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BLACKLISTING DUE TO POOR PAST PERFORMANCE IN LITHUANIAN PUBLIC PROCUREMENT

Dainius Kenstavičius

Mykolas Romeris University, Lithuania
dainius@kenstavicius.lt

Abstract

Purpose – to analyse the main rules of blacklisting due to poor past performance in Lithuanian public procurement.

Design/methodology/approach – document analysis, comparison, generalisation.

Finding – Blacklisting due to poor past performance in Lithuanian public procurement comes from the directive of European Union (2014/24), which came into effect in April 2016. It is designed to prevent corruption and protect from economic operators who do not perform public contracts properly. Blacklisting is introduced as a step-forward in Lithuanian public procurement. However, this new institution must be used wisely and no party can abuse the applicable rules. To ensure the proper implementation of blacklisting the Public Procurement Office and Lithuanian courts should prevent both economic operators and contracting authorities from abusing the newly introduced rules of blacklisting.

Research limitations/implications – Blacklisting due to poor past performance is a new institution in Lithuanian public procurement and therefore it is still unknown how exactly it will function. Moreover, the new version of the Law on Public Procurement has not been adopted yet at the time the publication is being prepared, leaving it unclear how Lithuania will regulate the new institution. Finally, there are many situations where the Law on Public Procurement and EU directives are not detailed enough to answer some practical questions arising from the new legal regulation. The findings of this research paper may differ from the real practice, but this should be understandable.

Practical implications – Blacklisting due to poor past performance in public procurement is particularly important to all economic operators participating in public procurement. No economic operator wishes to be blacklisted from participation in public procurement procedures in Lithuania for three years. Contracting authorities are also very interested in the new institution of public procurement and are concerned about how the new legal regulation of blacklisting due to poor past performance will function in practice.

Originality/Value – Blacklisting due to poor past performance in public procurement is a brand new institution in Lithuania and so far there has been no scientific analysis of its functioning. This analysis is new and may have central importance in the future development of blacklisting in Lithuanian public procurement.

Keywords: public procurement, blacklisting, public contracts, contracting authority.

Research type: research paper

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Introduction

New European Union's directives on public procurement enable the national law to introduce blacklisting of economic operators failing to properly perform public contracts (otherwise known as unreliable economic operators). As blacklisting due to poor past performance is a new legal regulation, this research and the problems it addresses are very actual in Lithuania.

It is considered that many countries and international organisations, such as multilateral development banks, have introduced blacklisting systems due to corruption[1]. Blacklisting may be used as a form of (administrative or criminal) sanction to those companies and individuals involved in corruption; a deterrent to corrupt behaviour; an incentive for companies to establish appropriate anti-corruption policies; as a means to strengthen and promote open and transparent procurement processes, and as a means to support honest competitive bidding[2]. Thus, blacklisting helps to ensure both the transparency of public procurement and fair competition. debarment can be an effective tool for governments to promote integrity in public procurements, reduce performance risk[3]. The threat of debarment as well as the impact of negative publicity can deter contractors from committing wrongdoing[4]. However, as explained below, the objective of fair competition will be achieved only when the said institution of public procurement is applied fairly and in accordance with the principles of transparency and equality.

Blacklisting due to poor past performance aims at protecting contracting authorities from economic operators who fail to perform their contracts properly. Essentially, this is achieved in two ways. First, the list of unreliable economic operators is publicly available[5] and any person (not necessarily a contracting authority), at any time, may have access to details of economic operators who are listed as unreliable. Making this information available to the public is one of the key requirements for blacklisting in public procurement procedures. It is considered best practice to maintain a register with details of all debarred companies, including the relevant offence, the length of the debarment and the reasons for debarment. Preferably, the list should be made publicly available so that citizens and other companies have access to the information[6]. The private sector also uses blacklists that are publicly available, even though they have a legal power only in the public sector. For instance, in Brazil the private sector has also been using the list to acquire information on whether certain companies should be hired or included in their supply

[1] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 1

[2] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 2

[3] Dubois, P. S., Swan, C. D., Castellano, N. E. (2015). Suspension and Debarment on the Rise: A Popular Enforcement Tool in the United States. *International Bar Association Anti-Corruption Committee Newsletter*, Vol. 7 No. 2, p. 4.

[4] Schoenmaekers, S. (2016). The EU debarment rules: legal and economic rationale. *Public Procurement Law Review*, No 3, p. 99.

[5] A list of unreliable economic operators is published on the website of the Public Procurement Office at <http://vpt.lrv.lt/lt/kiti-duomenys/nepatikimu-tiekeju-sarasas>.

[6] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 3.

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chain[1]. Secondly, contracting authorities have the right to establish in the procurement conditions that any blacklisted economic operator will be excluded from the procurement procedure. Authors who analyse blacklisting in public procurement state that "it seems sensible to introduce its use for 'negative' purposes in order to allow contracting authorities to (self) protect their interests by not in view"[2].

Main aims of the research are: 1) to analyse the key conditions in new legal regulation; 2) to evaluate if blacklisting due to poor past performance is a proportionate measure; 3) to analyse the main points of evaluation of blacklisted economic operators' qualification; 4) to analyse material breach of contract as a ground for blacklisting due to poor past performance; 5) to analyse blacklisting in case of consortia and subcontracting.

Key conditions in new legal regulation

Firstly it should be noted that in the literature and in legislative provisions on blacklisting, such measures are variously referred to as disqualification, debarment, exclusion, suspension, rejection or blacklisting. These terms may be used interchangeably, as they are used in very similar contexts, with small nuanced differences depending on jurisdiction[3].

According to preamble article 101 of Directive 2014/24/EU[4] of the European Parliament and of the Council of 26 February 2014 (hereinafter – the "Directive"), contracting authorities should further be given the possibility to exclude economic operators which have proven unreliable <...>. They should also be able to exclude candidates or tenderers whose performance in previous public contracts has shown major deficiencies with regard to substantive requirements, for instance failure to deliver or perform, significant shortcomings of the product or service delivered, making it unusable for the intended purpose, or misbehaviour that casts serious doubts as to the reliability of the economic operator. National law should provide for a maximum duration for such exclusions.

Some authors believe that "this is something that the private sector does quite naturally. If a supplier lets you down, then you don't give them the next contract. It is as simple as that. So we might wonder why it has taken the EU and public procurement generally so long to realise that this is a sensible move"[5].

Article 57(4)(g) of the Directive establishes that contracting authorities may exclude or may be required by Member States to exclude from participation in a procurement procedure any economic operator in any of the following situations: where the economic operator has shown significant or persistent deficiencies in the performance of a substantive requirement under a prior public contract, a prior

[1] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 5.

[2] Graells, A. S. *Public Procurement and the EU Competition Rules.* 2nd edition. Oxford; Portland: Hart Publishing, 2015, p. 371.

[3] Williams-Elegbe, S. (2016). Debarment in Africa: a cross-jurisdictional evaluation. *Public Procurement Law Review*, No 3, p. 71.

[4] Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC (Text with EEA relevance). [2014] OJ L 94.

[5] Smith, P. New Procurement Directives – Will Authorities Really Be Able To Exclude Bidders? [interactive]. *Public Spend Matters Europe*, 2015 [accessed on 03/04/2016]. <http://public.spendmatters.eu/2015/01/14/new-procurement-directives-will-authorities-really-be-able-to-exclude-bidders/>.

contract with a contracting entity or a prior concession contract which led to early termination of that prior contract, damages or other comparable sanctions.

This provision establishes the so-called blacklist, also known as "a list of unreliable economic operators" due to poor past performance. The introduction of past performance as an exclusion ground responds to long-standing requests of practitioners and brings the EU system closer to that of the US[1]. Moreover, "this new ground for exclusion addresses a key concern for contracting authorities, namely when it is entitled to reject a bidder it knows has let it or others down in the past from being awarded public contracts in future"[2].

On 9 June 2015, the Seimas of the Republic of Lithuania adopted law No XII-1768 amending Articles 2, 8^2, 10, 21^1, 33, 38, 87, 93, 94, 96, Annex 2 and Annex of the Law of the Republic of Lithuania on Public Procurement No I-1491 and supplementing the Law with Article 18^{13}. Article 6 of this law came into force on 1 January 2016. Article 33(2)(8) of the Law on Public Procurement establishes that the contracting authority may establish in procurement documents that any application or any proposal shall be rejected if the economic operator concerned has failed to perform a procurement contract or has performed it improperly and that was a material breach of procurement contract, a procurement contract has been terminated within the last three years or an effective court decision was adopted satisfying the requests of the contracting authority to recognise the non-performance or improper performance of the procurement contract a material breach of contract and to compensate the losses incurred.

It is so far (at the time the publication is being prepared) not clear what legal regulation of public procurement will look like in the Republic of Lithuania after implementing the Directive. However, blacklisting due to poor past performance is likely to remain and legal regulation will not see any significant changes. After all, the Directive itself establishes a possibility of blacklisting.

The Explanatory Notes on the Law on Public Procurement[4] (hereinafter – the "Explanatory Notes") maintain that the purpose of the proposed amendment is to "ensure that only those economic operators who pay taxes honestly and perform contracts properly could participate in public procurement procedures". Moreover, the Explanatory Notes point out that "problems often arise during procurement procedures and the evaluation of economic operators' qualification when a proposal is submitted by an economic operator who has improperly performed a previous contract <...> or has failed to perform it at all. The problem is that after evaluating the proposal of such economic operator and determining that it is the winning proposal, the contracting authority is forced to conclude a contract with this economic operator,

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[1] Graells, A. S. *Public Procurement and the EU Competition Rules.* 2nd edition. Oxford; Portland: Hart Publishing, 2015, p. 349.

[2] Kale, W. Excluding poorly performing bidders [interactive]. *Thomson Reuters: Practical Law Public Sector Blog,* 2014 [accessed on 03/04/2016]. <http://publicsectorblog.practicallaw.com/excluding-poorly-performing-bidders/>.

[3] Law amending of Articles 2, 8^2, 10, 21^1, 33, 38, 87, 93, 94, 96, Annex 2 and Annex of the Law of the Republic of Lithuania on Public Procurement No I-1491 and supplementing the Law with Article 18^1. *Register of Legal Acts*. 2015, No 9610.

[4] Explanatory Notes on the draft law amending Articles 2, 8^2, 10, 21^1, 33, 38, 87, 93, 94, 96, Annex 2 and Annex of the Law of the Republic of Lithuania on Public Procurement No I-1491 and supplementing the Law with Article 18^1 and on the draft law amending Article 171^3 of the Code of Administrative Offences of the Republic of Lithuania [interactive]. *The Seimas of the Republic of Lithuania* [accessed on 03/04/2016]. <https://e-seimas.lrs.lt/portal/legalAct/lt/TAK/b54caf006b4311e48710f0162bf7b9c5?jfwid=-aor8dayz0>.

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while being fully aware of a strong probability that it will fail to fulfil its obligations under the new contract or will fulfil them improperly."

Considering that blacklisting-related amendments to the Law on Public Procurement entered into force only on 1 January 2016 and that Article 57(4)(g) of the Directive (which must be implemented by 18 April 2016) creates a framework for blacklisting, such legal regulation is brand new and the application of the law in practice may raise various questions that will need to be answered.

It should be noted that a blacklisted due to poor past performance economic operator will not necessarily be excluded from participation in public procurement procedures. Both the Law on Public Procurement and the Directive stipulate that contracting authorities have the right (but not the responsibility) to establish that any blacklisted economic operator will be excluded from participation in a public procurement procedure conducted by the contracting authority. Of course, the Directive must be implemented in national law and the Republic of Lithuania may choose a stricter form of implementation, requiring to exclude from participation in a public procurement procedure (that falls in the scope of the Directive) any blacklisted economic operator. Member States are entitled to introduce this legal regulation under Article 57(4)(g) of the Directive. However, according to the current legal regulation (applicable at the time the publication is being prepared), contracting authorities have the right to choose whether to establish exclusion grounds (for blacklisted economic operators) in the procurement conditions or not. Another very important aspect is that if contracting authorities do not establish this exclusion ground in the procurement conditions, at a later stage they will not have the right to change their mind and exclude from participation in a public procurement procedure any blacklisted economic operator. This conclusion is derived from the obligation of contracting authorities to ensure transparency in public procurement. The Supreme Court of Lithuania has noted that one of the elements of the principle of transparency is compliance with the public procurement law and conditions established by contracting authorities in procurement documents[1]. That is why before launching a specific public procurement procedure contracting authorities should think carefully and decide whether to exclude blacklisted economic operators already when drafting the procurement conditions.

Another important aspect is that any blacklisted due to poor past performance economic operator may be (or must be, depending on the procurement conditions) excluded from participation in any other public procurement procedure. Article 57(4)(g) of the Directive and Article 33(2)(8) of the Law on Public Procurement do not provide for any exceptions in relation to the exclusion of blacklisted economic operators based on certain conditions. Thus, any economic operator who has failed to perform a public contract or performed it improperly, regardless of the nature and subject-matter of the contract (products, services or works), will be debarred from participation in another public procurement procedure, even though the subject-matter (products, services or works) is different. Moreover, any economic operator who has failed to properly perform a public contract with a contracting authority may be excluded from participation in any public procurement procedures conducted by any other contracting authority. Finally, considering the fact that the possibility of excluding any economic operator from a public procurement procedure is established

[1] The Supreme Court of Lithuania, Civil Division, 4 May 2010 ruling of the board of judges in civil case No 3K-3-126/2010.

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by the Directive (Article 57(4)(g)), an economic operator is obligated to properly perform all public contracts at the European Union level. An economic operator who fails to properly perform a public contract in another Member State may also be excluded from participation in a public procurement procedure conducted in Lithuania.

However, economic operators have the right to defend themselves against blacklisting by contracting authorities. However, their legal defence should be very expeditious as legislation provides for very short deadlines for such remedies. Article 93(1)(5) of the applicable Law on Public Procurement establishes that an economic operator who believes that the contracting authority has not complied with the requirements of this law and violated or will violate its legitimate interests by illegally terminating the contract on the basis of a material breach of contract shall have the right to refer to a regional court as a court of first instance for declaring termination of the contract invalid. According to Article 94(5) of the Law on Public Procurement, an economic operator who believes that the contracting authority has wrongly terminated the contract based on a material breach of contract has the right to bring an action before court within 15 days after the termination of the contract. 15 days provided for by legislation for going to court for the termination of contract is a very short term. With this legal regulation in place, economic operators will have to quickly respond to actions by contracting authorities to terminate public contracts. Moreover, the legal regulation will encourage economic operators to promptly respond to any notices of contracting authorities in relation to derogation from the contract and promote close cooperation with contracting authorities when performing public contracts. Overall, any legal regulation resulting in better performance of contracts is viewed as positive.

Is blacklisting due to poor past performance a proportionate measure?

The principle of proportionality restricts the length of debarment in terms of protecting the rights of individuals, owners and firms, and averts reactions that are "harsher" than they "need" to be, given the purpose of these specific rules[1]. A period for which economic operators may be debarred from participation in public procurement procedures is a subject for discussion. For instance, in Brazil it is two years[2] and in the US (who was the first to implement the concept of a blacklist) three years[3].

Thus, the current three-year period of debarment (blacklisting) should not be considered disproportionate. What is more, if a debarment period is not sufficiently long, it might not be deterrent at all[4].

It may seem that debarment from participation in any public procurement procedure for three years is a substantial sanction, in particular if a large part of the

[1] Hjelmeng, E. J., Søreide, T. (2014). Debarment in Public Procurement: Rationales and Realization. *Integrity and Efficiency in Sustainable Public Contracts*. University of Oslo Faculty of Law Research Paper No. 2014-32, p. 4.

[2] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 4.

[3] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 6.

[4] Schoenmaekers, S. (2016). The EU debarment rules: legal and economic rationale. *Public Procurement Law Review*, No 3, p. 100.

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economic operators' customers comes from the public sector (contracting authorities). Therefore, one of the legal requirements for blacklisting due to poor past performance is assurance of due process, i.e. the process of suspension or exclusion of a company or individual from contracting with the public administration should ensure that due process is respected, and that those involved have an appropriate opportunity to defend themselves. In addition, clear rules for removing individuals and companies from the blacklist should be in place, as well as referral mechanisms in case the information provided in debarment registers is incorrect[1].

To avoid any disproportionate sanctions for economic operators, the Directive provides for the so-called self-cleaning. A supplier who has made convincing efforts in becoming trustworthy, for example by introducing control and compliance systems, reorganized and replaced management, or reconsidered its institutional work ethics and visions, should be considered differently than suppliers who have failed to take such steps[2]. Even though the current version of the Law on Public Procurement does not provide for this doctrine, in the near future (when a new version of the Law on Public Procurement has been adopted in accordance with the Directive), the doctrine of self-cleaning will have to be implemented in Lithuania, too. This doctrine means that any economic operator has the right to prove to the contracting authority that it has made certain improvements that will prevent the economic operator from repeated failure to properly perform a public contract. In such a case, the economic operator, even if it is blacklisted, will not be excluded from participation in other public procurement procedures. Article 57(6) of the Directive establishes that any economic operator that is in one of the situations referred to in paragraphs 1 and 4 may provide evidence to the effect that measures taken by the economic operator are sufficient to demonstrate its reliability despite the existence of a relevant ground for exclusion. If such evidence is considered as sufficient, the economic operator concerned shall not be excluded from the procurement procedure. For this purpose, the economic operator shall prove that it has paid or undertaken to pay compensation in respect of any damage caused by the criminal offence or misconduct, clarified the facts and circumstances in a comprehensive manner by actively collaborating with the investigating authorities and taken concrete technical, organisational and personnel measures that are appropriate to prevent further criminal offences or misconduct. The measures taken by the economic operators shall be evaluated taking into account the gravity and particular circumstances of the criminal offence or misconduct.

Literature considers blacklisting due to poor past performance in public procurement as a proportionate measure for economic operators, in particular where the doctrine of self-cleaning exists: "this seems particularly proportionate in view of the rules on 'self-cleaning' that allow contractors to compensate such poor past performance by showing that they have implemented changes to avoid them recurring, always provided that only serious instances of properly documented poor past performance are used as an exclusion or negative qualitative selection criterion, given that exclusion grounds need to be interpreted strictly"[3]. Even though the doctrine of

[1] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 3.

[2] Hjelmeng, E. J., Søreide, T. (2014). Debarment in Public Procurement: Rationales and Realization. *Integrity and Efficiency in Sustainable Public Contracts*. University of Oslo Faculty of Law Research Paper No. 2014-32, p. 4.

[3] Graells, A. S. *Public Procurement and the EU Competition Rules.* 2nd edition. Oxford; Portland: Hart Publishing, 2015, p. 372.

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self-cleaning will be applicable to many cases of exclusion (e.g. where the economic operator has been the subject of a conviction for corruption or fraud, is guilty of grave professional misconduct or is subject to a bankruptcy proceedings, etc.), it will also be applicable to blacklisted economic operators. Subject to self-cleaning, any blacklisted economic operator will be able to prove to contracting authorities that it has taken appropriate measures (technical, organisation, etc.) to prevent further misconduct. If the evidence presented by the economic operator is considered sufficient by the contracting authority, the economic operator concerned may not be excluded from the procurement procedure and its proposal may be considered acceptable. However, the principle of self-cleaning is applied on a case-by-case basis, not automatically to all public procurement procedures. A blacklisted economic operator may convince one contracting authority that it has taken preventive measures to avoid any misconduct in future, but fail to convince other contracting authorities. Whether an economic operator manages to convince contracting authorities of self-cleaning highly depends on the nature of misconduct, i.e. the reason why the economic operator concerned has been blacklisted, since it may determine what preventive measures it can and must take to prevent similar misconduct in future.

Evaluation of blacklisted economic operators' qualification

One of the non-mandatory requirements for the qualification of economic operators is not to be blacklisted due to poor past performance. The reason why an economic operator has been blacklisted plays no role when considering whether the economic operator concerned should be excluded from participation in a public procurement procedure. The mere fact that a particular economic operator is blacklisted is sufficient.

Nevertheless, there are two main ways for economic operators to be blacklisted due to poor past performance.

In the first case, any economic operator may be blacklisted without a court order. For this, the economic operator concerned must commit a material breach of public contract, which results in termination by the contracting authority. In this case, terminating the contract does not require any legal proceedings. It is sufficient that the contracting authority informs the economic operator concerned about the termination of the contract in accordance with legislation and the contract itself.

In the second case, any economic operator may be blacklisted if there is a legal dispute between the contracting authority and the economic operator. However, the legal dispute must concern a particular matter, namely recognition of the non-performance of the public contract a material breach of contract and compensation for the losses incurred. The economic operator is blacklisted only if the court satisfies both of the requests. Thus, if the contracting authority files a claim and the court only awards damages (but does not recognise the non-performance of the contract a material breach of contract), the economic operator is not blacklisted.

The economic operator's qualification in relation to blacklisting is evaluated on the last day of the term for submission of proposals. Following the case law of the court of cassation, the compliance of the economic operator to the qualification requirements may be evaluated only if the factual circumstances confirming the economic operator's competence, capacity and reliability arise no later than the last day of the term for submission of proposals (as established by the procurement

documents)[1]. According to Article 33(8) of the Law on Public Procurement, the contracting authority cannot request documents or information that are available to it free of charge in registers of the Republic of Lithuania, state information systems and other information systems in accordance with the Law of the Republic of Lithuania on State Information Resources Management. Information about blacklisting is made public and is freely available. Contracting authorities have the right and obligation to check whether the economic operator who submitted a proposal is blacklisted.

Material breach of contract as a ground for blacklisting due to poor past performance

Not all breaches of a public contract by an economic operator (together with the compensation for losses or termination of the contract) may serve as a ground for blacklisting due to poor past performance. Article 33(2)(8) of the Law on Public Procurement establishes that it must be a material breach of contract. Similarly, Article 57(4)(g) of the Directive states that an economic operator may be excluded from participation in a procurement procedure, where the economic operator has shown significant or persistent deficiencies in the performance of a substantive requirement under a prior public contract.

The Law on Public Procurement does not specify what constitutes a material breach of contract, making it a subject of civil law. This is also confirmed by Article 8^2(1)(18) of the Law on Public Procurement, stipulating that one of the functions of the Public Procurement Office is to administer information about economic operators who have failed to perform or improperly performed a contract, where the contract was terminated because of a material breach of contract as defined by the Civil Code of the Republic of Lithuania (hereinafter – a "material breach of contract") or where there is an effective court ruling satisfying the requests of the contracting authority to recognise the non-performance or improper performance of the contract a material breach of contract and compensate the losses incurred.

The Civil Code defines criteria for a material breach of contract. According to Article 6.217(2) of the Civil Code, the following criteria must be taken into account: (1) whether the aggrieved party is substantially deprived of what it was entitled to expect under the contract, except in cases when the other party did not foresee or could not have reasonably foreseen such result; (2) whether, taking into consideration the nature of the contract, strict compliance with the conditions of the obligation is of essential importance; (3) whether the non-performance is made of malice prepense or of great imprudence; (4) whether the non-performance gives the aggrieved party the basis to suppose that it cannot believe in the future performance of a contract; (5) whether the defaulting party, who was preparing for performance or was effectuating the performance of the contracts, would suffer significant damages if the contract were dissolved. The court of cassation has noted that "the analysis of the content of criteria for a material breach of contract should firstly include the evaluation of two types of performance of the obligation: the promised one and the actual one. The larger the gap between these two types of performance, the higher the probability of a material breach of contract. The gap reaches its maximum in case of total non-performance. Secondly, looking at whether strict compliance with the obligation is of essential

[1] The Supreme Court of Lithuania, Civil Division, 24 February 2016 ruling of the board of judges in the civil case No e3K-3-112-969/2016.

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importance within the context of the contract, it should be considered whether particular terms of the contract will determine the loss of the creditor's interest in the obligation. Thirdly, to decide whether the obligations was not performed intentionally or due to gross negligence, it is important to analyse the form of the offender's fault in accordance with general civil liability provisions and to decide whether the offender's fault is major and, if so, whether it its intentional. The greater the fault, the smaller the reasonable interest of the aggrieved party to remain in contractual relations. Fourthly, deciding whether non-performance gives the aggrieved party the basis to suppose that they cannot believe in the future performance of a contract requires determining whether the defaulting party acts passively in fulfilling the obligations assumed, also whether it is capable of performing the contract even with the best intentions in mind. And fifthly, it is important to consider whether the defaulting party, who was preparing for performance or was performing the contract, would suffer significant damages if the contract were terminated. This refers to very large, disproportionate damages rather than ordinary damages.[1]"

The Supreme Court of Lithuania has spoken in great detail about termination conditions. The court of cassation has noted that "according to Article 6.217 of the Civil Code, a breach of contract may be considered material on two grounds: a breach may be considered material by law and the parties may agree on what constitutes a material breach"[2]. Moreover, "if the parties agree that a breach of a contract clause leads to unilateral termination, they do not necessarily have to agree to consider this breach material"[3].

The said rule and the case law of the Republic of Lithuania allow concluding that within the context of the Law on Public Procurement, a public contract is considered terminated for a material breach of contract, if this breach is consistent with Article 6.217(2) of the Civil Code or is described as material by the contract itself. Hence, contracting authorities are recommended to specify in the procurement conditions (as well as the contract) all and any cases where a breach of contract is considered material.

On the other hand, contracting authorities are not totally free to define a material breach of contract in the contract. It may be the case that a contract establishes that missing a deadline by one day or failing to inform about changes in contact details within two days is a material breach of contract. Of course, there may be cases where the said breaches are indeed material. However, contracting authorities do not have the right to distort the principle equality of parties and consider even the slightest inconsistency with the performance of the contract a material breach of contract. The court of cassation has pointed out that "the basis for termination established by the contract is a contract clause and therefore is considered and controlled by the court in terms of the legitimacy and fairness of contract clauses[4]". In case of a dispute with the contracting authorities, economic operators will be able to prove that the breach of contract is not material.

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[1] The Supreme Court of Lithuania, Civil Division, 26 June 2012 ruling of the board of judges in civil case No K-7-297/2012.

[2] The Supreme Court of Lithuania, Civil Division, 26 June 2012 ruling of the board of judges in civil case No 3K-7-297/2012.

[3] The Supreme Court of Lithuania, Civil Division, 15 May 2015 ruling of the board of judges in civil case No 3K-3-298-687/2015.

[4] The Supreme Court of Lithuania, Civil Division, 8 May 2015 ruling of the board of judges in civil case No 3K-3-261-421/2015.

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Quite often a public contract is being properly performed, but the economic operator is simply late with the deadlines. In such cases, the contracting authority has the right to request the economic operator to pay a penalty (e.g. default interest), and if the economic operator fails to do so, the contract authority has the right to claim it in court. If, in addition to a penalty, the contracting authority requests the court to recognise the non-performance of the contract by the economic operator a material breach of contract, will the economic operator be blacklisted, provided that the court satisfies the requests of the contracting authority? Article 33(2)(8) of the Law on Public Procurement uses the term "losses" (which is not the same as penalty), while Article 57(4)(g) of the Directive goes with "damages or other comparable sanctions". A penalty is clearly a comparable sanction. Moreover, a penalty as a form of contractual civil liability performs a compensatory function – it compensates the aggrieved party for losses[1]. Therefore, a penalty (e.g. default interest) should be treated as a similar sanction to compensation for losses. And if the court awards a penalty as well as recognises the non-performance of the contract by the economic operator a material breach of contract, the economic operator concerned should be blacklisted.

Blacklisting in case of consortia and subcontracting

In certain cases, public contracts are performed by a group of economic operators rather than by one individual economic operator. Article 5(2) of the Law on Public Procurement establishes that an application or a proposal may be submitted by a group of economic operators. There may be a question of how liability is distributed among joint activity partners (members of the group of economic operators), if any act or omission by one of them leads to non-performance of the public contract and its termination by the contracting authority. On the one hand, a group of economic operators consists of individual legal entities with independent (individual) legal capacity. On the other hand, a group of economic operators is considered a contracting party to a particular public contract. The contracting authority should not be obligated to establish which member of the group of economic operators have committed an act or omission resulting in improper performance of the entire public contract. The contracting authority is usually unable to identify the entity that has failed to perform the contract (where the contract had to be performed by a group of economic operators) for objective reasons (information on relations among member of the group of economic operators, cooperation and internal actions in relation of the performance of the contract), therefore if a contract is poorly performed by a group of economic operators, all (individual) member of the group of economic operators concerned should be blacklisted. This may seem to violate the right of the economic operator that has properly performed the public contract, but, in fact, economic operators have several ways how to avoid negative legal consequences. On the one hand, economic operators need to choose their partners more carefully and participate in a public procurement procedure only with reliable partners. On the other hand, economic operators should also use due care in performing public contracts. Finally, if a contract is improperly performed through the fault of one member of the group of economic operators, the remaining members of the group who performed the contract properly will be able to

[1] The Supreme Court of Lithuania, Civil Division, 13 March 2015 ruling of the board of judges in civil case No 3K-3-138-686/2015.

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use self-cleaning (Article 57(6) of the Directive) and implement certain preventive measures.

A question may arise whether this kind of legal regulation does not contradict the objective of public procurement to ensure competition. Following the case law of the court of cassation, the main aim of the regulation of public procurement procedures is to ensure competition[1]. Unfounded exclusion of economic operators from participation in public procurement procedures undoubtedly restricts competition. Undeniably, debarment reduces the number of suppliers available and will sometimes force procuring entities to buy at higher prices or lower quality than what they would otherwise select, or from a supplier whose technology is unknown[2]. A very important blacklisting-related aspect is the fact that contracting authorities cannot abuse their position and act in a way that results in blacklisting. Experts have raised concerns over the economic impact such systems may have if not applied fairly and uniformly[3]. Also, contracting authorities cannot abuse their position in another sense – they cannot make any exceptions or give any privileges to large businesses. If there is a legal basis, the contracting authority must take all necessary measures to blacklist any economic operator who has failed to properly perform a public contract, regardless of whether the economic operator concerned is a small company or a large business entity. A practice where large companies have more opportunities to influence decisions by contracting authorities is noticed in foreign countries and therefore is also relevant in the Republic of Lithuania. For instance, according to studies, debarment tends to be used more frequently against small firms, while large and powerful firms are rarely suspended or debarred from contracting with the public administration[4]. It is therefore crucial to ensure that legal regulation of blacklisting is applied not only to small and medium-sized business, but also to all economic operators without exception and in accordance with the principle of equality, i.e. without discrimination and any privileges.

On the other hand, fair competition would also be impaired if an economic operator who has failed to properly perform a prior public contract is allowed to participate in other public procurement procedures. A restriction may be justified if it pursues a legitimate aim in the public interest and is proportional in that it is suitable for securing the attainment of that objective and does not go beyond what is necessary in order to attain it[5]. The objective of ensuring competition does not mean that every public procurement procedure should be open to all or the maximum number of economic operators operating in a particular market. Ensuring competition means that all economic operators must have a level playing field to compete with each other, and economic operators who violate the law (e.g. have not paid their taxes or have committed an offence), also economic operators who fail to properly perform public contracts cannot expect their unlawful acts not to evoke any legal consequences. With

[1] The Supreme Court of Lithuania, Civil Division, 24 May 2011 ruling of the board of judges in civil case No 3K-3-249/2011.

[2] Hjelmeng, E. J., Søreide, T. (2014). Debarment in Public Procurement: Rationales and Realization. *Integrity and Efficiency in Sustainable Public Contracts*. University of Oslo Faculty of Law Research Paper No. 2014-32, p. 6.

[3] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 4.

[4] Blacklisting in public procurement [interactive]. *Transparency International*, 2013 [accessed on 03/04/2016]. <http://www.transparency.org/files/content/corruptionqas/Blacklisting__in__public__procurement.pdf>, p. 4.

[5] Schoenmaekers, S. (2016). The EU debarment rules: legal and economic rationale. *Public Procurement Law Review*, No 3, p. 99.

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the exclusion of dishonest suppliers, the market is supposedly reduced to trustworthy players, and it will be more difficult for dishonest players to survive in the market for public contracts[1]. One has to agree with the authors saying that blacklisting is a proportionate measure to exclude from public procurement procedures dishonest economic operators[2]. In the longer term, debarment is an investment in public trust and the public procurement system[3]. There is less competition, but at least this competition is presumed to be fair[4].

Additional questions arise when a group of economic operators perform a public contract in cooperation with subcontractors. Article 32(3) of the Law on Public Procurement establishes that as necessary in a specific contract the economic operator may rely on the capacity of other economic entities, regardless of its legal relations with them. This rule is related to the objective of including in a procurement procedure as many potential economic operators as possible, providing them a level playing field to participate in procurement procedures, promoting competition, ensuring wider powers to the contracting authority in evaluating proposals and determining the successful economic operator[5]. A possibility of relying on the capacity of other economic operators enables large companies as well as small and medium-sized businesses to participate in larger-scale procurement procedures. The Law on Public Procurement does not provide for the distribution of responsibilities between the economic operator and subcontractors. However, Article 6.650(3) of the Civil Code[6] establishes that the general independent work contractor shall be liable before the customer for the failure to perform or improper performance of the obligations by subcontractors, and before subcontractors for the failure to perform or improper performance of the obligations by the customer. Hence, economic operators are liable before the contracting authority for any obligations improperly fulfilled by subcontractors. If a subcontractor fails to properly perform a contract with the economic operator, which results in the improper performance of the public contract, the economic operator concerned (a group of economic operators) should be blacklisted. A subcontractor is not considered an economic operator within the meaning of the Law on Public Procurement and does not directly perform a public contract. Moreover, a subcontractor is not related with the contracting authority by any contractual relations. Thus, in case of improper performance of a public contract, subcontractors should not be blacklisted, irrespective of whose fault it is that the public contract has been poorly performed.

In some cases, an economic operator who is not blacklisted may intend to participate in a public procurement procedure with a subcontractor who is. A proposal submitted by such economic operator should be evaluated in accordance with the procurement conditions. Based on the case law, the contracting authority has discretion to determine minimum qualification requirements for economic operators

[1] Hjelmeng, E. J., Søreide, T. (2014). Debarment in Public Procurement: Rationales and Realization. *Integrity and Efficiency in Sustainable Public Contracts*. University of Oslo Faculty of Law Research Paper No. 2014-32, p. 6.

[2] Graells, A. S. *Public Procurement and the EU Competition Rules.* 2nd edition. Oxford; Portland: Hart Publishing, 2015, p. 372.

[3] Williams-Elegbe, S. (2016). Debarment in Africa: a cross-jurisdictional evaluation. *Public Procurement Law Review*, No 3, p. 74.

[4] Schoenmaekers, S. (2016). The EU debarment rules: legal and economic rationale. *Public Procurement Law Review*, No 3, p. 99.

[5] The Court of Appeal of Lithuania, 23 May 2011 ruling in civil case No 2A-937/2011.

[6] Civil Code of the Republic of Lithuania. *Official Gazette*. 2002, No 74-2262.

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intending to participate in the procurement procedure (each member of the group of economic operators), while to prove the compliance with the qualification requirements economic operators may rely on the capacity of other economic operators[1]. Likewise, the contracting authority lays down requirements for both economic operators and subcontractors in the procurement conditions. Unless the procurement conditions include a provision that the subcontractors proposed may not be included in the list of unreliable economic operators, economic operators may use blacklisted subcontractors for the performance of the contract.

Conclusions

Blacklisting due to poor past performance aims at protecting contracting authorities from economic operators who improperly perform their contracts.

Any blacklisted economic operator may be (or must be, depending on the procurement conditions) excluded from participation in any other public procurement procedure (even organised by other contacting authorities).

To avoid any disproportionate sanctions for economic operators, the Directive establishes a doctrine of self-cleaning, meaning that any economic operator has the right to prove to the contracting authority that it has made certain improvements which will prevent the economic operator from repeated failure to properly perform a public contract.

Contracting authorities cannot abuse their position and act in a way that results in blacklisting. It is therefore crucial to ensure that legal regulation of blacklisting is applied not only to small and medium-sized business.

In cases where a group of economic operators fails to properly perform a contract, all (individual) members of this group should be blacklisted. Meanwhile if a subcontractor fails to properly perform a contract with the economic operator, which results in the improper performance of the public contract, the economic operator concerned (a group of economic operators) should be blacklisted. Thus, in case of improper performance of a public contract, subcontractors should not be blacklisted, irrespective of whose fault it is that the public contract has been poorly performed.

The contracting authority lays down requirements for both economic operators and subcontractors in the procurement conditions. Unless the procurement conditions include a provision that the subcontractors proposed may not be included in the list of unreliable economic operators, economic operators may use blacklisted economic operators for the performance of the contract.

Within the context of the Law on Public Procurement, a public contract is considered terminated for a material breach of contract, if this breach is consistent with Article 6.217(2) of the Civil Code or is described as material by the contract itself. However, contracting authorities do not have the right to distort the principle equality of parties and consider even the slightest inconsistency with the performance of the contract a material breach of contract.

A penalty (e.g. default interest) should be treated as a similar sanction to compensation for losses. And should the court award a penalty as well as recognise the non-performance of the contract by the economic operator a material breach of contract, the economic operator concerned should be blacklisted.

[1] The Court of Appeal of Lithuania, 22 February 2012 ruling in civil case No 2A-1089/2012.

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