SUBMISSION TO THE SENATE STANDING COMMITTEE ON FINANCE AND PUBLIC ADMINISTRATION REFERENCES COMMITTEE

Inquiry into Commonwealth Procurement Procedures

Dr Nick Seddon, Adjunct Professor, College of Law, ANU; Special Counsel, Ashurst

This submission is made in my personal capacity and is not intended to reflect the views of either the ANU College of Law or Ashurst.

I am happy to discuss with the Committee any points I have made in this submission. I may make a further submission after considering other submissions made to the Committee.

EXECUTIVE SUMMARY

- The Reference appears to be focused on the possibility of government buying Australian.
- This is surprising in the light of various free trade agreements entered into by the Australian government.
- The Australia-United States Free Trade Agreement chapter 15 is the most comprehensive treatment of government procurement and is the basis for the Commonwealth Procurement Rules.
- A central principle of free trade agreements covering government procurement is the elimination of local preference.
- This principle is stated in both chapter 15 and in the Commonwealth Procurement Rules with provision for exemptions.
- Chapter 15 has no legal status in domestic law but can be enforced between governments under international law.
- The Commonwealth Procurement Rules can be enforced domestically by a dissatisfied tenderer through administrative law but there are difficulties in pursuing this type of case.
- Because of the commitments made in the Australia-United States Free Trade Agreement chapter 15, the Commonwealth is not free to pursue a buy Australian policy unless an exemption applies.

THE REFERENCE

Although the Terms of Reference could be interpreted widely, it is reasonably clear that the focus is on Commonwealth government procurement from Australian suppliers, in short, buying Australian.

On the face of it, it is difficult to understand why the Committee has been asked to focus on buying Australian. This is because the Australian government is locked in by free trade agreements, an important part of which is that procurement by government must *not* give preference to local companies.

I will refer to the Australia-United States Free Trade Agreement (AUSFTA) chapter 15 on government procurement. Although Australia has entered into a number of free trade agreements that include chapters on government procurement, chapter 15 of the AUSFTA is the most comprehensive. It was the basis for the Commonwealth Procurement Guidelines promulgated in 2005. The text of the Guidelines followed chapter 15 very closely. The current version of those Guidelines is the

Commonwealth Procurement Rules (CPRs) which remain a close copy of chapter 15. The CPRs are a legislative instrument under section 64(3) of the *Financial Management and Accountability Act 1997* (Cth). (The original Guidelines were merely guidelines and had no legal status.)

AUSFTA CHAPTER 15 AND PROHIBITION OF LOCAL PREFERENCE

The overall aim of the chapter is to eliminate preferential treatment (Art 15.2), provide for transparency in process,[1] tendering procedures[2] and a tender challenge mechanism (Art 15.11). The Agreement covers purchase of goods, services or both, including construction services, above set monetary levels.[3] It does not cover grants on conditions, internal purchasing within a government, aid projects, procurement of research and development, government advertising services, purchasing of motor vehicles, acquisition of fiscal agency or depository services, liquidation and management services for regulated financial institutions and sale and distribution services for government debt.[4] Nor does it cover Defence purchasing of listed military equipment or services.[5]

The Agreement covers Commonwealth entities (departments, agencies and listed statutory corporations) and listed agencies and entities of all States and Territories but not local government bodies. On the United States side, there is similarly a list of agencies and entities covered at both Federal and State levels.

Importantly for the present purpose, local preference must be eliminated and "offsets", that is, requiring a contractor to subcontract a certain percentage of work to domestic companies, are not permitted[6] with exceptions for Defence (noted above) and where measures are in place to support small and medium enterprises (SMEs).[7]

The legal status of AUSFTA chapter 15

The various requirements outlined above have no legal standing in domestic law. They must be implemented by local legislation to achieve legal status domestically. This has been done through the CPRs. As noted above, these are Commonwealth delegated legislation (a legislative instrument) under section 64(3) of the *Financial Management and Accountability Act*.

---

1 This is achieved through a number of Articles: Art 15.3 (publication of procurement information), Art 15.4 (publication of notice of intended procurement), Art 15.6 (provision of information on tender documentation), Art 15.7 cls 10 and 11 (information on decision made by procuring entity) and Art 15.9 cls 9-11 (publication of award information and disclosure of methodology used to award a contract).

2 Arts 15.2.3, 15.5-15.9.

3 The contract values differ as between goods and services, on the one hand, and construction, on the other hand (Annex 15-A Section 1). The money limits will rise over time (Annex 15-A Section 8). There are measures to prevent "splitting" of contracts so as to evade the operation of the Agreement (Art 15.1.6-8).

4 Art 15.1 cl 3.

5 Notes to the Schedule of Australia item 3.

6 Art 15.2.5

7 Annex 15-A Section 7.

In international law, Australia or the United States could face proceedings under the AUSFTA if a government is alleged to have breached the AUSFTA. Chapter 21 Section B establishes a dispute settlement process. This process is attenuated and endeavours to achieve agreement on a settlement but, ultimately, could result in a government having to pay compensation. It is not possible for a government to sue the other government in a domestic forum (Art 21.15).

NON-DISCRIMINATION IN PURCHASING UNDER CPRs

For present purposes, CPR rule 5.1 provides:

> 5.1 Competition is a key element of the Australian Government's procurement framework. Effective competition requires non-discrimination and the use of competitive procurement processes.

Rule 5.3 provides:

> 5.3 The Australian Government's procurement framework is non-discriminatory. All *potential suppliers* to government **must**, subject to these CPRs, be treated equitably based on their commercial, legal, technical and financial abilities and not be discriminated against due to their size, degree of foreign affiliation or ownership, location, or the origin of their *goods* and services.

These rules appear in Division 1 of the CPRs. The significance of this will appear below in discussing Defence exemptions.

Exceptions

General exemptions

Appendix A of the CPRs lists a number of specific exemptions from the requirements of Division 2 (but not Division 1), some of which are referred to above in discussion of chapter 15 of the AUSFTA. These exceptions are not relevant to the present enquiry as the non-discrimination principle appears in Division 1.

SMEs

Rule 5.4 provides an exception for SMEs:

> 5.4 To ensure that *Small and Medium Enterprises (SMEs)* can engage in fair competition for Australian Government business, officials should apply procurement practices that do not unfairly discriminate against *SMEs* and provide appropriate opportunities for *SMEs* to compete. Officials should consider, in the context of value for money:
>
> a. the benefits of doing business with competitive *SMEs* when specifying requirements and evaluating value for money;
>
> b. barriers to entry, such as costly preparation of *submissions*, that may prevent *SMEs* from competing;
>
> c. *SMEs*' capabilities and their commitment to local or regional markets; and
>
> d. the potential benefits of having a larger, more competitive *supplier* base.

SME is defined Appendix C of the CPRs to mean:

> Small and medium enterprises (SMEs) – an Australian or New Zealand firm with fewer than 200 full-time equivalent employees.

It is not clear whether rule 5.4 permits discrimination *in favour of* Australian SMEs. It does not state so. It merely provides that government must not "unfairly discriminate against SMEs". In my view, this rule does not permit a government decision that favours a local company over a foreign company on the basis that the Australian company is a SME. However, it seems clear from the AUSFTA itself that the intent was to allow discrimination in favour of SMEs. Chapter 15 Annex A Section 7 General Notes provides:

> This Chapter does not apply to:
>
> (a) any form of preference to benefit small and medium enterprises;

Defence

Mention was made above that, under chapter 15 of the AUSFTA, Defence is exempt in respect of certain listed military purchases. This list does not appear in the CPRs but is instead found in the Defence Procurement Policy Manual (DPPM) at 1.2 para 28. This list copies the list in chapter 15 of the AUSFTA but is presented in the DPPM as determined by the Secretary and CEO DMO as exempt under a general rule in the CPRs, namely, rule 2.6:

> Nothing in any part of these CPRs prevents an official from applying measures determined by their Chief Executive to be necessary for the maintenance or restoration of international peace and security, to protect human health, for the protection of essential security interests, or to protect national treasures of artistic, historic or archaeological value.

The DPPM asserts that Defence is bound by Division 1 of the CPRs for all purchases and that exemptions only apply to the mandatory tendering procedures found in Division 2 of the CPRs.[8] It is arguable that a Defence exemption under rule 2.6 is in respect of the whole of the CPRs and not just Division 2. This is of significance in the present context because the non-discrimination rule 5.3 appears in Division 1, not Division 2, of the CPRs. Defence practice in contracting includes requiring contractors to subcontract to Australian companies (called "offsets" in the AUSFTA). Offsets, unless exempt, do not comply with the AUSFTA. Defence considers that it is exempt from the CPRs Division 1 at least to this extent. It is clear that the AUSFTA treats Defence exemption as applying to all requirements under chapter 15, including allowing Defence to pursue Australian Industry Development in Defence purchasing.[9]

WHAT IS THE CONSEQUENCE OF BREACHING THE CPRs?

I have outlined the international law consequences of Australia being in breach of chapter 15 of the AUSFTA. What are the domestic consequences of breaching the CPRs? This is a surprisingly complicated question to answer.

---

8 See, for example DPPM 1.2 para 26.

9 See AUSFTA chapter 15 Notes to the Schedule of Australia item 3(d) and chapter 22 Art 22.2.

The basic position is that a disgruntled tenderer could complain that the government has not adhered to the CPRs. A breach of the CPRs does not by itself provide a "private" right of action under which the tenderer could seek damages. The tenderer would have to challenge the tender process under administrative law, arguing that the government failed to adhere to legislation (the CPRs). A successful challenge would result in a court declaring that the government's decision to award a contract to a particular tenderer was invalid. The government would then have to start again. No compensation is awarded in such cases. This means that there is little incentive to pursue a public law remedy to challenge a government tender process, although this has happened in Australia.[10]

There is a further complication. Not all breaches of legislation necessarily result in a court declaring that what was done was invalid. This is a complex topic.[11] It is arguable that a failure to comply with rule 5.3 of the CPRs would not necessarily result in invalidity of the award of a contract.

The uncertainties associated with challenges to government tender processes in a domestic forum can probably be put aside in the present enquiry. The Terms of Reference are not focused on the question: what rights do tenderers have to challenge tender processes that have not been conducted properly by government? (I have plenty to say about that if the question should ever by considered by the Committee).

IS THERE ROOM FOR DEVELOPING A POLICY OF BUYING AUSTRALIAN?

It is a fundamental principle of free trade agreements that trade should be subject to unfettered competition so far as possible. Local preference is therefore inimical to this principle and is the specific target of prohibition. In my view, the Commonwealth government is not free to develop buy Australian policies (exemptions apart). If the Commonwealth were to develop such policies, it would risk the United States invoking the dispute resolution procedures under the AUSFTA.

---

10 See *MBA Land Holdings Pty Ltd v Gungahlin Development Authority* [2000] ACTSC 89 discussed in Seddon, N, *Government Contracts: Federal, State and Local* (5 ed 2013) [8.17]. This case did not involve a breach of any specific legislation.

11 Discussed in Seddon, ibid, at [8.18]-[8.25].