptions in Article 6. The latter is a difficult hurdle for a competitor, and for the reasons given above the Solicitor General thinks there is a reasonable prospect of successfully defending such an action.

20. You then raised the further question of what the Government should do if proceedings were brought. The Attorney General has already advised in relation to the PAYE contract that, if any challenge is mounted in the United Kingdom

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Courts or in the European Court of Justice before the contract is granted, seeking to impugn the validity of a single tender approach, it would be quite wrong for the Government to award a contract for the supply of equipment before the Court gave a final decision. The Solicitor General would give the same advice in the circumstances which you suggest.

21. If such proceedings were commenced after the contract has been executed, ICL would have acquired legal rights and obligations under a contract. Consequently it would not be just a case of holding the single tender procedure in abeyance while matters are sorted out. In these circumstances the question whether an injunction could in similar circumstances be obtained against a defendant other than the Crown might be relevant, although it must be pointed out that in the absence of horizontal direct effect no such situation could occur.

22. If it were decided not to suspend the carrying out of the contract whilst such proceedings were considered by the Courts, the consequences from the Department's point of view might at the end of the day be worse than if such a suspension had operated. This would be the case if the Court did in fact determine that re-tendering was necessary, or if any Order of like effect was made, since there would be a potential claim for compensation by ICL arising out of the damage caused to them as a consequence of the Government's action, plus the additional problems caused by having to rethink the entire procurement in the light of the Court's judgment. The Solicitor General thinks it likely that the nearer to completion the ICL contract is, the more difficult would be these problems.

Conclusion:

23. The Solicitor General's answers to your questions are, therefore, as follows :

- (i) There are good arguments for relying on the exceptions set out in Article 6(1)(b) of the Directive and Clause V.15(b) of the Agreement. In the case of the exception set out in Article 6(1)(e) of the Directive and Clause V.15(d) of the Agreement,

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there is an attractive and respectable argument which could be advanced and which might well find favour with the European Court.

- (ii) and (iii) It would be improper for the Government to award a contract on the basis of the single tender procedure if, before it was concluded, proceedings were brought against the Government by a competitor in the domestic courts or by the Commission in the European Court of Justice. Whether or not the contract, once entered into, should proceed if proceedings were thereafter commenced is to be determined in the light of the circumstances existing at that time, but one of the relevant factors might well be whether or not in a similar situation a domestic court would be prepared to grant an injunction against a defendant other than the Government.
- (iv) There is a very real risk that if a competitor could establish that the Directive has direct effect and that the Government was not entitled to rely on any of the exemptions in Article 6, a Court would then declare that the Government had failed to comply with its obligations and possibly that the contract is void. In any event, it is likely that the Department would have to re-tender in the light of such a declaration.

Yours sincerely,

David Pearson.

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