

## DELIVERY OF THE GOODS UNDER THE ROTTERDAM RULES: DEPARTURE FROM THE FUNDAMENTAL PRINCIPLES

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*SUMMARY: I. General principles related to delivery of the goods. II. Legal background of the rules on delivery of the goods. III. Delivery of the goods under the rotterdam rules. IV. Charterparties and article 47(2). V. The houda case lessons. VI. Deviation from the fundamental principles. VII. Relation to the right of constrol. Relation to the right of constrol. VIII. Article 47(2) and the CISG. IX. Conclusion.*

A new and important piece of legislation has been adopted under the auspices of the United Nations Commission on International Trade Law (UNCITRAL). On July 3, 2008 the UNCITRAL approved the Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea (the Rotterdam Rules).<sup>1</sup> This new UNCITRAL legislation has an ambitious goal to restore the uniformity of law governing the international carriage of goods by sea. Presently there are three international regimes governing the carriage of goods by sea: the Hague Rules,<sup>2</sup> the Hague-Visby Rules<sup>3</sup> and the Hamburg Rules.<sup>4</sup> If widely adopted, the Rotterdam Rules may be able to replace these three conventions and restore the uniformity of law.

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<sup>1</sup> [http://www.uncitral.org/pdf/english/texts/transport/rotterdam\\_rules/09-85608\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/transport/rotterdam_rules/09-85608_Ebook.pdf).

<sup>2</sup> International Convention for the Unification of Certain Rules of Law relating to Bills of Lading ('The Hague Rules') and Protocol of Signature, signed in Brussels on 25 August 1924 (entered into force on 2 June 1931).

<sup>3</sup> Protocol to Amend the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, 1968.

<sup>4</sup> United Nations Convention on the Carriage of Goods by Sea 'the Hamburg Rules', signed in Hamburg on 31 March 1978 (entered into force on 1 November 1992), UN.Doc.A/Conf. 8915.

The Rotterdam Rules address a number of issues that have not been regulated by previous international conventions. There are completely new sections which cover the delivery of the goods and the right of control. The growing use of non-negotiable documents and documents in electronic form has drawn the attention of the legislators to these areas that previously had been ignored by all of the international conventions governing carriage of goods by sea. This innovative approach was probably motivated by the need to adjust the international regime governing carriage of goods by sea in such a way as cope with various modern developments, such as the increased importance of container transport, logistics and electronic commerce.

The ambitious and innovative approach of the Rotterdam Rules, which in some sections departs from certain well established principles, has drawn criticism from a number of scholars. A number of other scholars have, however, defended the text and offered various arguments to justify its novel approach. This paper will mainly focus on provisions related to the delivery of the goods, and particularly Article 47(2) which, as one of the most controversial provisions of the Rotterdam Rules, deserves the specific attention it will receive in this paper.

## I. GENERAL PRINCIPLES RELATED TO DELIVERY OF THE GOODS

All previous international conventions governing the carriage of goods by sea have failed to regulate the issue of delivery of the goods. Differences among national laws and different practices may have been the reason that this issue was left aside by the drafters of those conventions. At the moment, the rules on delivery of the goods are still based on domestic laws.

In maritime law, there is a well established rule that the carrier can deliver the goods at the destination only against the surrender of a bill of lading by the consignee. Once the master has issued the bill, the carrier has an independent, contractual obligation towards the bill of lading holder which derives from the nature of the bill of lading. Since the bill of lading is a negotiable document, its holder is entitled to require that the goods are delivered to him.

As long as the consignee can obtain a bill of lading before the goods arrive, there should be no problem for him to present it before delivery. However, in practice, for various reasons, it is often the case that the ship arrives at the port of destination before the consignee has obtained the bill of lading. In such situations, waiting for the bill of lading may cause numerous problems to all parties involved. In order to solve this problem, the practice of delivering the goods without the production of a bill of lading has been developed. This practice, however, may also cause a number of problems.

If the carrier delivers the goods without requiring the production of a bill of lading, he does so at his own risk. If the goods are delivered to a person who was not entitled to receive them, the carrier will be liable for breach of contract and for conversion of the goods.<sup>5</sup> In such cases the carrier may be deprived of the benefit of limitation of liability and may not be able to get indemnification from the P&I clubs.

There are some exceptions to the rule that the consignee must present the bill of lading before delivery. The carrier might deliver the goods without the production of a bill of lading if it is proven to his reasonable satisfaction both that the person demanding delivery was entitled to possession of the goods and that there was some reasonable explanation for what happened to the bill of lading.<sup>6</sup> Carriers should, however, be very cautious with respect to this exception.<sup>7</sup>

## II. LEGAL BACKGROUND OF THE RULES ON DELIVERY OF THE GOODS

The first issue that needs explanation relates to the rationale for the rule that the carrier must deliver the goods against the bill of lading. It seems that the reasons for such an obligation on the part of the carrier are sometimes not properly understood. Hence, in order to examine the issues related to the delivery of the goods against the surrender of the bill of lading, the reasons for this rule should be examined.

The first thing that needs to be addressed in this context is the nature of the bill of lading as a document of title, which is directly related to the issue of delivery of the goods.<sup>8</sup> In common law the bill of lading is characterized as a document of title, which means that the person in possession of it is entitled to receive, hold and dispose of the bill of lading and the goods it represents.<sup>9</sup> In civil law there are documents corresponding to documents of

<sup>5</sup> *Barclays Bank Ltd. V. Commissioners of Customs and Excise* [1963] 1 Lloyd's Rep. 81, *Sze Hai Tong Bank Ltd. V. Rambler Cycle Co. Ltd.* [1959] 2 Lloyd's Rep. 114. See also *Mobile Shipping Co. v. Shell Eastern Petroleum Ltd (The Mobile Courage)* [1987] Lloyd's rep. 655.

<sup>6</sup> *SA Sucre Export v. Northern River Shipping Ltd. (The Sormovskiy)* [1994] 2 Lloyd's Rep. 266.

<sup>7</sup> *Motis Exports v. Dampskibsselskabet AF 1912* [2000] 1 Lloyd's Rep. 121; affirming [1999] 1 Lloyd's Rep.837. See also *East West Corp. v. DKBS 1912* [2002] 2 Lloyd's Rep. 182, at 205.

<sup>8</sup> The author has examined this issue in more details in, Caslav Pejovic, *Documents of Title in Carriage of Goods by Sea: Present Status and Possible Future Directions*, *The Journal of Business Law*, 461 (2001).

<sup>9</sup> The term "document of title" was first defined by section 1(4) of the English Factors Act as follows: "The expression 'document of title' shall include any bill of lading, dock warrant, warehouse-keeper's certificate, and warrant or order for the delivery of goods, and any other document used in the ordinary course of business as proof of the possession or control

title, but the approach is different. While in common law, there are several types of documents, such as negotiable documents, negotiable instruments and securities, in civil law all these documents are covered by a single type of document.<sup>10</sup> The “*Wertpapiere*” in German law, “*titre*” in French law, “*titoli di credito*” in Italian law, “*yuka shoken*” in Japanese law and so on can be defined as “documents of value” which contain certain rights embodied in the documents themselves (such as the right to obtain delivery of the goods specified in the document, or the right on payment of a certain sum of money). They confer upon the holder the right to transfer these rights to third parties by transferring the documents. By means of a legal fiction, the bill of lading is deemed to represent the goods, so that possession of a bill of lading is equivalent to possession of the goods. The right to obtain the goods from the carrier is not based on the contract of carriage, but on the lawful possession of the bill of lading. The bill of lading enables its lawful holder to use it to obtain physical delivery of the goods at the port of destination, as well as to dispose of them during transit by transferring the bill of lading.

The effect of the transfer of a bill of lading is a result of the special character of the object of sale —goods carried by sea— such that it is impossible to make a physical delivery of the goods while they are in transit to the buyer. The delivery has to be carried out through the carrier as an intermediary, who receives the goods from the shipper (typically the seller) and is bound to deliver it to the consignee (typically the buyer) in exchange for the bill of lading. In fact, the seller performs the delivery of goods by transferring the bill of lading to the buyer, thereby transferring to the buyer the right to demand the delivery of the goods from the carrier at the port of destination. Through the contract of carriage, evidenced by the bill of lading, the carrier undertakes to deliver the goods as described in the bill of lading to the consignee to whom the shipper transfers the bill. After the bill of lading has been transferred to the consignee, it represents the contract between the carrier and the consignee who has an independent right against the carrier to demand delivery of the goods as described in the bill of lading.

The shipper can retain control over the goods after he has delivered them to the carrier, if the bill of lading is issued on his order, until the buyer pays the price or accepts the bill of exchange. The consignee cannot receive

of goods, or authorizing or purporting to authorize either by endorsement or delivery, the possessor to transfer or receive goods thereby represented”.

<sup>10</sup> This difference between civil law and common law is probably a result of the different nature and approaches of these two largest legal families. While civil law often relies on broad concepts, common law has a preference for narrow concepts.

ve the goods from the carrier without the bill of lading, and he will not obtain the bill of lading before he pays the price or accepts the bill of exchange. The seller will lose control over the goods and the right to dispose of the goods at the moment he transfers the bill to the buyer. By acquiring the bill, the buyer acquires control over the goods and constructive possession. Hence, the rule that the goods must be delivered only against the bill of lading serves to protect against the risk that the goods are delivered to someone who is not entitled to receive them. This rule protects both the carrier and the persons entitled to receive the goods.

### III. DELIVERY OF THE GOODS UNDER THE ROTTERDAM RULES

In contrast to all previous conventions, the Rotterdam Rules expressly regulate the delivery of the goods. Article 11 first provides for the carrier's obligation to deliver the goods to the consignee. This obligation is also mentioned in Article 13(1). Most importantly, Chapter 9 is dedicated to delivery of the goods, where this issue is regulated in detail. With respect to the delivery of the goods, the Rotterdam Rules make a distinction between a non-negotiable transport document (Article 45), a non-negotiable transport document that requires surrender (Article 46), and a negotiable transport document (Article 47). This corresponds to the practice that has developed in which in parallel to bills of lading, sea-waybills are increasingly being used. In addition, the Rotterdam Rules envisage the use of non-negotiable transport documents that require surrender (Article 46), by which the use of straight bills of lading has been expressly recognized for the first time by an international convention. Adding to this complexity is Article 47(2) which entitles the carrier (under certain conditions) to deliver the goods without the surrender of a negotiable transport document.

The Rotterdam Rules do not give a precise definition of negotiable documents, focusing more on appearance and whether a document contains words such as "to order" or "negotiable", but failing to define the concept of negotiability.<sup>11</sup> Since there is no universally adopted meaning of the term negotiable documents, obviously the Rotterdam Rules have left this issue to be determined by the governing law.

<sup>11</sup> Article 1(15). "Negotiable transport document" means a transport document that indicates, by wording such as "to order" or "negotiable" or by some other appropriate wording recognized as having the same effect by the law applicable to the document, that the goods have been consigned to the order of the shipper, to the order of the consignee, or to bearer, and is not explicitly stated as being "non-negotiable" or "not negotiable".

Article 47(2) contains several rules that apply “*if the negotiable transport document expressly states that the goods may be delivered without the surrender of the transport document or the electronic transport record...*” This provision applies in cases where the holder of the document fails to claim the goods at the place of destination, or to identify himself in an appropriate way. In such cases, the carrier may ask for instructions from the shipper, or from the documentary shipper. This provision raises a number of complex questions, as it clearly departs from the fundamental principles applicable to negotiable documents.

As has been mentioned above, in maritime law there is a well established rule that the carrier must not deliver the goods in any way other than against the presentation of an original bill of lading. It may therefore be asked why the Rotterdam Rules have departed from this fundamental principle. How common is the practice of containing clauses in negotiable documents which state that the goods can be delivered without the transport document? Are clauses that provide for delivery without production of the bill of lading so prevalent that it has become necessary for the practice to be legitimized by an international convention? Even if such a practice has become widespread, is it a good practice? Was it really necessary to legalize a practice that contravenes the fundamental principles of negotiable documents? How would this affect the role of transport documents in international trade? Would a bank be willing to pay under a letter of credit against a negotiable document which provides that delivery can be made without its presentation? Is article 47(2) the best solution to the existing problem of delivery of the goods without the surrender of a negotiable document? If the negotiable document expressly states that the goods may be delivered without the surrender of this document, this means that this kind of situation was envisaged at the moment the negotiable document was issued. Why then, it may be asked, was a negotiable document issued at all? Wouldn't it have been more practical and simple for a non-negotiable document to have been issued? Was it really necessary to invent a new transport document that would be called negotiable while, in fact, it would not be negotiable in the usual meaning of the term as it would be deprived of an essential feature of negotiable documents: surrender in exchange for the goods? Can a document that does not require it to be presented against delivery of the goods be considered a negotiable document, or have the Rotterdam Rules created a new type of negotiable document which does not have to be presented to the carrier? Was this article necessary at all? This paper will attempt to answer some of these questions.

#### IV. CHARTEPARTIES AND ARTICLE 47(2)

Article 47(2) applies only when the transport document “*expressly states that the goods may be delivered without surrender of the document*”. If the carrier is unable to locate the consignee, “*the carrier may so advise the shipper and request instructions in respect of delivery of the goods*”. The holder of the document should therefore be aware that, if one of the situations mentioned in that provision occurs, the goods may be delivered on the basis of the instructions of the shipper in the event that the carrier is unable to obtain instructions from the consignee.

The impression is that the drafters were influenced by the practice that exists in many charter parties where the carrier has to obey the charterer’s instructions with respect to the delivery of the goods. Such a conclusion may be made based on illustrations the authors of the book “The Rotterdam Rules” (who were at the same time the drafters of the Rotterdam Rules),<sup>12</sup> used in the discussion related to Article 47: each of their illustrations referring to Article 47(2) makes reference to the charterer acting as a shipper.<sup>13</sup>

Under the charter party contracts the master should act “*under the orders and directions of the Charterers as regards employment, agency and other arrangements*”.<sup>14</sup> The charterer may wish to extend his authority by stating that he shall have the right to order the master to deliver the goods without a bill of lading. This is sometimes done in practice and this right has been recognized by the courts.<sup>15</sup> However, this situation under charter parties should be clearly distinguished from the contract of carriage governed by international conventions. This practice, which is valid in charter contracts where the freedom of contract prevails, may not be recognized as valid in a contract of carriage carried out under a bill of lading.

The identification of the charterer with the shipper can also be questioned, as it should be clear that the shipper and the charterer are not necessarily the same party.<sup>16</sup> There is a clear distinction between the contract of carriage, which has the carriage of goods as its main subject-matter, and the charter contract, which is basically a contract of hire with the use of a ship as its main subject matter. While in the case of charter contracts the

<sup>12</sup> Michael F. Sturley, Tomotaka Fujita, Gertjan van der Ziel, *The rotterdam rules*, Sweet and Maxwell, 2010.

<sup>13</sup> *Ibidem*, pp. 264 and 269.

<sup>14</sup> Gentime, cl. 12. NYPE 1993, cl. 8.

<sup>15</sup> *Enichem Anic SpA vs Ampelos Shipping Co Ltd, The Delfini*, 1990, 1 Lloyd’s Rep 252.

<sup>16</sup> Article 1(8) defines shipper as “a person that enters into a contract of carriage with a carrier.”

charterer may have the right to make orders to the master with respect to the voyage the situation is completely different in liner carriage.

The relationship between the charterer and the shipowner in a charter party contract is qualitatively different from the relationship between the shipper and the carrier. The relationship between the shipper and the carrier is based on a document of a very different nature, the bill of lading, which is not a contract but a document of title. While the shipper may at the same time be the charterer, it is clearly wrong to have provisions related to the shipper with the assumption that the shipper is always the charterer. The application of Article 47(2) may lead to a situation in which the carrier requests instructions from the shipper when the shipper is not the charterer and has transferred the bill of lading. Clearly, in such case asking instructions from the shipper would contravene the fundamental principles on negotiable transport documents.

Article 47(2) is based on the assumption that the shipper has information on the consignee. While in some carriages the shipper may be aware of the ultimate consignee, in many situations that is not the case. One of the key problems with Article 47(2) is that it fails to fully take into consideration the fact that the goods may be resold in transit, sometimes many times. In the commodity trade, the shippers often have no clue who the final holder of the goods will be. They simply charter a vessel in order to load their cargo and sell it in transit. In such cases it makes no sense to ask the shipper for instructions with respect to delivery. After the shipper has sold the cargo to the first buyer in the chain, under Article 51 he has lost the status of the controlling party and is not qualified to give instructions to the carrier related to delivery of the goods. In fact, in the most common case of problems of delivery of the goods without a bill of lading, the shipper's instructions under Article 47(2) have the lowest value. Or, to put in it a different way, the intended effect of the provision on the shipper's instructions might be the least effective in situations where it is the most needed.

Instead of asking the shipper for instructions, there is already a well established practice that bills of lading contain the notify party, whom the carrier must notify when the goods arrive at the port of destination. The notify party is normally in a better position to provide information on the consignee.

## V. THE HOUDA CASE LESSONS

In most jurisdictions, the courts take the position that the shipowner must not deliver the goods other than against presentation of a bill of la-

ding, even if he has been instructed by the charterer to make such a delivery.<sup>17</sup> In *The Houda* case,<sup>18</sup> the charterer ordered the shipowner to deliver the goods without a bill of lading, against a letter of indemnity countersigned by a bank, but the shipowner declined to accept this order. The court at first instance held that while under a time charter the charterer cannot lawfully order the shipowner or the Master to deliver the cargo to a consignee who is not entitled to possession of the cargo, the charterer is not prevented from ordering delivery of the cargo without production of the bill of lading in circumstances where the charterer is entitled to possession of the cargo or gives an order with the authority of the person entitled to possession of the cargo. The Court of Appeal, however, took a different view and rejected the argument that a time charterer could order a shipowner to deliver the goods without production of an original bill of lading, even to a person who was entitled to possession of the goods.

Lord Judge Millet examined the consequences of such a solution:<sup>19</sup>

*“But the real difficulty of the Judge’s conclusion is that it leads to this: the charterers can lawfully require shipowners to deliver the cargo without presentation of the bills of lading if, but only if, the person to whom the cargo is delivered is in fact entitled to receive it. If that is indeed that law, it places the master in an intolerable dilemma. He has no means of satisfying himself that it is a lawful order with which he must comply, for unless the bills of lading are produced he cannot know for certain that the person to whom he has been ordered to deliver the cargo is entitled to it. One solution, no doubt, is that, since the master’s duty is not of instant obedience but only of reasonable conduct, he can delay complying with the order for as long as is reasonable necessary to satisfy himself that the order is lawful, possibly by obtaining the directions of the Court in the exercise of its equitable jurisdiction to grant relief in the case of lost bills. But in my judgement the charterers are not entitled to put the master in this dilemma.”*

The point is, as Lord Judge Millet states in the last sentence of the quote, that the charterer puts the master in a difficult situation. The mas-

<sup>17</sup> *The Stetin* (1889) 14 PD, 142 at 147., *A/S Hansen-Tangens Rederei III vs. Team Transport Corporation (The Sagona)*, 1984, 1 Lloyd’s Rep. 194, *Kuwait Petroleum Corp. vs. I and D Oil Carriers, The Houda*, 1994, 2 Lloyd’s rep. 541, *Motis Exports vs. Dampskibsselskabet AF 1912*, 2000, 1 Lloyd’s Rep. 121, *Allied Chemical International Corp. vs. Comphania de Navegacao Lloyd Brasileiro*, 1986, AMC 826 (2d. Cir. 1985), *C-Art Ltd. V Hong Kong Island Lines America* [1991] AMC 2888 (9th. Cir. 1991), *Glencore Intenational AG vs. Owners of the ‘Cherry’*, Singapore High Court, Kan Ting Chiu J., April 2002 (available at: [http://onlinedmc.co.uk/glencore\\_v\\_‘cherry’.htm](http://onlinedmc.co.uk/glencore_v_‘cherry’.htm)), *International Harvester Co vs. TFL Jefferson* 695 F.Supp 735 (S.D.N.Y. 1988), *Cour d’Appel d’Aix*, September 6, 1984, DMF 1986, 157, *Ap. Paris 11 January 1985* (1986) DMF 166 (note by R. Achard), *Trib. Livorno 10 December 1986* (1987) Dir. Mar. 961.

<sup>18</sup> *Kuwait Petroleum Corp. v. I and D Oil Carriers, The Houda*, 1994, 2 Lloyd’s Rep. 541.

<sup>19</sup> *The Houda*, 1994, 2 Lloyd’s Rep. p. 558.

ter takes an obvious risk when he delivers the goods to a consignee which cannot produce the bill of lading. The question one may ask is whether the charterer may require the shipowner to take such a risk. Even though the master may always require that the charterer puts up adequate security before he delivers the goods, the section must still be considered to weaken the shipowner's position. To demand such security will, in most cases, be both more cumbersome and unreliable than to demand that the bill of lading be presented.

The claim that such a delivery is lawful if ordered by the person entitled to possession of the cargo contravenes the fact that the bill of lading is a document of title. It is a well established principle that the carrier is bound to deliver the goods only to a lawful holder of the bill of lading, and he is not bound to investigate who is entitled to possession of the goods. When the consignee is not able to produce the bill of lading, the shipowner as carrier has the option of refusing the charterer's order of delivering the goods without the bill of lading or to deliver the goods in exchange for a letter of indemnity that was offered to the shipowner in the present case. The most serious consequence of this judgment would be that the carrier would no longer be justified in refusing to deliver the goods to a party who is not the lawful holder of the bill of lading, or in the case of a non-negotiable bill of lading to a party who is not named in the bill of lading, when such a party is actually entitled to the goods. Such a radical change would endanger the role of the bill of lading as a document of title and discredit its commercial value. In addition the carrier would be put in an extremely difficult position because he would be forced to judge whether the person to whom delivery is to be made under the charterer's order is entitled to possession of the goods.

This illustration from the charter party contracts in the relationship between the charterer and the shipowner may serve as an indication of potential problems that may arise if the shipper were to be asked to give instructions to the carrier under a contract of carriage. Article 47(2) would make sense in the relationship between the charterer and the shipowner under a charter party contract, and the outcome of *The Houda* case would have been different if there had been an express term in the charter party entitling the charterer to order the owners to deliver the goods without a bill of lading. However, the Rotterdam Rules should not enter that area, because contracts under charter parties are expressly excluded from their scope. It should be noted that the Rotterdam Rules expressly provide that the convention applies to liner carriage (Article 1.3), and that it does not apply to the charter party contracts (Article 6.1).

## VI. DEVIATION FROM THE FUNDAMENTAL PRINCIPLES

The solution proposed under the Rotterdam Rules represents a substantial deviation from the existing and well established practice. It seems that the Rotterdam Rules, in attempting to tackle the issue of delivery without a bill of lading, risked creating confusion by addressing problems that are typical for charter contracts. The drafters of the Rotterdam Rules obviously aimed at solving the problem of delivery of the goods when a negotiable document is not or cannot be surrendered. Normally, in such case the carrier should demand instructions from the lawful holder of the document, which is the consignee and not the shipper. It seems that the assumption of the drafters was that the consignee often does not demand delivery.<sup>20</sup> However, it is more likely for the consignee to not have the document, so that delivery is not possible. If the consignee has obtained a bill of lading, that normally means that he has paid the price, so it would be strange if he did not demand the goods. The consignee may refuse to accept delivery if the goods are defective, but this situation has nothing to do with delivery without a bill of lading. The typical problem with failing to present the transport document is that documents are subject to examination in a letter of credit transaction and where the goods are resold several times in transit the procedure with the document may be time consuming, particularly in the commodity trade.

Charles Debatista argues that under Article 47(2) “*the holder must still possess the bill but need not surrender it for delivery of the goods*” and that possession of the bill of lading is “*manifested through presentation but not surrender*”.<sup>21</sup> My reading of this provision is different. In my view, Article 47(2) can apply in situations when the consignee does not have the bill of lading at the moment the goods arrive at the destination, i.e. the consignee does not have possession of the bill and consequently cannot present it. This view is supported by subparagraphs 2(d) and 2(e), which expressly state that a holder becomes a holder after the carrier has delivered the goods pursuant to subparagraph 2(b). In any event, what would be the logic behind a consignee presenting the bill and refusing to surrender it?

The basic requirement of the rule contained in article 47(2) is that the negotiable transport document expressly states that the goods may be delivered without the surrender of the transport document. This clause contravenes a fundamental feature of negotiable documents, as the presentation

<sup>20</sup> Alexander von Ziegler, Johan Schelin, Gertjan van der Ziel (eds.), *The rotterdam rules*, Walters Kluwer, 2010, p. 207.

<sup>21</sup> *Ibidem*, p.146.

and surrender of a transport document is an essential ingredient of negotiable transport documents. The rule that the goods are to be delivered only to the lawful holder of a bill of lading who must present it prior to delivery is essential to the function that the bill of lading performs as a document of title. One of the key functions of negotiable transport documents is enabling the transfer of the right to the delivery of the goods by transfer of the document itself. If the goods can be made deliverable without a negotiable transport document, this key function of negotiable documents would be compromised. This function also represents the basis of security of the holders of those documents, as the lawful holder is guaranteed that nobody else can receive the goods. If it were possible to deliver the goods without surrender of the transport document, that security function of negotiable documents would be undermined.

In cases where presentation is not required at the destination from the very beginning, in practice the document may be marked on its face with a stamp stating “not negotiable”. While working for a shipping company I remember seeing a number of bills of lading stamped “not negotiable” on their face. The common understanding was that these were not negotiable documents and that delivery was to be made either to the consignee named in the document, or under the shipper’s instruction. It can be said that calling such documents “bills of lading” was a misnomer, as they were, in fact, waybills, and they were not considered to be negotiable documents.

Article 47(2) is designed in such a way as to create a document that is called a negotiable document, but which is not necessarily negotiable, since the goods can be delivered without its surrender. Article 47(2) identifies as a negotiable transport document a document whose surrender is not required. This creates a contradiction -- in the case of negotiable transport documents, the delivery of the goods can be made only against the surrender of the document. Was this kind of acrobatics really necessary? Wouldn’t it be better to simply follow the already existing practice that non-negotiable documents are used in this kind of situation? The maritime practice has developed the use of the sea waybill to tackle the problem of delivery of the goods without the surrender of a transport document. The Rotterdam Rules have adopted this solution in Article 45. Was it really necessary to have in addition to non-negotiable documents, a new type of document that would be called “negotiable” but whose surrender would not be necessary?

Such a rule may also open a possibility for maritime fraud. The seller may sell the goods to another buyer leaving the first buyer with a claim against the carrier, who may not be liable at all under the Rotterdam Rules, if delivery was made according to the shipper’s instructions. The shipper

may also collude with the first buyer to defraud all subsequent buyers. If the goods are delivered without production of a bill of lading, there is also a risk that the buyer who received the goods before payment is made can later refuse to pay because he has already obtained possession of the goods. Another danger is that the buyer can resell the goods by transferring the bill of lading to a new buyer, so that another party can present the bill of lading and claim the goods from the carrier.

All situations of delivery without the surrender of the document should be treated as risky exceptions. The attitude of the business community towards delivery of the goods without a bill of lading is very negative, a fact that is reflected in the rules of P&I clubs to deny indemnity to the carriers in such cases, as well as the fact that carriers are deprived of the benefit of limitation of liability. Against such a background, Article 47(2) can be considered as an attempt to legalize a practice that has been considered risky, exceptional and bad.

## VII. RELATION TO THE RIGHT OF CONTROL

The second part of article 47(2) is related to Chapter 10 of the Rotterdam Rules which deals with the right of control. Article 50(1)(a) provides that the rights of the controlling party include the right to give instructions in respect of the goods. Further, article 51(1)(a) provides that the shipper is the controlling party, except in a number of cases expressly referred to in this provision, which includes paragraph 3 of the same article that applies to the case when a negotiable document is issued; in this case the holder of the original negotiable document is the controlling party.

Here again several questions can be raised. If Article 51(3)(a) provides that when a negotiable document is issued the holder of the negotiable document is the controlling party, then why should the carrier ask instructions from the shipper? When the shipper is not the controlling party according to Chapter 10, but the controlling party is a transferee of the transport document pursuant article 57, on what legal basis can such shipper, or documentary shipper, give instructions to the carrier? Moreover, Subparagraph 2(b) provides that the carrier that delivers the goods upon instruction of the shipper is discharged from its obligation to deliver the goods to the holder, even if the transport document has not been surrendered. This is quite puzzling and it is not clear on what ground the carrier can be discharged against the lawful holder of the bill who has an independent right to delivery which is embodied in this document. How could

a carrier possibly be discharged from his obligation to deliver the goods if he were to deliver the goods according to the shipper's instructions? On whose behalf does the carrier hold the goods when a negotiable document is issued: on behalf of the shipper, or on behalf of the lawful holder of the negotiable document? When the shipper is not the controlling party, nor does he have any authority regarding the goods, it is not clear how instructions of such a party can discharge the carrier from its obligations embodied in a negotiable document. What would happen if the lawful holder appeared and claimed delivery after the carrier delivered the goods in accordance with the shipper's instructions to a party who was not entitled to delivery? Subparagraphs 2(c), 2(d) and 2(e) indicate that the carrier may still be held liable against a lawful holder, which seems to contradict subparagraph 2(b). How could the carrier be discharged from his obligation to deliver the goods to the holder if he can be held liable against the holder? In order to avoid misunderstanding and confusion, these provisions could have been drafted in a clearer way.

What would happen if the negotiable document is negotiated several times, as often happens in the commodity trade? The shipper may provide information on the first transferee, but he would normally not be able to give information on other holders of a negotiable document and probably would not know the identity of the last lawful holder of it. And why would the shipper bother to give instructions at all? Why would he risk potential liability under Article 47(2)(c), if the instructions were be wrong?

Article 28 provides for cooperation between the carrier and the shipper, including giving instructions related to the handling of cargo and carriage. Does this obligation extend to the shipper's duty to provide instructions related to the delivery of the goods? From the text it might be difficult to reach such a conclusion, unless "handling and carriage" is construed in a broad sense. Based on Article 29(1) which provides that the shipper will provide to the carrier "information, instructions and documents relating to the goods" that are necessary "(F)or the proper handling and carriage of the goods", it can be concluded that these instructions relate to the handling and carriage of the goods. But even though a broad interpretation would include instructions related to delivery of the goods, this does not mean that the shipper is the person who should give instructions related to the delivery of the goods after he has transferred the bill of lading. Finally, article 47(2) fails to give a clear solution for the situation where the shipper would not give any instruction to the carrier.

### VIII. ARTICLE 47(2) AND THE CISG

One of the intriguing questions that arises is related to the status of negotiable transport document under Article 47(2) in relation to Article 58 of the CISG; can this document be considered a document “controlling the disposition of the goods” in the sense of Article 58 of the CISG? According to Martin Davies, the drafters of the CISG likely “*had in mind the traditional, negotiable bill of lading issued by an ocean carrier, which is the paradigm document controlling the right to possession of the goods it represents*”.<sup>22</sup> A document under Article 47(2) equally likely does not meet this description. The fact that the goods may be delivered without the surrender of a negotiable transport document clearly compromises its negotiable character and the capacity to control disposition of the goods.

While a negotiable transport document under Article 47(1) qualifies as a document “controlling disposition of the goods”, a negotiable transport document under Article 47(2) is not a negotiable document in the full sense of the CISG, since disposition of the goods is not carried out on the basis of the document itself, but on the basis of the shipper’s instructions. This kind of disposition of the goods, as well as delivery without surrender of a transport document, is typical for non-negotiable documents which do not control disposition of the goods, since this is done by the shipper’s instructions to the carrier.

Hence, the “negotiable transport document” under Article 47(2) is not negotiable in the full sense, and as long as disposition of the goods is carried out on the basis of the shipper’s instructions, it is not a document that controls disposition of the goods in the sense of Article 58 of the CISG.

### IX. CONCLUSION

A challenging road lies ahead for the Rotterdam Rules. One of the potential problems is related to the way the Rotterdam Rules were drafted. After the task of unification of maritime law was transferred from the CMI to the UN and its agencies, it became impractical and maybe even impossible to make interventions by revisions, such as the Visby Rules. The most efficient and practical way would be to simply revise a number of provisions

<sup>22</sup> Davies, Martin, “Documents that Satisfy the Requirements of CISG article 58”, papers from *Uniform Sales Law: the CISG at its 30th Anniversary, a conference in memory of Albert H. Kritzer*, 12-13 November 2010, Belgrade, The Annals of the Faculty of Law in Belgrade - Belgrade Law Review, Year LIX (2011) num. 3 pp. 39-66.

from the Hague-Visby Rules, such as abolishing the nautical fault exception and adding a few more provisions, such as those related to electronic documents. It would however be difficult to expect the UNCITRAL to take such action, even though technically it was possible for the Rotterdam Rules to have simply been a revised version of the Hague-Visby Rules. The UNCITRAL generally has a preference for a more comprehensive approach, which is demonstrated by the text of the Rotterdam Rules. As result, the Rotterdam Rules contain 96 articles and 18 Chapters, compared to the 16 articles of the Hague Rules.

The Rotterdam Rules added a number of new issues, such as the right of control, delivery of the goods, transfer of rights, and volume contracts. The text might be too complex and too complicated to be suitable for use in practice. The commercial practice needs clarity and has a natural preference for simple over complicated texts. Moreover, some provisions, such as Article 47(2), are highly controversial as has been demonstrated in this paper.

It can be said that article 47(2) is controversial in the sense that this provision contravenes some well established principles on negotiable documents. Admittedly, the rule that the consignee must present a negotiable document prior to delivery is outmoded and can cause many problems in practice. Delivery of the goods without a bill of lading is something that should be avoided. The drafters of the Rotterdam Rules have attempted to find a solution to this problem. However, the suggested solution may undermine the value of the bill of lading as one of the key documents in international trade. If purchasers and banks feel that they can no longer rely on bills of lading as negotiable documents of title, to paraphrase Pearce L.J. in the *Brown Jenkinson* case, “*the disadvantage to the commercial community would far outweigh any convenience provided by delivery of the goods without bills of lading.*”<sup>23</sup>

The goal of uniformity is a worthy one and the efforts of the drafters of the Rotterdam Rules deserve respect. Instead of unifying the rules that govern the carriage of goods by sea, however, the Rotterdam Rules may end up being just another convention that exists in parallel with all previous ones, which would mean that this convention instead of contributing to the unification of law governing the carriage of goods by sea may, in fact, undermine the already existing chaotic level of uniformity. Under the existing text of the Rotterdam Rules, the road towards the stated goals has too many holes to feel comfortable with the proposed solution. It is a bumpy road that eventually may create more problems that it solves.

<sup>23</sup> *Brown Jenkinson vs. Percy Dalton (London) Ltd.*, 1957, 2 Q. B. 621, C. A.

## THE REMEDY OF DAMAGES IN PUBLIC PROCUREMENT

Arie REICH\* and Oren SHABAT\*\*

SUMMARY: I. Israeli statutory framewrok and court rulings governing the field of damages for aggrieved bidders – general overview. II. The statutory framework for lodging an action for damages in israeli public procurement law. III. The damages remedy in israeli public procurement case law. IV.

Damages are formally part of the arsenal of remedies that an aggrieved bidder in a public procurement procedure may use in most jurisdictions, such as the EU, the US and Israel. It is also required by the WTO Agreement on Government Procurement.<sup>1</sup> This remedy could have a critical role to play both in the encouragement of potential suppliers to invest in participation in the tender, as well as in curtailing and deterring improper or corrupt behavior by procuring agencies. However, in order for that to happen, the damages that are awarded must be effective and deterring. In spite of the great promise that such damages hold in encouraging greater competition in contracting and in reducing irregularity, the current rules that apply to the award of damages both in Israel and in other countries have made this remedy ineffective and non-deterrent. After reviewing the current Israeli rules and rulings in this field, this paper will examine the current situation in the EU and will focus on the similar problems of ineffectiveness and non-deterrence that exist in these jurisdictions. We will then propose changes aimed at improving the effectiveness of damages in public procurement so as to turn them into a deterrent factor in the fight against corruption.

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<sup>1</sup> See Article XX of the Agreement on Government Procurement, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 4, reprinted in *Results of the Uruguay Round* (WTO, 1994) at 438.

## I. ISRAELI STATUTORY FRAMEWORK AND COURT RULINGS GOVERNING THE FIELD OF DAMAGES FOR AGGRIEVED BIDDERS – GENERAL OVERVIEW

Current Israeli law recognizes the importance of action for damages for infringement of public tenders rules. In certain aspects, Israeli Public Procurement Law even encourages such an action for damages.<sup>2</sup> Paradoxically, damages for infringements of public tenders rules, and in particular damages for loss of profits, are difficult to obtain. This crucial difficulty may be attributed to certain rules to be further analyzed below: (1) the requirement to prove causality; (2) the requirement to seek a set-aside remedy before lodging an action for damages; (3) time limitations for lodging an action for damages, (4) lengthy and costly processes; and (5) generally low awards, even when an action for lost profits has succeeded. It will be seen that at least in relation to some of the factors mentioned below, Israeli law and EU countries generally share close similarities. Therefore, the proposals presented in this paper are relevant and, we believe, valuable for all of these jurisdictions, and perhaps others as well.

## II. THE STATUTORY FRAMEWORK FOR LODGING AN ACTION FOR DAMAGES IN ISRAELI PUBLIC PROCUREMENT LAW

Public tenders in Israel for central government authorities as well as for various other governmental and public entities are governed by the Tenders Duty Law, 1992 and the Tenders Duty Regulations, 1993. These pieces of legislation set out in detail the tendering rules to which government entities are bound whenever they want to purchase or sell goods or services.<sup>3</sup> However, they do not deal with the remedies available should the relevant rules be breached. This is a field that has been developed mainly by the courts.

The Administrative Courts Law, 2000, which established the Administrative Courts as part of the District Courts, authorized these courts to hear administrative cases which previously were heard by the Israel Supreme Court, in its capacity as the High Court of Justice. The law provides for two

<sup>2</sup> As will be shown below, the courts will sometimes reject a petition for an injunction against a procurement award based on the reason that if a breach will be proven it can be compensated by an action for damages, thus, implicitly encouraging such actions over petitions for injunctions.

<sup>3</sup> It is to be noted, that the rules that apply to public tenders in Israel originate both from Administrative and Private Law. This dual applicability is widely known as the “normative dualism principle”.

types of actions that are relevant to public procurement: 1. “Administrative Petitions”, which are petitions against a decision of an administrative agency (such as a contract award decision); and 2. “Administrative Actions”, which are actions for damages resulting from infringements of the public procurement rules.<sup>4</sup> Administrative actions are reviewed in accordance with the Civil Procedure Regulations, which provide the procedural framework for the review of most civil actions in Israel.<sup>5</sup> An important and distinctive feature of Administrative Actions is that such actions cannot be lodged with the court in parallel to lodging an Administrative Petition (i.e., a judicial review action which is targeted at setting aside the procuring authority’s decision). Practically, this means, that when an aggrieved bidder lodges an Administrative Petition he cannot, at the same time, apply for damages. Thus, in order to apply for damages he is required to ask for the court’s approval to convert his Administrative Petition into an Administrative Action<sup>6</sup> or wait until the Administrative Petition is decided. However, as will be shown later, the situation is more complex. It has lately been suggested by the Supreme Court that an aggrieved bidder seeking damages cannot skip the Administrative Petition review stage.<sup>7</sup> That is, she must first submit an Administrative Petition and pursue this petition. Then, and only if she fails to obtain a setting aside decision, by reasons which are not her fault, she may proceed with lodging an Administrative Action.

### III. THE DAMAGES REMEDY IN ISRAELI PUBLIC PROCUREMENT CASE LAW

#### 1. *Early Case Law on the Damages Remedy*

The damages remedy in Israeli Public Procurement case law dates back to the 1960’s, when the Israeli High Court of Justice awarded to a petitioner damages for the breach by the Ministry of Defense of its commitment to sign a contract with the petitioner for road construction. The unequivocal

<sup>4</sup> Article 5 of the Administrative Courts Law, 2000. The Court for Administrative Matters is the competent court for Administrative Actions. However, some actions for damages in connection with public tenders may be submitted to the Civil Courts.

<sup>5</sup> However in the case of a discrepancy between the provisions of the Administrative Courts Law, 2000 and the Administrative Courts Regulations (Procedure), 2000 on the one hand and the Civil Procedure Regulations, 1984 on the other hand, the former will prevail. See r. 30 of the Administrative Courts Regulations (Procedure), 2000.

<sup>6</sup> R. 30 of the Administrative Courts Regulations (Procedure), 2000.

<sup>7</sup> *The Broadcasting Authority vs. Katimora*, *infra* note 23, discussed below in section C(3).

and convincing reasoning of the ruling in the Construction & Development case, as expressed by Judge Berenzon, was based on the need to improve public efficiency and deterring the re-occurrence of such an impropriety:

“to improve the quality and fitness of action of the public system and boost its level of care and efficiency; as well as to provide further caution and agility in the handling of citizens’ matters; and in the responsiveness to their needs. It will also advance and improve the public service level of the State”.<sup>8</sup>

Despite the court’s unprecedented willingness to award damages for aggrieved bidders in a public tender, the court stressed that in its position as High Court of Justice<sup>9</sup> it may only award damages for “the sake of justice”, while the quantum of damages to be awarded shall be calculated according to a general estimate, “without a meticulous examination of the details”.<sup>10</sup> What the Court meant was, that it would be willing to award an aggrieved bidder some limited damages based on the court’s general and very approximate estimate, without conducting a thorough examination of the factual ground which gave rise to the damages claimed. A later case of the High Court of Justice placed a strict limitation on the scope of an action for damages by an aggrieved bidder. Thus, in the Migda case, Judge Aharon Barak<sup>11</sup> ruled, that only in “extraordinary cases” would the High Court of Justice be willing to employ its power to award damages to an aggrieved bidder.<sup>12</sup> The main reasoning expressed by the Court for its general reluctance to award damages was the lack of procedural means available to the High Court of Justice to perform the necessary judicial fact-finding and damage assessment, as opposed to the amplitude of means available to the Court for Civil Matters.<sup>13</sup>

<sup>8</sup> High Court of Justice 101/74 Construction and Development in Negev Ltd. (*Binui Upituach BaNegev*) vs. Minister of Defence, P. D. 28(2) 449,456-457, This and all other quotes from Israeli judgments are the authors’ translation from the Hebrew original.

<sup>9</sup> Which does not act as a fact finder and generally does not conduct cross examinations of witnesses on their affidavits.

<sup>10</sup> Supra note 9, p. 458-459.

<sup>11</sup> Judge Aharon Barak later presided over the Supreme Court of Israel from year 1993 to 2006.

<sup>12</sup> High Court of Justice 688/81 Migda vs. Ministry of Health, P.D. 36(4)85, 100-101. Nevertheless, the court held that such an action for damages would normally be referred to a competent court (i.e. to a competent Court for Civil Matters), to decide on the action. See also High Court of Justice 2167/90 Micronet vs. Ministry of Culture and Education, P. D. 45 (1)45, 54-55.

<sup>13</sup> *Idem*. At the time, the exclusively competent court for hearing disputes concerning public tenders was the High Court of Justice. However, this exclusive jurisdiction rule was later

In a case decided before the Supreme Court known as the Beit Yules case,<sup>14</sup> the court awarded an aggrieved bidder damages for expenses incurred in participating in the tender but refused to award him damages for lost profits, holding that he had failed to prove a causal link between the infringement and the claimed damages.<sup>15</sup>

## 2. *The Supreme Court's Decision in the Malibu Case – Damages for Lost Profits to Aggrieved Bidders*

### *The Malibu Decision*

A significant milestone in the development of the damages remedy for aggrieved bidders is the Supreme Court's decision in the Malibu<sup>16</sup> case.

The Supreme Court found that the Israel Electric Corporation had unlawfully deprived the respondent from being awarded a contract to build a part of a power plant in one of its facilities. The contract became a "fait accompli" because it was performed by another bidder.<sup>17</sup>

The Supreme Court held, therefore, that the appellant was entitled to recover the profits lost as a result of the unlawful deprivation of the contract award.<sup>18</sup> As will be shown below, the Malibu case has been very strictly

relaxed in the High Court of Justice decision 991/91 David Pasternak *vs.* The Minister of Construction and Housing, P. D. 45(5) 50. whereby the High Court of Justice granted the Courts for Civil Matters jurisdiction to hear such disputes.

<sup>14</sup> Civil Appeal 207/79 Raviv Moshe and Partners *vs.* Beit Yules, P.D. 37 (1) 533.

<sup>15</sup> This Supreme Court decision was later overturned in Further Hearing 22/82 Beit Yules *vs.* Raviv Moshe and Partners, P.D. 43(1)441 on grounds that are not relevant to this paper.

<sup>16</sup> Civil Appeal 700/89 The Electric Corporation of Israel Ltd. *vs.* Malibu Israel Ltd. and others, P.D. 47(1)667 (hereinafter "Malibu"). At the time when the Malibu dispute was heard, the Courts for Administrative Matters were not established yet. Actions for damages concerning public tenders were, therefore, brought before the Courts for Civil Matters (in this case it was the District Court); appeals were heard in accordance with the Civil Procedure Regulations, 1984. See also *supra* note 15. This clarifies why the Malibu case was heard by the Supreme Court of Israel as a civil appeal. Nowadays, as will be explained below, similar actions are brought before the Courts for Administrative Matters and (generally speaking) are governed by the Courts for Administrative Matters Law, 2000 and Courts for Administrative Matters Law Regulations (Procedure), 2000.

<sup>17</sup> It is important to stress, that the Supreme Court expressly held that a causal link between the infringement of public procurement law by the Electric Corporation and the contract award deprivation, had been established. Additionally, the contract had already been performed by another bidder. Under such circumstances the court decided that it was appropriate to award damages for loss of profits.

<sup>18</sup> Malibu, *supra* note 17, pp. 689-690. Nevertheless, in upholding the lower instance's factual findings in this matter, the court refused to award the appellant damages for loss of

interpreted by later case law and therefore fails to fully reflect the current legal situation in this field. Nevertheless, it still remains a remarkable case whereby damages for lost profits were awarded to an aggrieved bidder.

*Strict Interpretation of the Malibu Decision*

Later Israeli case law provided a strict interpretation of the Malibu decision, thereby limiting many aspects of the scope of an action for damages lodged by an aggrieved bidder, even when an infringement of public procurement law was duly proven.

Thus, in the Ports Authority case<sup>19</sup> the Supreme Court quashed the lower instance's decision to award an aggrieved bidder damages for lost profit. It was held, that no evidence was shown to convince the court that the procuring authority "accommodated" its calculations of the bids with prior intention to improperly award the contract to another bidder. It was also held, that neither bad faith nor improper or arbitrary considerations were employed by the procuring authority. The court found however, that the procuring agency unlawfully failed to, inter alia, publish in advance its calculation method of the economic value of the bids. The Supreme Court, therefore, refused to award damages for lost profits and decided to follow the principles laid down in the case of Construction and Development. It, therefore, awarded the aggrieved bidder damages based on a general estimation of the "expenses caused to (him) as a result of the infringements found in the procurement procedure" at the sum of 150,000 NIS (approximately US \$40,000). No legal expenses were awarded against the losing procuring agency. The Port Authority case seems to suggest, that only in circumstances of extreme impropriety or bad faith could the court be convinced to award damages for lost profits, while in all other cases of a lower degree of impropriety, an aggrieved bidder may be awarded more limited damages, which may be based on some unknown standard and method of calculation. Furthermore, given the length of the particular proceedings that took place before the first instance and the Supreme Court<sup>20</sup> it is doubtful whether the damages awarded to the aggrieved bidder could actually cover its high legal expenses and expenses incurred in preparing the bid and in participating in the tender.

reputation and for general damages (pp. 691-629).

<sup>19</sup> Administrative Petition Appeal 7357/03 Ports Authority *vs.* Tzomet Engineers, Planning, Coordination and Projects Administration Ltd. P.D. 59(2)145.

<sup>20</sup> The proceedings before the first instance started in year 2001. The Supreme Court ruling was given on September 2004.

Despite the very strict limitations set by the courts on the scope of the action for damages, some actions were indeed successful,<sup>21</sup> however such successful actions are only very few and mostly predate the Broadcasting Authority case, which will be analyzed below.

### 3. *Further Limitations on the Scope of the Damages Remedy*

In the Broadcasting Authority case<sup>22</sup> the Supreme Court overturned another ruling of a lower instance, the Administrative Court, which awarded damages for loss of profit to an aggrieved bidder. The Supreme Court held that a causal link between the impropriety that was revealed in the public tender and the aggrieved bidder's loss could not be established. Furthermore, the court was not convinced that the Broadcasting Authority had accommodated the tender so as to exclude the aggrieved bidder and thus award the contract to its commercial rival. In other words, the court was not convinced that there had been bad faith on the part of the procuring agency.

However, in an obiter dictum, Justice Grunis also remarked that the aggrieved bidder did not fully pursue her petition before the first instance to obtain a set-aside relief. Bringing an action for damages by an aggrieved bidder, without initially pursuing a set-aside relief could, in the court's view, lead to an undesirable result of what the court notoriously named "a virtual winner". The "virtual winner" phenomenon, the court feared, will expose procuring authorities to a risk of paying twice (although not the same amount) for the same project: one to the actual contractor and one to the "virtual winner" who should have won the contract but who in effect has not provided any consideration. Interestingly, Justice Grunis refers to the fact that also in the United States, the vast majority of the cases have denied expectation damages (i.e., compensation for lost profits) from aggrieved bidders and only awarded reliance damages.<sup>23</sup> The court also raises the con-

<sup>21</sup> One rare example is a judgment by the District Court of Tel-Aviv in *Administrative Case 124/06 Avigal Manpower Services Ltd. vs., Herzlia Municipality Tak-Mech 2010(1) 14685 (2010)*, where NIS 1 million was awarded for lost profits, but the court does not elaborate on the reasons which lead it to this decision. See also *MA (T.A.) 107/02 Jaljuli Planning and Execution G.L. 1996 Ltd. vs. Municipality of El Tira*; and *C.C. (Jer.) 2220/00 Lighting Factory A. Hecht Ltd. vs. The Postal Authority Tak-Mech 2003(2) 16627 (2003)*.

<sup>22</sup> *Appeal on Administrative Petition 9423/05 The Broadcasting Authority vs. Katimora Ltd Tak-Al 2007(3) 2403* (hereinafter: "The Broadcasting Authority" case).

<sup>23</sup> The Court refers to the judgment of the Supreme Court of California in *Kajima/Ray Wilson vs. Los Angeles County Metropolitan Transportation*, 1 P3d 63, 2000; Cal. LEXIS 4551.

cern of two contradicting judgments: one judgment in relation to the administrative petition ruling that Supplier A was justifiably awarded the contract, and one —by a different judge— in the action for damages ruling that Supplier B should have won the contract, and therefore is entitled to expectation damages. The court seems to suggest, that if we were to require the aggrieved supplier to pursue, to the end, an administrative petition against the contract award, the risk for such conflict of judgments would be averted, since the supplier would be bound by the first ruling as a *res judicata*.

However, the Supreme Court did not in the end base its ruling on this consideration, but rather on the failure of the plaintiff to prove causality. The court therefore awarded the aggrieved bidder only reliance damages, that is, damages for expenses incurred in preparing the bid, at the sum of NIS 75,000, instead of the NIS 1.3 million awarded by the Administrative Court for lost profits. The aggrieved bidder was also required to pay court and attorney fees to the appellant, the procuring agency, at the sum of 10,000 NIS. However, the more troubling aspect of the Broadcasting Authority case, in our opinion, is the suggestion by the *obiter dictum* that there may be a requirement on the aggrieved bidder to pursue an action for obtaining a set-aside relief, before he can claim damages. The President of the Court, Justice Beinisch, also expressed in her concurring opinion agreement in principle with this dictum of Justice Grunis. She writes:

As a rule, it seems that one should not accept the skipping over the phase of the execution, that is a petition to enforce the winning of the tender, to the phase of the administrative action for the purpose of receiving expectation damages.<sup>24</sup>

She also holds that as a rule only reliance damages should be awarded, and only in exceptional circumstances there may be a justification to award expectation damages. In holding so she also refers to a previous decision of hers in the matter of the Port Authority, discussed above, where she held that expectation damages should be awarded only in cases of bad faith on behalf of the procuring agency.<sup>25</sup> However, she too prefers to leave these questions for later deliberation, since there was no need to rule on them in the case at hand. A later decision by the Supreme Court has also expressed concurrence with this dictum, although suggested not to implement it stringently.<sup>26</sup>

<sup>24</sup> Page 7 of the judgment, *supra* note 23.

<sup>25</sup> Port Authority *vs.* Tzomet Engineers, *supra* note 20, at 166-168.

<sup>26</sup> Appeal on Administrative Petition 5487/06 Supermatic Ltd *vs.* Israel Electric Corporation Ltd. (12.4.2009). Justice Naor, who wrote the Supreme Court's unanimous opinion,

The Administrative Courts in Israel, which are (generally speaking) the competent courts for legal disputes on public tenders, seem to have accepted the *obiter dictum* expressed in the Broadcasting Authority case as a binding ruling and also interpreted it very widely, thereby imposing strict limitations on the scope of an action for damages. This approach is clearly reflected in the case of *Koach Otzma Ltd.*<sup>27</sup> In this case the Administrative Court of Tel-Aviv struck out an Administrative action —an action for damages lodged by a supposedly aggrieved bidder— without considering the merits of the case. Apparently, the plaintiff did follow the *obiter dictum* expressed in the Broadcasting Authority case and lodged a timely Administrative Petition for a set-aside relief with the Administrative Court. He also applied for an interim injunction in order to prevent the contract from being granted to the winning bidder during the legal proceedings, thus transforming the tender into a “*fait accompli*”. However, the plaintiff failed to obtain an interim relief, which meant for him, that the procuring authority could not longer be prevented from granting the contract to the winner. The plaintiff then withdrew its Administrative Petition for a set-aside relief, which had seemed obsolete to him, as he became unable to stop the contract from being awarded and performed. Furthermore, as aforesaid, it is not possible for an aggrieved bidder to bring an Administrative Action as long as an Administrative Petition for a set-aside relief is pending.

The plaintiff brought instead an Administrative Action - an action for damages. Nevertheless, as aforesaid, the court struck out the action without referring to the merits of the case. In its decision, the court held that the plaintiff’s withdrawal of its Administrative Petition for a set-aside relief amounted to giving up its right to be declared the winner in the competition. Since, in the view of the court, no proper explanation was given as to why the plaintiff had withdrawn its set-aside petition, the action for damages was due to be struck out.<sup>28</sup>

tended to agree with the mentioned *obiter dictum* on the requirement to pursue a set-aside relief prior to lodging an Administrative Action for lost profits, however she decided that this requirement should not be applied as a “stringent rule” The appeal was refused on the merits of the case.

<sup>27</sup> Administrative Action (Tel-Aviv-Yaffo) 106/07 *Koach Otzma Ltd. vs. The State of Israel – Office of Prime Minister*, Tak Mech 2008 (3) 9072 (27.8.2008).

<sup>28</sup> See also Administrative Action (Jerusalem) 12/01 *Atir Ltd. vs. The State of Israel Tak-Mech 2008(4) 13329* (hereinafter: “*Atir Ltd.*”). The judge in this case explained his judgment as follows : “According to this approach, the expectation from the plaintiff to exhaust her enforcement rights timely, prior to bringing an action for damages for lost profit, conforms with the public interest in general and with public procurement law in particular in all

As we will explain below, the requirement to lodge an Administrative Petition for set-aside of the contract award is a major cause for dissuading aggrieved bidders from bringing actions for the remedy of damages.

#### *4. The Requirement to Lodge an Administrative Petition as a Dissuading Factor from Bringing an Action for Damages*

It will rarely be possible to obtain damages for lost profits if the aggrieved bidder has failed to seek a set-aside relief prior to lodging an Administrative Action. This rule has the effect of imposing a quite heavy restriction on the practical option to pursue an action for damages in Israel. In order to understand this assertion, it is essential to first briefly examine the basic procedural rules governing the lodging of an Administrative Petition.

### IV. REVIEW OF THE RULES GOVERNING ADMINISTRATIVE PETITIONS AND INTERIM ORDERS IN PUBLIC TENDERS

An aggrieved bidder who wants to file an administrative petition is likely to go through several trials and tribulations. According to the Administrative Courts Regulations (Procedure)<sup>29</sup> an Administrative Petition has to be lodged with the court within 45 days from the date that the contested decision of the procuring authority was published.<sup>30</sup> However, even a petitioner who lodges an Administrative Petition within this statutory period still runs the risk of his petition being struck out without being reviewed on its merits if the court finds that in the circumstances of the case the petition was lodged in delay.<sup>31</sup>

In order to prevent the contract from being awarded and performed by the winning bidder, and thus becoming a *fait accompli*, the petitioner will

aspects concerning public efficiency, taxpayers' money saving, and the interest of certainty and stability in public activities. Aggrieved bidder's option to wait on the side, that is, to "sit on the fence" while the public authority proceeds to the conclusion and performance of a contractual relationship with the winner in the public tender, and then brings an action for loss of profits only at a later stage, is unreasonable and leads to harsh results. It has, therefore, been ruled more than once, that damages for lost profit should be used as a residual remedy only, in exceptional circumstances whereby it is not possible anymore to bring legal proceedings aimed at declaring the plaintiff as the winner in the tender, or where it is not possible anymore to set aside the tender, particularly in situations of "*fait accompli*" which are not a result of the plaintiff's conduct" (*Afir Ltd.*, p. 13341).

<sup>29</sup> R. 3 of Administrative Court Regulations (Procedure), 2000.

<sup>30</sup> Alternatively, the Administrative Petition has to be presented within 45 days of when the contested decision was presented to the petitioner or from the date when it was known to him.

<sup>31</sup> R. 4 of the Administrative Court Regulations (Procedure).

normally lodge a petition for an interim order.<sup>32</sup> Such a petition may be rejected without reference to its merits if the court considers it right to do so. Alternatively, the court may also order the respondent to present its response to the petition and summon the parties to a hearing before the court.

The court may also make a ruling on the basis of the parties' written arguments only, without a hearing at court. If the court considers that irreparable damage may be inflicted on the petitioner until its ruling on the merits of the interim order is given, it may grant an *ex parte* provisional injunction and summon the parties to a court hearing within 10 days of the grant of this injunction.<sup>33</sup> Even if an inter parties hearing is conducted, cross examination of witnesses is very time limited or entirely barred. Therefore, at this very stage, aggrieved bidders' chances to bring evidence on impropriety (and obtain an interim relief) are extremely limited since they mainly rely on oral arguments and written documents, making it easy for the respondents to fend off allegations of improprieties.

A court granting an interim order may, upon its discretion, require the petitioner to provide a guarantee. The purpose of such guarantee is to secure compensation to the respondent for damages that may be caused to him as a result of the interim order, should the court eventually reach the conclusion that it was unjustified. In practice, petitioners are required to provide both a written undertaking in damages (thereby agreeing to fully compensate the respondent) and a bank guarantee at the amount deemed appropriate by the court. The guarantee requirement is normally a substantial financial burden on the petitioner considering that not only has the contract not been awarded to him, but he is also required to finance an expensive bank guarantee for the full duration of the provisional or interim injunction, (the length of which is hard to foresee at the time).

This is not the only heavy financial burden imposed on the petitioner who seeks to enforce his rights through a set-aside relief. According to a recent Israeli Supreme Court decision, a petitioner seeking a set-aside remedy in which he asks to be declared the winner of a tender, is required to maintain a valid bank guarantee throughout the trial proceedings in order to secure the performance of his commitments should he succeed.<sup>34</sup> <sup>35</sup> Additionally, the

<sup>32</sup> R. 9 of the Administrative Court Regulations (Procedure).

<sup>33</sup> R. 9 of the Administrative Court Regulations (Procedure).

<sup>34</sup> A Civil Appeal 7699/00 Tamgash Management Company *vs.* Kishon Drainage Authority Tak-Al 2000(3) 419.

<sup>35</sup> Bidders in Israeli public tenders are normally required to submit, together with their bids, a bank guarantee at a fixed amount for a fixed percentage of the value of their offers.

petitioner will also incur attorney fees, which are often very high, and other expenses ordinarily associated with the handling of a trial.<sup>36</sup>

What are the conditions that have to be fulfilled for a court to be willing to issue an interim order against the implementation of a contract award? First, the aggrieved supplier must show an arguable cause of action against the procuring agency. Secondly, he must convince the court that, on the balance of convenience, the harm that may be caused to him if relief is refused is greater than the damage to be inflicted upon the respondents (that is, both the winning supplier and the procuring entity) should the requested relief be granted.<sup>37</sup> Thirdly, even if the balance of convenience supports the petitioner's interests, the court will still consider if there are any relevant overriding public policy considerations that weigh against granting the requested relief. Frequently, courts refuse to grant interim orders on public interest grounds.<sup>38</sup> As a matter of fact the vast majority of petitions for interim orders in public tenders are denied. Fourthly, courts will also consider whether perhaps compensation is a more appropriate remedy in the case at hand than a set-aside injunction. This last consideration is often heavily relied upon by the courts in support of a refusal on their part to grant an interim order,<sup>39</sup> thus indicating that the petitioner ought to file an action for damages instead. However, as mentioned, at this interim stage of the proceedings, cross examination of witnesses is extremely limited (if allowed at all) and document disclosure procedures are still not available. It is, therefore, hard to see how, at this condensed stage of trial proceedings, the court can rule on the appropriateness of an action for damages.

Whilst bringing an Administrative Petition is, by no means, inexpensive, chances for success in such legal proceeding are rather small, as most of these petitions are denied. The cumulative effect of the obstacles described above, namely the high legal expenses coupled with a low chance of success, create a deterring effect against the filing of an Administrative Petition. Furthermore, failure to obtain an interim order would under normal circumstances mean that the contract will be awarded to the winner. By the

The bank guarantee can be invoked against the bank if the bidder is declared the winner, but for some reason refuses to sign the contract.

<sup>36</sup> Such as court fees, expert fees etc.

<sup>37</sup> *Petition for an Approval to Lodge an Appeal no. 1557/02 Megamart Sport Equipment Ltd. vs. The State of Israel – Ministry of Defense Tak-Al 2002(2) 1807, 1808 (2002).*

<sup>38</sup> See e.g., *An Appeal on an Administrative Action no. 2803/06 Meyer and Sons Ltd. vs. HaGichon Water Factory and Drainage Jerusalem Ltd. Tak-Al (2)2006 235.*

<sup>39</sup> *A Petition for an Approval to Lodge an Appeal no. 7306/07 D.N. Kol Gader Ltd vs. Local County Council Eshkol (19.10.2007).*

time the court will reach its final decision on the merits of the Administrative Petition (and presumably, even prior to that stage), the project for which the tender was carried out, will be deemed as a “fait accompli”. Nevertheless, an aggrieved bidder who as a result of these obstacles chooses not to fully pursue an Administrative Petition for a set-aside relief, even in a case where the contract has already been awarded and performed, runs the risk of being barred from suing damages. Not only that, but also the limitation period which normally applies to ordinary civil claims (7 years) does not apply in respect to Administrative Actions – such action must be brought “in real time”<sup>40</sup> as the Administrative Court of Jerusalem has held lately.<sup>41</sup>

Only very few aggrieved bidders will be convinced to conduct an expensive trial with very low prospects of winning. So much less will they agree to conduct an expensive trial to try to obtain an interim order just for the sake of later being legally entitled to lodge an action for damages, especially considering that the chances of success in such an action are inherently vague, not to mention the poor prospects of obtaining damages for lost profits, and the requirement to take action without delay.

The reason for requiring an aggrieved bidder to seek a set-aside relief prior to bringing an action for damages —.i.e. to avoid the risk of a procuring authority paying more than once for the same project— can indeed be understood on some public policy grounds. There are, however other, more important, public policy considerations, such as the need to ensure prudence and probity in public procurement, that have been compromised as a result of these stringent conditions imposed on the right to sue for damages. We shall therefore propose below a reform of the rules applying to damages in public procurement so as to make them much more effective in providing remedies to aggrieved bidders on the one hand, and in creating positive deterrence against infringements of the procurement rules, on the other hand.

## V. GENERAL OVERVIEW OF THE DAMAGES REMEDY FOR INFRINGEMENT OF THE EU PUBLIC PROCUREMENT RULES

In order to obtain a comparative perspective on the issue at hand, we turn now to the legal situation in the European Union (EU). The rules gov-

<sup>40</sup> I.e., it should be brought in close proximity to the delivery of the arguably wrongful decision by the procuring agency.

<sup>41</sup> Administrative Action (Jerusalem) 202/05 T.V Three Ltd, *vs.* The Second Television and Radio Broadcasting Authority Tak-Mach (1)2007, 9805, 9809.

erning the damages remedy for breach of the EU public procurement rules are governed by the Remedies Directives.<sup>42</sup> Article 2 of Directive 89/665/EEC provides:

“1. The Member States shall ensure that the measures taken concerning the review procedures specified in Article 1 include provision for powers to:

...

(c) Award damages to persons harmed by an infringement....

...

5. The Member States may provide that where damages are claimed on the grounds that a decision was taken unlawfully, the contested decision must first be set-aside by a body having the necessary powers”.

Similar provisions are found in Article 2 of Directive 92/13/EEC.<sup>43</sup>

Thus, the Remedies Directives provide only very general and superficial guidelines on the rules that are to govern the award of damages for aggrieved bidders. This could be seen to imply that the potential deterring effect of such remedy against infringement of EU public procurement rules has not been given much weight. Indeed, these provisions have been criticized by legal commentators.

Treumer argues that, while the Remedies Directives set the basic rule that review bodies must be able to award damages to persons injured by the infringement of the EU procurement rules, the details of the issues concerning damages are not regulated in detail and their formulation does not contribute to the creation of a clear legal situation.<sup>44</sup> He further argues that it is not even clear from the Directives whether they require the award of

<sup>42</sup> Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts (hereinafter the “Public Procurement Remedies Directive”) and Council Directive 92/13/EEC of 25 February 1992 coordinating the laws, regulations and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors (hereinafter “Public Utilities Remedies Directive”). On December 11, 2007 the European Parliament adopted a new Directive amending the Public Procurement and Public Utilities Remedies Directives (Directive 2007/66/EC of the European Parliament and of the Council). However, the new Directive did not make any changes to the damages remedy.

<sup>43</sup> The provisions of these two Remedies Directives are not fully identical. However a discussion of the differences between them is outside the scope of this paper.

<sup>44</sup> Steen Treumer “Damages for Breach of the EC Public Procurement Rules – Changes in European Regulation and Practice” P.P.L.R. 2006(4) 159-170, at p.161 (hereinafter “Treumer”).

lost profits or not, which is, in Treumer's view, of crucial importance for the efficiency of the remedy of damages.<sup>45</sup> Likewise, Pachnou argues that *Directive 89/665/EEC* does not give any guidelines on the conditions and extent of the damage remedy while such matters are left for the discretion of Member States.<sup>46</sup> It is "not unusual" in Member States, according to Pachnou, to impose a stringent burden of proof on the plaintiff: some Member States require the plaintiff to prove that it would have won the contract in order to be granted compensation for lost profits. Such a requirement, she asserts, is onerous to a degree that it paralyses the operation of the remedy for damages.<sup>47</sup>

Another usual problem, according to Pachnou, is the quantum of damages. While, the recovery of costs is usually covered in most Member States, the question of damages for lost profits is "less certain".<sup>48</sup> A further serious critique of Pachnou relates to the Remedies Directives provisions which

<sup>45</sup> *Ibidem*, p. 170.

<sup>46</sup> Despina Pachnou *The Effectiveness of Bidder Remedies for Enforcing the EC Public Procurement Rules: A Case Study of the Public Works Sector in the United Kingdom and Greece*. Thesis submitted to the University of Nottingham for the Degree of Doctor of Philosophy, March 2003, p. 84.

<sup>47</sup> *Ibidem*, p. 85. Under the law of England and Wales an aggrieved bidder is required to show high probability, almost a certainty that he would have been successful had the relevant laws not been infringed. See: Despina Pachnou "Bidder Remedies to Enforce the EC Procurement Rules in England and Wales" P.P.P.L.R. 2003(1) 35-64, 57-61. Under German law, apparently, no loss of profit can be claimed for failure to award a contract since as a consequence of the principle of contractual freedom, under normal circumstances no legal obligation lies on a procuring authority to award a contract to a bidder, even if there is no valid reason for not wanting to award the contract to him. Damages for loss of profits can be obtained where an aggrieved bidder can prove that he submitted the most advantageous bid, but the contract was awarded to another bidder. Thus, damages for loss of profits may not be available where the tender was cancelled. The bidder further has to show that the contract would have been awarded to him had it not been for the infringement claimed. See Anne Rubach-Larsen "Damages Under German Law for Infringement of EU Procurement Law" P.P.L.R. 2006 (4) 179-194, 188-190. Under French law, in order to obtain damages for loss of profit an aggrieved bidder must convince the court that he has a very serious or a serious chance of winning the contract. See Francois Lichere "Damages for Violation of the EC Procurement Rules in France" P.P.P.L. 2006(4) 171-178, 174-176. It is to be noted, that despite the relatively difficult level of proof required ("very serious" or "serious" chance), it is claimed that as of 2006 in 30 cases out of 53, French courts concluded that there was a serious chance or a very serious chance of winning. *Ibidem*, p. 173. Under Swedish law, an aggrieved bidder has to prove that there is a proper causal link between the infringement and the loss of profits. She is also required to show that she has made a reasonable effort to minimize her losses: See Michael Slavicek "Damages for Breach of the EC Public Procurement Rules in Sweden" P.P.P.L., 2006(4) 223-240, p. 239-240 (hereinafter: "Slavicek").

<sup>48</sup> *Supra* note 47, p.85.

enable Member States to require aggrieved bidders to ask for a set-aside remedy before lodging an action for damages<sup>49</sup> (similar to the obiter dictum of the Israeli Broadcasting Authority judgment).<sup>50</sup> This requirement, Pachnou argues, increases the legal expenses incurred by an aggrieved bidder in the process of seeking compensation. Furthermore, it makes the admission of an action in damages dependent on the success of the application to set aside.<sup>51</sup> It is claimed that at least one Member State requires aggrieved bidders to prove some degree of bad faith on behalf of the procuring authority in order to determine the quantum of damages.<sup>52</sup>

In most Member States, compensation tends to be relatively low; only in very few cases have plaintiffs been successful in obtaining damages for lost profits.<sup>53</sup> The rules governing the action for damages in Israel and the corresponding rules in EU Member States, while not identical, share some general common features. Actions for damages are severely restricted by the requirement for a strict causal link, chances for success are not impressive and compensation awards are low. And the requirement that an aggrieved bidder first seek a set-aside order before lodging an action for damages, can be found both in Israel and in at least some of the EU Member States. Generally speaking it may be concluded that the damages remedy in Israel as well as in the EU is hard to obtain, and therefore has no real deterring effect against improprieties in public tenders.

## VI. FACTORS DISSUADING AGGRIEVED BIDDERS FROM LODGING ACTIONS FOR DAMAGES IN EU MEMBER STATES

A study conducted by the European Commission, found three main factors that are seen as responsible for discouraging aggrieved bidders from lodging actions for damages in the EU. First, it was found that actions for damages are perceived by EU bidders as remedies lacking real corrective

<sup>49</sup> See above.

<sup>50</sup> *Supra*, note 23.

<sup>51</sup> Failure to comply with the above procedural requirement will cause the action for damages to be rejected and will preclude the aggrieved bidder from obtaining compensation. *Supra* note 47, p.87-88.

<sup>52</sup> It would seem that under Swedish law, the quantum of damages is determined in relation to the severity of the infringement by the procuring authority (Slavicek, *supra* note 48, p. 239). Cf. The European Court of Justice decision in C-275/03, *Commission v. Portugal*, where it was decided that it was a violation of the Remedies Directive to make damages conditional on proof of intentional or negligent breach (cited in Treumer, *supra* note 45, p. 161, fn 24.)

<sup>53</sup> Slavicek *supra* note 48.

effect. That is, even if an action for damages is successful, the bidder will still not be awarded the contract. In the bidders' view this would mean an unwelcome compromise regarding their future business with the procuring authorities. Second, actions for damages are hindered by practical difficulties. Hence chances for winning such an action are viewed as extremely low. These very low chances are attributed to the requirement to prove a causal link as a condition for obtaining lost profits. Third, it was found that, actions for damages tend to be lengthy and costly. Litigation and legal costs are sometimes higher than what can be expected to be awarded for costs incurred in bidding for the contract.<sup>54</sup> A closer look into the consultation papers on which the above study was based, reveals that in addition to the above considerations, aggrieved bidders are also dissuaded from bringing actions for damages because of the obligation under their national legal system "to obtain beforehand the annulment or the declaration of illegality of the contested decision made by the contracting authority".<sup>55</sup> In addition, in another study, conducted by Pachnou, there seems to be strong evidence that bidders are deterred from enforcing their rights against infringing procuring authorities because of fear of being blacklisted by them<sup>56</sup>. No doubt, the combined effect of the practical difficulties inherent in actions for damages, low chances of success, high costs and lengthy processes, coupled with the bidders' fear of retaliation, has a powerful discouraging effect from lodging actions for damages.

## VII. PROPOSALS FOR CHANGE

### 1. *The problems with the current situation*

The situation described above, both in the EU and in Israel, where aggrieved bidders are largely dissuaded from lodging actions for damages even

<sup>54</sup> Commission Staff Working Document *annex to the proposal for a directive of the European Parliament and of the Council amending Council Directives 89/665/EEC and 92/13/EEC CEE with regard to improving the effectiveness of review procedures concerning the award of public contracts* (presented by the Commission COM(2006) 195) Impact Assessment Report – Remedies in the Field of Public Procurement, 12-13. The surveys on which the above Impact Report was based can be found on the EU's website.

<sup>55</sup> The consultation results reveal that this obligation is claimed by the consultees (EU economic operators, lawyers, professional associations and non-governmental organizations) to be one of the causes for their reluctance to bring actions for damages – and where such actions were indeed brought: one of the reasons for their relative lack of success (*idem*).

<sup>56</sup> Despina Pachnou "Bidders' Use of Mechanisms to Enforce EC Procurement Law" P.P.L.R., 2005(5) 256-263, p. 258.

when procurement rules have been violated and where irregularities in the tendering process have occurred, is a troubling one. If one adds to that our observation that often also the alternative remedy of administrative petitions to set-aside wrongful decisions is not an effective remedy —because of the procedural and financial obstacles facing a petitioner and since often the contract is already a “*fait accompli*”<sup>57</sup>— it would seem that we have here a systemic lack of deterrence against infringements of the procurement rules. In other words, this system of judicial supervision over the procurement process is not a very effective tool in ensuring compliance with the rules. Nor is it doing a good job in ensuring confidence on the part of potential suppliers in the system, as is evident from the EU survey mentioned above.

If these conclusions are correct, we may have here a significant welfare loss resulting mainly from two sources: 1. Abuse of the procurement rules which lead to inefficient use of public funds: government agencies are not getting the best value for our tax dollars; 2. Lack of confidence by potential suppliers in the integrity of the procurement system prevent their participation in public tenders. This means that potential Pareto optimal contracts between such suppliers and the government are lost, competition for government contracts decreases and the arena is left open to those suppliers that know how to manipulate or bribe procurement officers to act in their interest.

## 2. *The importance of an effective remedy of damages*

We are also not convinced by the argument raised by the courts that to award damages, in particular expectation damages, means to force the pro-

<sup>57</sup> It may be argued that the implementation of the new Remedies Directive (2007/66/EC) by the EU Member States will result in less tenders becoming a “*fait accompli*” since now all EU Member States must allow for a mandatory 10 days “standstill” period after award of a contract, wherein the contract may not be signed. During the “standstill” period aggrieved bidders may seek for review of the award decision and apply for an interim remedy for the duration of the trial, in order to prevent the contract from being concluded. Although, undoubtedly, the “standstill” period may indeed prevent tenders from becoming a “*fait accompli*” before aggrieved bidders manage to bring their legal challenges before the courts, it still does not guarantee a successful application for an interim order. Interim order applications may still be denied on public policy grounds and on other grounds, (such as the balance of convenience test, etcetera). Thus, failing to obtain an interim order may, even under the new regime result in the contracts becoming concluded, which leaves the aggrieved bidder with the sole option of bringing an action for damages.

This suggests therefore, that the action for damages has not lost its importance as a potential deterring tool against infringement of public procurement laws, although, to some extent, it may become less abundant. Israeli Public Procurement Law, however, does not impose a “standstill” period on procuring authorities, as detailed above.

curing agency to “pay twice” for the product. This is in our opinion nothing but rhetoric, because the agency is not really paying twice. It pays only once for the product or service that it has chosen. However, if it has bluntly violated the procurement rules and hence caused damage to bidders who participated in the tender in good faith (expecting the government agency to abide by its own rules), it is only fair and prudent that it should compensate such bidders for the damage it has inflicted.

In fact, payment of damages for infringement of procurement rules serves three main purposes:

1. To compensate the bidder for the losses it has unjustly suffered as a result of the infringement of the procurement rules. This is in essence a deontological corrective justice rationale, based on the moral bindingness of the procuring agency’s declared commitment to respect these rules and of its legal obligation to respect the law. This created a legitimate expectation on the part of the bidder that indeed the rules will be respected and this expectation ought to be protected. This rationale is somewhat similar to the moral justification for compensation for torts committed or for contracts breached;<sup>58</sup>

2. To restore the confidence of the aggrieved bidder in the procurement system, so that it and other potential bidders will continue to participate in government tenders. This is a utilitarian rationale similar to those found in the literature on remedies for breach of contracts;<sup>59</sup> and

3. To create a deterrent effect on procuring agencies that will improve future adherence to the rules.<sup>60</sup> This too is a utilitarian rationale similar to those found in the literature on tort law and criminal law in connection with the objective of deterrence.<sup>61</sup> The courts are absolutely right in asserting

<sup>58</sup> See e.g. Fried, *Contract as promise* (1986); Ernest J. Weinrib, *The idea of private law*, 50-53, 136-140 (1995); Izhak England, *The philosophy of tort law* (1993), ch. 1-6; Andrew Burrows, *Remedies for torts and breach of contract*, 3rd. ed., 2004, pp. 34-44. For a discussion of the corrective justice rationale in the realm of tort as well as in contract law, see also: Curtis Bridgeman “Notes: Corrective Justice in Contract Law: Is there a case for Punitive Damages?” 56 *Vanderbilt Law Review*, 2003, 237.

<sup>59</sup> Lon L. Fuller and William R. Perdue, “The Reliance Interest in Contract Damages”, 46 *Yale Law Journal* 52 and 373, 1936-37; Richard Posner, *Economic analysis of law*, 6th. ed., 2003, ch. 4.

<sup>60</sup> See Arie Reich, *International Public Procurement Law: The Evolution of International Regimes on Public Purchasing* (Kluwer Law International, 1999), pp. 336-340.

<sup>61</sup> See for instance Glanville Williams, “The Aims of the Law of Tort”, 4 *Current Legal Problems* 137, 1951, at pp. 144-151; Salmond, *Law of Torts*, 7th. ed., 1928, pp. 11-12. The deterrence objective was adopted and rejuvenated by the Law & Economics movement, such as in the writings of Guido Calabresi, “The Costs of Accidents: A Legal and Economic Analysis”,

that government agencies have limited budgets, and that payment of damages are a burden on them. But precisely for that reason such damages will serve as a deterrent against violating the rules and against awarding government contracts to undeserving bidders. Such imposition is also bound to cause a stir in the agency and to prompt it to investigate the actions and motives of the officers that were involved in such ill-fated procurements. One could expect this to help in preventing further infringements in the future.

Having said that, we do however recognize a potential problem where rules are ambivalent or where we deal with technical violations performed in good faith or by mistake. Given the complexity of the procurement rules, a procurement officer may make an error in the handling of a tender without any bad intentions. Also the procuring agency may have been convinced that it took the right decision, but the court may think otherwise. Here the objectives set out above do not necessary mandate the award of high damages. There is less of a need to deter the procuring agency if it did not act in a reprehensible way, and the damage award is less likely to bring about any specific change in future behavior. The corrective justice justification for the award is also less pertinent. Therefore, we can understand why some courts require bad faith on the part of the procuring agency before it awards damages. However, it would not be right to be too stringent on this requirement, since to prove bad faith is not an easy task. To impose on an aggrieved bidder a strict burden of proof in relation to the state of mind of procuring officers whom he may not even know, and on the dealings of which he has very little information, is likely to serve as an insurmountable obstacle for many damages actions. Instead, the courts should decide about the severity of the violations from the objective, not subjective, circumstances of the case, in order to make sure that it imposes expectation damages only in cases of clear and blunt violations of the procurement rules, i.e., such violations that ought to be deterred.

### *3. Damages Based on the Aggrieved Bidder's Loss of Chance*

After having established the important functions of the remedy of damages in public procurement and the need to preserve its effectiveness, we need to discuss the question of which type of damages? When should a court award expectation damages, i.e., compensation for loss of expected

*Yale University Press*, 1970, and Richard Posner's, e.g. William M. Landes and Richard Posner, "The Economic Structure of Tort Law", Cambridge, *Mass. Harvard Univ. Press*, 1987.

profits from the government contract? And when should it limit its award to reliance damages, i.e., compensation for the expenses incurred in connection with the preparation of the bid and participation in the tendering process.

We believe that in order to preserve the deterrent effect of damages, and pursuant to the other objectives of this remedy, an aggrieved bidder should in principle be entitled to expectation damages, whenever she can show that she had a real chance of winning the contract, but for the infringement. However, under the law as it stands now the requirement to prove causation is a major obstacle for the success of any action for damages.<sup>62</sup> To prove a proper causal link between the procuring authority's infringement and lost profits from the contract — i.e., that but for the infringement the plaintiff would most likely have won the contract — is rarely possible.<sup>63</sup> Therefore strict adherence to the causation requirement where an infringement has occurred in the tendering process means a weakened level of private enforcement of public procurement law. Such a situation may lead to underdeterrence, which could in turn, result in a low adherence to public procurement rules by procuring authorities (as well as bidders). Nevertheless, the contrary argument is that loosening the causation requirement may lead to an adverse situation. This may lead to a flood of opportunistic and frivolous actions, which will make the entire public tender process more cumbersome and expensive not only for the relevant procuring authorities but also and particularly for the taxpayer, for whom the public tender is performed.

In the authors' view, a compromise-solution should be adopted between a total relaxation of the causation requirement and between strict adherence to it. Such a compromise may obtain both deterrence and prevent the risk of many frivolous actions. We therefore propose that, an aggrieved bidder will be required to prove only a material infringement of

<sup>62</sup> See for instance J.M. Fernandez, "Recent Cases of the Court of Justice Relevant to Public Procurement", 6 *PPLR*, Issue 5, CS p.141, 1997, who writes (at pp. CS 149-150): "It is unlikely that complainants can overcome the obstacle of proving a better right to the contract, especially with regard to those contracts awarded pursuant to the most economically advantageous offer, which, according to statistics, by far outweighs the lowest price criterion. As for the bidders, it is a well known fact that the supply of such evidence is an almost insurmountable obstacle in public procurement cases, unless the award is made on the basis of the lowest offer criterion. National experiences and case law on the matter largely supports this conclusion".

<sup>63</sup> This may be attributed to the special particularities of the public tender and also to evidence law as practiced in Israel and in other jurisdictions.

public procurement law in order to be entitled to compensation for lost profits. However, quantification of the damages will depend on an assessment of the plaintiff's chances to have won the contract but for the material infringement of the rules. In other words, under the new regime proposed, the aggrieved bidder will no longer have to prove, that but for the alleged infringement he would have won the competition. Rather, he will have to prove that a material infringement has occurred in the tender process and that in itself ought to make him eligible for damages. The amount of the damages will depend on the chance he had of winning the contract, but for the infringement. If, for instance, the court arrives at the conclusion that he had a 50% chance of winning the contract, instead of the suit being dismissed because of failure to meet the required standard of proof (preponderance of evidence), he will be entitled to damages at the amount of 50% of his expected profits from the contract. Likewise, if he proved a 33% chance, he will be entitled to 33% of these profits, and so on. The quantification of damages will, therefore, rely on the degree of chances lost by the aggrieved bidder as a result of the alleged infringement, multiplied by the amount of her expected profit.<sup>64</sup> A similar approach has been proposed by several scholars in the field of torts<sup>65</sup> and adopted to some extent by the Israeli Supreme Court.<sup>66</sup>

#### 4. *Reversal of the Burden on Proo*

In the authors' view, relaxing the causal link requirement as explained above, is still insufficient to transform the damages remedy to a deterrent one. Proving a loss of a chance to win the tender competition may still be difficult for aggrieved bidders, the reason being that most of the information regarding the tender process is kept in the hands of the procuring authority, making it extremely difficult for an aggrieved bidder to prove the degree of these lost chances. Furthermore, proving the chances lost to a bidder will often require the court to make a thorough study of the winning chances of all the qualified bidders in the same tender. The procuring authority is, in this case, the most efficient party to prove the bidders' chance

<sup>64</sup> See also Omer Dekel, *Public Tenders*, 2006, Hebrew, part B., p. 326-328.

<sup>65</sup> See for instance, Ariel Porat and Alex Stein, "Tort Liability under Uncertainty", Oxford University Press, 2001.

<sup>66</sup> For instance: C.A. 231/84 *Kupat Cholim vs. Fatach* PD 42(3)312; and C.A. 7375/02 *Carmel Hospital vs. Malul* PD 60(1)11. The last decision was lately overturned by a 5-4 majority of the Supreme Court in a reconsideration hearing SCH 4693/05 *Carmel Hospital vs. Malul*.

of winning the competition and to present all the necessary factual background information to the court.<sup>67</sup>

It is, therefore, proposed, that whenever an aggrieved bidder is successful in showing a material breach of the relevant laws, the burden of proof regarding the degree of chance lost by him (which is essential for the damages quantification) will shift to the procuring agency.<sup>68</sup> The point of departure for the court will be that the aggrieved bidder is entitled to 100% of the lost profits, unless the procuring agency discharges its burden of proof and convinces the court that this bidder's chances of winning was lower. In such a case, the bidder will receive the percentage of the expected profits that the court has been convinced better reflects his actual chances of winning.

5. *Damages for bid preparation and participation costs upon proof of a material infringement*

In certain cases the procuring agency will be able to prove that the aggrieved bidder did not have any chance whatsoever to win the contract, or that his chances were so low that the compensation for lost profits will not cover the expenses caused to the bidder in preparing the bid and in participating in the tendering process.

In such a case, we propose that the aggrieved bidder, who has proven a material infringement, will be able to recover, as a minimum, the full costs he incurred in preparation of the bid and in participating in the tender.

## VIII. CONCLUSION

As discussed above, actions for damages in public tenders can serve as an important deterrent against improprieties in the public tendering process and against infringements of public procurement law in general. Nevertheless, Israeli law and some of the EU Member States have failed to fully recognize the importance of the damages remedy and have cre-

<sup>67</sup> This view is particularly true when only one or a few of the qualified bidders in a tender decide to bring an action for damages, whereas others decide to refrain from such an action even though, they may be entitled to damages.

<sup>68</sup> A proposal to shift the burden of proof from aggrieved bidders to procuring authorities was already made in Reich, *supra* note 61 on p. 338, and is mentioned in the Thesis paper of Despina Pachnou, p. 122, fn. 215, citing Prof. Sue Arrowsmith in her book: *The Law of Public and Utilities Procurement*, 1996. Here we develop the proposal to combine it with the doctrine of proportional damages based on the chances of having won the contract.

ated unnecessary obstacles on aggrieved bidders' track to obtain damages for profit they lost as a result of infringements of the law - possibly out of fear of forcing the taxpayer to pay more than once for the same project.

This paper proposes to transform the damages remedy to a more deterrent instrument that will contribute to the fight against corruption and misconduct in public procurement. The proposal suggests doing so by getting rid of the unnecessary procedural obstacles to actions for damages. An aggrieved bidder should not be required to first submit and exhaust a set-aside petition, before being allowed to sue for damages. In fact, we see no reason to require such a bidder to divide his requested remedies into two separate legal actions. As in most other fields of law, an aggrieved bidder should be allowed to sue in the alternative for an injunction to correct the infringement or damages if such correction is denied for whatever reason.

As for the action for damages, once a material infringement has been proven by the aggrieved bidder, the burden of proof to show that he had no chance of winning the contract should lie with the procuring authority. We further propose that expectation damages be the rule, and that they be calculated on the basis of the degree of chance lost as a result of the infringement. Here too, we propose to place the burden of proof on the procuring entity, which has access to the pertinent information in this regard. In addition to that, in any case of material infringement, damages will not be less than full bid preparation and participation costs.

Arguably, the proposed solution will need to be further elaborated in order for it to adjust to each and every jurisdiction and legal system. However, in the authors' opinion, from a general perspective, the proposed solution presents an improvement to the current rules governing the damages remedy in Israel and in some of the EU Member States, and if adopted will yield more deterrence and adherence to the public tendering rules of the said jurisdictions, provide more just remedies to aggrieved bidders and contribute to the public confidence in the government procurement system..