

**THE IMPACT OF THE EU PROCUREMENT RULES ON CORPORATE  
RESPONSIBILITY IN THE SUPPLY CHAIN: A STUDY OF UTILITIES**

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## **Abstract**

Corporate social responsibility (CSR) refers to the voluntary integration of social and environmental concerns into business practice. It is of increasing importance to utilities, with commercial pressure to be socially responsible coming from, *inter alia*, consumers, investors and employees. One way in which utilities can integrate CSR into their business is in their procurement. However, the potential scope for the inclusion of CSR considerations in procurement regulated by the EU is uncertain, with some policies clearly restricted but the legality of others being less clear.

This thesis examines the practical impact of the EU procurement regulation on the use of CSR policies in utilities procurement, focusing specifically on the inclusion of labour concerns. The project aims to discover practitioners' opinions of the EU law in this area and their experience in applying it, looking at positive and negative aspects of the law. In order to do so, a qualitative study was completed, with semi-structured interviews conducted with a sample of procurement practitioners based in UK utilities. The study covers the level of use of labour policies in procurement, the types of labour policy commonly included and the means by which those policies are integrated into procurement, with emphasis on the impact of the EU regulation on each issue.

The thesis concludes that the impact of the EU regulation was relatively low, with most practitioners feeling that the procurement rules did not generally restrict their inclusion of labour policies. Instead, practical concerns governed the choice of labour policy and the means by which those policies were integrated into procurement. The major exception to this was in the area of policies which favoured local labour or firms, where practitioners felt that the EU regulation was very restrictive and prevented them from achieving their commercial aims.

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## **Chapter 1 - Introduction**

### **I. Introduction**

This thesis examines the impact of the European Union (EU) rules on public procurement on the use of corporate social responsibility (CSR) policies in utilities procurement. This chapter will begin by setting out an introduction both to utilities procurement and the concept of CSR (Section II). It will then set out the aims of this research and the main research questions (Section III). Section IV will offer an introduction to the methodology of the study. The chapter will conclude with an overview of the whole thesis structure (Section V).

### **II. Public Procurement and Corporate Social Responsibility**

The European Commission has defined CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with stakeholders on a voluntary basis."<sup>1</sup> The concept of CSR has risen in importance in recent years and the EU now has an official CSR strategy which calls on businesses to integrate CSR into their practical application of EU policies wherever possible.<sup>2</sup>

This growth in the importance of CSR is partly due to the argument made by many commentators that socially responsible companies will in fact be more profitable than their less ethical competitors, known as the "business case" for CSR. This business case is supported by the EU, which notes "[t]here is a growing perception that sustainable business success and shareholder value cannot be achieved solely through maximising short-term profits but instead through market-oriented yet responsible behaviour."<sup>3</sup> Following this position, companies face pressure to be more socially responsible from their stakeholders, with the main sources of pressure being investors, the company's

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<sup>1</sup> European Commission, *Communication from the Commission concerning Corporate Social Responsibility: A business contribution to Sustainable Development COM(2002) 347*, ("Commission Communication concerning Corporate Social Responsibility"), at p.5.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*, at p.5.

employees, and consumers, and it is argued that a company which satisfies the demands of these stakeholders will gain more custom than a company which does not.<sup>4</sup>

It has been suggested that the utilities sector may be particularly sensitive to such public pressure due to its historical position as part of the public sector and the belief that private utilities are still subject to state influence.<sup>5</sup> In addition to these pressures, companies may also be influenced by the desire to avoid the stricter regulation which might result if they do not regulate themselves.<sup>6</sup> In support of this, Arrowsmith and Maund note the increase in CSR reporting amongst large corporations, which has led to the creation of detailed statistical reports which are now often independently audited.<sup>7</sup> The authors also note the recent action by utilities to be listed in social investment indices such as FTSE4Good and the increased use of CSR policies by many utilities to protect their brand image.<sup>8</sup>

One of the possible methods by which utilities can integrate CSR concerns into their business is through including CSR requirements in their procurement contracts. Public and utilities procurement refers to the process of awarding contracts for the goods, works and services the public and utilities sector needs. It is potentially a powerful way of influencing companies' policies due to the size and the high visibility of the contracts awarded by the public and utilities sector.<sup>9</sup> By choosing to purchase goods and services which are socially and environmentally responsible, utilities can have a substantial influence on CSR issues.

Utilities in the UK are not totally free to determine their procurement process, however. The public and utilities procurement market often poses significant barriers to international trade, with public bodies favouring national suppliers for a variety of

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<sup>4</sup> Vogel, D. *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (2005, Washington DC: Brookings Institution Press), Ch. 3.

<sup>5</sup> Arrowsmith, S. and Maund, C. 'CSR in the utilities sector and the implications of EC procurement policy: a framework for debate', Ch. 11 in Arrowsmith, S. and Kunzlik, P. (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (2009, Cambridge: CUP), at p.440.

<sup>6</sup> *Ibid*, at p.438.

<sup>7</sup> *Ibid*, at p.439.

<sup>8</sup> *Ibid*, p.440.

<sup>9</sup> Arnould, J. 'Secondary Policies in Public Procurement: the Innovations of the New Directives' (2004) 13 PPLR 187 at 187.

reasons, ranging from intentional favouritism to support national industry to unintentional factors such as a lack of knowledge of foreign suppliers.<sup>10</sup> Due to this tendency towards national favouritism and the size of the market, it is common for public procurement to be subject to international regulation to ensure the liberalisation of the market.

Within the EU, public procurement has been regulated in some form to ensure competition and prevent national discrimination since the 1970s. The main EU rules governing utilities procurement currently come from the free movement provisions of the Treaty on the Functioning of the European Union (TFEU), supported by secondary legislation in the form of two directives, Directive 2004/17/EC ("the Utilities Directive")<sup>11</sup> and Directive 92/13/EEC ("the Utilities Remedies Directive").<sup>12</sup> These regulations, consistent with the overall aim of opening up the procurement market to competition, focus on the commercial aspects of the procurement process. The procurement rules both limit the possible use of certain social and environmental policies in procurement and also lack clarity as to the legality of some policies, creating legal risks for utilities that wish to use procurement to support their CSR objectives. The combination of this restrictive and confusing regulation with the pressures on utilities to include CSR in their business could potentially cause some difficulties for utilities.

### **III. Aims and Objectives of this Study**

The main aim of this research is to examine the practical impact of the EU procurement regime on the use of CSR policies in procurement. The project aims to discover practitioners' opinions of the law and their experiences in applying it, identifying any positive and negative aspects of the law. This will enable an analysis of whether the

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<sup>10</sup> For more information, see Arrowsmith, S. *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> Ed), (2005, London: Sweet and Maxwell), at pp.121-122.

<sup>11</sup> Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 No. L134/1.

<sup>12</sup>Council Directive 92/13/EEC of 25.2.92 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, [1992] O.J. L76/7.

procurement law as it is on the books is influencing behaviour as the EU legislators intended. It will also help to identify certain problems with the law.

While CSR covers both social and environmental issues, this thesis will focus only on the social side. It was felt that attempting to investigate both aspects of CSR in one project would lead to a more superficial examination of the topic given the time restraints of the research, whereas focusing on one allowed much deeper analysis. In recent years, environmental issues have been seen as increasingly important, and the possibility of including environmental issues in procurement has been examined by several authors.<sup>13</sup> Social policies, covering a range of issues such as promoting gender and race equality, supporting the local community and promoting core labour standards, do not appear to have been researched at the same level of detail. Labour policies in particular are of increasing importance for utilities which are more commonly outsourcing to developing countries where they cannot be sure of the employment standards. For this reason, this research focuses in particular on labour-related policies, which aim to improve the working conditions of the workforce of the utility and that utility's suppliers further down the supply chain. The research aims to identify issues which might provide guidance as to current practice in this area and the legal issues surrounding it.

While the EU procurement regime covers both the public sector and the utilities sector, the vast majority of academic research focuses on the public sector regime. In the specific field of social and environmental concerns in procurement, there have been several legal studies into the impact of the EU regime on the public sector, but very little examination of the issues relating to the utilities sector.<sup>14</sup> Equally, the official guidance on social and environmental issues in procurement produced by the Office of

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<sup>13</sup> See, for example, Kunzlik, P. 'The procurement of 'green' energy', Ch. 9 in Arrowsmith and Kunzlik, above n. 5.; Westphal, T. 'Greening Procurement: An Attempt to Reduce Uncertainty' (1999) 8 PPLR 196; Nijholt, H. 'Environmental Provisions in Public Procurement Directive 2004/18/EC' (2004) 21 ICLR 268.

<sup>14</sup> For previous studies into social and environmental concerns in public sector procurement, see Caranto, R. and Trybus, M. (eds), *The Law of Green and Social Procurement in Europe*, (2010, Copenhagen: DJØF Publishing); Arrowsmith, S. and Kunzlik, P. (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions* (2009, Cambridge: CUP); McCrudden, C., *Buying Social Justice: Equality, Government Procurement, and Legal Change*, (2007, Oxford: OUP); Kunzlik, P. (ed.), *The Environmental Performance of Public Procurement* (2003, OECD); McCrudden, C. "Social Policy Issues in Public Procurement: a Legal Overview", Ch.12 in Arrowsmith and Davies (eds.), *Public Procurement: Global Revolution* (1998, London: Kluwer Law International) .

Government Commerce deals only with the public sector rules.<sup>15</sup> The most recent guidance produced by the European Commission fares slightly better, giving references to the utilities legislation, but still focuses on the public sector requirements. It has no discussion of the parts of the utilities regulation which differs from the public sector.<sup>16</sup> However, the utilities rules vary significantly from the public sector rules in some places, making the public sector research and guidance of limited use to the utilities sector. This gives bodies in the utilities sector very little direction when looking to include social and environmental policies into procurement and one of the aims of this thesis is to remedy this, focusing on the problems specific to the utilities regulation in this area.

In addition to potentially providing valuable information on the impact of the EU regime on utilities procurement in the specific area of social procurement, the thesis aims to provide information on the more general procurement practice of the utilities sector, which has also been little researched. The research will offer an insight into the practical methods used by practitioners, looking at collaborative procurement within utilities and the use in practice of some utility-specific procurement options, such as supplier lists.<sup>17</sup>

As well as analysing issues relating specifically to utilities procurement, the research also aims, through the specific case study of labour policies, to shed some light on the more general issue of how those who apply the law deal with regulation which is either commercially restrictive or lacks clarity. Building on research looking at compliance theory, this thesis will examine some of the factors which impact on procurement practitioners' decisions over whether or not to take action which might be legally risky. It also aims to examine whether the current form of procurement regulation is the most effective, looking at academic theories on compliance and deterrence approaches to regulation in light of practitioners' experiences with the procurement regulation.

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<sup>15</sup> See Office of Government Commerce, *Buy Green and Make a Difference: How to address environmental issues in public procurement* (2008), available at [http://www.oqc.gov.uk/documents/Environmental\\_Issues.pdf](http://www.oqc.gov.uk/documents/Environmental_Issues.pdf) [accessed 18/05/2011] and Office of Government Commerce, *Social Issues in Purchasing* (2006), available at [http://www.oqc.gov.uk/documents/Social\\_Issues\\_in\\_Purchasing.pdf](http://www.oqc.gov.uk/documents/Social_Issues_in_Purchasing.pdf) [accessed 18/05/2011].

<sup>16</sup> European Commission, *Buying Green! A Handbook on Environmental Public Procurement* (2004) and European Commission, *Buying Social: A Guide to Taking Account of Social Considerations in Public Procurement*, SEC(2010) 1258.

<sup>17</sup> For more information on supplier lists, see Chapter 5, Section IV.

In order to accomplish the aims set out above, the thesis focuses on four main areas. Firstly, the thesis aims to investigate the level of use of labour policies in procurement. It will examine the factors which impact on procurement practitioners' decision over whether or not to include labour policies in procurement, with special focus on the impact of the EU legal regime in this area. Secondly, the thesis aims to investigate which types of labour policy are most commonly included in utilities procurement and if the requirements of the EU legal regime impact on the choice of policy in any way. Thirdly, the thesis aims to determine how labour policies are integrated into procurement given the requirements of EU law. Finally, the thesis looks at general regulatory and compliance issues linked to the use of labour policies in procurement, with a focus on the impact of the grey areas in the law on compliance.

#### **IV. Overview of Methodology**

The thesis takes a socio-legal approach, involving an empirical study of procurement practitioners in the regulated utilities sector and focusing on the effects of legal regulation in practice. The thesis is split into two parts. Part I consists of a literature review giving the background to the issues covered in the thesis along with a doctrinal study of the law governing the use of labour policies in EU utilities procurement. Part II sets out the results of the empirical study, examining how the legal requirements as identified in Part I are interpreted in practice. This section sets out an overview of the methodology of the two parts, with more detail of the methodology for the empirical study being set out in Chapter 8.

Part I of the thesis primarily uses doctrinal legal analysis, examining the law on the books to examine the possibility for including labour policies in procurement under the EU legal regime. The analysis examines the law as set out in both the requirements in TFEU and the Utilities Directive, as interpreted by the Court of Justice of the European Union (CJEU). In order to get a more complete picture of the legal situation, the analysis also considers the interpretation of the law given in the official guidance by both the

European Commission and the Office of Government Commerce (OGC). This doctrinal analysis sets out both the areas in which the law clearly restricts the use of labour policies and areas where the law lacks clarity on that issue.

The doctrinal analysis of the EU procurement regime in Part I is supported by socio-legal analysis examining the law in light of business research and regulatory theory. The thesis examines both the business concept of CSR and the requirements of commonly-used labour codes to determine possible commercial needs for utilities in their procurement related to labour. The procurement law is analysed in light of those commercial needs to determine any areas in which there is conflict. Finally, the EU legal regime is examined in light of regulatory theories on compliance and deterrence to determine whether the approach taken by the EU to procurement regulation is the most appropriate way of achieving the EU's aims.

The issues raised in Part I of the thesis form the basis of the main part of the research, the empirical study in Part II. The study is qualitative in nature, involving semi-structured interviews with a sample of procurement practitioners from UK utilities. Qualitative research was deemed appropriate for this research given the lack of detailed research and theory which currently exists in this area, making it difficult to define the relevant issues with enough clarity for a quantitative statistical study. It was also felt that qualitative research was appropriate given the focus of this project on the experiences and opinions of the practitioners involved, an area more suited to in-depth interviews than to statistical research.

The sample of procurement practitioners was chosen on the basis of theoretical sampling, a non-statistical method of sampling whereby interviewees are chosen on the basis of their relevance to the research questions.<sup>18</sup> The sample for this research covered twenty-two utilities, including all of the regulated utility sectors (water, energy, transport and postal services), and was chosen so as to ensure number of key factors were met,

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<sup>18</sup> For more on theoretical sampling, see Mason, J, *Qualitative Researching*, (2<sup>nd</sup> Ed), (2002, London: SAGE Publishing), at p. 137.

including variance in company size and coverage of both public and private sector bodies (see Chapter 8, Section III.2 for full details).

Once data collection was complete, the interview data were analysed by coding for themes. Analysis was done inductively, with codes being driven by the data rather than pre-existing theory. Themes were coded until the point of theoretical saturation was reached, i.e. when the analysis no longer revealed new theoretical insights.<sup>19</sup>

## **V. Overview of Conclusions**

This section offers a brief overview of the conclusions of the thesis in the four main research areas identified in Section III above.

### V.1 Use of Labour Policies

The thesis will show that the overall impact of the EU legal regime on the use of labour policies in procurement was minimal, with most interviewees feeling that the regime neither prevented nor promoted the use of labour policies. One important exception to this, however, is in the area of local labour policies, where the EU law was felt to have a very noticeable effect, as discussed further in Chapter 9, Section IV.1. In practice, labour policies were included by those practitioners who had motives outside of the EU procurement system to include them, and neither the decision to include labour policies nor the content of those policies was greatly affected by EU law constraints. The main motives for those who included labour policies in procurement were moral, with interviewees feeling they had a duty to ensure that workers on their contracts had a good working environment. There was also a strong desire amongst interviewees to avoid the bad publicity which might arise if a contractor was found to have poor labour standards, leading to interviewees requiring minimum labour standards in their procurement contracts. By contrast, the main concerns of those interviewees who did not include labour policies were commercial, with the cost of introducing labour issues into the procurement process being considered too high.

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<sup>19</sup>Charmaz, K. *Constructing Grounded Theory*, (2006, London: SAGE Publications), at p.113.

## V.2 Type of Labour Policies

The thesis will show that the types of labour policy used in utilities procurement are varied, ranging from simply requiring compliance with national employment law to detailed requirements relating to health and safety or discrimination. While for the most part the EU legal regime again had only a minimal impact, the regime was significant when it came to the use of local labour policies. It will be shown that the issue of favouring local labour or firms was considered highly important by interviewees and was the area where the restriction of the legal regime was felt most keenly. The research will show that majority of interviewees stated that they had considered favouring local labour or firms in some manner in their procurement but did not do so due to the restrictions of the EU legal regime, and a minority attempted to favour local labour despite the legal restrictions.

## V.3 Structure of Labour Policies

It will be shown that there are three main methods for including labour policies in procurement: contract conditions setting labour requirements to be completed during the contract, prequalification criteria setting minimum labour standards for a firm to meet to be entitled to participate in the procurement process, and including labour related award criteria in the tender evaluation requirements. Of these, prequalification criteria were the most commonly used by interviewees since this method was the easiest to ensure compliance with minimum requirements, the main concern of most interviewees. Overall, as with the findings above, the impact of the EU legal regime in this area was relatively low. Where the correct interpretation of the law was unclear, interviewees tended to assume that their approach was legal, taking a flexible view of the law. This meant that practical, rather than legal, concerns were the main factor behind the choice of structure.

#### V.4 Regulatory and Compliance Issues

The thesis will show that interviewees were generally happy with the EU procurement regime, believing it to be fair and to improve competition in procurement. Linked to this, there is no real evidence of “creative compliance” or deliberate breach of the EU legal regime by utilities, with interviewees generally doing their best to comply with what they thought the legal requirements were. Any breach of the law was generally down to ignorance rather than malice. There was, however, a relatively low level of knowledge of the actual requirements of the law, which meant that interviewees often did not feel the need to evade the legal restrictions partly due to a lack of awareness that the restrictions existed. Given this lack of deliberate breach of the regulation, the thesis will show that a compliance approach to regulating procurement where utilities are helped to understand and comply with the law rather than being subject to punitive sanctions when they breach the law might be preferable to the current deterrence approach for dealing with compliance with this area of the law by companies within the UK.

### **VI. Overview of Thesis Structure**

Excluding this introductory chapter, Part I of this thesis consists of Chapters 2-7. Chapter 2 sets out an introduction to the concept of CSR. It looks at the difficulty of setting out a precise definition of CSR and examines the most common features of the concept. The development of the concept and the main reasons behind its growth in recent years are analysed, focusing on the notion of the “business case” for CSR. The chapter also examines the importance of the concept of CSR for the EU, examining the EU’s CSR requirements.

Chapter 3 builds on the general discussion of CSR, taking a closer look at labour issues in particular. The chapter examines the background to the use of labour codes in business, setting out the growth in the use of such codes and the reasons behind them. The various possible types of labour codes are analysed, looking at the different focuses of codes designed at company level as opposed to international codes and the reasons

behind that focus. The chapter finishes by examining the specific requirements of the most-commonly used labour codes in detail, giving an insight into the types of labour policies which might be used by utilities in procurement.

Chapter 4 sets out an overview of the UK utilities sector, examining the sectors regulated by the Utilities Directive. The chapter sets out the operation of utilities in each area, examining the regulation and amount of competition in each sector and providing a background to the procurement regulation.

Chapters 5 and 6 set out the doctrinal analysis of the EU procurement regime. Chapter 5 gives a general overview of the EU procurement regime, providing the background to Chapter 6, which examines the specific issue of the use of labour policies in procurement. The possible methods for including labour policies in procurement are analysed, based on the types of policy examined in Chapter 3. Chapter 6 then sets out the risk of challenge associated with each method and analyses the areas in which the law lacks clarity.

Chapter 7 concludes Part I of the thesis with a discussion of regulatory theory, focusing on compliance with and enforcement of regulation. The chapter first sets out the background to the theory with a discussion of the types of regulation available to regulatory bodies. The issue of indeterminacy in the law is covered, examining the problems which might be caused by the lack of clarity in the EU legal regime. The chapter then discusses compliance theories, looking at factors which might impact on procurement practitioners' decision over whether or not to comply with the law. Finally, the chapter examines theories on enforcement of regulation and evaluates the effectiveness of the EU regime in this area.

Part II of the thesis covers Chapters 8 and 9, excluding the conclusions chapter (Chapter 10). Chapter 8 provides a detailed explanation of the methodology and conduct of the empirical research in this project. Chapter 9 sets out the results of that research, detailing the practical impact of the EU legal regime on the use of labour policies in

procurement. The data analysis covers interviewees' views of both CSR and the EU legal regime generally, factors which impact on the use of labour policies in utilities procurement, the types of labour policy commonly used by interviewees, and the methods which interviewees used to structure labour policies in EU procurement.

## **Chapter 2 - Corporate Social Responsibility**

### **I. Introduction**

This chapter will examine the business concept of corporate social responsibility (CSR). The chapter aims to describe the concept of CSR and examine the reasons why the phenomenon may affect the business decisions of the utilities sector. In order to do so, a general overview of CSR will first be given in Section II, offering a definition of CSR and discussing the common qualities of CSR before looking at its development in the EU context in more detail. Section III will then examine some of the factors which have driven the development of CSR, focusing on the link between CSR and increased profitability. The chapter will conclude with an examination of some common criticisms of the concept of CSR in Section V.

### **II. Overview of Corporate Social Responsibility**

#### **II.1. Definition of Corporate Social Responsibility**

Companies have been considering their social responsibilities for as long as they have been operating. The Industrial Revolution created wide-spread urban migration and a subsequent loss of social cohesion.<sup>20</sup> In response many of the early industrialists took a paternal approach to their workers, taking measures ranging from simple corporate philanthropy to creating better living conditions for their workers, even setting up whole villages.<sup>21</sup> While some of these social capitalists may have been driven by moral or religious reasons, often self-interest was the main cause. The reformers wished to avoid revolt in their labour force and to avoid trade unions being established, along with hoping to attract new workers.<sup>22</sup> Equally, as today, they may have wished to protect their reputation and avoid negative media attention from activists.<sup>23</sup>

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<sup>20</sup> Van Tulder, R. and van der Zwart, A. *International Business-Society Management: Linking Corporate Responsibility and Globalisation*, (2006, London: Routledge), at p.133.

<sup>21</sup> *Ibid*, at p.134.

<sup>22</sup> *Ibid*, at p.134.

<sup>23</sup> Waddock, S. *The Difference Makers: How Social and Institutional Entrepreneurs Created the Corporate Responsibility Movement*, (2008, Sheffield: Greenleaf Publishing), at p.22.

CSR today goes beyond philanthropy to cover all social and environmental policies adopted by companies. The concept, however, appears to mean different things to different people. There is no generally accepted definition of CSR, with most companies and international organisations using their own definition of the concept, emphasising different aspects.<sup>24</sup> The term CSR itself is also not generally accepted, being used interchangeably with corporate responsibility, corporate accountability, corporate citizenship and sustainable business.<sup>25</sup> Businesses often also refer to their CSR policies as a "triple bottom line" approach, a term popularised by Elkington's book *Cannibals with Forks*.<sup>26</sup> This section aims to offer a description of the main elements of CSR by presenting and analysing the EU definition, which has the benefit of covering many of the most commonly included elements of CSR definitions and is also the definition most relevant to the impact of the concept on EU law, the focus of this thesis.

Within the EU, CSR is defined as:

A concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with stakeholders on a voluntary basis.<sup>27</sup>

The EU definition does not make it clear who the 'stakeholders' of a company are. Stakeholders may generally be said to be anyone with an interest in the business of the firm. Stakeholders may be either internal to the firm, such as employees or shareholders, or external, such as consumers or the local community in which the firm operates. A distinction is also sometimes made between primary stakeholders, the group "without whom the company cannot realise its objectives" covering employees, shareholders, investors, consumers and suppliers, and secondary stakeholders such as

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<sup>24</sup> For an overview of common definitions, see Blowfield, M. and Murray, A. *Corporate Responsibility: A Critical Introduction* (2008, Oxford: OUP), at p.13.

<sup>25</sup> For a detailed examination of various terms and definitions of CSR, see Hopkins, M. *Corporate Social Responsibility and International Development: Is Business the Solution?*, (2007, London: Earthscan), Ch. 2.

<sup>26</sup> Elkington, J. *Cannibals with Forks: The Triple Bottom Line of 21<sup>st</sup> Century Business*, (1999, Oxford: Capstone).

<sup>27</sup> European Commission, *Communication from the Commission concerning Corporate Social Responsibility: A business contribution to Sustainable Development COM(2002) 347*, ("Commission Communication concerning Corporate Social Responsibility"), at p.5.

trade unions and environmental or social activist groups.<sup>28</sup> One of the aspects of CSR which is often emphasised in definitions is the move away from focusing on the needs of shareholders alone to considering the needs of all the stakeholders of the company.

The first thing to note about the EU definition is that while it emphasises that CSR is concerned with environmental issues as well as purely social ones, it does not mention economic responsibility, (a company's responsibility to its shareholders to increase its profit), which is included in several other definitions. For example, economic, social and environmental issues together form Elkington's "triple bottom line" and Hopkins' definition states that the 'social' in corporate social responsibility "includes economic and environmental responsibility".<sup>29</sup> This raises the issue of the correct balance between CSR concerns and economic concerns. Definitions such as Elkington's and Hopkins' rank social and environmental concerns as equal to the usual economic concerns of businesses. The Commission Communication which sets out the EU CSR definition, on the other hand, notes that the main aim of business is generally "to create value", suggesting that economic issues will be dealt with in normal business with social and environmental issues being extras that an enterprise would not normally be concerned with.<sup>30</sup> Later in the Communication, however, the Commission states that businesses "need to integrate the economic, social and environmental impact in their operations" and makes it clear that "CSR is not an optional 'add-on' to business core activities".<sup>31</sup> It is thus somewhat unclear how the EU views the appropriate balance between economic concerns and other CSR issues. It is notable, however, that the EU does seem to place a lot of value in the argument that being socially responsible will itself lead to greater economic returns (see further below, Section III.1), suggesting perhaps that economic issues are key and CSR is relevant mostly for improving those issues.

It was noted above that the EU definition covers both social and environmental aspects of CSR. These categories were expanded on in the CSR Chapter of the 2008 European

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<sup>28</sup> Van Tulder and van der Zwart, above n.20, at pp.136-138.

<sup>29</sup> Hopkins, above n.25, at p.16.

<sup>30</sup> Commission Communication concerning Corporate Social Responsibility, above n.27, at p.5.

<sup>31</sup> *Ibid*, at p.5.

Competitiveness Report.<sup>32</sup> This report divides CSR into four main categories: workplace, marketplace, environment and community.<sup>33</sup> Workplace CSR relates to labour issues, looking at how the company (and, from the procurement perspective, the company's suppliers) treats its employees. Marketplace CSR covers more economic issues, relating to the way the company interacts with its customers, suppliers and competitors, looking at issues such as anti-corruption measures and fair advertising. Environmental CSR covers green issues, looking at matters such as carbon-reduction and energy efficiency. Finally, community CSR relates to how the company affects the communities it operates in, including human rights issues. As explained in Chapter 1, this thesis is concentrating on the area of workplace CSR, an area which has been researched less than other CSR issues but which is of increasing importance for utilities which are outsourcing more of their work to suppliers in developing countries in recent years, and may struggle to ensure their desired labour standards are met. A more detailed examination of the particular issues relating to workplace CSR will be set out in the following chapter, Chapter 3.

The next aspect of the EU CSR definition to consider is the reference to CSR being completed on a "voluntary basis". This is one of the more controversial aspects of any definition of CSR. Many non-governmental organisations (NGOs) argue that voluntary initiatives are not enough to make companies responsible and regulation is also necessary for CSR to be effective. The most obvious possible problem with making CSR voluntary is that companies may choose not to undertake CSR at all. McBarnet notes that while the practice is common amongst large multinational companies, CSR is much more rarely used by small and medium sized companies, limiting its power.<sup>34</sup> It has also been argued that relying on voluntary measures alone will let companies set the standards for CSR rather than the stakeholders CSR should be benefiting, giving

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<sup>32</sup> 'Overview of the Links between Corporate Social Responsibility and Competitiveness', Ch. 5 in European Competitiveness Report 2008, available at [http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr/documents/csrreportv002\\_en.pdf](http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr/documents/csrreportv002_en.pdf) [accessed 19/06/11] ("Competitiveness Report")

<sup>33</sup>*Ibid*, p. 107.

<sup>34</sup> McBarnet, D. 'Corporate social responsibility beyond law, through law, for law: the new corporate accountability', Ch. 1 in McBarnet, D, Voiculescu, A. and Campbell, T. (eds) *The New Corporate Accountability: Corporate Social Responsibility and the Law*, (2007, Cambridge, CUP), at p.26

companies too much power to determine the issues.<sup>35</sup> There are also issues with monitoring and enforcing voluntary CSR policies, with CSR policies sometimes seeming to be simple PR, with no real consequences.

Companies argue in response to this that it is important for CSR policies to remain voluntary, claiming regulation in this area would stifle innovation and would be hard to formulate to cover all situations and all types and sizes of corporation.<sup>36</sup> Generally speaking, the companies' view has won out and CSR is still taken to be voluntary. Importantly for this thesis, the EU Multi-stakeholder Forum, examining this issue in the EU definition, made it clear that, for the EU, CSR is about policies which are not legally or contractually required of the company; "CSR is about going beyond these, not replacing or avoiding them".<sup>37</sup> This research will thus focus on the inclusion of voluntary CSR issues in procurement. It should be noted, however, that one of the most common policies included in CSR codes is compliance with legal requirements relating to social and environmental standards (see further Chapter 3), blurring the line between the law and CSR. These legal compliance standards will also be considered by this thesis.

## II.2. Corporate Social Responsibility in the EU

The EU has been considering the role of business from as early as 1993, when the President of the European Commission Jacques Delors appealed to European businesses to combat social exclusion.<sup>38</sup> In response to this appeal the European Business Declaration against Social Exclusion was signed in 1995 and a business network was formed from its signatories in 1996, originally called the European Business Network for Social Cohesion but renamed CSR Europe in 2000.<sup>39</sup> CSR Europe's membership now covers 70 multinational corporations and the network is linked with 25 national CSR organisations.

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<sup>35</sup> Murray, A. *Corporate Social Responsibility in the EU*, (2003, London: Centre for European Reform), at p.9.

<sup>36</sup> Commission Communication concerning Corporate Social Responsibility, above n.27, at p.4.

<sup>37</sup> European Multi-stakeholder Forum on CSR, Final Report, 29 June 2004, available at

[http://ec.europa.eu/enterprise/csr/forum\\_2002\\_04\\_documents.htm](http://ec.europa.eu/enterprise/csr/forum_2002_04_documents.htm) [accessed 21/10/08], at p.3.

<sup>38</sup> Murray, above n.35, at p.25.

<sup>39</sup> Source: <http://www.csreurope.org/pages/en/history.html> [accessed 20/10/08].

CSR has increased in importance for the EU since 2000, when it was made a specific EU policy commitment at the Lisbon summit.<sup>40</sup> In 2001, the Commission published a Green Paper on CSR, designed to open a debate on the possible ways the EU could promote CSR.<sup>41</sup> The Commission felt that a European approach would complement other existing CSR activities by providing an "overall European framework", which would improve the standard and coherence of existing CSR practices, and by supporting "best-practice approaches to cost-effective evaluation and independent verification" of CSR approaches.<sup>42</sup>

This Green Paper was followed by the Commission Communication regarding Corporate Social Responsibility in 2002.<sup>43</sup> Here it was argued that there were two main reasons for Community action in this field. The first was the possibility that CSR could be useful in furthering Community policies, especially the goal set in Lisbon to be "the most competitive and dynamic knowledge-based economy in the world" by 2010.<sup>44</sup> The second was the need for Community action to create a common standard, given the wide range of existing CSR instruments.<sup>45</sup> The Commission stated in this Communication that the European Union was committed to integrate CSR in all its policies, an indication of the importance attached to CSR in the EU.<sup>46</sup>

This Communication also established the EU Multi-stakeholder Forum on CSR. This Forum delivered its final report in 2004, reaffirming the possible benefits of CSR in Europe and also identifying possible obstacles and future initiatives. The Forum recommended that the EU raise awareness of CSR and help improve the capacity of business to mainstream CSR policies in their everyday business.<sup>47</sup> The Forum also emphasised that the right environment was key to the success of CSR and recommended that the "EU institutions and governments step up their efforts towards a more co-

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<sup>40</sup> Murray, above n.12, at p.25.

<sup>41</sup> Commission of the European Communities, *Promoting a European Framework for Corporate Social Responsibility*, COM(2001) 366.

<sup>42</sup> *Ibid*, at p.6.

<sup>43</sup> Above n.27.

<sup>44</sup> *Ibid*, at p.3.

<sup>45</sup> *Ibid*, at p.8.

<sup>46</sup> *Ibid*, at p.18.

<sup>47</sup> EU Multi-stakeholder Forum, above n.37, at pp.12-14.

ordinated policy approach" and also emphasised the need for transparency in CSR practices.<sup>48</sup>

The most recent EU policy document on CSR is the Commission Communication of 2006.<sup>49</sup> In this Communication, the Commission:

calls on the European business community to publicly demonstrate its commitment to sustainable development, economic growth and more and better jobs, and to step up its commitment to CSR, including cooperation with other stakeholders.<sup>50</sup>

The Commission argues that the uptake and integration of CSR policies in EU businesses should be enhanced, and the role of both internal stakeholders such as employees and trade unions, and external stakeholders such as NGOs should be stronger. Equally, it argues that public authorities should also improve their supporting policies.<sup>51</sup>

The Commission also states that it accepts that voluntary measures are the most effective way of promoting CSR and that the best way for the EU to encourage CSR is thus to work with business. To accomplish this, the Communication establishes a European Alliance on CSR, in addition to re-convening the Multi-stakeholder Forum.<sup>52</sup> The Alliance is coordinated by three business organisations; CSR Europe, BusinessEurope and UEAPME (European Association of Craft, Small and Medium-Sized Enterprises). It works primarily as a business network which helps businesses exchange CSR knowledge, but there are also high-level meetings around once a year with the Commission, where the Alliance and the Commission discuss how CSR policies could be better integrated in EU policy.<sup>53</sup>

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<sup>48</sup> *Ibid*, at p.15.

<sup>49</sup> European Commission, *Implementing the Partnership for Growth and Jobs: Making Europe a Pole of Excellence on Corporate Social Responsibility*, COM(2006) 136 ("Commission Communication on Growth and Jobs").

<sup>50</sup> *Ibid*, at p.2.

<sup>51</sup> *Ibid*, at p.5.

<sup>52</sup> *Ibid*, at p.3.

<sup>53</sup> Source: [http://www.csreurope.org/pages/en/european\\_dialogue.html](http://www.csreurope.org/pages/en/european_dialogue.html) [accessed 28/07/11].

Murray states that some business groups and European governments were concerned by the EU's commitment to develop an EU wide approach to CSR, arguing that a separate EU approach was not necessary in addition to national policies, and fearing that it was simply an attempt by the Commission to re-introduce failed social legislation.<sup>54</sup> The Commission seems to have dismissed the second concern through its commitment to a voluntary business-led approach. As for the first, Murray argues that an EU level approach will benefit CSR, noting that the EU provides a "natural arena" for Member States to share their CSR experiences. Also, the EU already has power to make laws in many areas which CSR might cover while EU laws may themselves make it hard for Member States to adopt national law in CSR areas.<sup>55</sup> A European approach is intended to complement existing policies, not to replace them.

### **III. What Drives the Development of CSR?**

Vogel states three main factors which drive the development of the CSR movement: (1) investors; (2) consumers; and (3) employees.<sup>56</sup> Other secondary drivers may include public authorities, NGOs, trade unions and other businesses.<sup>57</sup> These factors are also linked to the so-called "business case" for CSR, which links social responsibility to profit. All these drivers may have more influence on companies which operate in "high-risk" areas, such as the oil/gas and energy industries. Equally, more focus will usually be on the market leaders in each sector. This section will first give an overview of the business case for CSR in Section III.1, as this general factor is affected by all the other driving factors discussed. The following sections will then examine the individual factors driving the development of CSR and forming part of the business case in more detail.

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<sup>54</sup> Murray, above n.35, at p.25.

<sup>55</sup> *Ibid*, at pp.26-27.

<sup>56</sup> Vogel, D. *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (2005, Washington DC: Brookings Institution Press), at p.46. See also Van Tulder and van der Zwart, above n.20 pp.207-213.

<sup>57</sup> EU Multi-stakeholder Forum, above n.37, at p.9.

### III.1. The business case for CSR

The early reformers did not suggest that their actions would make their company more profitable. Their donations and social work helped the general community rather than the firm, who received only indirect benefits such as a stable social environment in which to do business.<sup>58</sup> Today, however, most advocates of CSR stress the “business case” of social responsibility, arguing that CSR directly improves a company’s profitability.<sup>59</sup> In the words of the European Commission:

There is a growing perception that sustainable business success and shareholder value cannot be achieved solely through maximising short-term profits but instead through market-oriented yet responsible behaviour.<sup>60</sup>

Vogel offers two reasons for this recent focus on the link between CSR and profits. The first is the nature of the modern firm: increased competition, the power of institutional investors and the financial markets and the risk of takeover mean that directors must now be much more focused on short-term rewards for their shareholders than they used to. While this has not stopped companies including social and environmental policies in their business, it has required them to show a financial basis for those policies.<sup>61</sup>

The second reason is a change in the way people viewed the social role of business. In the 1980s and 1990s the number of people going into business grew, and many of these people had social values which they wished to include in their business.<sup>62</sup> They instilled their ethical views on the business world, and the business case for CSR allowed them to make money while doing so. Such social entrepreneurs have left a lasting impression on the business world.<sup>63</sup>

CSR policies most obviously have an impact on profitability if those policies are overt. If consumers and campaign groups are aware of the firm’s CSR actions, it may boost the

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<sup>58</sup> Vogel, above n.56, at p.19.

<sup>59</sup> For examples of literature citing this link between CSR and profit, see Vogel, above n.56, at p.20.

<sup>60</sup> Commission Communication concerning Corporate Social Responsibility, above n.27, at p.5.

<sup>61</sup> Vogel, above n.56, at pp.24-26.

<sup>62</sup> *Ibid*, at pp.26-28.

<sup>63</sup> See Waddock, above n.23, for an in-depth examination of the effect of such social reformers.

firm's reputation and help public relations. Cause-related marketing works on this basis, making the social aspects of the firm and its products a key aspect of the marketing and advertising programme of the firm. Cause-related marketing has grown significantly in recent years, from \$125 million in 1990 to \$991 million in 2004 and is discussed further below in Section III.3.<sup>64</sup>

The argument is also made, however, that CSR may make a company more profitable even if the CSR policies are not made public. In the 2001 Green Paper on CSR, the European Commission gave examples of several direct and indirect benefits of CSR such as a more productive workforce and savings made from "more efficient use of natural resources".<sup>65</sup> It has also been argued that CSR not only aids profitability, it is now required for a company to be profitable. One example is given in an article by Lovins, Lovins and Hawken, who state that companies who make no effort towards sustainability "won't be a problem because ultimately they won't be around".<sup>66</sup> The sections below on the various factors which drive CSR will examine their possible links to the success of the company in more detail.

This relationship between CSR and profits has been examined in many academic studies and the results are often contradictory.<sup>67</sup> Orlitzky, Schmidt and Rynes conducted a meta-analysis of the previous literature and concluded that the overall relationship was positive, with increased CSR leading to increased profitability.<sup>68</sup> Margolis and Walsh also found a general positive relationship reported in the literature, but argued that the results were unsatisfactory due to the different measurements for CSR and profitability used in the various studies.<sup>69</sup> A recent study by Margolis and Anger Elfenbein examining 167 previous studies concluded that there was a small correlation between positive

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<sup>64</sup> Vogel, above n.56, at p.21.

<sup>65</sup> European Commission, Green Paper, above n.41, at p.7.

<sup>66</sup> Lovins, A.B., Lovins, L.H. and Hawken, P. 'A Road Map for Natural Capitalism' (May-June 1999) *Harvard Business Review* 145 at 158.

<sup>67</sup> See Margolis, J.D. and Walsh, J.P., *People and Profits? The Search for a Link Between a Company's Social and Financial Performance*, (2001, Mahwah, NJ: Lawrence Erlbaum Associates) for the most comprehensive review of these studies.

<sup>68</sup> Orlitzky, M., Schmidt, F. and Rynes, S. 'Corporate Social and Financial Performance: A Meta-Analysis' (2003) 24 *Organisation Studies* 403, at 415.

<sup>69</sup> Margolis and Walsh, above n.67, at p.13.

corporate behaviour and increased profits, which they noted could equally be explained by the fact that more profitable firms are simply more able to engage in CSR.<sup>70</sup> Margolis and Anger Elfenbein also note that CSR policies, while not increasing profits, also do not appear to increase costs, suggesting that CSR is effectively neutral.<sup>71</sup> Vogel, however, argues that while it may be true that CSR will not cost a firm, "some more responsible firms might be even more profitable if they were less responsible".<sup>72</sup>

The EU has generally seemed to support the concept of the business case for CSR, as seen by the argument in the Commission's 2002 Communication that there is a "broad consensus among businesses about the expectation that CSR will be of strategic importance to ensure the long-term business success".<sup>73</sup> In recent years it has researched into the concept more deeply, examining the criticisms of the concept set out above. The CSR chapter of the 2008 European Competitiveness Report examined the impact of CSR on six indicators of competitiveness: cost structure, human resource performance, customer perspective, innovation, risk and reputation management, and financial performance.<sup>74</sup> The report concluded that CSR impacted positively on all areas, having the most impact in the areas of human resource performance, risk and reputation management and innovation. It also noted that, while the strength of the business case depended very much on the competitive positioning of the company, CSR was fast becoming a competitive necessity, with companies which did not meet certain minimum standards falling behind competitively.<sup>75</sup> Overall, it was argued that CSR did indeed positively impact on competitiveness and should be promoted at EU level for that reason.<sup>76</sup> This focus by the EU on the economic benefits of CSR may impact on the interpretation of the law relating to CSR, as will be seen in Chapter 6.

### III.2. Investors

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<sup>70</sup> Margolis, J.D. and Anger Elfenbein, H. 'Do Well by Doing Good? Don't Count on It' ( Jan 2008) *Harvard Business Review* 19, at 19.

<sup>71</sup> *Ibid*, at 20.

<sup>72</sup> Vogel, above n.56, at p.33.

<sup>73</sup> Commission Communication concerning Corporate Social Responsibility, above n.27, at p.9.

<sup>74</sup> Competitiveness Report, above n.32, at p.107.

<sup>75</sup> *Ibid*, at p.118-119.

<sup>76</sup> *Ibid*, at p.119.

Socially responsible investment (SRI) has been defined by the European Social Investment Forum (Eurosif) as:

a generic term covering any type of investment process that combines investors' financial objectives with their concerns about Environmental, Social and Governance (ESG) issues.<sup>77</sup>

It has seen a growth in popularity in recent years. According to Eurosif, the total SRI assets managed in Europe was €5 trillion as of 1<sup>st</sup> December 2009, of which €1.2 trillion was "core" SRI (screening using more than two negative criteria, e.g. screening for tobacco or defence companies, and also using positive criteria), and €3.8 trillion was "broad" SRI (fewer than two negative criteria used).<sup>78</sup> To aid such investment several social indexes have been created. The best-known are the FTSE4Good, the Dow Jones Sustainability Index (DJSI), and the Domini 400 Social Index (DSI400). With such a massive amount of funds at stake, companies wish to become more socially responsible in order to be listed on social indexes and qualify for investment under SRI.

Vogel critically examines the effect of social investing on the overall market. He notes that the demand of SRI investors for responsible shares cannot lower the overall cost of capital for responsible firms given the small market share of SRI and the varying criteria used.<sup>79</sup> However, the prestige of some SRI indexes means that some firms are willing to change their SRI policies in order to join, so social investing may lead to some change in individual firms.<sup>80</sup>

### III.3. Consumers

Consumers often state they prefer socially and environmentally sound products, and would even be willing to pay more for them, suggesting that becoming more socially

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<sup>77</sup> Eurosif, *European SRI Study 2010*, available at <http://www.eurosif.org/research/eurosif-sri-study/2010> [accessed 28/07/11], at p.8.

<sup>78</sup> *Ibid*, at p.11.

<sup>79</sup> Vogel, above n.56, at p.62.

<sup>80</sup> *Ibid*, at p.64.

responsible could be a good move to increase sales.<sup>81</sup> Nevertheless, as Hawkins notes, while consumers may indeed want companies to be responsible, they also want good quality goods for the best possible value, and it is these factors which have the most actual impact on sales.<sup>82</sup> Vogel presents several statistical studies in this area and the gap between what consumers tell researchers they would be willing to do and what they *actually* do is striking: while some studies have reported that up to 75% of people would be willing to pay more for a responsible product, the number of people who actually do so appears to be somewhere between 3 and 5%.<sup>83</sup>

A lack of awareness among consumers about companies' CSR policies may lie behind this discrepancy. Firms which directly link their CSR policies to their products in their marketing, such as the Body Shop or Ben and Jerry's, may have more success in attracting sales from consumers who wish to buy ethical products because that ethical aspect to their products is the integral part of their brand which distinguishes them from other companies in the field.<sup>84</sup> Equally, a well-known social label such as Fairtrade or Rugmark may be able to attract a price-premium to products they are attached to since people know precisely what the label means. For those firms, however, which do not make their CSR policies clear explicitly to the public in their marketing, those policies are unlikely to affect their sales.<sup>85</sup>

Consumers' values, however, may have an effect not only by boosting sales, but also by causing them to fall. Negative actions such as a consumer boycott may cause a company to change its CSR policies. The classic examples of a consumer boycott affecting company policy are the Nike labour standards case and the Shell Brent Spar case.<sup>86</sup> Following harsh criticism of the working conditions of Nike's suppliers by several NGOs in the late 1990s and a Global Alliance report on working conditions in Indonesia in 2001

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<sup>81</sup> *Ibid*, at p.47.

<sup>82</sup> Hawkins, D. *Corporate Social Responsibility: Balancing Tomorrow's Sustainability and Today's Profitability*, (2006, Houndsills: Palgrave Macmillan), at p.147.

<sup>83</sup> Vogel, above n.56, at pp.47-48.

<sup>84</sup> *Ibid*, at p.50.

<sup>85</sup> *Ibid*, at p.49.

<sup>86</sup> Extended examinations of both cases can be found in Vogel, above n.56, at Ch.4 and Ch.5, and in van Tulder and van der Zwart, above n.20, at Ch.14 and Ch.15.

many consumers boycotted the firm, leading to a decrease in sales, especially in the United States.<sup>87</sup> In response, Nike created a code of conduct which is monitored by both Nike and outside consulting firms, and cancels contracts with suppliers which do not comply with that code.<sup>88</sup> Equally, a boycott of Shell petrol stations after the announcement of its intention to sink the Brent Spar oil rig in 1995 was instrumental in the company's ultimate decision to dispose of the rig on land.<sup>89</sup> Vogel argues, however, that these cases are exceptional. Most boycotts have little, if any, effect on sales and what impact they do have does not last long.<sup>90</sup>

#### III.4. Employees

Employees may affect a company's CSR policies either through the operation of the labour market, or through pressure on the company while working there. The reputation of a company may be a factor in attracting new employees, with many business graduates saying they would prefer to work for a socially and environmentally sound firm.<sup>91</sup> However, no follow-up studies appear to be done, making it impossible to tell whether the graduates stuck to these values, or whether these findings are as suspect as the consumer surveys mentioned above.<sup>92</sup> Employees may have more effect on a company through internal pressure while working for that firm. Employees worried by the social and environmental actions of their company may bring it to the attention of their superiors, or even to NGOs, and external actions against the company may affect company morale and so drive employees to take action.<sup>93</sup>

#### III.5 Secondary drivers

Public authorities may drive the development of CSR by promoting its use at the government level. For example, in the UK the Department for Business, Innovation and

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<sup>87</sup> Van Tulder and van der Zwart, above n.20, at p.284.

<sup>88</sup> Vogel, above n.56, at p.80.

<sup>89</sup> Van Tulder and van der Zwart, above n.20, at p.297.

<sup>90</sup> Vogel, above n.56, at p.52.

<sup>91</sup> Van Tulder and van der Zwart, above n.20, at p.213.

<sup>92</sup> Vogel, above n.56, at p.58.

<sup>93</sup> *Ibid*, at p.59.

Skills works to raise the awareness of CSR issues among businesses.<sup>94</sup> Equally, public authorities may promote CSR through their own purchasing habits, choosing to buy only socially and environmentally sound products, and it is this aspect of CSR that this thesis will focus on. In addition to this role of "example-setting", it was argued at a conference on CSR held jointly by the Organisation for Economic Co-operation and Development (OECD) and the International Labour Organisation (ILO) that public authorities should also promote CSR through embracing the notion of transparency and through constant dialogue with business, supported by appropriate social legislation.<sup>95</sup>

NGOs are often strong supporters of CSR and their campaigns against companies which they consider to be performing badly in this area can often lead to changes in company policy, especially where their action leads to consumer boycotts (see the section on consumers above). Certain NGOs are dedicated to monitoring and exposing companies' social and environmental failings, see, for example, CorpWatch.<sup>96</sup> This bad publicity is often a factor in a company's decision to become more socially responsible.

Business networks may also help to develop CSR by sharing good practice and raising awareness of the demands and benefits of CSR. One of the major CSR business networks in the UK is the Corporate Responsibility Group, which offers a means for CSR experts from various different sectors to exchange information.<sup>97</sup>

These secondary drivers are not linked as strongly to increasing profit as the primary drivers, seeming to be based more on the idea that CSR is the "right" thing for business to do. This research will examine the main factors which utilities feel drive their use of CSR in procurement, determining whether it is these moral concerns or the more commercial concerns examined above which are the more relevant. As will be shown in discussed in Chapter 6, this may be relevant for the interpretation of the EU law

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<sup>94</sup> HM Government, *Corporate Responsibility Report* (2009), available at <http://www.bis.gov.uk/files/file50312.pdf> [accessed 14/06/11]

<sup>95</sup> OECD, *Employment and Industrial Relations: Promoting Responsible Business Conduct in a Globalising Economy*, 23-24 June 2008, available at <http://www.oecd.org/dataoecd/56/11/41484109.pdf> [accessed 28/07/11]

<sup>96</sup> [www.corpwatch.org](http://www.corpwatch.org)

<sup>97</sup> [www.crguk.org](http://www.crguk.org)

governing procurement, with commercial concerns seeming to be emphasised by the European Commission and possibly more acceptable in procurement than policies undertaken for purely moral reasons.

#### **IV. Criticisms of CSR**

CSR has been criticised both by people who think it is too liberal and distracts business from its true purpose of making money, and by groups which believe it does not go far enough to protect social and environmental issues. Both arguments will be considered.

The classic statement criticising CSR comes from Milton Friedman's 1970 article, where he states that "there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits".<sup>98</sup> The argument is that companies which include CSR policies in their business lose sight of their true aim, making a profit, which in turn damages the corporate sector and the overall economy.<sup>99</sup>

This argument was also made more recently by Martin Wolf, drawing on work by David Henderson.<sup>100</sup> Wolf argues that CSR is "not merely undesirable but potentially quite dangerous". He claims that the concept is based on a mistaken view of both the market economy and the powers of companies, arguing that it is through seeking new opportunities for profit that business aids social development, and that globalisation and increased competition has in fact reduced corporate power rather than increasing it as CSR supporters claim. He also argues that CSR risks increasing regulation throughout the world, requires corporations to make political decisions and creates a form of "global neo-corporatism" which gives too much power to companies, activist groups and international organisations.

It is the possibility of giving too much power to companies which also concerns those who believe that CSR is not enough to protect social and environmental issues. As

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<sup>98</sup> Friedman, M. 'The social responsibility of business is to increase its profits', *New York Times Magazine*, September 13<sup>th</sup> 1970.

<sup>99</sup> Murray, above n.35, at p.11.

<sup>100</sup> Wolf, M. 'Sleep-walking with the enemy: Corporate social responsibility distorts the market by deflecting business from its primary role of profit generation', *Financial Times*, May 16<sup>th</sup> 2001; Henderson, D. *Misguided Virtue: False Notions of Corporate Social Responsibility*, (2001, London: Institute of Economic Affairs).

mentioned above when examining the definition of CSR in Section II.1, the fear is that a purely voluntary approach to CSR will allow business to simply focus on the social and environmental issues which it feels are important, not those that other stakeholders wish to address. It has been argued that without government regulation to support CSR, it may be nothing more than a public relations exercise for companies.<sup>101</sup>

## **V. Conclusion**

This chapter has shown the importance of CSR both globally and specifically in the EU. From its beginnings as simple corporate philanthropy, CSR has grown to become a global business phenomenon, driven by a wide variety of interest groups, especially investors, consumers and employees, and recently also driven by the supposed link between CSR and profit. The EU has seen in CSR a useful way to help achieve its social and environmental aims and has pushed for CSR to be included throughout its policies in recent years. This recent pressure from so many sources has led to many companies paying more attention to their social and environmental responsibilities than in the past. The chapter has also shown the factors most commonly cited as the driving force behind the growth of CSR, focusing on the business case for CSR which sets out the economic benefits of CSR and appears to have been accepted by the EU. The chapter has also discussed common criticisms of CSR and the problems which might face companies which choose to include CSR policies in their business practice. The following chapter will use this discussion of CSR as a base, building on it to look at the specific issues relating to workforce CSR and setting out the precise workforce CSR policies utilities might include in their procurement.

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<sup>101</sup> Murray, above n.35, at p.12.

## **Chapter 3 - Corporate Social Responsibility: Labour Policies**

### **I. Introduction**

This chapter gives an overview of commonly used corporate labour policies. The term “labour policies” is here used to cover any voluntary labour-related policy, including corporate codes of conduct, certification standards and product labelling schemes. Given that this thesis is looking at voluntary corporate social responsibility policies,<sup>102</sup> the chapter does not include legal requirements, except where those voluntary policies themselves make reference to legal requirements.

The chapter will first look at the background to and development of labour policies, including the various forms those policies can take. The chapter will then examine some of the most commonly used policies, examining their development, their requirements and how they are monitored, if at all. The analysis will start with an overview of internal company policies before considering the major externally designed policies in more detail. The analysis will then be applied in Chapter 6, which will examine how these specific policies might be included in procurement under the Utilities Directive.

### **II. Background to Corporate Labour Policies**

#### II.1. General Background

As with corporate social responsibility (CSR) more generally, the use of labour policies has increased dramatically since the 1970s.<sup>103</sup> The rise of voluntary labour codes is generally seen as a response to globalisation. Many corporations take advantage of the lower prices offered by foreign suppliers, with these low prices often due to poor employment conditions at the relevant factory. This leads to a situation in which suppliers compete to offer ever lower prices, worsening the labour conditions in the so-called “race to the bottom”. This situation can be difficult to legislate for since the goods may be manufactured in many different countries, meaning that employers are not

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<sup>102</sup> See Chapter 2, Section II.1.

<sup>103</sup> For discussion of the rise of CSR generally, see Chapter 2, Section II.1.

bound to the labour conditions of any one jurisdiction.<sup>104</sup> As Bercusson and Estlund note, this both undermines the use of national labour standards and weakens the control of governments over market activity.<sup>105</sup> Given these problems in regulating labour standards, and given the general pressures on companies to be socially responsible as discussed in Chapter 2 on Corporate Social Responsibility, many companies choose to adopt codes of conduct to self-regulate their labour conditions and the labour conditions of their suppliers.

Labour policies may be formulated and monitored purely internally, with the relevant company responsible for all aspects of that particular policy, or the policy may have external aspects, with design and/or monitoring done by an external organisation. Closely related to simple company policies, a policy may be adopted with other companies based in the same industry. Policies known as International Framework Agreements may also be adopted by companies or industry with a Global Union Federation as a signatory. Finally, a company may adopt a policy designed solely by an external body, usually a Non-Governmental Organisation (NGO) such as the International Labour Organisation (ILO).

Labour policies may take a variety of forms. Liubicic lists two main types of voluntary social measures: codes of conduct and product labelling measures.<sup>106</sup> Codes of conduct set out a certain level of labour standards which the company agrees to uphold in its business. Often the company also agrees to ensure that the standard is upheld in the business of its suppliers. Product labelling schemes affix a certain label (the most well-known, for example, being the Fairtrade label) to a product to show that the workforce producing that product operated under certain minimum labour standards.<sup>107</sup> To these policies we may also add certification policies, which operate in a similar way to product

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<sup>104</sup> Bercusson, B. and Estlund, C. 'Regulating Labour in the Wake of Globalisation', in Bercusson, B and Estlund, C. (eds) *Regulating Labour in the Wake of Globalisation: New Challenges, New Institutions* (2007, Oxford: Hart Publishing), at p.2.

<sup>105</sup> *Ibid*, at p.2.

<sup>106</sup> Liubicic, R.J. 'Corporate Codes of Conduct and Product Labeling Schemes: The Limits and Possibilities of Promoting International Labor Rights Through Private Initiatives' (1999) 30 *Law and Policy in International Business* 111, at 113.

<sup>107</sup> *Ibid*, at 113.

labelling schemes. In this case, however, rather than the product produced being awarded a level, the supplier making that product receives a certificate to show that all products are produced by them under certain specified minimum labour conditions.

## II.2 The ILO Declaration on Fundamental Principles and Rights at Work 1998<sup>108</sup>

Many of the labour schemes discussed below refer to or draw requirements from the ILO's 1998 Declaration on Fundamental Principles and Rights at Work. The Declaration commits member countries to uphold the principles of certain "core" conventions in the areas of recognition of the right to collective bargaining, the elimination of forced or compulsory labour, the abolition of child labour and the elimination of discrimination.

The core ILO Conventions are:<sup>109</sup>

- Convention (No. 29) concerning Forced or Compulsory Labour
- Convention (No. 87) concerning Freedom of Association and Protection of the Right to Organise
- Convention (No. 98) concerning the Application of the Principles of the Right to Organise and to Bargain Collectively
- Convention (No. 100) concerning Equal Remuneration for Men and Women Workers for Work of Equal Value
- Convention (No. 105) concerning the Abolition of Forced Labour
- Convention (No. 111) concerning Discrimination in Respect of Employment and Occupation
- Convention (No. 138) concerning Minimum Age for Admission to Employment
- Convention (No. 182) concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour

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<sup>108</sup> Full text of the Declaration may be found on the ILO website at

<http://www.ilo.org/declaration/thedeclaration/textdeclaration/lang--en/index.htm> [accessed 04/07/11].

<sup>109</sup> ILO, *The International Labour Organisation's Fundamental Conventions*, (2<sup>nd</sup> Ed), (2003), available at

[http://www.ilo.org/wcmsp5/groups/public/---ed\\_norm/---declaration/documents/publication/wcms\\_095895.pdf](http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---declaration/documents/publication/wcms_095895.pdf) [accessed 04/07/11].

Countries are bound whether or not they have ratified the relevant conventions. Any country which has not ratified a convention is required to produce an annual report setting out the national laws in this area.<sup>110</sup> This report is then reviewed by the Committee of Independent Expert Advisors and the ILO's Governing Body.

### **III. Internal Policies**

This section will briefly examine codes of conduct designed by individual companies and codes designed by groups of businesses from within an industry. It has been argued that these codes are much less likely to reflect the real concerns of workers and to change working conditions in practice than codes developed by external organisations.<sup>111</sup> The content of these codes can vary significantly from one code to another given the diversity of the corporations designing them and their varying needs, but this section aims to offer an overview of the most commonly included aspects.

The most comprehensive review of corporate codes was completed by the Organisation for Economic Co-operation and Development (OECD) in 2001. This examined 246 total codes, including 118 company codes and 92 codes issued by industry associations.<sup>112</sup> The review noted that "fair employment and labour rights" was a common subject in corporate codes, with over half of the codes including at least a reference to employment issues.<sup>113</sup> Within those codes dealing with labour issues, the most common requirement was simply to provide a "reasonable" working environment, included in 75.7% of codes. The next most common requirement is compliance with national law.<sup>114</sup> These are very minimal requirements for a company to meet. Even for those requirements mentioned expressly there was a high degree of variation in the way in which the codes dealt with those requirements, e.g. in the minimum age set for child labour to be acceptable and the methods for dealing with the employment of underage children.

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<sup>110</sup> Follow-Up to the Declaration 1998, II.B.

<sup>111</sup> Kolk, A., van Tulder, R. and Welters, C. 'International Codes of Conduct and Corporate Social Responsibility: Can Transnational Corporations Regulate Themselves?' (1999) 8(1) *Transnational Corporations* 143.

<sup>112</sup> OECD, *Codes of Corporate Conduct: Expanded Review of their Contents* (2001), available at <http://www.oecd.org/dataoecd/57/24/1922656.pdf> [accessed 04/07/11], at p.4.

<sup>113</sup> *Ibid*, at p.9.

<sup>114</sup> *Ibid*, at p.10.

In a study relating corporate codes of conduct to the core labour rights under the 1998 ILO Declaration, Jenkins noted the varying concerns of company codes compared to codes developed by international organisations. The most common requirement in international codes is the freedom of association, mentioned in 95% of the international codes examined by Jenkins. In comparison, it is the least frequently mentioned requirement in company and industry codes, mentioned in less than a quarter of cases.<sup>115</sup> Jenkins also noted that corporate codes generally go into much less detail about precise requirements when compared to external policies. For example, only 11% of company codes and no industry codes set maximum working hours, as compared to 42% of international codes.<sup>116</sup> These facts may be due to the fact that many corporate codes are created as a response to campaigns against the company by NGOs and are designed to deal only with the particular problem highlighted in that campaign.<sup>117</sup>

#### **IV. International Framework Agreements**

An International Framework Agreement (IFA) is a code of conduct agreed between a company and a trade union. As of 2011, 72 IFAs had been signed.<sup>118</sup> Generally, an IFA should fulfil six criteria:<sup>119</sup>

1. It should be a global agreement.
2. It should refer to ILO Conventions in the agreement.
3. It must require the company to influence its suppliers to also comply with the agreement.
4. A Global Union Federation must be a signatory to the agreement.
5. There should be trade union involvement in the implementation of the agreement.

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<sup>115</sup> Jenkins, R. 'The Political Economy of Codes of Conduct', Ch. 2 in Jenkins, R., Pearson, R. and Seyfang, G. (eds), *Corporate Responsibility and Labour Rights: Codes of Conduct in the Global Economy*, (2002, London: Earthscan), at p.19.

<sup>116</sup> *Ibid*, at p.20.

<sup>117</sup> OECD, above n.112, at p.9.

<sup>118</sup> A full list may be obtained at <http://www.imfmetal.org/main/index.cfm?n=47&l=2&c=10266> [accessed 04/07/11].

<sup>119</sup> Hammer, N. 'International Framework Agreements: global industrial relations between rights and bargaining' (2005) 11(4) *Transfer* 511, at 518.

6. Workers and other parties must be able to bring complaints to the company relating to the implementation of the agreement.

Hammer notes that IFAs are useful for protecting core labour rights given their reference to the core ILO conventions.<sup>120</sup> However, he also notes that when the agreements move on to other employment rights such as wages or hours of work, "their phrasing tends to be more opaque" and often refers only to compliance with national legal and industry standards.<sup>121</sup> They generally also declare compliance with the UN Universal Declaration of Human Rights and the codes of conduct developed by the ILO, OECD and United Nations discussed in the next section. There is no consensus on health and safety, training or restructuring issues, with the standards set varying by company. As Hammer notes, IFA seem to focus more heavily on trade union rights than other employment issues, perhaps inevitably given their design by Global Union Federations.<sup>122</sup>

## **V. External Policies**

### V.1. Codes of Conduct

Several international bodies have created voluntary codes of conduct for multinational companies, aiming to minimise the possible effects of globalisation on social issues. This section will examine the largest of those codes, the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, the UN Global Compact, the OECD Guidelines for Multinational Enterprises and the Ethical Trading Institute's Base Code. Outside of codes designed by international bodies, it will also examine the scheme operated by the World Fair Trade Organisation.

#### *V.1.1. ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy*

The ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy ("the Declaration") was first established in 1977 and was revised in 2000

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<sup>120</sup> *Ibid*, at 520.

<sup>121</sup> *Ibid*.

<sup>122</sup> *Ibid*, at 522.

and 2006. The Declaration is an agreement between governments, employers' organisations and workers' organisations which aims to "encourage the positive contribution that multinational enterprises can make to economic and social progress and resolve the difficulties to which their various operations may give rise".<sup>123</sup> To fulfil this aim it sets out certain labour principles which companies and governments are recommended to follow. While the principles in the Declaration were designed with developing countries in mind, they are equally applicable when the member companies are operating in their home countries. The Declaration is completely voluntary.<sup>124</sup>

The Declaration first sets out certain general principles which all relevant parties should abide by in their operations. Parties are required first to comply with national laws and to consider the local practices. They should also comply with the Universal Declaration of Human Rights. The Declaration then refers to the "core" ILO Conventions, as set out in the 1998 ILO Declaration on Fundamental Principles and Rights at Work, discussed above. Governments are urged to ratify these conventions if they have not done so and companies should aim to comply with them in their business, regardless of the state of ratification in the country in which they are operating.<sup>125</sup>

The ILO Declaration then moves on to principles in the areas of employment, training, conditions of work and life and industrial relations. The principles do not generally set out specific standards to be met but aim to set out more general suggestions on how companies could operate in a socially responsible manner. For example, one employment principle states that companies "should have regard to the importance of using technologies which generate employment, both directly and indirectly".<sup>126</sup>

Within the area of employment, companies agree to promote employment opportunities, with priority given to the nationals of the state in which they are operating. The

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<sup>123</sup> International Labour Organisation Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (2006), available at [http://www.ilo.org/wcmsp5/groups/public/@ed\\_emp/@emp\\_ent/@multi/documents/publication/wcms\\_094386.pdf](http://www.ilo.org/wcmsp5/groups/public/@ed_emp/@emp_ent/@multi/documents/publication/wcms_094386.pdf) [accessed 04/07/11], at p.2.

<sup>124</sup> *Ibid*, at p.2.

<sup>125</sup> *Ibid*, at p.3.

<sup>126</sup> *Ibid*, at p.4.

Declaration states that this should include concluding supply contracts with national operators, though this may not be done in order to avoid the other responsibilities of the Declaration.<sup>127</sup> Companies are also required to avoid discrimination in every area of their business. Finally, companies must promote "stability of employment", discussing possible changes in operations with workers and avoiding arbitrary dismissal of workers.<sup>128</sup>

In the area of training, companies should participate in any training schemes which are organised by the national government and help to administer those programs where practicable. Companies should ensure that all their workers receive relevant training, aiming to enhance their skills and career opportunities.<sup>129</sup>

Within the area of conditions of work and life, it is stated that companies should offer the best possible wages and conditions of work and, in any case, no less than those offered by comparable employers in the area and enough to satisfy the basic needs of the worker. Companies must comply with the minimum age for workers as set out in Convention No. 138.<sup>130</sup> Companies should also ensure "the highest standards of health and safety" in their operations and cooperate with national health and safety authorities.<sup>131</sup>

Within the area of industrial relations, companies must ensure that workers have the right to establish and join any union without requiring prior authorisation. Companies should promote negotiations between employers' organisations and workers' organisations for the purposes of collective bargaining and provide for regular consultation between those organisations.<sup>132</sup> Companies must ensure that workers have

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<sup>127</sup> *Ibid*, at p.4.

<sup>128</sup> *Ibid*, at p.5.

<sup>129</sup> *Ibid*, at p.6.

<sup>130</sup> The age of completion of compulsory schooling or 15, whichever is higher. ILO Convention 138, Art.2(3).

<sup>131</sup> *Ibid*, at p.7.

<sup>132</sup> *Ibid*, at p.8.

a method to have grievances examined by the employers without suffering any prejudice.<sup>133</sup>

The ILO does not monitor compliance with the Declaration and cannot enforce its provisions. However, the Declaration does include a procedure under which parties may bring a dispute about the meaning of the Declaration principles before the International Labour Office. The dispute must be based on an actual situation.<sup>134</sup> Applications should be brought by the government of an ILO member State, either on its own initiative or at the request of an organisation of workers or employers. Where it can be shown that the government has refused to bring an application, or three months have elapsed since the organisation requested the government submit an application and no reply has been made, the organisation may make the application itself.<sup>135</sup> The Office will then prepare a reply to the query with the Officers of the Committee on Multinational Enterprises.<sup>136</sup>

#### *V.1.2. UN Global Compact*

The UN Global Compact was launched in 2000 following an address by UN Secretary General Kofi Annan at the Davos World Economic Forum in which he called on business leaders to join a “global compact of shared values and principles”.<sup>137</sup> The Global Compact is currently the largest CSR initiative, having over 8000 participants, including over 5300 businesses as of 2011.<sup>138</sup>

The Global Compact has two stated aims: to mainstream its ten principles throughout business and to help inspire action in support of broader UN goals.<sup>139</sup> The Global Compact sets out general principles which the corporate members agree to abide by in their business. Originally covering nine principles in the fields of human rights, labour and the environment, it was decided in 2004 to add a tenth principle in the field of

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<sup>133</sup> *Ibid*, at p.9.

<sup>134</sup> *Ibid*, at p.17, para. 1

<sup>135</sup> *Ibid*, at p.17, para. 6.

<sup>136</sup> *Ibid*, at p.17, para. 7.

<sup>137</sup> Kofi Annan, “Business and the UN: A Global Compact of Shared Values and Principles”, 31 January 1999, Davos World Economic Forum, quoted in Williams, O. ‘The UN Global Compact: The Challenge and the Promise’ (2004) 14(4) *Business Ethics Quarterly* 755, at 755.

<sup>138</sup> Source: <http://www.unglobalcompact.org/ParticipantsAndStakeholders/index.html> [accessed 04/07/11].

<sup>139</sup> Source: <http://www.unglobalcompact.org/AboutTheGC/index.html> [accessed 04/07/11]

corruption.<sup>140</sup> For the purposes of this thesis, the relevant principles are the labour principles. These are:

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining.
- Principle 4: The elimination of all forms of forced and compulsory labour.
- Principle 5: The effective abolition of child labour.
- Principle 6: Elimination of discrimination in respect of employment and occupation.

These principles are taken from the ILO's Declaration on Fundamental Principles and Rights at Work 1998, meaning that the Global Compact principles overlap to a great extent with the general principles contained in the ILO Tripartite Declaration. The Global Compact does not set out any more specific principles or require companies to meet certain standards in their business to show compliance with the general principles. Companies signed on to the Global Compact are required to include a communication on their progress in applying Compact principles in their business in their annual report, giving specific examples. Any company which does not comply with this may be delisted from the Global Compact.

The Global Compact is completely voluntary and has no monitoring system. Because of this, it has been often been seen as ineffective and used as a simple PR tool by its signatories.<sup>141</sup> Many of its members, such as Nike and Shell, have been subject to heavy criticism in the past for poor labour standards. In 2004, several of the NGOs associated with the Global Compact issued a statement that they felt the Compact had "fallen far short of expectations" and called for the creation of an independent complaints mechanism in order to boost the integrity of the code.<sup>142</sup>

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<sup>140</sup> The principles are set out in full on the UN Global Compact website: <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html> [accessed 06/07/11].

<sup>141</sup> Wick, I. *Workers' Tool or PR Ploy? A Guide to Codes of International Labour Practice*, (4<sup>th</sup> Ed), (2005, Bonn: Friedrich-Ebert-Siftung), at p.98.

<sup>142</sup> Statement by NGO Participants in the Global Compact Summit, (2004), available at <http://www.unqls.org/orf/cso/cso3/statement.html> [accessed 04/07/11].

### *V.1.3. OECD Guidelines on Multinational Enterprises*

The OECD Guidelines for Multinational Enterprises ("the Guidelines") were first published in 1976. These original guidelines focused on ensuring that multinational enterprises complied with the relevant national law and were limited in operation to the OECD area itself.<sup>143</sup> Because of this, the Guidelines had limited impact and were substantially revised in 2000. The Guidelines now apply to any multinational enterprise which operates in or from any adhering country, acknowledging the growth in global supply and extending the reach of the Guidelines to developing countries.<sup>144</sup> There is also a much greater emphasis on compliance with international standards and going beyond national legal requirements.<sup>145</sup>

As with the ILO Tripartite Declaration, the Guidelines start by setting out general principles before moving onto more specific principles. The Guidelines set out principles in the areas of disclosure, employment and industrial relations, the environment, combating bribery, consumer interests, science and technology, competition, and taxation. This section will examine the general principles and those related to employment and industrial relations. The general principles do not set out any minimum standards to be met but, similar to the ILO Tripartite Declaration, set out general aims.

Several general principles deal with labour issues. Companies should encourage local employment and local capacity building, working with the community in the area.<sup>146</sup> The Guidelines also state that companies should refrain from taking disciplinary action against any employees who report any breach of the law, the Guidelines or the company's own code to either management or the relevant authorities.<sup>147</sup> Importantly in relation to supply chain issues, General Principle 10 requires companies, "where practicable", to encourage their suppliers and sub-contractors to also follow all the principles of the Guidelines.

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<sup>143</sup> For an examination of the previous regulations, see Murray, J. 'A New Phase in the Regulation of Multinational Enterprises: The Role of the OECD' (2001) 30(3) *Industrial Law Journal* 255 at 256-261.

<sup>144</sup> OECD Guidelines 2000, at p.12.

<sup>145</sup> Murray, above n.42, at 262.

<sup>146</sup> OECD Guidelines 2000, p.19, at General Principles 3 and 4.

<sup>147</sup> OECD Guidelines 2000, p.19, at General Principle 9.

The principles on employment and industrial relations are found in Section IV of the Guidelines, and these principles do set out minimum standards to be met. Emphasis is placed on promoting a good relationship between the business and its workers. Companies must allow trade unions and collective bargaining in their organisation, and they should consult workers' groups before undertaking any major change in business.<sup>148</sup> Linked to this requirement, companies should provide any necessary facilities and information to workers in order to promote negotiation on terms of employment.<sup>149</sup> The Guidelines also expressly forbid a company from threatening to transfer employees away from the site in order to influence the results of any collective bargaining.<sup>150</sup>

Beyond issues of industrial relations, companies must "contribute" to the abolition of child and forced labour, though no more specific requirements are given relating to this.<sup>151</sup> Discrimination amongst employees on the grounds of race, sex, religion or other similar grounds is expressly forbidden. There is an exception to this where the discrimination either follows a government policy of positive discrimination to ensure greater equality throughout the workforce, or where the discrimination "relates to the inherent requirements of a job".<sup>152</sup> There should also be positive discrimination in favour of local employees wherever possible and the company should train those employees to improve their skills and future employment prospects.<sup>153</sup> As regards general employment standards, the standards must be no less favourable than those of comparable employers in the host country and "adequate steps" should be taken to ensure good health and safety standards throughout the workplace.<sup>154</sup>

Under the OECD Guidelines, each adhering country must set up a National Contact Point (NCP).<sup>155</sup> These NCPs are responsible for promoting awareness of the Guidelines in the relevant country and for handling inquiries or complaints regarding the implementation

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<sup>148</sup> OECD Guidelines 2000, at pp.21-22, Employment and Industrial Relations Principles 1(a), 6 and 8.

<sup>149</sup> *Ibid*, Principle 2.

<sup>150</sup> *Ibid*, Principle 7.

<sup>151</sup> *Ibid*, Principles 1(b) and (c).

<sup>152</sup> *Ibid*, Principle 1(d).

<sup>153</sup> *Ibid*, Principle 5.

<sup>154</sup> *Ibid*, Principle 4.

<sup>155</sup> OECD Guidelines 2000, at p.32.

of the Guidelines. In the UK, the NCP is currently based within the Department for Business, Innovation and Skills (BIS).<sup>156</sup> Under the UK procedure, any “interested party” may make a complaint to the NCP if they feel that a company registered in or operating from the UK has breached the Guidelines in any way. There is no set definition of “interested party”, with examples covering workers, local communities and trade unions, making the only limitation on bringing a case the ability to collect the information the NCP will need to deal with the complaint.<sup>157</sup> If a complaint is accepted, the NCP will first try to deal with the complaint through a mediation procedure. If this fails, the NCP will examine the complaint itself before preparing a report which will set out the relevant breaches of the Guidelines, if any, and offer suggestions as to how the company may bring its conduct in line with those Guidelines.<sup>158</sup> These suggestions are voluntary with no further action taken against a company in breach. This weakness has been criticised by NGOs, especially Oxfam, who call for much stricter monitoring and penalties for breach.<sup>159</sup>

#### *V.1.4. Ethical Trading Institute Base Code*

The Ethical Trading Institute (ETI) was established in 1998. Composed of NGOs, trade union representatives and corporate members, it aims to set out good labour practice and to work with companies to improve labour standards throughout their supply chain. The main platform for the ETI's work is the Base Code, a code of conduct which aims to set out key labour principles which must be adhered to by all corporate members of the ETI. The Base Code is accompanied by the Principles of Implementation, which set out

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<sup>156</sup> Source: <http://www.bis.gov.uk/policies/business-sectors/low-carbon-business-opportunities/sustainable-development/corporate-responsibility/uk-ncp-oecd-guidelines> [accessed 04/07/11].

<sup>157</sup> BIS, *UK NCP Procedures for Dealing with Complaints Brought Under the OECD Guidelines for Multinational Enterprises*, (2011), available at <http://www.bis.gov.uk/assets/biscore/business-sectors/docs/u/11-651-uk-ncp-procedures-for-complaints-oecd.pdf> [accessed 04/07/11] at p.4.

<sup>158</sup> *Ibid*, sec. 5.1.

<sup>159</sup> Oxfam, *Rigged Rules and Double Standards? Trade, Globalisation and the Fight against Poverty*, (2002), available at [http://www.maketradefair.com/assets/english/report\\_english.pdf](http://www.maketradefair.com/assets/english/report_english.pdf) [accessed 22/08/11] at p.205.

the responsibilities of the ETI members relating to the Base Code, focusing on monitoring requirements.<sup>160</sup>

Companies who become members of the ETI must make a public commitment to adopt the Base Code and to implement it in their supply chain.<sup>161</sup> Members must submit annual progress reports on their code implementation activities to the ETI and must commit not only to transparent reports on their own business but also to encouraging their own suppliers to be transparent about their ethical trading standards.<sup>162</sup> The annual progress reports aim to set out the ethical trading risks inherent in the company's business and how those risks are being mitigated, how the company is working on its ethical trade strategy and how the company is delivering improvements to the companies and individuals in the area in which it is operating, and must show how the company is meeting set benchmarks.<sup>163</sup> The ETI Secretariat conducts random validation visits to at least 20% of the companies submitting reports annually to determine that the systems for preparing the annual report are valid. Where companies fail to make sufficient progress in improving their business or breach the membership obligations of the ETI Base Code their membership is terminated.<sup>164</sup>

The ETI Base Code has nine main principles, each of which contains several sub-principles which set out certain specific standards which must be reached. In common with most codes, the Base Code prohibits totally the use of forced labour.<sup>165</sup> Both discrimination against employees on any grounds and physical or mental abuse of employees are also completely prohibited.<sup>166</sup> In contrast, however, child labour is not prohibited outright. The recruitment of new child labour is forbidden, but a company may continue to employ any child labourers currently working for them so long as they

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<sup>160</sup> The ETI Base Code and Principles of Implementation may be accessed on the ETI website at <http://www.ethicaltrade.org/resources/key-eti-resources> [accessed 04/07/11]

<sup>161</sup> Principle 1, Principles of Implementation.

<sup>162</sup> Principle 6, Principles of Implementation.

<sup>163</sup> Ethical Trading Initiative, *Ethical Trading Initiative Management Benchmarks* (2010), available at <http://www.ethicaltrade.org/sites/default/files/resources/ETI%20Management%20benchmarks.pdf> [accessed 04/07/11]

<sup>164</sup> Source: <http://www.ethicaltrade.org/about-eti/what-companies-sign-up-to> [accessed 04/07/11]

<sup>165</sup> Principle 1, ETI Base Code.

<sup>166</sup> Principles 7 and 9, ETI Base Code.

“develop or participate in and contribute to policies and programmes which provide for the transition of any child found to be performing child labour to enable her or him to attend and remain in quality education until no longer a child”.<sup>167</sup> As is usual, compliance with national labour law is required and the code notes that a company may not attempt to evade any responsibilities owed to workers under the national law by engaging workers under any arrangements such as home-working or labour-only contracting.<sup>168</sup>

In the field of industrial relations, the Base Code states that companies must allow workers to form trade unions and permit collective bargaining.<sup>169</sup> Where freedom of association and collective bargaining are restricted under national law, the company must facilitate the development of a parallel means for bargaining by workers.<sup>170</sup> More generally, it is stated that companies must adopt an “open attitude” towards the activities of the trade unions and their representatives.<sup>171</sup>

The Base Code deals with health and safety in Principle 3. Along with providing that a safe and hygienic workplace should be ensured, the Base Code also sets out some specific standards to be met, requiring clean toilet facilities, potable water and sanitary conditions for food storage.<sup>172</sup> Workers must receive health and safety training and the company must assign responsibility for ensuring health and safety throughout the business to a senior management representative.<sup>173</sup>

Principles 5 and 6 set out the standards for wages and working hours and set out very specific aims. Wages and working hours must, as a minimum, comply with national law or the industry benchmark wage (whichever is higher).<sup>174</sup> In addition, wages must always be enough to meet a worker’s basic needs and also “provide some discretionary income”, which may in some cases require a higher wage than the national law provides

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<sup>167</sup> Principle 4.2, ETI Base Code.

<sup>168</sup> Principle 8, ETI Base Code.

<sup>169</sup> Principle 2.1, ETI Base Code.

<sup>170</sup> Principle 2.4, ETI Base Code.

<sup>171</sup> Principle 2.2, ETI Base Code.

<sup>172</sup> Principles 3.1 and 3.3, ETI Base Code.

<sup>173</sup> Principles 3.2 and 3.5, ETI Base Code.

<sup>174</sup> Principles 5.1 and 6.1, ETI Base Code.

for.<sup>175</sup> Workers must be provided with accurate information about their wages before they begin work and must also be provided with the details of their wages at each pay period.<sup>176</sup> The company may not make deductions from a worker's wages as a disciplinary measure and any other deductions not provided for in national law may not be made without permission of the worker concerned.<sup>177</sup> Workers should not be required to work more than 48 hours per week and must be entitled to at least one day off for every seven day period.<sup>178</sup> Overtime must be completely voluntary and should be compensated at a premium rate, and in any case, should not exceed 12 hours work for any worker in any one week.<sup>179</sup>

#### *V.1.5. World Fair Trade Organisation<sup>180</sup>*

The World Fair Trade Organisation (WFTO) is one of several fair trade initiatives (for fair trade product labelling, see the next section). The organisation is composed of companies which follow its "Ten Principles of Fair Trade", which cover both social and environmental aspects though the emphasis is on labour conditions.<sup>181</sup> The organisation publishes a list of the companies which meet its requirements on its website. Member companies which have completed the auditing process may use the WFTO logo to prove this. To complete the audit, a company must complete a self-assessment examining their business in light of the ten principles every two years and this assessment will be reviewed by the Registration Sub-Committee of the WFTO.<sup>182</sup>

Under the labour principles set out by the WFTO, a company must create opportunities for the economically disadvantaged producers it uses in its business. The company should help build the capacity of the producers it uses and help to develop the producers' independence. As regards employment standards, the company must pay a fair price

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<sup>175</sup> Principle 5.1, ETI Base Code.

<sup>176</sup> Principle 5.2, ETI Base Code.

<sup>177</sup> Principle 5.3, ETI Base Code.

<sup>178</sup> Principle 6.2, ETI Base Code.

<sup>179</sup> *Ibid.*

<sup>180</sup> For more info, see [www.wfto.com](http://www.wfto.com) [accessed 04/07/11].

<sup>181</sup> The principles are set out on the WFTO's website at

[http://www.wfto.com/index.php?option=com\\_content&task=view&id=2&Itemid=14](http://www.wfto.com/index.php?option=com_content&task=view&id=2&Itemid=14) [accessed 04/07/11].

<sup>182</sup> Source: [http://www.wfto.com/index.php?option=com\\_content&task=view&id=21&Itemid=302](http://www.wfto.com/index.php?option=com_content&task=view&id=21&Itemid=302) [accessed 04/07/11]

(agreed through dialogue with the producer), ensure gender equality in the workplace, make sure the workplace is safe to work in and comply with local law regarding child labour along with the UN Convention on the Rights of the Child. In any case, child labour should not adversely affect the well-being or educational requirements of the child. Finally, fair trade organisations should endeavour to build long-term relationships with their suppliers.

## V.2. Certification Standards

While there are many CSR certification standards, very few relate to labour issues directly, concentrating instead on environmental and sustainability issues. A major exception to this is the SA 8000 certification scheme, which will be examined in detail below.

### *V.2.1. SA 8000*

SA 8000 is a labour standard accreditation scheme produced by Social Accountability International (SAI) under which a company meeting the standards set in the scheme will receive a certificate to prove this. It was first published in 1997 and was revised in 2001 and 2008. Unlike the codes of conduct discussed above, the scheme is independently monitored. The code is designed not only to be used internally but also to be used as a tool to manage the labour standards of a company's supply chain.<sup>183</sup> Despite the scheme's generally positive reception, certification does have significant costs and so the scheme has been criticised for disadvantaging smaller suppliers.<sup>184</sup>

As with the codes previously discussed, SA 8000 first requires that a company comply with the relevant national law in its operations.<sup>185</sup> It also requires compliance with the core ILO Conventions, along with several other ILO Conventions covering matters such as maternity protection and home work and international standards including the

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<sup>183</sup> Rohitratana, K. 'SA8000: Tool to Improve Quality of Life' [2002] *Managerial Auditing Journal* 60, at 60.

<sup>184</sup> *Ibid*, at 61.

<sup>185</sup> SA 8000 (2008), at p.4.

Universal Declaration of Human Rights.<sup>186</sup> SA 8000 then sets out requirements in the areas of child labour, forced and compulsory labour, health and safety, freedom of association, discrimination, disciplinary practices, working hours, remuneration, and management systems. Unlike most of the codes of conduct, these set out very specific minimum requirements, such as a maximum 48 hour working week.

For a company to be certified to SA 8000 standard it must undergo an independent audit by an SAI-accredited certification body to test its labour standards against those set out in SA 8000. Certification lasts for three years and certified companies are audited on a semi-annual basis.<sup>187</sup> The company may choose which body audits its operations so long as the body is certified by the SAI.

### V.3. Product Labelling

Product labels have been developed to deal with a variety of issues over a variety of products, most often covering environmental issues such as sustainability and labour standards in the production of the product. This wide variety of labels has been criticised by some commentators as the different requirements for each label and the lack of publicity for the requirements of each label makes it difficult for consumers to know precisely what a label means.<sup>188</sup> Labels denoting products which have been made under labour conditions guaranteed to a certain level are generally known as "fair trade" labels. The fair trade business is swiftly developing, growing by 92% in the UK in 2004.<sup>189</sup> There are in fact several fair trade initiatives and the work of the World Fair Trade Organisation was examined previously. This section will examine the work of Fairtrade Labelling Organisations International, an umbrella organisation for 20 fair trade labelling initiatives and producer of the "Fairtrade" label used in the UK.

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<sup>186</sup> *Ibid.*

<sup>187</sup> Source: <http://www.saasaccreditation.org/certprocess.htm> [accessed 04/07/11]

<sup>188</sup> Liubicic, above n.106, at 131.

<sup>189</sup> Wick, above n.141, at p.15.

### V.3.1. Fairtrade Labelling<sup>190</sup>

The Fairtrade label on a product allows consumers to be sure that that product was produced according to the labour (and some environmental) standards of Fairtrade Labelling Organisations International (FLO). The standards are developed by the FLO Standards Committee and reviewed on a regular basis. FLO has been operating since 1997, when the organisation was created to standardize the requirements for the various fair trade labels used on products globally. In 2002 the international Fairtrade label was launched and is now used in all but two of the countries who are a member of FLO.<sup>191</sup>

For a product to be certified as Fairtrade, the producer must meet both FLO's generic standards and also certain product specific standards. This limits the number of products which the Fairtrade label may be used on to those that have had specific standards developed, although this number is rapidly expanding as new standards are developed. Standards have currently been developed for 18 product categories, mostly covering food products but also covering cotton and sports balls production.<sup>192</sup>

Generic standards exist for both trade and production. The relevant generic production standards vary depending on whether the product is being produced by a "small-scale producer" (producers who are organised in co-operatives), contract production (small producers not currently organised in a co-operative) or by producers operating in a hired labour situation. For hired labour, in addition to several environmental requirements relating to sustainable production, the producer must also meet specific labour conditions in several areas.<sup>193</sup> Employment must be non-discriminatory and forced or compulsory labour is forbidden. As regards the general standards of employment, as a minimum the standards must be in line with or exceed the relevant national law or

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<sup>190</sup> For more information, see the website of Fairtrade Labelling Organisations International: [www.fairtrade.net](http://www.fairtrade.net). [accessed 04/07/11].

<sup>191</sup> Source: [http://www.fairtrade.net/about\\_the\\_mark.0.html](http://www.fairtrade.net/about_the_mark.0.html) [accessed 04/07/11]. The exceptions are Canada and the USA, who use the Fair Trade Certified mark.

<sup>192</sup> Full list available at:

[http://www.fairtrade.net/fileadmin/user\\_upload/content/2009/standards/documents/2011-06-28\\_LIST\\_OF\\_FLO\\_Standards.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/2011-06-28_LIST_OF_FLO_Standards.pdf) [accessed 04/07/11].

<sup>193</sup> Fair Trade Labelling Organisations International, *Generic Fairtrade Standards for Hired Labour* (2011), available at [http://www.fairtrade.net/fileadmin/user\\_upload/content/2009/standards/documents/generic-standards/2011-05-11-HL\\_EN\\_01.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/generic-standards/2011-05-11-HL_EN_01.pdf) [accessed 04/07/11]

regional agreements. Express minimum standards are set out in a range of employment areas including, *inter alia*, working hours and leave entitlement. Minimum standards are also set out to ensure health and safety in the workplace. Finally, it must be shown that the relationship between the buyer and the producer helps the producer to develop their workforce and to build the capacity of their company. Where the product is produced by a small-scale producer, all the previous conditions must be complied with and there are also further conditions relating to the social development of the organisation.<sup>194</sup> Contract production again requires all the conditions set out for hired labour but also sets out requirements intended to develop the workers into a small-scale producer.<sup>195</sup> The generic trade standards are aimed at companies which buy the Fairtrade products and, *inter alia*, require the payment of the "Fairtrade Minimum Price" and a "Fairtrade Premium" to the producers.<sup>196</sup> The minimum price covers the costs of sustainable production and the premium should give the producer money to invest into improving their livelihood.

Certification is monitored by an independent company, FLO-CERT GmbH.<sup>197</sup> The company employs a team of around 60 independent inspectors who regularly visit all Fairtrade producers to investigate the conditions there. FLO-CERT also conducts a trade audit, checking that Fairtrade certified products sold to consumers have in fact been produced by a Fairtrade certified producer.

## **VI. Conclusion**

This chapter has offered an overview of labour codes of conduct, certification schemes and product labelling schemes. It has been shown that the requirements included in labour codes vary depending on whether or not the code has been designed internally by

<sup>194</sup> Fair Trade Labelling Organisations International, *Generic Fairtrade Standards for Small Producers' Organisations* (2011), available at [http://www.fairtrade.net/fileadmin/user\\_upload/content/2009/standards/documents/2011-05-11\\_new\\_CP\\_EN\\_final.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/2011-05-11_new_CP_EN_final.pdf) [accessed 04/07/11]

<sup>195</sup> Fair Trade Labelling Organisations International, *Generic Fairtrade Standard for Contract Production* (2011) available at [http://www.fairtrade.net/fileadmin/user\\_upload/content/2009/standards/documents/2011-05-11\\_new\\_CP\\_EN\\_final.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/2011-05-11_new_CP_EN_final.pdf) [accessed 04/07/11]

<sup>196</sup> Fair Trade Labelling Organisations International, *Generic Fairtrade Trade Standard* (2011), available at [http://www.fairtrade.net/fileadmin/user\\_upload/content/2009/standards/documents/generic-standards/2011-06-08\\_GTS\\_EN.pdf](http://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/generic-standards/2011-06-08_GTS_EN.pdf) [accessed 04/07/11]

<sup>197</sup> For more info, see [www.flo-cert.net](http://www.flo-cert.net) [accessed 04/07/11].

the company or designed by an external international organisation, with internally designed codes having fewer precise requirements. The largest and most commonly used externally designed labour codes have then been examined to determine the requirements of each. This analysis has revealed the many common concerns of such labour codes, including a focus on compliance with the core ILO conventions, maximum working hours and minimum wage rates and, importantly for the EU regime, a focus on promoting the use of local labour. These common requirements will provide a base for the legal analysis in Chapter 6 of this thesis, which will examine the possibility of including such requirements under the EU procurement regime in more detail.

## **Chapter 4 - Overview of the UK Utilities Sector**

### **I. Introduction**

This chapter will give an overview of those utilities sectors in the UK that are regulated by Directive 2004/17/EC<sup>198</sup> ("the Utilities Directive"); (1) energy (composing oil and gas extraction, coal mining and gas/electricity supply); (2) water; (3) transport (airport, port, bus and rail) and; (4) postal services. Telecommunications will not be considered in this overview due to its removal from the EU procurement regime in the 2004 reforms (see Chapter 5 on the EU procurement regime). This chapter aims to examine the operation of the various firms in the sectors, looking at what they do, how they are regulated and the extent of the competition they are exposed to, all of which are factors which may affect their procurement and corporate social responsibility practices. Each section aims set out the state of liberalisation in the sector and to offer an overview of the relevant regulation, including, where appropriate, the licensing regime. Finally, an overview of the relevant bodies in the sector will be given.

### **II. Energy**

#### **II.1. Oil and Gas Extraction**

The UK oil and gas extraction sector is fully open to competition. Licences to extract oil and gas are awarded by the Department of Energy and Climate Change (DECC) under section 3 of the Petroleum Act 1998. Licensees may be a single company or a group of companies working together.<sup>199</sup> All licences are for a limited period of time. DECC currently awards four main types of licence:<sup>200</sup>

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<sup>198</sup> Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 No. L134/1.

<sup>199</sup> Source: <https://www.og.decc.gov.uk/upstream/licensing/overview.htm> [accessed 05/07/11].

<sup>200</sup> Source: <https://www.og.decc.gov.uk/upstream/licensing/lictype.htm> [accessed 05/07/11].

(1) Seaward Production Licences, which allow exclusive exploration and extraction in a small geographical area in the UK continental shelf. These operate over three terms, whereby a company may extend their licence into the second and third terms if their work programmes have been satisfactorily completed. There are four forms of Seaward Production Licence. The first type is the Traditional Licence, which is the most commonly granted licence, requiring technical and environmental capacity to be proved prior to the licence being granted. The second type is the Promote Licence, which is designed for start-up companies and allows the licence to be granted without the technical and environmental capacity being proved, so long as the capacity can be shown by the second year of operation of the licence. The remaining two types of Seaward Production Licences are Frontier Licences which are designed for areas with particularly challenging terrain and differ in the lengths of the first term, with Frontier Licences having first terms of either six or nine years as compared to the four years of Traditional and Promote licences.

(2) Seaward Exploration Licences, which allow exploratory surveys over any area of the UK continental shelf, except those areas covered by a production licence. The licences last for three years.

(3) Petroleum Exploration and Development Licences, which are onshore production licences and operate in a similar manner to offshore production licences. As with those licences, they operate over three terms.

(4) Supplementary Seismic Survey Licences, which allow a company with an onshore production licence to survey an area up to one kilometre adjacent to the area covered by the production licence. The licence lasts for one year.

Licences must be awarded using certain objective and non-discriminatory criteria set out in Directive 94/22/EC<sup>201</sup> and implemented into UK law in the Hydrocarbons Licensing

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<sup>201</sup> Directive 94/22/EC of the European Parliament and of the Council of 30 May 1994 on the conditions for granting and using authorisations for the prospection, exploration and production of hydrocarbons, OJ L 164.

Directive Regulations 1995<sup>202</sup>. This sets out certain criteria, such as technical and financial capability and the price the applicant is willing to pay for the licence, which must be used when determining whether to award the licence.<sup>203</sup> DECC awards licences through competitive Licensing Rounds, with companies bidding for the licences. The department runs one offshore and one onshore Licensing Round each year.<sup>204</sup> DECC has awarded over a thousand licences in total.<sup>205</sup>

## II.2. Coal Mining

Following the recent focus on oil and gas, the UK coal industry is no longer such a major part of the economy.<sup>206</sup> In hopes of revitalising the industry, the UK coal industry was privatised in 1994 by the Coal Industry Act 1994, which also created the regulatory body the Coal Authority. The sector is now open to competition, with the Coal Authority responsible for awarding licences to companies to operate coal mines. The Authority awards three main types of licence:

- (1) Underground and opencast operating licences, which grant a company the right to operate either a deep mine or an opencast mine (mining from an open pit);
- (2) Exploration licences, giving a company the right to explore an area of land for coal;
- (3) Coal methane access agreements, which grant a company the right to use a site for the extraction of methane from coal.<sup>207</sup>

Written agreement is also need from the Coal Authority for a company to drill through a coal mine for non-coal mining business and to dig and carry away coal in the course on non-mining activities (incidental coal)

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<sup>202</sup> SI 1995 No.1434.

<sup>203</sup> Reg. 3, Hydrocarbons Licensing Directive Regulations 1995.

<sup>204</sup> Source: <https://www.og.decc.gov.uk/upstream/licensing/licawards.htm> [accessed 05/07/11]

<sup>205</sup> A database of all oil and gas extraction licences can be accessed on BERR's website at <https://www.og.decc.gov.uk/information/licensing.htm> [accessed 13/11/09]

<sup>206</sup> Newbery, D. and Pollit, M. 'The Restructuring and Privatisation of Britain's CEGB – Was it Worth it?' (1997) 45(3) *Journal of Industrial Economics* 269, at 271.

<sup>207</sup> Model licences may be found at

[http://coal.decc.gov.uk/en/coal/cms/services/licensing/license\\_apps/license\\_apps.aspx](http://coal.decc.gov.uk/en/coal/cms/services/licensing/license_apps/license_apps.aspx) [accessed 05/07/11]

As of 2011, The Coal Authority reports that there were 51 sites with 52 licences operating throughout the UK, with 36 of those sites being opencast and 15 being underground mines.<sup>208</sup>

### II.3. Gas and Electricity

The energy market in the UK comprises of both the gas market and the electricity market. The energy market is an area where there has been substantial influence from the EU, with the intention of introducing competition throughout the sector and creating a functioning internal energy market. In the UK, both the gas and electricity markets have been substantially opened to competition in the last ten years and the country now has the most developed market in Europe. While there are certain differences between the operation of the electricity and gas markets, there are also many similarities. Following a general overview of the various activities in both the gas and electricity markets, the section will also examine the bodies operating in each area. Finally, the state of competition and the regulatory controls over the sector will be examined.

#### *II.3.1. Electricity: Activities and Companies*

The electricity market may be divided into four separate stages; (1) Generation, the original production of electricity through a power station, wind farm etc; (2) Transmission, the transport of electricity over nation-wide high tension cables; (3) Distribution, the transport of electricity over local low tension cables; (4) Supply, the sale and delivery of electricity to the final user.<sup>209</sup> In the UK the operation of these stages has been fully separated with separate licences necessary and different companies operating in each stage.

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<sup>208</sup> The Coal Authority, *Production and Manpower Returns for 3 Month Period January 2011-March 2011*, available at <http://coal.decc.gov.uk/assets/coal/Production-and-Manpower-Returns-Jan-Mar-2011-Q1.pdf> [accessed 05/07/11]

<sup>209</sup> Kotlowski, A. 'Third-Party Access Rights in the Energy Sector: A Competition Law Perspective' [2006/2007] 16(3) *Utilities Law Review* 101, at 101.

## 1. Generation

Generation accounts for 50% of the cost of electricity to final users.<sup>210</sup> The UK electricity generation sector is fully open to competition. Under section 6(1)(a) Electricity Act 1989, a licence from the Office of Gas and Electricity Markets (Ofgem) is required for a company to operate as an electricity generator. These licences are available without limit on number to any company who satisfies certain basic requirements covering issues such as criminal convictions.<sup>211</sup> Ofgem currently lists over 100 companies with electricity generation licences.<sup>212</sup>

## 2. Transmission

Energy transmission is generally regarded as a natural monopoly given the fact that the national network of wires needed for transmission cannot be replicated by another company in a commercially viable manner, and the fact that scale economies mean that a transmission network can be more economically run by a single company than by several competing companies.<sup>213</sup> In the UK, the transmission systems are operated by National Grid Electricity Transmission plc (National Grid). The transmission assets are owned by regional monopoly Transmission Owners. For England and Wales, the Transmission Owner is National Grid. For northern Scotland, the Transmission Owner is Scottish Hydro-Electric Transmission Ltd, and for southern Scotland, the Transmission Owner is Scottish Power Transmission Ltd.<sup>214</sup> Under section 6(1)(b) Electricity Act 1989, an electricity transmission licence must be granted to the company by Ofgem, which also monitors and regulates the performance of the monopoly companies.

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<sup>210</sup> McHarg, A. 'Reshaping the Electricity Generation Market in England and Wales' [1999] 10(1) *Utilities Law Review* 34, at 34.

<sup>211</sup> Ofgem, *Guidance for Gas and Electricity Licence Applications* (2010), available at <http://www.ofgem.gov.uk/Licensing/Work/Documents1/SupplementaryAppendix2-Guidanceforgasandelectricityapplications.pdf> [accessed 05/07/11], at pp.25-27.

<sup>212</sup> A list of all electricity licensees in the UK is available at [http://www.ofgem.gov.uk/Licensing/Work/Documents1/external\\_electricity\\_list\\_excel1.pdf](http://www.ofgem.gov.uk/Licensing/Work/Documents1/external_electricity_list_excel1.pdf) [accessed 05/07/11]

<sup>213</sup> Kotlowski, above n.209, at 102.

<sup>214</sup> Source: <http://www.ofgem.gov.uk/Networks/Trans/Pages/Trans.aspx> [accessed 05/07/11].

### 3. Distribution

As with electricity transmission, distribution is seen as a natural monopoly.<sup>215</sup> The UK is split into 14 regional monopoly regions, each run by a Distribution Network Operator (DNO). These 14 monopoly regions are currently controlled by seven separate companies; Central Networks (part of the E.ON group), Electricity North West, CE Electric UK, Western Power Distribution, EDF Energy Networks, Scottish Power Networks and SSE Power Distribution.<sup>216</sup> In addition to the DNOs, there are also six licensed independent distribution network operators, who operate in a similar manner to DNOs but do not have a specific service area.<sup>217</sup> Licences for electricity distribution are granted under section 6(1)(c) by Ofgem and, as with transmission, the distribution companies are monitored and regulated by Ofgem.

### 4. Supply

As with generation, the electricity supply market has been fully opened to competition. The market has been unregulated since 2002 when Ofgem judged that the market was sufficiently competitive to remove the previous system of price controls.<sup>218</sup> Domestic customers are mainly served by six large suppliers (British Gas, E.ON, Npower, EDF Energy, Scottish and Southern Electric (SSE), and Scottish Power), though there are also several smaller suppliers.<sup>219</sup> In addition to these companies, there are also several suppliers who serve non-domestic customers exclusively.<sup>220</sup> Electricity supply licences are awarded by Ofgem under section 6(1)(d) Electricity Act 1989. They are awarded without limit on number to any company who satisfies the same general requirements as are required for generation licences, and who can also satisfy certain other requirements

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<sup>215</sup> Saplakan, R. 'Competition in electricity distribution' (2008) 16 *Utilities Policy* 231, at 231.

<sup>216</sup> Ofgem, *Electricity Distribution Annual Report for 2008-9 and 2009-10* (2011), available at [http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/Electricity\\_Distribution\\_Annual\\_Report\\_for\\_2008-09\\_and\\_2009-10v2%5b1%5d.pdf](http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/Electricity_Distribution_Annual_Report_for_2008-09_and_2009-10v2%5b1%5d.pdf) [accessed 05/07/11], at p.3.

<sup>217</sup> Ofgem Licence Database, above n.212.

<sup>218</sup> Ofgem, *Domestic Retail Report – June 2007*, available at <http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/DRMR%20March%202007doc%20v9%20-%20FINAL.pdf> [accessed 05/07/11].

<sup>219</sup> *Ibid*, at p.3.

<sup>220</sup> Ofgem Electricity Licence Database, above n.212.

such as ensuring security of supply and certain obligations to vulnerable customers.<sup>221</sup> A single company cannot hold both a supply licence and a distribution licence.<sup>222</sup>

### *II.3.2. Gas: Activities and Companies*

The gas market operates in approximately the same stages as the electricity network, though the licences use slightly different terminology. Transmission and distribution are referred to as "transport", though there are still two distinct stages involved with high pressure transport through national pipes and low pressure transport through local pipes. Gas is not generated in the same manner as electricity; the comparable stage is "shipping", the introduction of gas into the network.

#### 1. Shipping

Gas shipping, like electricity generation, is fully open to competition. A gas shipper licence may be awarded to a company by Ofgem under section 7A(2) of the Gas Act 1986. Licences are available without restriction on number to any company who can satisfy the same general requirements as are relevant for electricity generation.<sup>223</sup> Ofgem currently lists over 200 companies with a gas shipping licence.<sup>224</sup>

#### 2. High pressure transport

As with electricity transmission, the gas transport infrastructure is a natural monopoly. The UK's high pressure gas transport assets are owned and operated by National Grid Gas plc. Gas transport licences are granted by Ofgem under section 7 of the Gas Act 1986. Ofgem also monitor and regulate National Grid Gas' performance.

#### 3. Low pressure transport

There are eight low pressure gas transport networks in the UK, owned by four companies; National Grid Gas, Northern Gas Networks, Scotia Gas Networks and Wales

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<sup>221</sup> Ofgem, Guidance for Licence Applications, above n.211, at p.5.

<sup>222</sup> Section 6(2) Electricity Act 1989.

<sup>223</sup> Ofgem, above n.211, at pp.25-27.

<sup>224</sup> A full list of all gas licensees is available on Ofgem's website at [http://www.ofgem.gov.uk/Licensing/Work/Documents1/external\\_gas\\_list\\_excel1.pdf](http://www.ofgem.gov.uk/Licensing/Work/Documents1/external_gas_list_excel1.pdf) [accessed 05/07/11]

& West Utilities.<sup>225</sup> As with high pressure gas transport, companies distributing gas require a gas transport licence under section 7 of the Gas Act 1986. The performance of the gas distributors is monitored and regulated by Ofgem.

#### 4. Supply

Gas supply has been fully opened up to competition. Most domestic customers are supplied by the same six suppliers as previously mentioned in electricity supply, though again there are also several smaller suppliers available and the non-domestic market also has several other suppliers available to it.<sup>226</sup> Gas supply licences are awarded by Ofgem under section 7A(1) of the Gas Act 1986 under the same terms as apply to electricity suppliers.

##### *II.3.3. Regulation and Competition*

In those sectors where the market has not been fully opened to competition (gas transport and electricity transmission and distribution), Ofgem regulates the companies' performance. The UK is currently the only market in Europe which has opened its markets through the method of "third party access". Under this method, independent companies operating in the shipping, generation or supply markets have a legally enforceable right to access and use the network facilities owned by the transmission and distribution companies.<sup>227</sup> Ofgem regulates the terms and prices charged under these access arrangements to ensure that all firms can reasonably gain access to the network and to prevent discrimination among the firms.

Because of the absence of comparator firms, especially in the transmission sector, the method of comparative competition used in the water sector (see below) is not available. The predecessors to Ofgem, the Office of the Gas Regulator (Ofgas) and the Office for Electricity Regulation (Offer) experimented with comparing the gas network with the

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<sup>225</sup> Ofgem, *Gas Distribution Quality of Service Report 2007-2008*, (2008), available at <http://www.ofgem.gov.uk/Networks/GasDistr/QoS/Documents1/2007%20to%2008%20QoS%20report.pdf> [accessed 05/07/11], at p.6.

<sup>226</sup> A full list of all gas suppliers can be found on Ofgem's website, above n.224.

<sup>227</sup> Kotlowski, above n.209, at 101.

electricity network, but the two systems were too technologically different for meaningful comparison, and the option was in any case removed in 2002 by the merger between Transco plc (the previous gas network operator) and National Grid Company plc.<sup>228</sup> Recent price caps appear to be based on a combination of methods, including econometric analysis by independent consultants and financial data such as cost projections from the companies themselves.<sup>229</sup>

### **III. Water**

Water management in the UK is a devolved issue. This means that the water market has developed in different ways and at a different rate in England and Wales as compared to Scotland. England and Wales are unusual in having privatised their water sector. Water is often seen as a public right, making water supply a controversial issue, and globally around 95% of water supply and sewerage services are provided by the public sector.<sup>230</sup> This is the case in Scotland, where water remains under the control of the public sector, though competition for the business supply market has recently been introduced. In contrast, the English and Welsh water sector is characterised by "vertically-integrated, equity-financed, monopoly provision of water supply by private corporations".<sup>231</sup> There is also an unusual regulatory framework in place to ensure competition between these monopoly suppliers, relying on price caps set by an independent regulatory body and so-called "comparative competition".<sup>232</sup> This section will examine both the Scottish and the English and Welsh regimes.

#### III.1. Water Sector Activities

The water sector covers two distinct activities; (1) the operation of a network which supplies drinking water to the public, and (2) the treatment and disposal of sewage.

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<sup>228</sup> Dassler, T., Parker, D. and Saal, D. 'Methods and trends of performance benchmarking in UK utility regulation' (2006) 14 *Utilities Policy* 166, at 169.

<sup>229</sup> *Ibid*, at 170.

<sup>230</sup> Hall, D. and Lobina, E. 'International actors and multinational water company strategies in Europe, 1990-2003' (2007) 15 *Utilities Policy* 64, at 67.

<sup>231</sup> Bakker, K.J. *An Uncooperative Commodity: Privatising Water in England and Wales*, (2003, Oxford: OUP), at p.3.

<sup>232</sup> *Ibid*, at p.3.

Historically, these two branches developed separately. Both were natural monopolies, having distinct distribution and collection networks.<sup>233</sup> It was also impossible originally to create and operate a national network given the difficulty and high cost of transporting the necessary chemicals over long distances.<sup>234</sup> However, as technology progressed the two fields began to merge and currently the main companies in the UK provide both water and sewerage facilities, though there remain a number of smaller water-only companies.

Water supply takes place in four main stages; (1) collection and abstraction, the process by which water is removed from the source of supply (rivers, streams etc); (2) treatment, the process by which the water is made suitable for human consumption; (3) distribution from the treatment plant into the network; (4) final supply to the consumer. Sewerage disposal takes place in three main stages; (1) collection from the customer and transport to the treatment plant; (2) treatment of the sewage; (3) disposal of the sewage. While it is possible in theory for these various stages to be completed by different entities, in practice the companies throughout the UK complete all stages (vertical integration).

### III.2. England and Wales

#### *III.2.1. England and Wales: History*

Throughout the twentieth century, water supply was run as a public monopoly, with the infrastructure owned and operated by the government (originally local governments and then later national government).<sup>235</sup> Water pricing was linked to property value.<sup>236</sup> The first major reform in the water sector was created by the Water Act 1973, which consolidated the various local water and sewerage companies into 10 Regional Water Authorities (RWAs) which were able to provide both water and sewerage services and 29

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<sup>233</sup> Sawkins, J.W. 'The Development of Competition in the English and Welsh Water and Sewerage Industry' (2001) 22(2) *Fiscal Studies* 189, at 190.

<sup>234</sup> *Ibid*, at 190.

<sup>235</sup> Bakker, above n.231, at pp.4-5.

<sup>236</sup> *Ibid*, at p.5.

private statutory companies which could provide water-only services as agents of the RWAs. Even after this, however, the system was very inefficient, with major problems being "a high level of debt, variable quality of management (particularly of sewage works), and sustained water pollution".<sup>237</sup> These inefficiencies and a wide conception of state failure led to the move to privatisation. The Water Act 1989 was passed and in December 1989 the RWAs and the water-only companies were privatised by flotation on the London Stock Exchange.

### *III.2.2. England and Wales: Competition*

In addition to privatising the water companies, the Water Act 1989 also created a regulatory body designed to facilitate competition in the water market, the Office of Water Services (Ofwat). The water sector operates on the basis of comparative competition, whereby each company, while having a regional monopoly and so not competing directly against the other water companies, has its performance compared to and targets set by the standards achieved by the other water companies.

In order to operate as a water and sewerage company or water-only company, the company must obtain a licence from Ofwat. The current water and sewerage companies obtained their licence when they were privatised. As Hall and Lobina note, this means they gained their business through a sale without competition.<sup>238</sup> In addition, the possibility of competition while they are operating is minimal given the length of their concessions (the current licences are due to expire in 2014), and the fact that their concessions can only be ended by the government with 25 years notice.<sup>239</sup> It was to combat this limited competition that the method of comparative competition was introduced.

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<sup>237</sup> *Ibid*, at p.5.

<sup>238</sup> Hall and Lobina, above n.230, at 68.

<sup>239</sup> *Ibid*, at 68.

Under the terms of their licence, a company must supply annual information on their operations to Ofwat.<sup>240</sup> Ofwat has certain measures available to it which it may take against any company it feels is not performing satisfactorily, but as Sawkins notes, the main way Ofwat facilitates competition in the sector is simply by publishing the comparative information to allow companies to see how their performance rates against other companies.<sup>241</sup>

Ofwat also uses the information it receives from the companies to assess how efficient the companies are and so to set price caps on the amount charged by the companies for their services. The aim of these price caps is to provide an incentive to companies to improve their efficiency and to create price benefits for the customers.<sup>242</sup> Ofwat rates each company against the water company judged to be the most efficient in that period to create an efficiency improvement incentive target for the company.<sup>243</sup> Ofwat also makes an estimate of the likely improvement in efficiency that the sector as a whole might make and creates targets for a company based on that estimate.<sup>244</sup> A company profits if it outperforms Ofwat's targets, and the benefits in efficiency should be passed on to the consumer in the long-term.<sup>245</sup>

In addition to this system of comparative competition for the whole water sector, there is also a limited system of competition for water supply to businesses. Introduced in December 2005, this allows companies to apply for a licence to supply water and gives any business consumer who uses at least 50 megalitres of water a year the option to choose their water supplier. The system has, however, been very unsuccessful in

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<sup>240</sup> Source: <http://www.ofwat.gov.uk/regulating/junereturn/> [accessed 05/07/11].

<sup>241</sup> Sawkins, above n.233, at 195.

<sup>242</sup> Allan, G. 'Assessing capital efficiency in the water and sewerage industry in England and Wales: Ofwat's approach' (2006) 14 *Utilities Policy* 224, at 224.

<sup>243</sup> Ofwat, *Setting Price Limits for 2010-2015: framework and approach* (2009), available at

[http://www.ofwat.gov.uk/pricereview/pap\\_pos\\_pr09method080327.pdf](http://www.ofwat.gov.uk/pricereview/pap_pos_pr09method080327.pdf) [accessed 05/07/11], at p.41.

<sup>244</sup> *Ibid.*

<sup>245</sup> Allan, above n.242, at 225.

practice. In Ofwat's 2008 review of competition in the water sector they reported that the system had not resulted in any business customer switching supplier.<sup>246</sup>

### *III.2.3. England and Wales: Water and sewerage companies*

As noted above, the original privatisation created 10 water and sewerage companies with a regional monopoly over the area previously covered by the RWAs, in addition to 29 small water-only companies. There are currently 10 companies licensed as water and sewerage undertakers, operating in the original 10 monopoly regions, and 11 companies licensed as water-only undertakers.<sup>247</sup> These companies own and operate the network infrastructure in their monopoly region and complete all stages of water supply from abstraction from the original water source to final supply to the consumer.

The opportunities for merger were restricted for five years after privatisation, though during that period some water companies merged with electricity companies and many of the water-only companies also merged.<sup>248</sup> Even after the restriction ended mergers between the larger companies have been rare. Under section 32 of the Water Industry Act 1991, any merger between companies each with a turnover of over £10 million per annum must be referred to the Competition Commission. Ofwat presents evidence at these decisions and it is traditionally sceptical of such mergers, believing they damage the competitive market by diminishing the number of possible comparator companies. The water companies are, like all companies, open to acquisition at any time. While Ofwat cannot block an acquisition, they do review any proposed sale to ensure that the firm will be able to provide the required water services.<sup>249</sup>

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<sup>246</sup> Ofwat, *Ofwat's Review of Competition in the Water and Sewerage Industries: Part II*, (2008), available at [http://www.ofwat.gov.uk/competition/pap\\_con\\_reviewmrktcomp.pdf?download=Download#](http://www.ofwat.gov.uk/competition/pap_con_reviewmrktcomp.pdf?download=Download#) [accessed 05/07/11], at p.16.

<sup>247</sup> A full list of the licensees can be found on Ofwat's website at <http://www.ofwat.gov.uk/industrystructure/licences/> [accessed 05/07/11]

<sup>248</sup> Hall and Lobina, above n.230, at 68.

<sup>249</sup> Source: <http://www.ofwat.gov.uk/industrystructure/ownership/> [accessed 05/07/11].

### III.3. Scotland

#### *III.3.1. Scotland: History*

Scotland has historically resisted any privatisation of its water sector. When, in 1994, the government was consulting on possible options for the Scottish water and sewerage industry, a referendum was called in Strathclyde in which 97% voted against privatisation.<sup>250</sup> Ultimately, the decision was made to maintain public sector provision and three regional authorities (North, East and West) were established by the Local Government etc (Scotland) Act 1994. These authorities remained in operation until the Water Industry (Scotland) Act 2002 which established the current national monopoly supplier, Scottish Water.

#### *III.3.2. Scotland: Scottish Water*

Scottish Water is the fourth largest water and sewerage company in the UK, supplying 2.3 million households throughout Scotland, and with an average annual turnover of £1 billion.<sup>251</sup> The company is a publicly owned statutory corporation. As with the English and Welsh companies, Scottish Water is vertically integrated, completing all stages of the water supply and sewerage disposal process. The company set their water charges for domestic customers based on the council tax band of that customer, and the water rates are collected with that council tax.<sup>252</sup> Scottish Water's performance is monitored and regulated by the Water Industry Commission for Scotland (WICS), a regulatory body set up by section 9 of the Water Industry Act 1999. As with Ofwat in England and Wales, WICS sets certain price caps which Scottish Water must abide by.

#### *III.3.3. Scotland: Competition*

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<sup>250</sup> Hendry, S. 'Water for Sale? Market liberalisation and public sector regulation in Scottish Water Services' [2006/2007] 16(4) *Utilities Law Review* 153, at 153.

<sup>251</sup> Source:

[http://www.scottishwater.co.uk/portal/page/portal/SWE\\_PGP\\_ABOUT\\_US/SWE\\_PGE\\_ABOUT\\_US/SWE\\_AU\\_KEY\\_FACTS](http://www.scottishwater.co.uk/portal/page/portal/SWE_PGP_ABOUT_US/SWE_PGE_ABOUT_US/SWE_AU_KEY_FACTS) [accessed 05/07/11].

<sup>252</sup> Hendry, above n.250, at 156.

While Scottish Water has a monopoly over water and sewerage services in the domestic market, Scotland has recently opened up the business supply market to competition. The Water Services etc (Scotland) Act 2005 established a licensing scheme for water and sewerage suppliers. Since 1 April 2008 any non-domestic consumer in Scotland may choose their water and/or sewerage supplier from any of the licensed companies. Scottish Water continues to own and operate the water distribution network in Scotland.

Licences are granted by WICS and come in three forms; (1) General licences, which allow a company to supply water and/or sewerage services to any non-domestic customer in Scotland; (2) Specialist licences, which allow a company to supply any business which has a discount to their wholesale charge; (3) Self-supply licence, which allows a company to supply itself with water.<sup>253</sup> Licences are available without limit on number to any applicant who accepts the licence terms and conditions (setting out, *inter alia*, the required services to be provided and including operational terms setting out the interaction between the supplier and the network operator Scottish Water), and who satisfies certain technical checks.<sup>254</sup>

When the licensing framework was introduced, Scottish Power was required to separate its retail services to businesses from its other operations. This created a separate business company, now known as Scottish Water Business Stream Ltd. In addition to this company, there are currently four other licensed business suppliers in Scotland; Aimera Ltd, Wessex Water Enterprises Ltd, Osprey Water Services Ltd (part of the Anglian Water Group), and Satec Ltd.<sup>255</sup>

## **IV. Transport**

### IV.1. Airport Authorities

The UK airport sector was privatised in 1987 by the Airports Act 1986. Prior to this, airports in the UK were owned through local or central government, either directly or

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<sup>253</sup> Source: [http://www.watercommission.co.uk/view\\_Types\\_of\\_licence.aspx](http://www.watercommission.co.uk/view_Types_of_licence.aspx) [accessed 05/07/11].

<sup>254</sup> Source: [http://www.scotlandontap.gov.uk/view\\_Water\\_Suppliers.aspx](http://www.scotlandontap.gov.uk/view_Water_Suppliers.aspx) [accessed 05/07/11].

<sup>255</sup> Source: [http://www.watercommission.co.uk/view\\_Register\\_of\\_licenses.aspx](http://www.watercommission.co.uk/view_Register_of_licenses.aspx) [accessed 05/07/11].

through the British Airport Authority. The 1986 Act dissolved the British Airport Authority and its assets were vested in the successor company BAA plc which was floated on the stock exchange. The seven airports under its control (Heathrow, Gatwick, Stansted, Prestwick, Aberdeen, Edinburgh and Glasgow) were established as private companies owned by BAA.<sup>256</sup> The Act also required any municipal airports with an annual turnover of over £1 million to be registered as private companies, with the local authorities owning the shares in those companies.<sup>257</sup> The Civil Aviation Authority (CAA) was established to regulate the sector.

The majority of UK airports are now privately owned. BAA (now owned by Spanish company Ferrovial) remains the largest company in the sector, currently owning and operating six airports in the UK. All airports with an annual turnover of over £1 million must gain permission from the CAA in order to levy charges to use the airport from airlines.<sup>258</sup> Under section 40 of the Airports Act 1986 the Government may designate certain airports for detailed economic regulation. This has been done for Heathrow, Gatwick, Manchester and Stansted, and so for these companies the CAA sets a price cap on the charges levied by the airports for a five year period.<sup>259</sup>

#### IV.2. Port Authorities

As with the airport sector, ports in the UK are generally owned and operated by private companies. Privatisation of the UK port sector began in 1982 under the Transport Act 1981, which converted the British Transport Docks Board into a private company, known as Associated British Ports.<sup>260</sup> This company was set up as a subsidiary of Associated British Port Holdings plc, which was originally held by the Government but was later floated on the stock market, with 49% of the shares being sold in 1983 and the rest in

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<sup>256</sup> Humphreys, I. 'Privatisation and Commercialism: Changes in UK airport ownership patterns' (1999) 7 *Journal of Transport Geography* 121, at 124.

<sup>257</sup> Sections 13-14 Airports Act 1986.

<sup>258</sup> Section 37 Airports Act 1986.

<sup>259</sup> Section 40(3) Airports Act 1986.

<sup>260</sup> Section 5 Transport Act 1981.

1984.<sup>261</sup> The second stage of privatisation took place under the Ports Act 1991, which gave trust ports the right to establish themselves as companies.<sup>262</sup> This privatisation was not generally compulsory though the Secretary of State had the power, beginning two years after the Act came into force, to issue a direction to any port with an annual turnover of over £5 million to require them to privatise.<sup>263</sup> This Act led to the privatisation of seven trust ports; Clydeport, Dundee, Forth, Ipswich, Sheerness, Teesport and Tilbury. Of these, Ipswich was the only port forced to privatise by the Secretary of State.<sup>264</sup>

There are currently around 100 commercially active ports in the UK, of which 36 handle over two million tonnes annually.<sup>265</sup> The Department for Transport classifies ports in three different types; (1) Company owned ports; (2) Trust ports and; (3) Municipal ports.<sup>266</sup> The majority of ports are owned by companies and operate in a fully competitive market, competing with other ports for custom. The largest of these companies is still Associated British Ports Holdings, which currently owns 21 ports in the UK.<sup>267</sup> Trust ports are independent bodies created by statute for the purpose of administering a port. There are 28 trust ports in the UK which register an annual turnover of over £500,000, and the sector includes some important ports such as Dover.<sup>268</sup> The remaining ports are owned by local government, the largest of which are Portsmouth, Ramsgate, Sunderland, Weymouth and Workington.<sup>269</sup>

#### IV.3. Bus services

Under section 108 of the Transport Act 2000, every local transport authority in England and Wales must develop policies for the promotion of "safe, integrated, efficient and

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<sup>261</sup> Cullinane, K. and Song, D-K. 'Port privatisation policy and practice' (2002) 22(1) *Transport Reviews* 55, at 70.

<sup>262</sup> Section 1 Ports Act 1991.

<sup>263</sup> Sections 10 and 11 Ports Act 1991.

<sup>264</sup> Department for Transport, *Modern Ports: A UK Policy*, (2000), available at <http://www.dft.gov.uk/pgr/shippingports/ports/modern/modernportsaukpolicy> [accessed 05/07/11], at p.29.

<sup>265</sup> *Ibid* at p.5.

<sup>266</sup> *Ibid*, at p.28.

<sup>267</sup> A list of the ports owned by the company can be found at <http://www.abports.co.uk/index.htm> [accessed 20/01/09].

<sup>268</sup> Department for Transport, above n.264, at p.29.

<sup>269</sup> *Ibid*, at p.29.

economic transport facilities" in their local area. They must publish these policies in a Local Transport Plan (LTP) every five years and keep the plan under review.<sup>270</sup> Each county council within England and Wales (outside London) is classed as a local transport authority.<sup>271</sup> For London, the relevant body is Transport for London. Similar regional transport strategies are required in Scotland under the Transport (Scotland) Act 2005, where the strategies are the responsibility of regional Transport Partnerships. While bus transport is the most commonly used method for ensuring such transport facilities, trams and light railways (such as underground systems) are also used. As these fall under the jurisdiction of the Office of Rail Regulation along with national rail services, they will be discussed in the following section.

Under section 110 of the Transport Act 2000, every LTP in England and Wales must currently contain a bus strategy. This strategy must set out how bus services in the area will meet the needs of local residents, those services are provided to the standard that the authority considers appropriate and how any additional facilities the authority feels are necessary will be provided. The requirement for a bus strategy has been repealed by section 10 of the Local Transport Act 2008, though this section is not yet in force. While this reform will remove the need to prepare a separate bus strategy, bus policy will likely remain a major part of most local authorities' LTPs.

The bus sector in the UK was privatised and fully deregulated in 1985.<sup>272</sup> Private commercial bus operators are subject to two main licensing and registration requirements. Firstly, the operator must obtain a Public Service Vehicle (PSV) operator licence from the Vehicle and Operator Services Agency (VOSA) under the Public Services Vehicles (Operators' Licences) Regulations 1995. These are awarded without limit on number to any operator satisfying certain financial and technical requirements. Secondly, the operator must register the services he wishes to operate under the Public Service Vehicles (Registration of Local Services) Regulations 1986. Services are

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<sup>270</sup> Section 108(3) Transport Act 2000.

<sup>271</sup> Section 108(7) Transport Act 2000.

<sup>272</sup> For the history and impact of the deregulation, see White, P. 'Deregulation of bus services in Great Britain: an introductory review' (1995) 15(2) *Transport Review* 185.

registered with the Traffic Commissioner so long as there are no planned stops in London, in which case a London Service Permit must be obtained from Transport for London. The Traffic Commissioner must accept all properly completed registration applications from a company with a valid PSV operator licence.<sup>273</sup>

Despite this privatisation, the Transport Act 2000 provides a number of mechanisms for a local authority to work with a transport operator, including quality partnership schemes (QPS) and quality contracts schemes (QCS).<sup>274</sup> Under a QPS, a local authority agrees to provide certain bus facilities, in return for which the bus operator agrees to meet certain standards set by the authority in their services.<sup>275</sup> Under a QCS, the right to provide bus services in a certain area may be given exclusively to one operator in return for an agreement to meet certain standards in the service.<sup>276</sup> A QCS may only be made where it is the only practicable way of implementing the authority's bus strategy and the authority is satisfied the scheme will be "economic, efficient and effective".<sup>277</sup> These options offer local authorities a measure of control over the operation of bus services in their area.

#### Transport for London

Transport for London is the public sector body responsible for all transport within London, which covers bus services, the London Underground, Docklands Light Railway, London Overground, Tramlink, London River Services and Victoria Coach Station.<sup>278</sup> London Buses Ltd, the organisation within Transport for London with specific responsibility for bus services, plans the bus routes, sets the required service levels and

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<sup>273</sup> VOSA, *Local Bus Service Registration – Guide for Operators*, (2008), available at <http://www.vosa.gov.uk/vosacorp/publications/manualsandguides/busserviceregistrationguides.htm> [accessed 05/07/11], at p.5.

<sup>274</sup> Sections 114 and 124 Transport Act 2000.

<sup>275</sup> Section 114(2) Transport Act 2000.

<sup>276</sup> Section 124(4) Transport Act 2000.

<sup>277</sup> Section 124(1) Transport Act 2000.

<sup>278</sup> Source: <http://www.tfl.gov.uk/corporate/about-tfl/4510.aspx> [accessed 05/07/11].

monitors that service quality. Bus services within London are put out to tender, with each route being tendered separately.<sup>279</sup>

#### IV.4. National rail, tram and light railway services

##### *IV.4.1. Mainline rail*

Prior to 1994, all rail infrastructure and assets were owned and operated by the public sector through British Rail. Under the Railways Act 1993 this was changed, with the privatisation of the UK rail system, undertaken with the aim of improving the quality of the rail service and providing better value for money.<sup>280</sup> Under these reforms, the UK rail system was split into various parts, with the infrastructure being put under the control of one company (originally Railtrack plc, now Network Rail) and the routes being run by private companies under a franchise system. The Railways Act 1993 also established the regulatory body, the Office of Rail Regulation (ORR).<sup>281</sup> The Transport Act 2000 established a second regulatory body, the Strategic Rail Authority (SRA), with responsibility for the franchising process.<sup>282</sup> The SRA was, however, abolished in 2006 and its responsibilities split between ORR and the Department for Transport.<sup>283</sup>

- Infrastructure: Network Rail

At privatisation, the company Railtrack was formed to manage and maintain the rail infrastructure previously owned by British Rail, including all the track, signalling equipment and stations. Railtrack was run as a public company, aiming to provide a financial return to its investors through profit made from leasing track to the train operating companies (TOCs).<sup>284</sup> The company struggled, however, often failing to meet its targets and the rail infrastructure deteriorated throughout the country. In April 2001 the company was forced to seek a financial bailout from the government and falling

<sup>279</sup> Source: <http://www.tfl.gov.uk/businessandpartners/busoperators/9470.aspx> [accessed 05/07/11].

<sup>280</sup> Gladding, R. 'Rail Regulation in the UK: The Role of Quality in the Passenger Rail Franchises' [2004/2005] 14(4) *Utilities Law Review* 151, at 151.

<sup>281</sup> Section 4 Railways Act 1993.

<sup>282</sup> Section 201 Transport Act 2000.

<sup>283</sup> The Railways (Abolition of the Strategic Railway Authority) Order 2006, SI 2006 No.2925.

<sup>284</sup> Leyland, P. 'The Railtrack Case: Mainly on the Wrong Track?' [2004/2005] 14(5) *Utilities Law Review* 213, at 213.

share prices meant that a further £3.6 billion had to be requested later in 2001.<sup>285</sup> In October 2001 the Secretary of State for Transport placed Railtrack into administration, and in October 2002 the current body responsible for the rail infrastructure, Network Rail, was created.

Unlike Railtrack, Network Rail is a not-for-profit company limited by guarantee. Technically a private company separate from the government, the company is primarily financed by debt from the capital markets.<sup>286</sup> The company inherited ownership of the rail infrastructure from Railtrack, and also owns and operates 18 of the largest stations throughout the UK (the remaining stations are leased from Network Rail and operated by franchisee TOCs as part of their franchise).<sup>287</sup> The company operates on the basis of a network licence granted by ORR, which sets out the conditions under which Network Rail must operate and the standards it must meet.<sup>288</sup> ORR monitors Network Rail's performance and has various enforcement powers at its disposal should it feel that performance has been unsatisfactory, including enforcement orders and fines.

- Train Operating Companies

The TOCs operate the passenger and freight train services over the UK rail system. Passenger services may either be operated by franchisees or by open access operators. In order to operate, all TOCs must apply for an access agreement with Network Rail to use the rail infrastructure. There is a right of appeal to ORR for any company who feels access has been unfairly refused or that the terms are unfairly onerous.<sup>289</sup>

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<sup>285</sup> *Ibid* at 213.

<sup>286</sup> Source: <http://www.networkrail.co.uk/aspx/1385.aspx> [accessed 05/07/11].

<sup>287</sup> Birmingham New Street, Cannon Street, Charing Cross, Edinburgh Waverley, Euston, Fenchurch Street, Gatwick Airport, Glasgow Central, King's Cross, Leeds, Liverpool Lime Street, Liverpool Street, London Bridge, Manchester Piccadilly, Paddington, St. Pancras, Victoria, and Waterloo. Source:

<http://www.networkrail.co.uk/aspx/765.aspx> [accessed 05/07/11].

<sup>288</sup> A copy of the licence is available from ORR's website at [http://www.rail-reg.gov.uk/upload/pdf/netwrk\\_licence.pdf](http://www.rail-reg.gov.uk/upload/pdf/netwrk_licence.pdf) [accessed 05/07/11].

<sup>289</sup> The Railways Infrastructure (Access and Management) Regulations 2005, SI 2005 No. 3049.

## 1. Freight

Freight trains move goods by rail. All freight companies must obtain a licence from ORR under Reg. 5 of the Railway (Licensing of Railway Undertakings) Regulations 2005<sup>290</sup>. Licences are available without limit on number to any operator satisfying certain financial and technical criteria.<sup>291</sup>

## 2. Franchisees

Franchisees run the majority of the passenger services in the UK. When British Rail was privatised, the routes the company ran were split into various regional franchise routes. These franchise routes are awarded to companies under competitive tendering procedures run by the Department of Transport. The franchising process was chosen in order to introduce competition into the sector but also to maintain the possibility of government subsidies to keep rural unprofitable services operating.<sup>292</sup>

As with freight services, a licence is necessary from ORR under Reg. 5 of the Railway (Licensing of Railway Undertakings) Regulations 2005 and an access agreement must be made with Network Rail for access to the infrastructure network. The franchisee leases their trains from rolling stock companies (ROSCOs), a cost they must factor into their bid. There are currently 16 franchisees operating in the UK.<sup>293</sup>

## 3. Open Access

Open access passenger TOCs operate outside of a franchise agreement, applying to ORR for the right to operate a specific train route.<sup>294</sup> Open access operators are fully private companies who compete with the franchisees for passengers. As with both freight and franchise services, a licence to operate a passenger service must be obtained from ORR

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<sup>290</sup> SI 2005, No. 3050.

<sup>291</sup> ORR, *Criteria and Procedures for granting licences and licence exemptions* (2011), available at <http://www.rail-reg.gov.uk/upload/pdf/406.pdf> [accessed 05/07/11]

<sup>292</sup> Gladding, above n.280, at 153.

<sup>293</sup> A list of current franchisees can be found on the Department for Transport website at <http://www.dft.gov.uk/topics/rail-passenger-franchises/public-register/> [accessed 05/07/11]

<sup>294</sup> Downie, G. And Sjostedt, C. 'ORR: Open Access is Back on Track, *GNER v Office of Rail Regulation'* [2005/2006] 15(2) *Utilities Law Review* 59, at 59.

and an access arrangement made with Network Rail. There are currently eight open access operators in the UK: Eurostar, London Underground, Heathrow Express, Hull Trains, North Yorkshire Moors Railway, Nexus, Grand Central, and West Coast Railway.<sup>295</sup>

#### *IV.4.2. Trams, Underground Rail and Light Railways*

A tramway is a rail system built at street level, and often sharing the road with traffic. A light railway is an urban rail transportation system which operates with lighter equipment and at lower speeds than the mainline rail system. These systems are also regulated by ORR, mainly to ensure health and safety. There are 9 companies in the UK providing tram and underground or light rail services<sup>296</sup>:

- Croydon Tramlink
- Docklands Light Railway
- London Underground
- Manchester Metrolink
- Midland Metro
- Nottingham Express Transit
- Sheffield Supertram
- Strathclyde Partnership for Transport (operating the Glasgow subway system)
- Tyne and Wear Metro

Docklands Light Railway, the London Underground and Croydon Tramlink are all owned and operated by the public sector body Transport for London. The Strathclyde Partnership for Transport is also a public sector body, established by the Transport (Scotland) Act 2005.<sup>297</sup> The Tyne and Wear Metro is owned and operated by Nexus, the Tyne and Wear Passenger Transport Executive. The remaining tramways and light

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<sup>295</sup> Source: <http://www.networkrail.co.uk/aspx/2369.aspx> [accessed 05/07/11].

<sup>296</sup> Source: <http://www.rail-reg.gov.uk/server/show/nav.1353> [accessed 05/07/11].

<sup>297</sup> Section 1 Transport (Scotland) Act 2005.

railways have been awarded by the relevant local transport authority to the private companies through a competitive tendering process.

## **V. Postal Services**

The postal services sector is the most recent sector to be included in the utilities procurement regime, being added in the 2004 reforms. As Glynn and Stubbs note, the regulatory history of this sector has shown slower progress towards deregulation and more opposition to opening to competition than in the other utility sectors.<sup>298</sup> While the UK has made moves to open the sector to competition in recent years – and now has one of the most open markets in Europe – Royal Mail is still the major player in the sector, delivering 99% of all mail in the UK<sup>299</sup>, and so this company will be the main focus of this section. The section will begin with a brief overview of Royal Mail's structure before examining the various postal activities, the universal service obligation and finally, the state of competition in the UK.

### V.1. Royal Mail

Royal Mail Group Ltd is the main postal service provider in the UK. This company is a wholly-owned subsidiary of Royal Mail Holdings plc, a public limited company in which the UK Government hold 100% of the shares. The company was first established under the name Consignia in 2001, replacing the previous service provider, the Post Office, which was a statutory public corporation. The company changed its name to Royal Mail in 2002. Royal Mail Group Ltd operates its mail services through the Royal Mail brand and operates an express/courier service in the UK through the Parcelforce Worldwide brand. Royal Mail Group Ltd also owns the subsidiary companies General Logistics Systems BV (GLS), which operates express/courier parcel delivery services in Europe, and Post Office Ltd, which offers a range of postal, financial and retail services. The

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<sup>298</sup> Glynn, D. and Stubbs, D. 'The end to the postal exception?', in Robinson, C. (ed.), *Utility Regulation in Competitive Markets*, (2007, Cheltenham: Edward Elgar), at p.119.

<sup>299</sup> Hooper, R., Hutton, D. and Smith, I. *Modernise or Decline: Policies to maintain the universal postal service in the United Kingdom*, (2008), available at <http://www.berr.gov.uk/files/file49389.pdf> [accessed 05/07/11], at p.48.

majority of Royal Mail Group's revenue comes from the postal services of the main Royal Mail brand.<sup>300</sup>

## V.2. Postal Services Activities

The postal sector as it relates to the Utilities Directive covers the collection, sorting, transportation and delivery of mail (covering letters, packets and parcels). It also covers some financial activities such as postal giro orders when these activities are done by a body which also provides postal services.<sup>301</sup> The postal market as a whole is worth an estimated £11 billion per year.<sup>302</sup> The market may usefully be divided into addressed letters, unaddressed mail, express or courier delivery, standard parcel delivery, and the auxiliary services provided by Post Office Ltd.

### *V.2.1. Letters*

The letter market covers addressed mail under 350g and/or which costs less than £1 to send (the area for which a licence is required). It also covers any parcels which are small enough to fit through a letter box.<sup>303</sup> Mail delivery is completed in five stages: (1) collection from post boxes, post offices and businesses; (2) sorting by region; (3) transport to the correct regional mail centre; (4) sorting into the correct local delivery "walks"; (5) delivery to final address. While this sector is now fully open to competition, in practice most operators still rely on Royal Mail to complete the final stage, the delivery to the consumer.

### *V.2.2. Unaddressed Mail*

This covers any mail put through a letterbox which does not have an address, such as free newspapers and advertisements. It does not require any kind of licence to deliver.

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<sup>300</sup> 72.8% in 2007-8, see Hooper, Hutton and Smith, *ibid*, at p.24.

<sup>301</sup> Art. 6(2) Utilities Directive.

<sup>302</sup> Postcomm, *UK Postal Market: Competitive Market Review*, (2008), available at

<http://www.psc.gov.uk/documents/571.pdf> [accessed 05/07/11] at p.4.

<sup>303</sup>*Ibid*, at p.5.

#### *V.2.3. Express or courier delivery*

This area covers any mail over 350g which is guaranteed to arrive by a certain time or day, and any service which requires a signature on receipt or which includes a tracking service. Express and courier services are not regulated in the UK.<sup>304</sup>

#### *V.2.4. Standard Parcel Delivery*

Standard parcel delivery covers any package over 350g which is not guaranteed to arrive before a certain time.<sup>305</sup>

#### *V.2.5. Auxiliary Services: Post Office Ltd*

There are approximately 11,500 Post Office outlets in the UK.<sup>306</sup> The Post Office offers a range of postal services supporting Royal Mail such as collection of postal items and the sale of stamps. In addition to this it also provides a number of financial and retail services. These include insurance, banking and investment services, which are regulated activities under the Utilities Directive when completed by a body which also offers postal services. However, they also include unregulated activities such as licensing services.

### V.3. The Universal Service Obligation

The requirement for a “universal postal service” in each EU Member State is laid down in Article 3 of Directive 97/67/EC.<sup>307</sup> In the UK, this is implemented in Section 4 of the Postal Services Act 2000. This sets out the requirements of a universal postal service as:

- At least one delivery of postal items every working day to the home of every individual in the UK.
- At least one collection of postal items every working day from each access point.

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<sup>304</sup>Hooper, Hutton and Smith, above n.299, at p.26.

<sup>305</sup>Postcomm, above n.302, at p.5.

<sup>306</sup> Source: <http://www.postoffice.co.uk/portal/po/jump1?mediaId=20000192&catId=63400714> [accessed 05/07/11]

<sup>307</sup> Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, OJ L15.

- A service of conveying postal items from one place to another, in addition to the incidental services of receiving, collecting, sorting and delivering those items, provided at an affordable price which is uniform throughout the UK.
- A registered post service provided at an affordable price.

The requirement that the price be uniform throughout the country is a UK addition. The EU Directive requires only that the prices be affordable and does not expand on this obligation.<sup>308</sup> Royal Mail is the current universal service provider (USP) for the UK and is required under the terms of its postal licence to ensure the requirements of Section 4 of the Postal Services Act 2000 are fulfilled. This Act also created the Postal Services Commission (Postcomm), a regulatory body whose duty it is to protect the universal service.<sup>309</sup>

#### V.4. Competition

The impetus for opening the postal market to competition has mainly come from the EU, which aims to create an internal market for postal services, with the most recent directive setting a date of December 2010 for competition to be introduced throughout the EU.<sup>310</sup> The UK has opened the market faster than the EU required. Postcomm introduced competition in the UK in a number of stages since 2001, moving from the introduction of niche licences to opening up the bulk mail market until finally fully opening the postal market from 1 January 2006.

With the exception of letter delivery, the majority of postal services are unregulated and open to any company. A licence is required from Postcomm in order to deliver any mail weighing under 350g. As of 2011, there were 57 licensed operators, including Royal Mail.<sup>311</sup> Licences are available without restriction on number to any company which can

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<sup>308</sup> Art. 12 Directive 97/67/EC.

<sup>309</sup> Sections 1 and 3 Postal Services Act 2000.

<sup>310</sup> Art. 2 Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008 amending Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services, OJ L52/3.

<sup>311</sup> An up-to-date list of all licensed postal operators can be found on Postcomm's website at <http://www.psc.gov.uk/postallicencesandoperators/licensedoperators> [accessed 05/07/11].

fulfil the requirements set down by Postcomm regarding mail integrity and common operational procedures.<sup>312</sup>

While some licensed companies have developed a local delivery network and offer “end-to-end” collection and delivery services, most competition operates through commercial “access arrangements” due to the difficulty in setting up a nationwide network. Under these arrangements the postal companies negotiate with Royal Mail for access to their main sorting offices and for permission to use Royal Mail staff and services for the final delivery to the consumer, in return for a fee paid by the company to Royal Mail. Under the terms of Royal Mail’s postal licence Royal Mail is required to negotiate such an agreement with any rival licensed postal operator who wishes access to the postal network. If Royal Mail and the company are unable to come to a suitable arrangement they may ask Postcomm to intervene and set the terms. Postcomm may also intervene where access is denied.<sup>313</sup>

## **VI. Conclusion**

This chapter has set out an overview of the operation of the UK utility sector in those areas governed by the Utilities Directive from which the sample for the empirical research was drawn. It can be seen that the size of the different sector and the amount of competition in each varies greatly, factors which may impact on both the use of CSR policies by the companies and their views and approach to compliance with the EU procurement regime. The following chapter will set out an overview of the EU utilities procurement regulation, setting out in more detail the precise level of procurement regulation applicable to each sector covered in this chapter.

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<sup>312</sup> Postcomm, *Postal Licence Applications – Guidance for Applicants* (2010), available at <http://www.psc.gov.uk/documents/1962.pdf> [accessed 05/07/11]

<sup>313</sup> Information on access complaints may be found at [http://www.psc.gov.uk/regulating/postcomm\\_investigations](http://www.psc.gov.uk/regulating/postcomm_investigations) [accessed 05/07/11]

## **Chapter 5 - The European Union Legal Regime on Procurement**

### **I. Introduction**

This chapter will set out the EU legal regime applying to procurement, focusing on utilities procurement. The chapter aims to describe the framework of legal rules which govern the procurement of the utilities sector, giving a background to a more specific discussion of the particular procurement rules relating to labour policies which this thesis will consider later. The procurement policy and legal framework discussed here will influence the procurement practices of utilities, whether CSR policies are included in those practices and, if so, how they are structured. The chapter will first examine the policy behind the EU procurement regulation. This will be followed by an overview of the relevant rules under both the Treaty on the Functioning of the European Union (TFEU) and Directive 2004/17/EC<sup>314</sup> (the Utilities Directive).

### **II. Reasons for Procurement Regulation**

One of the most important aims of the European Union (EU) is the creation of a common market, an area of economic integration which will eliminate any barriers in the free movement of goods, persons, services and capital.<sup>315</sup> The EU is based on the economic theory that removing these trade barriers will improve the economic growth of the EU in general, and of the individual member states.<sup>316</sup> Public procurement refers to the purchase by the public sector of the goods, services and works it requires, and it may act as a barrier to trade where government favours national suppliers over international suppliers, specifically European suppliers in the EU context. Governments may favour national suppliers for a variety of reasons, including policy reasons such as supporting national industry or combating local unemployment, and more simple reasons such as a

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<sup>314</sup> Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 No. L134/1.

<sup>315</sup> Art. 3 Treaty on European Union.

<sup>316</sup> For a detailed discussion of the theory behind, and development of, the EU single market, see Craig, P. and de Búrca, G. *EU Law: Text, Cases and Materials*, (4<sup>th</sup> Ed), (2008, Oxford: OUP), at Ch. 17.

lack of awareness of foreign suppliers.<sup>317</sup> These barriers to trade caused by nationalistic purchasing practices are significant due to the size of the government market, estimated in 2002 to be worth 16.3% of the overall GDP of the EU.<sup>318</sup>

Procurement regulation often focuses on the special nature of public markets. In private procurement the effect of competition should prevent nationalistic purchasing where this would be unprofitable, but public markets do not operate in the same manner. They do not have the same focus on increasing profit and also differ in structure both in demand and supply and in other areas such as risk.<sup>319</sup> Procurement regulation aims to ensure that public markets operate like private markets despite these differences, opening up public procurement to competition and preventing discrimination on grounds of nationality.

The utilities sector regulation covers both public bodies and public undertakings, to which the above arguments will also apply, and private bodies with "special or exclusive rights"<sup>320</sup> (discussed further below, in the section on the Utilities Directive). There are two connected reasons for including these private bodies in any procurement regulation. The first is that the special or exclusive rights which the firm is in possession of may make them vulnerable to pressure from government to favour national suppliers in its procurement.<sup>321</sup> Being dependent on the rights awarded by the government to stay in business will make a utility less able to resist such pressure than other private firms. The second reason is the fact that the rights on which the firms operate are limited to a certain number of firms and so those firms are not subject to the same competitive pressures when purchasing as firms in a completely open market would be.<sup>322</sup> Linked to the first reason, this lack of competition also makes it harder for the firms to resist

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<sup>317</sup> Arrowsmith, S. *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> Ed), (2005, London: Sweet and Maxwell), at pp.121-122.

<sup>318</sup> *Ibid*, at p.123.

<sup>319</sup> Bovis, C. *EU Public Procurement Law*, (2007, Cheltenham: Edward Elgar Publishing), at p.12.

<sup>320</sup> Art. 2(2)(b) Utilities Directive.

<sup>321</sup> Kotsonis, T. 'The Definition of Special or Exclusive Rights in the Utilities Directive: Leased Lines or Crossed Wires?' [2007] 1 PPLR 68, at 87.

<sup>322</sup> *Ibid*, at 88.

government pressure. As with public bodies, it is felt that regulation is needed to combat the effects of this lack of competition.

The EU regulation of procurement thus aims to prevent discrimination, especially on grounds of nationality, and to combat the lack of competition in public and utilities procurement. In order to fulfil these aims the EU regulation both prevents public and utility sector bodies from adopting procurement practices which discriminate against other European states, and imposes certain transparent regulatory procedures which must be followed when procuring, to allow the non-discrimination obligations to be monitored easily.<sup>323</sup> Member States, however, may be less concerned with avoiding discrimination in their procurement and more concerned with ensuring the process is as efficient as possible and that they receive value for money in their procurement. Entities in the utility sector may also face commercial pressures (such as those mentioned in the previous chapter as factors which drive the development of CSR policies) which mean that they need to include CSR issues in their procurement to stay profitable. These needs may conflict with the strict requirements of the EU rules. In addition, utilities must balance the non-discrimination demands of the EU's procurement policy with the focus on improving CSR policies which the EU also promotes, as discussed in the previous chapter.

The EU regime is in theory only a framework of rules designed to apply only to those contracts where there is a possibility of intra-Community competition, and Member States are free to regulate how they wish within this framework.<sup>324</sup> However, as Trepte notes, the recent trend in the EU regulation has been "towards applying ever more regulation to contracts of diminishing value".<sup>325</sup> This trend reduces states' freedom to regulate their procurement as they wish, including their freedom to include policies such as CSR policies. The sections which follow will examine the EU rules in more detail.

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<sup>323</sup> Arrowsmith, above n.317, at p.125.

<sup>324</sup> Case C31/87 *Gebroeders Beentjes BV v Netherlands* [1988] ECR 4635, at para. 20.

<sup>325</sup> Trepte, P-A, *Public Procurement in the EU: A Practitioner's Guide*, (2<sup>nd</sup> Ed), (2007, Oxford: OUP), at p.3.

### **III. The TFEU Rules**

#### III.1 Introduction

While the TFEU has no principles in it which relate expressly to procurement, several of the internal market provisions and the fundamental principles of the Treaty affect procurement in practice. These Treaty principles operate in addition to the rules under the directives and so affect all procurement contracts, but they are of special importance for contracts which fall outside the scope of the procurement directives, such as contracts below the financial thresholds. The Treaty rules are also relevant for utilities which have gained an exemption from the Utilities Directive rules under Article 30 of that directive (see below). The most important rules for procurement are the free movement provisions; the free movement of goods (Article 34 TFEU), freedom of establishment (Article 49 TFEU) and the freedom to provide services (Article 56 TFEU). Article 18 TFEU, which prohibits discrimination on grounds of nationality, and Article 107 TFEU, dealing with state aid, are also relevant. Finally, in the utilities context, Article 106 TFEU is important when considering the position of private entities with special or exclusive rights under the Treaty.

#### III.2 The Free Movement Provisions

##### *III.2.1. Free Movement of Goods*

Article 34 TFEU forbids “quantitative restrictions on imports and all measures having equivalent effect”. The Court of Justice of the European Union (CJEU) has held that this prohibits any rule which is “capable of hindering, directly or indirectly, actually or potentially, intra-Community trade”.<sup>326</sup> Article 49 prohibits a state from discriminating against foreign individuals and companies wishing to establish themselves in that state. Article 56 is similar, but prohibits discrimination against individuals wishing to provide a temporary service in a Member State rather than establish themselves there.

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<sup>326</sup> Case 8/74, *Procureur du Roi v Dassonville* [1974] ECR 837

While Article 34 and the other free movement provisions are generally used to prevent restrictions affecting the whole market, they apply equally where only access to the public market is restricted, as with discriminatory procurement measures.<sup>327</sup> Article 34 and the other free movement provisions apply to the state, which includes public bodies and local authorities, covering contracting authorities under the Public Sector Directive and Utilities Directive.<sup>328</sup> Bodies classed as public undertakings under the Utilities Directive are probably also covered, though it is arguable that this is not automatic but depends on the level of control by public authorities in the specific procurement.<sup>329</sup> It is less clear whether it covers bodies with special or exclusive rights under the Utilities Directive (see section on Article 106 below).

The free movement provisions prevent both rules which discriminate against imports (direct discrimination)<sup>330</sup> and rules which appear to apply to both national and foreign goods equally but which are in fact harder for foreign goods to comply with (indirect discrimination).<sup>331</sup> They also prevent rules which do not discriminate against foreign goods either directly or indirectly but which nevertheless form hindrances to trade (non-discriminatory rules).<sup>332</sup>

The application of Article 34 to these non-discriminatory rules was later limited by the CJEU in the case of *Keck*, which introduced a distinction between rules relating to the characteristics of the goods themselves, which are caught by Article 34, and rules concerning selling arrangements, which are not.<sup>333</sup> This distinction is hard to apply in a procurement situation, however, where conditions may concern matters such as the pay of the workforce producing the goods, which is neither a rule concerning the characteristics of the supplies nor a selling arrangement. Unlike Article 34, the impact of

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<sup>327</sup> Arrowsmith, above n.317, at p.183.

<sup>328</sup> Trepte, above n.325, at p.8.

<sup>329</sup> Arrowsmith, above n.317, at p.208.

<sup>330</sup> See, for example, Case C-21/88, *Du Pont de Nemours Italiana SpA v Unita Sanitaria Locale No. 2 Di Carrara* [1990] I-ECR 889.

<sup>331</sup> See, for example, Case 45/87, *Commission v Ireland* [1988] ECR 4929.

<sup>332</sup> See Case 120/78, *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein* [1979] ECR 649, ("Cassis de Dijon") for goods, and Case C-384/93, *Alpine Investments BV v Minister van Financien* [1995] ECR I-1141 for services.

<sup>333</sup> Cases C-267 and 268/91, *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097, ("Keck"), at paras. 15-17.

Articles 49 and 56 on non-discriminatory measures has not been limited in any way and so it appears that any condition imposed by an authority in a procurement for services is *prima facie* a restriction on trade which must be justified.<sup>334</sup>

If a measure is found to violate Article 34 it may be saved if it is justifiable under a Treaty exception or an objective justification recognised by the CJEU. The Treaty exceptions to Article 34 are found in Article 36 TFEU. The Treaty exceptions for Articles 49 and 56 are found in Articles 51 and 52.<sup>335</sup> To successfully derogate from Article 34, the measure must also not discriminate “arbitrarily” and must not be a “disguised restriction on trade”.<sup>336</sup> Also, under the principle of proportionality, the measure must not go beyond what is necessary to achieve its aim.<sup>337</sup> A measure may also be justified by a ground recognised by the CJEU (a “mandatory requirement” for goods, “objective justifications” for services and establishment).<sup>338</sup> A non-exhaustive list of such mandatory requirements was given by the Court in *Cassis de Dijon* and the court may add to that list at any time. It was previously argued that directly discriminatory measures could only be justified by Treaty exceptions but this no longer seems to be the case since *Preussen-Elektra*<sup>339</sup>, where environmental concerns, a court-based justification, were used to justify a directly discriminatory measure.

The free movement rules significantly restrict a procuring entity’s ability to impose any CSR conditions focusing on improving local conditions, for example to combat local unemployment. If it is the case that any condition is *prima facie* a restriction on trade, utilities may be unable to include most labour policies, as they would seem to be unjustifiable under the Treaty or CJEU justifications, as discussed in Chapter 6.

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<sup>334</sup> Case C-234/03, *Contse SA, Vivisol Srl & Oxigen Salud SA v Instituto Nacional de Gestión Sanitaria (Ingesa)* [2005] ECR I-9315, (“Contse”)

<sup>335</sup> Made applicable to services by Article 62 TFEU.

<sup>336</sup> Article 36 TFEU.

<sup>337</sup> Case 104/75, *Officier van Justitie v De Peijper*[1976] ECR 613.

<sup>338</sup> *Cassis de Dijon*, above n.20.

<sup>339</sup> Case C-379/98, *Preussen-Elektra AG v Schleswag AG* [2001] ECR I-2099, (“Preussen-Elektra”)

### III.3 The Principle of Transparency

While most of the requirements of the TFEU are simply negative obligations such as non-discrimination, the CJEU has also stated that the Treaty sets out a positive obligation of transparency. This obligation generally requires that procuring entities advertise the contracts they propose to award, even where they fall outside the scope of the procurement directives. The scope of the requirement and the degree of advertising required are debated widely.

A principle of transparency under the TFEU had been mentioned by the CJEU in the cases of *RI.SAN*<sup>340</sup> and *Unitron*,<sup>341</sup> but the principle was not examined in any detail or its obligations stated until the case of *Telaustria*.<sup>342</sup> This case concerned a service concession contract, a type of contract excluded from the procurement directives. The CJEU stated that the transparency obligation under the TFEU required "a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of procurement procedures to be reviewed".<sup>343</sup> The Court did not, however, expand on what a "sufficient" degree of advertising would be.

The CJEU confirmed that Treaty principles (which would include the principle of transparency) apply to contracts below the directives' thresholds in the case of *Vestergaard*.<sup>344</sup> The application of the principle to non-priority services (or "Part B services, see further below in Utilities Directive section), which are subject to a more flexible regime under the directives, was confirmed by the CJEU in *Commission v Ireland*.<sup>345</sup> Beyond this the scope of the obligation is uncertain, though Advocate-General Jacobs has stated in his Opinion in the case of *Commission v Italy*<sup>346</sup> that any contract

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<sup>340</sup> Case C-108/98, *RI.SAN. Srl v Comune di Ischia, Italia Lavoro SpA and Ischia Ambiente SpA*[1999] ECR I-05219

<sup>341</sup> Case C-275/98, *Unitron Scandinavia A/S and 3-S A/S, Danske Svineproducenters Serviceselskab v Ministeriet for Fødevareer, Landbrugog Fiskeri* [1999] ECR I-08291.

<sup>342</sup> Case C-324/98, *Telaustria and Telefonadress v Telekom Austria* [2000] ECR I-10745.

<sup>343</sup> *Ibid*, at para. 62.

<sup>344</sup> Case C-59/00, *Bent Moustsen Vestergaard v Spøttrup Boligselskab*[2001] ECR I-09505.

<sup>345</sup> Case C-507/03, *Commission v Ireland* [2007] ECR I-09777.

<sup>346</sup> Opinion of Advocate General, Case C-525/03, *Commission v Italy*, [2005] ECR I-09405, at paras. 40-49.

which would have a derogation from the directives were it subject to those directives (e.g. for extreme urgency) should also have a derogation from the Treaty requirements.

In this case the CJEU also confirmed the requirement, previously suggested in *Coname*,<sup>347</sup> that for the Treaty principles to apply, the contract must be of cross-border interest. In the case of a dispute, the burden of proof for showing such cross-border interest lies with the Commission.<sup>348</sup> This was confirmed recently in the case of *SECAP*.<sup>349</sup> Generally it is for the procuring entity to decide whether a particular contract is of cross-border interest, though a Member State may set out guidelines for determining this in national law.<sup>350</sup>

The degree of advertising required to fulfil the transparency obligation has not been considered by the CJEU. The Commission has released a Communication in which it sets out its interpretation of the requirement.<sup>351</sup> Following this, it is for the contracting authority to determine the degree of advertising appropriate for the particular contract, though there must be some positive advertising; it is not enough to simply contact a range of firms.<sup>352</sup> Possible means of advertising suggested by the Commission are through websites, national newspapers and through publication in the Official Journal of the European Union. The advertisement should set out the essential details of the contract and the award procedure the contracting entity is using.<sup>353</sup>

#### III.4 Non-discrimination

Article 18 TFEU prohibits any discrimination on the grounds of nationality. It requires that any EU member is treated no less favourably than nationals of the particular Member State in question, and so would prevent any procurement measures which favoured national suppliers over other EU suppliers. The Article only applies to EU

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<sup>347</sup> Case C-231/03, *Consorzio Aziende Metano (Coname) v Comune di Cingia de' Botti* [2005] I-07287.

<sup>348</sup> *Commission v Ireland*, above n.331, at para. 32.

<sup>349</sup> Joined Cases C-147/06 and C-148/06, *SECAP SpA v Commune di Torino*, Judgment of the Court of 15 May 2008.

<sup>350</sup> *Ibid*, at para. 30.

<sup>351</sup> European Commission, *Commission Interpretive Communication on the Community law applicable to contract awards not or not fully subject to the provisions of the Public Procurement Directives* (2006) OJ C 179/2.

<sup>352</sup> *Ibid*, at para. 2.1.

<sup>353</sup> *Ibid*, at para. 2.1.3.

nationals, allowing discrimination against non-EU persons.<sup>354</sup> All the free movement provisions implement the principle of non-discrimination in their particular areas and so the provision is rarely invoked independently.<sup>355</sup>

### III.5 State Aid<sup>356</sup>

To prevent any distortion to competition, the TFEU, in Article 107, forbids any aid given by a state to industry in that state. The concept of aid covers any "economic advantage which [the undertaking] would not have received under normal market conditions", examples being a contract awarded on unusually favourable terms or a contracting entity procuring something for which it has no genuine need.<sup>357</sup> Since an advantage must be conferred, there is no state aid if the aid given to a firm is simply compensation for services provided by that firm, as will be the case in properly performed procurement procedures.<sup>358</sup> Article 107(2) sets out types of aid which are automatically compatible with the Treaty, for example aid to deal with the consequences of natural disasters. Article 107(3) sets out types of aid which may be considered compatible with the Treaty at the discretion of the European Commission, which includes regional development and may be relevant for social policies in procurement.<sup>359</sup> If the Commission decides that the aid is not compatible, the aid must be repaid with interest.<sup>360</sup>

There are two conditions for aid to fall within Article 107; the advantage given to the undertaking must come from state resources, and the measure must be imputable to the state.<sup>361</sup> As regards the first condition, aid comes from state resources when it is given by any entity subject to the dominant influence of the state, which for bodies covered by the Utilities Directive will cover contracting authorities and public undertakings.<sup>362</sup> For

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<sup>354</sup> Trepte, above n. 325, at p.6.

<sup>355</sup> Arrowsmith, above n.317, at p.218.

<sup>356</sup> *Ibid*, at pp.219-232.

<sup>357</sup> Case C-39/94, *Syndicat Français de l'Express International (SFEI) v La Poste* [1996] ECR I-3547.

<sup>358</sup> Case C-280/00, *Altmärk Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmärk GmbH*, [2003] ECR I-7747.

<sup>359</sup> For an overview of the procedural rules for notifying state aid to the Commission, see Craig and de Burca, above n.316, at pp. 1098-1102.

<sup>360</sup> Case 310/85, *Deafil v Commission* [1987] ECR 901.

<sup>361</sup> Cases 67, 68 and 70/85, *Kwerkerij Gebroeders Van der Kooy BV v Commission* [1988] ECR 219.

<sup>362</sup> Case C-482/99, *France v Commission* [2002] ECR I-4397, ("Stardust Marine").

private entities with special or exclusive rights no state resources are generally used so those entities will only be covered by Article 107 if the state provides the entity with specific resources for that contract.<sup>363</sup> As regards the second requirement, while actions by a contracting authority will probably always be imputable to the state, for a public undertaking it must be considered whether a public authority was involved in giving the aid. In the case of *Stardust Marine* the CJEU set out a number of indicators of the relevant amount of control needed for a measure to be imputable to the state, such as the level of managerial supervision.<sup>364</sup> If these are not satisfied, the measure will not fall within Article 107.

### III.6 Article 106: Entities with special or exclusive rights

Article 106(1) TFEU states:

In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty.

This article is important for determining the application of other Treaty articles to public undertakings and entities with special or exclusive rights under the Utilities Directive. The article is addressed to the Member States, not the undertakings themselves, and so it would seem that only the government will be liable for any breach of a Treaty provision by an undertaking. However, where an undertaking is covered directly by a Treaty provision, as may be the case with public undertakings under the free movement provisions (see above), there will be joint liability.<sup>365</sup>

As under the Utilities Directive, public undertaking covers any undertaking which a public authority has a dominant influence over due to ownership, financial participation, or the rules governing that undertaking.<sup>366</sup> For entities with special or exclusive rights, an

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<sup>363</sup> Arrowsmith, above n.317, at p.230.

<sup>364</sup> *Stardust Marine*, above n.362, at paras.55-56.

<sup>365</sup> Arrowsmith, above n.317, at p.236.

<sup>366</sup> Joined Cases 188-190/80, *France, Italy and the UK v Commission* [1982] ECR 2545. See also Art. 2(1)(b) Utilities Directive.

exclusive right appears to refer to any right given to a single entity, and special rights to rights given under certain conditions to a limited number of entities, such as a licence to operate an energy network.<sup>367</sup> It is arguable that where the right is open to anyone under objective criteria it is not a special or exclusive right given that there is little opportunity for the state to influence the undertaking in those circumstances.<sup>368</sup> While it is not clear whether the concept of special and exclusive rights under Article 2 of the Utilities Directive is the same as under Article 106, it seems likely that most utilities have special or exclusive rights within the Article 106 definition and so will also be regulated by the Treaty.

A Member State will violate Article 106 when it takes a measure in relation to a public undertaking or an entity with special or exclusive rights which is itself a violation of another Treaty article.<sup>369</sup> Sierra argues that the article may also be violated when the entity itself takes a measure which would violate another Treaty provision if it were a Member State.<sup>370</sup> Arrowsmith, however, argues that the position is analogous to the rules for state aid set out in *Stardust Marine* (see above), and so the article is only violated where the Member State is involved in the relevant measure, determined by examining the factors set out in that case.<sup>371</sup> If this is correct, it would remove private utilities from the scope of the Treaty for most contracts, allowing them greater freedom in their procurement and increasing the scope for CSR policies to be included.

#### **IV. The Procurement Directives**

##### IV.1 History

In addition to the rules on procurement deriving from the TFEU, the EU also regulates procurement through a system of directives. These directives set out certain positive obligations, such as transparent award procedures, which support the negative Treaty obligations. Essentially, the directives require that procuring entities advertise their

<sup>367</sup> Arrowsmith, above n.317, at p.238.

<sup>368</sup> *Ibid*, at p.238.

<sup>369</sup> *Ibid*, at p.235.

<sup>370</sup> Sierra, B. *Exclusive Rights and EC Monopolies under EC Law*, (1999, Oxford: OUP), at p.192.

<sup>371</sup> Arrowsmith, above n.317, at p.235.

contracts and then hold a competition between any interested firms on the basis of certain specified criteria, within certain set time frames. In 2004, the procurement directives underwent a major reform. This section will examine the rules under the directives and the effects of this reform in more detail, focusing on the Utilities Directive.

For the public sector, the first procurement directives (the co-ordination directives) were adopted in the 1970s, regulating public works contracts and public supplies contracts.<sup>372</sup> These directives were amended in the 1980s and again in the 1990s, eventually forming Directive 93/36/EEC<sup>373</sup> on supply contracts and Directive 93/37/EEC<sup>374</sup> on works contracts. It was also at this time that a directive was issued for services contracts (Directive 92/50/EEC<sup>375</sup>). A system of remedies to deal with breach of these directives was set out in Directive 89/665/EEC.<sup>376</sup> While these directives continued to be amended slightly over the years, the relevant procurement rules remained substantially the same until 2004, when the three separate directives for award procedures were replaced with one consolidated directive, Directive 2004/18/EC ("the Public Sector Directive").<sup>377</sup> The rules in this directive apply to most contracts awarded in the public sector. Detailed examination of its procedures is beyond the scope of this thesis, which is focusing on the utilities sector.<sup>378</sup>

When the early procurement directives were adopted, they excluded most contracts made in the utilities sectors of transport, energy, water and telecommunications. This exclusion was due to the fact that these sectors were subject to different regimes in the various Member States, with some utilities being publicly owned and others private.<sup>379</sup> It was felt that it was inappropriate to regulate only public utilities, as this would give an unfair advantage to private utilities who would still be able to discriminate, and equally it

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<sup>372</sup> Directive 71/305/EEC, OJ 1971 L185/1 and Directive 77/62/EEC, OJ 1977 L13/1.

<sup>373</sup> OJ 1993 L199/1.

<sup>374</sup> OJ 1993 L199/54.

<sup>375</sup> OJ 1992 L209/1.

<sup>376</sup> OJ 1989 L395/33.

<sup>377</sup> Directive 2004/18/EC of the European Parliament and of the Council on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts, OJ 2004 L132/114.

<sup>378</sup> For detailed examination of the public sector directive, see Arrowsmith, above n.317, Trepte, n.325 above, and Bovis, n.319 above.

<sup>379</sup> Bovis, n.319 above, at p.26.

was seen as unacceptable at the time to regulate private entities.<sup>380</sup> Nevertheless, these sectors created a possible barrier to trade due to the absence of competition they usually faced and the possibility of government control where they were publically owned or relied on the state for their rights, both of which it was felt might lead to discriminatory procurement practices.<sup>381</sup>

Utilities were finally brought within the procurement regime by Directive 90/531/EEC<sup>382</sup>, which applied to works and supplies contracts in the energy, transport, water and telecommunications sectors. Services were added by Directive 93/38/EEC<sup>383</sup>, which also consolidated the works, supplies and services rules for the utilities sectors. To solve the problem of the different legal status of the various utilities in the different Member States, the directives applied to any entity, public or private, which operated in the relevant sectors and which fulfilled certain conditions which it was felt led to the possibility of discriminatory procurement. This covered public authorities, public undertakings and private bodies operating on the basis of special or exclusive rights.<sup>384</sup> A system of remedies for breach was set out in Directive 92/13/EEC<sup>385</sup> ("the Remedies Directive") giving courts the power to suspend or set aside a contract and to order payment of damages (see further below in section on remedies). This directive remains in force, though it was amended recently by Directive 2007/66/EC to add certain requirements, such as a standstill period of 10 days between contract award and contract completion to allow firms to challenge the decision if they wish.

In 1996, the Commission published a Green Paper to open a debate on reform of the procurement regulation.<sup>386</sup> This was followed by a Commission Communication in 1998, where the Commission proposed new procurement legislation on the basis of the

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<sup>380</sup> Arrowsmith, S. 'Deregulation of utilities procurement in the changing economy: towards a principled approach?' (1997) 18(7) *European Competition Law Review* 420, at 420.

<sup>381</sup> European Commission, *Communication from the Commission on a Community Regime for Procurement in the Excluded Sectors: Water, Energy, Transport and Telecommunications*, COM(88) 347.

<sup>382</sup> OJ 1990 297/1

<sup>383</sup> OJ 1993 L199/84

<sup>384</sup> Art. 2 Directive 93/38/EEC

<sup>385</sup> 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, OJ 1992 L76.

<sup>386</sup> European Commission, *Public Procurement in the European Union: Exploring the Way Forward*, COM(96) 583.

responses to the Green Paper.<sup>387</sup> It was not expected that the reforms would lead to any great change in the law, rather the aim was to simplify the current law and to increase flexibility, notably by including provisions to clarify the position as regards electronic procurement.<sup>388</sup> The Commission set out its proposals for new directives on both public sector and utilities procurement in May 2000 and the new directives, the Public Sector Directive and the Utilities Directive, were adopted in 2004. These directives came into force on publication on 1<sup>st</sup> May 2004, and had to be implemented by 31<sup>st</sup> January 2006 (except for the rules in the Utilities Directive on postal services, which had a later adoption date of 1<sup>st</sup> January 2009). The Utilities Directive has been implemented in the UK through the Utilities Contracts Regulations 2006.<sup>389</sup> In general, the Regulations use the same wording as the Directive with no changes made. This section will refer primarily to the Article references in the Utilities Directive, though where the Regulations vary this will be examined. UK case law interpreting the Directive and Regulations will also be considered.

While the reform process was not originally supposed to involve any major changes in the law, in fact in the end there have been some important reforms in the utilities regulation. For utilities these include the removal of the telecommunications sector and the addition of both the postal service sector and the general exemption for entities in a competitive market. These changes will be discussed further below in the sections examining the provisions of the Utilities Directive. The section will first set out the circumstances under which the directive's rules apply, and then examine the rules governing the award of contracts. The section will then look briefly at the procedural requirements a procuring entity must fulfil after the award of the contract. Finally, the section will examine the remedies system available to deal with any breach of the rules.

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<sup>387</sup> European Commission, *Public Procurement in the European Union*, COM(98) 143.

<sup>388</sup> *Ibid*, atp.3.

<sup>389</sup> SI 2006 No.6.

## IV.2 Scope of the Utilities Directive

The Utilities Directive covers contracts "for pecuniary interest concluded in writing".<sup>390</sup> It covers any works, services or supply contract (as defined in Article 1(2)(b)-(d)) which is above the monetary threshold.<sup>391</sup> Splitting contracts with the intention of avoiding the application of the Directive is forbidden.<sup>392</sup> Certain types of contract are excluded from the scope of the directive. This includes works and services concession contracts, which give the entity awarded the contract the right to exploit the work or service for payment.<sup>393</sup> Articles 19-23 of the Utilities Directive list other excluded contracts, such as those awarded to a joint venture.<sup>394</sup> Services which fall within Annex XVII B ("Part B Services"), such as legal services, are more lightly regulated than other services.<sup>395</sup>

The Utilities Directive covers any entity listed in Article 2 of the directive when that entity acts for the purpose of one of the utility activities listed in Article 3. The UK Regulations implement this in Schedule 1, with any entity listed in the first column of each Part to that section being covered by the Regulations when they are contracting for the purpose of an activity listed in the second column. To determine whether an entity is covered it is thus necessary to first examine whether that entity is a utility for the purpose of the directive and then, secondly, to examine whether the contract is made for one of the listed activities. Examples of covered utilities for each Member State are given in Annexes I-X of the directive. These lists are non-exhaustive, so entities which fall within the definition but which are not listed must also apply the directive's rules.<sup>396</sup> The entities and activities covered are examined in more detail below.

### *IV.2.1. Entities Covered by the Utilities Directive*

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<sup>390</sup> Art. 1(2)(a) Utilities Directive.

<sup>391</sup> Art. 16 Utilities Directive. See further Arrowsmith, above n.317, at pp.899-915.

<sup>392</sup> Art. 17(2) Utilities Directive.

<sup>393</sup> Art. 18 Utilities Directive.

<sup>394</sup> See further Arrowsmith, above n.317, at pp.916-929.

<sup>395</sup> Art. 32 Utilities Directive. See further Arrowsmith, above n.317, at pp.904-907.

<sup>396</sup> Art.8, Utilities Directive.

The entities covered by the Utilities Directive are stated in Article 2, and cover contracting authorities, public undertakings and private bodies with special or exclusive rights.

- Contracting authorities

This category covers traditional public bodies. It includes the state, local authorities, bodies covered by public law and any associations formed by any of these entities.<sup>397</sup> A body covered by public law is defined as an entity "established for the purpose of meeting needs in the general interest, not having an industrial or commercial character", which has legal personality, and which is funded by another contracting authority or which has an administrative board with at least half of its members appointed by another contracting authority.<sup>398</sup> This definition is the same as the definition for contracting authorities in the Public Sector Directive, and when making a contract which is not for a utility activity these entities will be covered by that directive.

The CJEU has significantly expanded the definition of contracting authority through its case law. One of the most important developments for utilities came in the case of *Mannesmann*.<sup>399</sup> In this case the Court ruled that any contracting entity which has any non-commercial activities, no matter how small a proportion of their overall activities, is classed as a contracting authority for the purposes of the procurement directives.<sup>400</sup> While in general the rules for contracting authorities and public undertakings are the same, the distinction may be important in the case of the new mandatory exclusions for criminal activity (see below in exclusion section), which only apply to contracting authorities.

- Public Undertakings

This category covers any entity over which any contracting authority may exercise, directly or indirectly, a "dominant influence", through their ownership, financial

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<sup>397</sup> Art. 2(1)(a) Utilities Directive.

<sup>398</sup> Art. 2(1)(a) Utilities Directive.

<sup>399</sup> Case C-44/96, *Mannesmann Anlagenbau Austria AG v Strohal Rotationsdruck GmbH* [1998] ECR I-73.

<sup>400</sup> *Ibid*, at paras. 31-33.

participation in the entity or through the rules applying to the entity.<sup>401</sup> The condition of a dominant influence is considered to be met when the contracting authority holds a majority of the undertaking's share capital or controls a majority of votes attached to its shares, or where it has the power to appoint more than half of the undertaking's administrative body.<sup>402</sup>

- Entities with special or exclusive rights

One of the reforms introduced by the Utilities Directive in 2004 was a new definition of special or exclusive rights. Under the previous directive an entity had special or exclusive rights where it had a right which reserved the exploitation of a regulated utility activity for one or more entities.<sup>403</sup> In addition, an entity was automatically considered to have such rights when; (1) they could take advantage of a procedure for the expropriation or use of property; (2) they could place network equipment on, under or over a public highway; or (3) if they supplied water, gas, electricity or heat to any network which enjoyed special or exclusive rights.<sup>404</sup>

The new definition in the Utilities Directive is narrower in scope and excluded some entities which were covered by the previous definition. Article 2(3) of the Utilities Directive defines special or exclusive rights as:

rights granted by a competent authority of a Member State by way of any legislative, regulatory or administrative provision the effect of which is to limit the exercise of [the regulated utility activities] to one or more entities, and which substantially affects the ability of other entities to carry out such activity.

Under this definition, whether a right is considered a special or exclusive right depends on whether having the right gives that entity a competitive advantage over other entities in that sector. The new provision has two main effects. First, it means that entities which would have automatically been considered to have special or exclusive rights under the

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<sup>401</sup> Art. 2(1)(b) Utilities Directive.

<sup>402</sup> *Ibid.*

<sup>403</sup> Art. 2(3) Directive 93/38/EEC.

<sup>404</sup> *Ibid.*

previous definition are no longer covered simply because they have those rights.<sup>405</sup> Whether these rights amount to special or exclusive rights falls to be determined under the same rules as apply to any other rights. Second, it seems that licences which are available to any entity which fulfils objective, non-discriminatory and transparent criteria do not constitute special or exclusive rights as they do not affect the ability of other entities to carry out the same activity.<sup>406</sup>

The position of entities which hold a right which was awarded under a competition applying objective, non-discriminatory and transparent criteria, but which is awarded to one or a limited number of entities is unclear. Given the definition's reference to a right which limits exercise of the right to "one or more entities" and which affects the ability of any other entities to carry out the ability, it would seem that any right which is limited in number should be covered. However, this is contradicted in Recital 25 of the directive, which states:

Nor may rights granted by a Member State in any form ... to a limited number of undertakings on the basis of objective, proportionate and non-discriminatory criteria that allow any interested party fulfilling those criteria to enjoy those rights be considered special or exclusive rights.

As Kotsonis argues, the reference to a "limited number" of entities in this recital suggests that any right awarded on the basis of objective criteria cannot be a special or exclusive right.<sup>407</sup> However, the later requirement that the right is open to "any interested party" contradicts this, implying that a right limited in number *is* a special or exclusive right.<sup>408</sup> It is arguable that any entity which receives its right under objective criteria is not susceptible to government influence as the government has no discretion over whether to award the licence, and so regulation is not necessary.<sup>409</sup> However, government pressure is only one of the policy reasons behind regulating utilities. The

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<sup>405</sup> Supported by Recital 25 of the Utilities Directive.

<sup>406</sup> Recital 25 Utilities Directive.

<sup>407</sup> Kotsonis, above n.321, at 71.

<sup>408</sup> *Ibid.*

<sup>409</sup> Arrowsmith, above n.317, at p.854.

other is the lack of competition and this is a factor where an entity holds an exclusive or limited right regardless of the conditions under which they received it, and so it seems arguable that such rights are covered by the directive.<sup>410</sup>

#### *IV.2.2. Activities covered by the Utilities Directive*

Entities falling within one of the categories discussed above are only covered by the Utilities Directive when they carry out one of the activities listed in the Directive, and only in relation to a contract awarded for the purpose of that activity. The relevant activities are listed in Articles 3-7 of the directive, and cover contracts in the fields of energy (gas, electricity and heat), water, transport (including providing terminal facilities), postal services and exploration for or extraction of oil, gas, coal or other solid fuels. These activities are specifically excluded from the Public Sector Directive, so any contracting authority which is usually covered by that directive is instead covered by the Utilities Directive for any contracts made for the purpose of providing those services.<sup>411</sup> Following Article 9, any contract which covers several activities is subject to the rules applicable to the activity for which it is principally intended.

Under the previous directive, 93/38/EEC, telecommunications services were also covered. This sector was removed entirely from the current directive due to the extensive liberalisation of the market throughout the EU which meant that such bodies were subject to full competition and no longer at the risk of government influence.<sup>412</sup> To ensure that public sector bodies providing telecommunications services are not subject to the Public Sector Directive following the removal of the sector from the Utilities Directive, Article 13 of the Public Sector Directive excludes contracts for the purpose of providing telecommunications services from the scope of the Directive.

- Energy (Article 3)

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<sup>410</sup> *Ibid*, at 89.

<sup>411</sup> Art. 12 Public Sector Directive.

<sup>412</sup> See Recital 5 Utilities Directive.

The directive applies to any procuring entity which provides or operates a fixed network which provides a service to the public in connection with the production, transport or distribution of electricity, gas or heat.<sup>413</sup> For any procuring entity which is a contracting authority within the meaning of Article 2, the supply of electricity, gas or heat to such a network is also covered.

For public undertakings and private bodies with special or exclusive rights, the supply of energy to a network may be covered if that supply is one of their main activities. In the case of the supply of electricity, the activity will not be covered where the production of electricity is necessary to carry out another activity (which is not itself an activity covered by the Utilities Directive), where that supply depends only on the entity's own consumption of the electricity and has not exceeded 30% of the entity's total average production of electricity over the last three years.<sup>414</sup> For gas and heat, supply will not be covered where production is an unavoidable consequence of carrying on another activity, supply is aimed only at the economic exploitation of that production and the supply does not amount to more than 20% of the entity's average annual turnover over the last three years.<sup>415</sup>

Under Article 26(b), bodies in the field of electricity, gas or heat are exempt from the Utilities Directive when they are purchasing fuels for the production of energy. The exemption was originally given because there was little possibility for cross-border competition in this area when utilities were first regulated, and the exemption was retained after the reform despite liberalisation in this area.<sup>416</sup>

- Water (Article 4)

The Utilities Directive applies to entities which produce or operate a fixed network which provides a service to the public in connection with the production, transport or

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<sup>413</sup> Art. 3(1) and (3) Utilities Directive.

<sup>414</sup> Art. 3(4) Utilities Directive.

<sup>415</sup> Art. 3(2) Utilities Directive.

<sup>416</sup> Trepte, above n.325, at p.153.

distribution of drinking water.<sup>417</sup> As with energy, where the entity is a contracting authority, the supply of water to such a network is also covered. Where the entity is not a contracting authority the supply of water is not covered, *mutatis mutandis*, under the same terms as electricity supply, discussed above.<sup>418</sup> In addition to this, the directive covers contracts relating to hydraulic engineering, irrigation or land drainage where the volume of water intended for the supply of drinking water exceeds 20% of the total volume of water made available by those projects, and also to any contracts relating to the disposal or treatment of sewage.<sup>419</sup> Contracts for the purchase of water are exempt under Article 26(a) of the directive.

- Transport (Articles 5 and 7)

The Utilities Directive covers the provision or operation of networks providing a service to the public in the field of transport by railway, automated systems, tramway, trolley bus, bus or cable.<sup>420</sup> Under the previous directive, entities were exempt from the directive if they provided a bus service in an area where others were free to provide the same service.<sup>421</sup> This exemption has not been retained in the current directive due to a general exemption for services in competitive markets under Article 30 (see below), but any providers which already had an exemption retain that exemption.<sup>422</sup> The directive also covers any entities which exploit an area for the purpose of providing airport, maritime or inland port or other terminal facilities.<sup>423</sup> It is unclear what type of activities might fall within the definition of providing “terminal facilities”, though guidance on various relevant activities for airport terminals has been given by an Advisory Committee.<sup>424</sup>

- Postal Services (Article 6)

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<sup>417</sup> Art. 4(1) Utilities Directive.

<sup>418</sup> Art. 4(3) Utilities Directive.

<sup>419</sup> Art. 4(2) Utilities Directive.

<sup>420</sup> Art. 5(1) Utilities Directive.

<sup>421</sup> Art. 2(4) Directive 93/38/EEC.

<sup>422</sup> Art. 5(2) Utilities Directive.

<sup>423</sup> Art. 7(b) Utilities Directive.

<sup>424</sup> Advisory Committee on the Opening Up of Public Procurement and the Advisory Committee on Public Procurement, *Policy Guidelines on Non-Relevant Airport Activities under the “Utilities Directive”*, CC/92/23 (Rev 1) final of 11 November 1992. For further discussion see Trepte, above n.325, pp161-164.

The current directive added the provision of postal services to the list of regulated activities. Postal services are defined in Article 6(2)(b) as "services consisting of the clearance, sorting, routing, and delivery of postal items". The directive also covers a number of other services such as mail service management which are set out in Article 6(2)(c). Previously, postal services which were provided by an entity which classed as a contracting authority for the purposes of the public sector directives was covered by those directives, and so the change allows these entities to take advantage of the more flexible regime under the Utilities Directive. Public undertakings and private bodies with special or exclusive rights will be regulated for the first time.

- Exploration and extraction of oil, gas, coal or other solid fuels (Article 7)

The Utilities Directive covers any entity which exploits an area for the purpose of exploring for, or extracting, oil, gas, coal or any other solid fuel.<sup>425</sup> As with entities providing an energy network, there is an exemption for the purchase of fuel.<sup>426</sup> Under the previous utilities directive, there was a major exemption for utilities in this area which could show that other entities were free to seek the same licence under the same conditions.<sup>427</sup> The exemption had to be granted by the Commission and was not complete: entities still had to prove certain non-discriminatory and competitive standards.<sup>428</sup> This exemption is not included in the current directive but any exemptions already granted continue to be valid.<sup>429</sup> The UK had gained this partial exemption in 1997<sup>430</sup> which was implemented in Reg. 8(1) of the Utilities Contracts Regulations. In March 2010, however, the UK was granted a full exemption for the exploitation of oil and gas under Article 30 of the Utilities Directive (see below, section IV.2.3.) which removes

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<sup>425</sup> Art. 7(a) Utilities Directive.

<sup>426</sup> Art. 26(b) Utilities Directive.

<sup>427</sup> Art. 3 Directive 93/38/EEC.

<sup>428</sup> See further Arrowsmith, above n.317, pp.862-868 and Maund, C. 'The derogation for the oil and gas sector under Article 3 of the Utilities Directive' (1997) 6 PPLR 226.

<sup>429</sup> Art. 27 Utilities Directive.

<sup>430</sup> Commission Decision 97/367/EC: Commission Decision of 30 May 1997 establishing that the exploitation of geographical areas for the purpose of exploring for or extracting oil or gas does not constitute in the United Kingdom an activity defined in Article 2 (2) (b) (i) of Council Directive 93/38/EEC and that entities carrying on such an activity are not to be considered in the United Kingdom as operating under special or exclusive rights within the meaning of Article 2 (3) (b) of the Directive, OJ 1997 L 156.

the sector fully from the procurement regime, making the previous partial exemption redundant.

#### *IV.2.3. Article 30 Exemption*

The previous utilities directive contained a series of sector-specific exclusions for entities in a competitive market. Due to substantial liberalisation in the utilities sector as a whole, the current directive replaces these specific exclusions with one general exclusion, found in Article 30. The article states that contracts will not be subject to the directive where "the activity is directly exposed to competition on markets to which access is not restricted".<sup>431</sup> The exemption is not automatic, but must be applied by the Commission through a formal Decision.<sup>432</sup> A Decision may be requested by either a Member State or the entity itself, or the procedure may be begun by the Commission on its own initiative.<sup>433</sup> The Commission must make its decision within three months, though it can extend this time in "duly justified cases".<sup>434</sup> If a decision is not made in this time, the exemption is automatically given.<sup>435</sup> For entities in the UK, three Decisions have currently been adopted under Article 30, exempting entities in the fields of electricity generation, the supply of gas and electricity and the exploration for and exploitation of oil and gas.<sup>436</sup>

The requirement that the activity is directly exposed to competition is expanded on in Article 30(2), which states that the existence of a competitive market must be decided

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<sup>431</sup> Art. 30(1) Utilities Directive.

<sup>432</sup> Art. 30(4)-(6) Utilities Directive.

<sup>433</sup> Art. 30(4) and (5) Utilities Directive.

<sup>434</sup> Art. 30(6) Utilities Directive. The extension is limited to one month where liberalising legislation is in place and market access is deemed.

<sup>435</sup> Art. 30(5) Utilities Directive.

<sup>436</sup> Commission Decision 2007/141/EC of 26 February 2007 establishing that Article 30(1) of Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors applies to the supply of electricity and gas in England, Scotland and Wales, OJ 2007 L62/23; Commission Decision 2006/211/EC of 8 March 2006 establishing that Art. 30(1) of Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors applies to electricity generation in England, Scotland and Wales, OJ 2006 L76/6; Commission Decision 2010/192 exempting exploration for and exploitation of oil and gas in England, Scotland and Wales from the application of Directive 2004/17 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors [2010] OJ L84/52.

by reference to criteria which conform with the Treaty provisions on competition, such as the existence of alternative goods or services. The tests which must be applied in this case are thus the tests used by the CJEU under Articles 101 and 102 TFEU to determine the relevant product and market for the purpose of competition law.<sup>437</sup> As shown by the Decisions which have currently been adopted considering Article 30, the existence of competition is determined by many different factors, none of which is decisive.<sup>438</sup>

When determining whether market access is unrestricted, the situation depends on whether the EU has adopted any liberalising legislation in the area. If liberalising measures have been adopted (relevant measures are listed in Annex XI of the Utilities Directive), and these measures have been implemented in the Member State, market access is "deemed" to be unrestricted.<sup>439</sup> Where there are no relevant measures, it must be shown "that access to the market in question is free *de facto* and *de jure*".<sup>440</sup> All the Decisions so far have concerned markets where liberalising legislation existed and had been implemented, so it is uncertain what precisely freedom *de facto* and *de jure* involves. It seems likely that freedom *de jure* requires that there be no legal restrictions on access to the market, and *de facto* freedom requires that there be no problems accessing the market due to a natural monopoly on the part of an entity.<sup>441</sup>

The exemption under Article 30 overlaps to a certain extent with the definition of special and exclusive rights. An entity which has a right which is open to anyone able to satisfy objective criteria would presumably satisfy the condition in Article 30 that access to the market is unrestricted, but would still have to show that the activity is open to competition.<sup>442</sup> However, arguably such an entity does not have special or exclusive rights and so is not covered by the directive at all (see above on special or exclusive

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<sup>437</sup> Arrowsmith, above n.317, at p.885.

<sup>438</sup> See, for example, Decision 2007/141/EC, n.436 above, at para. 8.

<sup>439</sup> Art. 30(3) Utilities Directive.

<sup>440</sup> *Ibid.*

<sup>441</sup> Arrowsmith, above n.317, at p.884.

<sup>442</sup> Kotsonis, above n.321, at 90.

rights). Such entities may wish to apply for an Article 30 exemption despite this, to provide legal certainty.<sup>443</sup>

Entities which obtain an exemption under Article 30 will still have to comply with the Treaty requirements, including the new transparency requirements. Equally, the exemption does not remove the entity from the Government Procurement Agreement (GPA) of the World Trade Organisation (WTO), which applies similar requirements to the Utilities Directive on utilities in the EU, which may limit the practical effect of the exemption.<sup>444</sup>

#### IV.3 Award Procedures under the Utilities Directive

This section will examine the rules a regulated utility must follow when awarding a contract covered by the directive. In addition to these specific rules, it must also comply with three general principles set out in the directive in Article 10; equal treatment, non-discrimination and transparency. Equal treatment requires that entities treat comparable situations in a similar way, unless objectively justified.<sup>445</sup> Non-discrimination is simply one aspect of equal treatment, forbidding unequal treatment on the grounds of nationality.<sup>446</sup> The aim of transparency is to ensure that the other principles of equal treatment and non-discrimination have been complied with.

##### *IV.3.1. The Award Procedures*

The Utilities Directive provides three procedures which utilities may use to award contracts; the open procedure and the restricted procedure, which are formal tendering procedures, and the negotiated procedure, which offers more flexibility.<sup>447</sup> The negotiated procedure may be split into two procedures, a procedure with a prior call for competition, and a procedure without such a call. Utilities have a free choice between the open procedure, the restricted procedure and the negotiated procedure with a call

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<sup>443</sup> Arrowsmith, above n.317, at p.854.

<sup>444</sup> Arrowsmith, S. 'An Assessment of the New Legislative Package on Public Procurement' (2004) 41 *Common Market Law Review* 1277, at 1311.

<sup>445</sup> Case C-243/89, *Commission v Denmark*, [1993] ECR I-3353.

<sup>446</sup> Arrowsmith, above n.317, at p.429.

<sup>447</sup> Art. 40 Utilities Directive.

for competition.<sup>448</sup> In practice, most utilities in the UK will choose the negotiated procedure, as it offers them the most freedom and flexibility.<sup>449</sup>

When awarding a contract using one of these methods, a procuring entity may choose to set up the contract as a framework agreement, a system under which certain suppliers are chosen, and terms of future contracts are established, and contracts may be awarded to those suppliers at future dates, with or without further competition.<sup>450</sup>

The procuring entity may also set up a qualification list which is a system listing firms which are qualified for, and interested in tendering for, any future contracts awarded by that utility.<sup>451</sup> Under this system, the utility issues an initial advertisement of a system setting out the types of contracts that may be awarded under it. After this, the utility may list all who applied, or limit the number using the same objective criteria as are used to limit the numbers in restricted and negotiated procedures, discussed below.<sup>452</sup> Many utilities in the UK delegate the operation of their qualification lists to third parties.<sup>453</sup>

- Open Procedure

Under this procedure, a contract notice giving precise details of the contract specification and award criteria of the contract will be published, and any interested party may put in a tender for that contract.<sup>454</sup> While this procedure offers the greatest competition, it may be inappropriate for reasons of cost and time where there are likely to be many tenderers, as each individual tender will have to be examined.<sup>455</sup> It may also be inappropriate where the contract is complex and it would be impossible to formulate a complete specification.<sup>456</sup> Once the call for competition has been made, there are set

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<sup>448</sup> Art. 40(2) Utilities Directive.

<sup>449</sup> Arrowsmith, above n.317, at p.964.

<sup>450</sup> Art. 14 Utilities Directive.

<sup>451</sup> Art. 53 Utilities Directive.

<sup>452</sup> Art. 53(2) Utilities Directive.

<sup>453</sup> See Maund, C. 'The Development of Vendor Registration Systems for European Utilities' (1996) 5 PPLR CS51.

<sup>454</sup> Art. 1(9)(a) Utilities Directive.

<sup>455</sup> Trepte, above n.325, at p.376.

<sup>456</sup> *Ibid.*

time limits for the supply of specifications and other supporting documents and for the receipt of tenders.<sup>457</sup>

- Restricted Procedure

The restricted procedure is similar to the open procedure, but the procuring entity may select a limited number of firms to tender from the firms which expressed an interest in tendering following the initial call for competition.<sup>458</sup> As with the open procedure, the time limits for the tendering process are found in Article 45 of the Utilities Directive. The number invited to tender should be enough as to ensure adequate competition.<sup>459</sup> When deciding which firms to invite, the procuring entity may only consider the criteria which may be considered when deciding if a firm is qualified for the contract, given in the directive in Article 54 (discussed further below in qualification section).<sup>460</sup> This article allows the procuring entity to use “objective rules and criteria” to determine who to invite.

- Negotiated Procedure

Under this procedure the entity invites certain firms to participate in the procedure (under the same terms as invitations for the restricted procedure discussed above), and then “negotiates the contract with one or more of these”.<sup>461</sup> Unlike the open and restricted procedures, this procedure does not require a precise specification of the goods, services or works to be set out at any time (see section on specifications below), and at no point does a formal tendering process have to be held.<sup>462</sup> The directive

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<sup>457</sup> Arts.45 and 46 Utilities Directive.

<sup>458</sup> Art. 1(9)(b) Utilities Directive.

<sup>459</sup> Art. 54(3) Utilities Directive.

<sup>460</sup> Case C-362/90, *Commission v Italy* [1992] ECR I-2353.

<sup>461</sup> Art. 1(9)(c) Utilities Directive.

<sup>462</sup> Arrowsmith, above n.317, at p.1024.

contains no explicit rules on how the award process should be structured, allowing the procuring entity great freedom.<sup>463</sup>

As previously mentioned, entities are free to use this procedure when they call for competition beforehand. The procedure is permitted without a call for competition in certain limited circumstances laid out in Article 40(3) of the Utilities Directive, which include where there is only one possible supplier and for reasons of extreme urgency.

#### *IV.3.2. Call for Competition*

Utilities may issue a call for competition in three ways.<sup>464</sup> Firstly, the procuring entity may publish a contract notice in the Official Journal. Where entities use the open procedure, this is the only method that may be used.<sup>465</sup> Contract notices detail the precise requirements of a specific contract. They should be sent to the Commission and should contain all the information set out in Annexes XIII A, B and C of the directive.<sup>466</sup> Secondly, the entity may publish a periodic indicative notice (PIN). A PIN gives advance notice to the market of a utility's general requirements, covering issues such as the essential characteristics of any works contracts the utility intends to award over the next year.<sup>467</sup> The notice should include all the information listed in Annex XV A. Finally, the utility may advertise the existence of a qualification system. The notice must contain the information listed in Annex XIV.

#### *IV.3.3. Technical Specifications*

In order to prevent a utility defining a product in such a way as to allow national favouritism when conducting a tendering procedure, the Utilities Directive sets out rules on the way the specific works, supplies or services that the utility requires may be defined.<sup>468</sup> The requirements for these technical specifications are slightly different depending on whether the contract is for works or for supplies or services, and are found

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<sup>463</sup> See further Arrowsmith, *ibid*, at pp.1027-1032.

<sup>464</sup> Art. 42(1) Utilities Directive.

<sup>465</sup> Art. 42(3) and Art.53(9) Utilities Directive.

<sup>466</sup> Art. 44 Utilities Directive.

<sup>467</sup> Art. 41 Utilities Directive.

<sup>468</sup> Art. 34 Utilities Directive.

in Annex XXI of the directive. For services or supplies, a technical specification is a specification "defining the required characteristics of a product or service".<sup>469</sup> For works, the specification covers the technical requirements which set out the characteristics of the relevant supply or material so that it may "be described in a manner such that it fulfils the use for which it is intended".<sup>470</sup> As Trepte notes, the works definition incorporates a functional definition, unlike the definition for supplies or services.<sup>471</sup>

Utilities may express their technical specifications either by using specifications as defined in Annex XXI and referring to certain European, national or international standards, by referring to performance or functional requirements, or by a combination of both methods.<sup>472</sup> Where the specification refers to standards, Article 34(3)(a) sets out an order of preference of types of standards, ranging from national standards which transpose European standards to national standards and national technical approvals. Each standard must be followed with the words "or equivalent" to allow products which match the functional requirements of the standard.

#### *IV.3.4. Qualification*

"Qualification" is the term used to refer to the process of determining which firms a utility feels are eligible to compete in the award procedure. Unlike the rules under the Public Sector Directive which limit the factors a procuring entity can consider at this stage to matters such as technical and financial ability, the Utilities Directive is fairly flexible, allowing entities to establish any qualification criteria "in accordance with objective rules and criteria".<sup>473</sup> In general, the directive does not *require* utilities to exclude firms for any reason, though there is an exception to this for utilities which are classed as "contracting authorities". These entities *must* exclude firms for the reasons

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<sup>469</sup> Annex XXI(1)(a) Utilities Directive.

<sup>470</sup> Annex XXI(1)(b) Utilities Directive.

<sup>471</sup> Trepte, above n.325, at p.273.

<sup>472</sup> Art. 34(3) Utilities Directive.

<sup>473</sup> Art. 54(1)and (2) Utilities Directive.

listed in Article 45(1) of the Public Sector Directive, which covers issues such as fraud and certain criminal convictions.<sup>474</sup>

The directive does not define what is meant by “objective rules and criteria”. This presumably covers all the matters listed in the Public Sector Directive, but should also allow other matters given the additional flexibility generally allowed by the Utilities Directive.<sup>475</sup> The possible scope of the term “objective rules and criteria” will be examined further in Chapter 6.

The Utilities Directive does not explicitly state the types of evidence which may be relied upon to prove the qualification criteria it sets, though it does require that utilities do not demand any test or evidence which duplicates other objective evidence which is already available.<sup>476</sup> Where the utility requires quality assurance certificates, they must accept equivalent evidence.<sup>477</sup> Notably for CSR issues, the current Utilities Directive also introduced a provision on environmental management standards.<sup>478</sup> This states that in appropriate cases, for works and services contracts, a procuring entity may require evidence of certain environmental measures that firm could apply in the contract. This suggests that such evidence may not be asked for in all cases, and never in supply contracts.

#### *IV.3.5. Contract performance conditions*

In addition to setting the precise technical specifications of the subject-matter of the contract, a procuring entity may also set down conditions relating to the performance of the contract. The provision allowing this is Article 38 of the Utilities Directive, which also states that such conditions “may, in particular, concern social and environmental conditions”. The conditions must be limited to the “performance” of the contract, preventing a procuring entity from requiring general changes going beyond that

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<sup>474</sup> Art. 54(4) Utilities Directive.

<sup>475</sup> Trepte, above n.325, at p.364.

<sup>476</sup> Art. 52(1) Utilities Directive.

<sup>477</sup> Art. 52(2) Utilities Directive.

<sup>478</sup> Art. 52(3) Utilities Directive.

performance, e.g. requiring certain standards of pay for all a firm's employees, rather than just the employees working on the contract.

It has been stated in the context of the public sector rules that, while such contract conditions are legally binding if accepted by the tenderer, a procuring entity cannot disqualify a firm which it believes cannot comply in practice as the condition is not relevant to the various qualification criteria set out in the Public Sector Directive.<sup>479</sup> However, as discussed above, the utilities rules are more flexible, allowing disqualification on the grounds of "objective rules and criteria", and so the position for contract performance conditions may be different. This possibility will be discussed further in Chapter 6.

#### *IV.3.6. Award Criteria*

The procuring entity may base the award of the contract on one of two criteria: the lowest price, or the most economically advantageous tender.<sup>480</sup> The choice of criterion must be stated in the contract documents. Where no choice is made, the award must be made on the basis of lowest price.<sup>481</sup>

Where lowest price is chosen, the contract must simply be awarded to the tenderer which offers the lowest tendered price, so long as they are qualified and fulfil the contract specifications. This criterion is very inflexible and is only really suitable for very simple products.

Where the most economically advantageous tender is chosen, the entity may consider price along with other criteria such as quality and delivery date. The Utilities Directive gives a list of possible criteria in Article 55(1)(a), though this list is non-exhaustive and entities may also use other criteria.<sup>482</sup> The criteria used must be linked to the subject-matter of the contract, preventing the use of award criteria to judge matters such as the

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<sup>479</sup> Case 31/87, *Gebroeders Beentjes BV v State of the Netherlands* [1988] ECR 4635, at para. 28.

<sup>480</sup> Art. 55(1) Utilities Directive.

<sup>481</sup> Case C-324/93, *R v Secretary of State for the Home Department, ex parte Evans Medical Ltd* [1995] ECR I-563.

<sup>482</sup> Case C-513/99, *Concordia Bus Finland Oy Ab, formerly Stagecoach Finland Oy Ab v Helsingin kaupunki and HKL-Bussiliikenne* [2002] ECR I-7213. ("Concordia Bus")

general labour conditions of the firms tendering (see further Chapter 6).<sup>483</sup> The CJEU has also stated that award criteria may not allow a procuring entity "unrestricted freedom of choice" when awarding the contract, though what might qualify as unrestricted freedom was not expanded upon.<sup>484</sup>

The procuring entity must specify the criteria it will be using and the relative weighting it will give to each of those criteria when awarding the contract. Where this is not possible, it must list the criteria in descending order of importance.<sup>485</sup> Where the procuring entity plans to use sub-criteria within those award criteria these must also be disclosed.<sup>486</sup> The CJEU in the case of *ATI* suggested that the weightings for sub-criteria may be determined by the procuring entity at a later date.<sup>487</sup> In the UK, however, the case of *Lettings International Ltd v London Borough of Newham* appears to hold that where sub-criteria and their weightings have been determined by a procuring entity before the tender process has begun, they must be disclosed to the tenderers.<sup>488</sup> This was confirmed in the recent High Court case of *McLaughlin and Harvey*, where it was stated that a procuring entity was required to disclose all criteria and weightings they had devised which could have an impact on a firm's preparation of a tender.<sup>489</sup>

The CJEU has drawn a distinction between award criteria and selection criteria. Criteria used at the selection stage (technical and financial criteria, see above) may not be used as award criteria as they examine the firm's ability to perform the contract and do not determine which tender is the most economically advantageous.<sup>490</sup> It is unclear whether the relative ability or likelihood of the various firms may be used as award criteria. The CJEU in *EVN* appeared to assume that the relative ability of the firms to supply the

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<sup>483</sup> Art. 55(1)(a) Utilities Directive.

<sup>484</sup> *Concordia Bus*, above n.159, at para. 61.

<sup>485</sup> Art. 55(2) Utilities Directive.

<sup>486</sup> Case C-532/06, *Emm.G. Lianakis AE v Dimos Alexandroupolis* [2008] ECR I-00251, ("Lianakis"), at para. 45.

<sup>487</sup> Case C-331/04, *ATI EAC Srl e Viaggi di Maio Snc, EAC Srl and Viaggi di Maio Snc v ACTV Venezia SpA, Provincia di Venezia and Comune di Venezia.* [2005] ECR I-10109, ("ATI"), at para. 32.

<sup>488</sup> [2007] EWCA Civ. 1522, at para. 25.

<sup>489</sup> *McLaughlin and Harvey v Department of Finance and Personnel (No.2)* [2008] NIQB 91, at para. 20.

<sup>490</sup> *Lianakis*, above n.486, at para. 30.

electricity required under the contract would be an allowable award criterion, but this case was not considered by the Court in *Lianakis*.<sup>491</sup>

#### *IV.3.7. Procedural requirements post-award under the Utilities Directive*

Under Art. 49(1), the procuring entity must inform all the participants in the award process of their award decision promptly. Unlike under the previous directive, this obligation applies to all the utility sectors equally and is also expressly stated to apply equally to the decision to award a framework agreement or a dynamic purchasing agreement. Following the new amendments to the Remedies Directive, under Art. 2b of that directive, the award notice sent to participants must also give the reasons for the failure of their tender, stating the “characteristics and relative advantages” of the winning tender.<sup>492</sup> It is unclear precisely how detailed these reasons should be. The General Court in *Strabag Benelux* stated that the main requirement was that the information given was clear and unequivocal, and suggested that it is sufficient simply to state the main criteria that the winning tender had an advantage in, e.g. price or quality.<sup>493</sup> Following this, it was held in the UK case of *Rapiscan* that it was not sufficiently clear and unequivocal to simply state that the tenderer lost for “commercial reasons” where it is not clear what criteria fell under the heading of commercial.<sup>494</sup>

Within two months of a contract, dynamic purchasing system or framework agreement award, the procuring entity must send a contract award notice to the Commission.<sup>495</sup> The notice must provide all the information set out in Annex XVI of the Utilities Directive. Where the notice is for a framework agreement, this notice is sufficient notification of all contracts awarded under that agreement and no further notices need to be sent when the individual contracts are awarded. For a dynamic purchasing system, the contracting authority has the choice of sending notices within two months of each individual contract

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<sup>491</sup> Case C-448/01, *EVN AG v Austria* [2004] 1 CMLR 22, at para. 70.

<sup>492</sup> Art. 49(2) Utilities Directive.

<sup>493</sup> Case T-183/00, *Strabag Benelux NV v Council of the European Union* [2003] ECR II-135, at para. 57.

<sup>494</sup> *Rapiscan Systems v Commissioners of HM Revenue and Customs* [2006] EWHC 2067, at para. 26.

<sup>495</sup> Art. 43(1) Utilities Directive.

award or grouping the notices on a quarterly basis and sending a notice within two months of the end of each quarter.<sup>496</sup> Where the contract is for Part B services, the utility must indicate in the contract notice whether they agree to the publication of a contract award notice, suggesting that publication is voluntary for these contracts.<sup>497</sup>

#### IV.4. Remedies

Where the procurement rules have been breached, there are two options to deal with the breach. Firstly, the Commission or the Member State can bring an action to the CJEU under Articles 258 and 259 of the TFEU. As well as bringing actions on its own initiative, the Commission may also respond to breaches reported to it by Member States or individual firms. The final decision on whether to bring a case is, however, solely down to the Commission.<sup>498</sup> The action is brought against the Member State and not against the particular procuring entity which has breached the rules. A Member State is held accountable for the actions of all “public” bodies in that State, which would appear to cover contracting authorities and public undertakings.<sup>499</sup> It is unclear, however, whether the State is responsible for the actions of private firms with special and exclusive rights. Where the CJEU finds a breach of the rules, it declares the Member State in breach and that State must take all “necessary measures” to fix that breach, up to and including setting aside a concluded contract.<sup>500</sup>

The second method of obtaining a remedy is for the aggrieved supplier to bring an action against the particular procuring entity in the national court. Certain minimum standards for the national procurement remedies system are set out by the Remedies Directive which was recently amended significantly.<sup>501</sup> In the UK, the obligations of the Remedies Directive have been implemented in Regs. 45A-45P of the Utilities Contracts Regulations 2006.

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<sup>496</sup> *Ibid.*

<sup>497</sup> Art. 43(3) Utilities Directive.

<sup>498</sup> Case T-126/95, *Dumez v Commission of the European Communities* [1995] ECR II-2863, para. 33.

<sup>499</sup> Case C-24/91, *Commission v Spain* [1992] ECR I-1989.

<sup>500</sup> Case C-503/04, *Commission v Germany* [2007] ECR I-06153.

<sup>501</sup> See Directive 2007/66/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directives 89/665/EEC and 92/13/EEC with regard to improving the effectiveness of review procedures concerning the award of public contracts, OJ 2007 L335/31.

The Remedies Directive applies wherever there is a breach of "Community law in the field of procurement", covering both breaches of rules under the Utilities Directive and under the TFEU.<sup>502</sup> Review procedures are available to any person who has or had an interest in obtaining the contract and who has been or risks being harmed by the relevant decision of the procuring entity.<sup>503</sup> A claim thus cannot be brought by a firm where the breach does not prejudice them in any way.<sup>504</sup> There are conflicting decisions on whether the likelihood of the firm winning the contract but for the breach is a relevant issue. In the High Court decision of *Jobsin* it was held that a claim should not be rejected simply because the breach would not have affected the outcome of the tender.<sup>505</sup> However, in the recent case of *Lion Apparel* it was held that a claim was not permitted where the procuring entity could prove that the breach did not affect the award decision.<sup>506</sup>

The particular remedies the national courts must make available are set out in Art. 2 of the Remedies Directive. First, the court must have the power to order interim relief in the form of suspension of the award procedure. Second, the court must have the power to set aside unlawful decisions. Finally, there must be a power to award damages. Art. 2(6) of the Remedies Directive offers Member States the option to provide that where the contract has been concluded the only possible remedy is damages, an option the UK has included in the Regulations in Reg. 45J. This option has been affected by the recent amendments which create a new mandatory standstill period between the conclusion of the award procedure and the conclusion of the contract and also by possibility of declaring a contract ineffective set out in the recent Remedies Directive reforms (see below).

#### *IV.4.1. Suspension*

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<sup>502</sup> Art. 1(1) Remedies Directive.

<sup>503</sup> Art. 1(3) Remedies Directive.

<sup>504</sup> *De la Rue International v Scottish Power* [2000] Scots CS 259.

<sup>505</sup> *Jobsin Internet Services v Department of Health*, High Court judgment of 18 May 2001.

<sup>506</sup> *Lion Apparel Systems v Firebuy* [2007] EWHC 2179 ("Lion Apparel").

A suspension halts the award procedure until a decision on whether to award a set-aside or damages can be made. In the UK, the courts have usually followed the general principles relating to awarding interim relief when considering whether to award a suspension. In UK law, interim relief will be denied where damages would be an adequate remedy. This principle has been applied in some procurement remedies cases in the UK, such as *Lion Apparel*. However, the CJEU case of *Alcatel* stated that EU law required a set-aside to be available in every case despite the availability of damages, and it is arguable that this also applies to interim relief.<sup>507</sup> This approach has also been applied in the UK in the cases of *Harmon*<sup>508</sup> and *BFS v Secretary of State for Defence*.<sup>509</sup> The UK cases similarly conflict over whether the usual UK requirement of an undertaking in damages applies to interim relief under the Remedies Directive with *Lion Apparel* suggesting an undertaking would be required and the judge in *Harmon* considering that the requirements of EU law, especially the principle of effectiveness, would prevent it. The court must also consider the balance of convenience in the case, weighing up the possible benefits of suspension against the possible detrimental effects on the procuring entity and the successful tenderer. In practice, suspensions are very rarely awarded.

The recent amendments add a requirement that where independent review of a procurement decision is requested, the contract is automatically suspended until the court makes a decision on whether the review is admissible and whether interim measures should be awarded.<sup>510</sup> Except in this case, a review does not have an automatic suspensive effect.<sup>511</sup>

#### *IV.4.2. Set-aside*

Review bodies have the power to set aside any unlawful decisions or to amend any relevant documents. As previously noted, the CJEU decision of *Alcatel* held that the

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<sup>507</sup> Case C-81/98, *Alcatel Austria AG and Others, Siemens AG Österreich and Sag-Schrack Anlagentechnik AG v Bundesministerium für Wissenschaft und Verkehr* [1999] ECR I-07671, at para. 43.

<sup>508</sup> *Harmon CFEM Facades (UK) Ltd v The Corporate Officer of the House of Commons* (2000) 2 LGLR 372.

<sup>509</sup> [2006] EWHC 1513.

<sup>510</sup> Art. 2(3) Remedies Directive.

<sup>511</sup> Art. 2(3a) Remedies Directive.

remedy of set-aside must be available in every case regardless of the availability of damages.

#### *IV.4.3. Damages*

Neither the Utilities Directive nor the Utilities Contracts Regulations specify how damages for breach of the procurement rules should be calculated. The UK courts have followed the usual tort standard of requiring the damages to put the claimant in the same position as if the breach had not occurred. Following *Harmon* damages for lost profits may be awarded either on a “loss of chance” basis, or where a firm can show that it was virtually certain that they would have won the contract damages may be awarded for the full value of the lost profits. Where the court is satisfied that a firm had a “real chance” of winning the contract it may recover its tender costs from the procuring entity.<sup>512</sup>

#### *IV.4.4. Mandatory Standstill*

In *Alcatel* the CJEU introduced a requirement that, for an effective remedies system to exist, a firm must have adequate time between the end of the award procedure and the conclusion of the contract to bring a review action in which it is possible for the contract to be set aside.<sup>513</sup> In those countries where the option to prevent a review action concerning a concluded contract resulting in any remedy other than damages has been utilised this requires a “standstill” period between the contract award and the contract conclusion during which a review may be requested. This requirement is implemented in the UK Regulations in Reg. 33A which requires a standstill period of 10 days between notification of the award decision to the parties and the conclusion of the contract. The requirement for a 10 day standstill has also now been included in the Remedies Directive in Art. 2a. The standstill does not have to be complied with where the contract is of a

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<sup>512</sup> Reg. 45(8) Utilities Contracts Regulations 2006.

<sup>513</sup> *Alcatel*, above n.507, at para. 43.

type which does not require a call for competition, where there is only one tenderer and in the case of specific contracts awarded under a dynamic purchasing system.<sup>514</sup>

#### *IV.4.5. Ineffectiveness*

The recent amendments to the Remedies Directive also add a new provision making contract awards ineffective in three situations: (1) where a procuring entity has made a direct award to a firm in a breach of the provisions of the Utilities Directive; (2) where the standstill requirement has not been complied with and there has also been a breach of the provisions of the Utilities Directive; (3) where the Member State has chosen to apply the derogation from the standstill for contracts under a dynamic purchasing system, the contract will be ineffective if the individual contract has not been advertised or all members of the system have not been invited to tender, and the individual contract is over the threshold value.<sup>515</sup> In the case of direct awards, ineffectiveness may be avoided if the procuring entity publishes a notice in the Official Journal and does not conclude the contract until 10 days after the publication of that notice.<sup>516</sup> The Member States may choose whether to make contracts ineffective retroactively or limit ineffectiveness to future performance but where the latter option is chosen the Member State must also provide for alternative remedies in the form of a fine or the shortening of the contract.<sup>517</sup> These ineffectiveness rules have been implemented in the UK in Regs. 45K-45O.

## **V. Conclusion**

This chapter has set out an overview of the EU utilities procurement regime under both the TFEU and the Utilities Directive. The chapter has set out the aims of EU procurement regulation, which focus mainly on economic issues, with the opening up of the European procurement market being key. This economic focus may have an impact on the interpretation of the procurement regime regarding labour policies and this issue will be

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<sup>514</sup> Art. 2b Remedies Directive.

<sup>515</sup> Art. 2d(1) Remedies Directive.

<sup>516</sup> Art. 2d(4) Remedies Directive.

<sup>517</sup> Art. 2d(2) and Art. 2e(2) Remedies Directive.

considered in more detail in the following chapter. The chapter has also set out the scope of the Utilities Directive, the possible procurement procedures available under that directive and the remedies available to supplier for a breach of the directive rules. This overview aimed to provide background to the more detailed discussion of the issue of labour policies in procurement in the following chapter.

## **Chapter 6 - Utilities Procurement and Labour Policies**

### **I. Introduction**

This chapter will examine the various methods available to utilities for implementing labour policies in their procurement, with special reference to the labour codes discussed in the previous chapter. The law in this area is very unclear, with a number of different interpretations being possible in some cases. This uncertainty means that implementing labour policies requires utilities to balance the possible risk of legal challenge against any social or commercial benefits to them of implementing the policy. The chapter aims to examine the possibilities for including labour policies in procurement, setting out methods which are clearly permitted under the EU regulation along with the constraints under that law, in order to examine how utilities respond to these opportunities and constraints. In addition to this, the chapter aims to highlight the grey areas in the law where the correct interpretation of the regulation is unclear, and examine the degree of risk associated with the various policies and implementation approaches. The issues discussed in this chapter will then be raised in the interviews with procurement practitioners to discover the impact, if any, they have in practice.

The chapter first offers an examination of the general uncertainties faced by utilities when procuring, such as uncertainty over which legal regime, if any, is applicable to their procurement. The following section will briefly examine specific issues which may arise under the Treaty on the Functioning of the European Union (TFEU) rules for those utilities subject to the Treaty.<sup>518</sup> The final section offers a detailed examination of the issues which may arise under Directive 2004/17/EC<sup>519</sup> ("the Utilities Directive"). The sections on the Treaty and the Utilities Directive discuss various methods by which the aims of the labour policies discussed in the previous chapter could be implemented,

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<sup>518</sup> Coverage of the TFEU is discussed in Chapter 5, Section II.

<sup>519</sup> Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 No. L134/1.

drawing on a taxonomy by Arrowsmith setting out possible ways social policies may be included in procurement.<sup>520</sup>

## **II. General Issues**

One of the first problems a utility may encounter is the issue of deciding which legal rules apply to that utility for a particular procurement. One uncertainty in this area is the applicability of the TFEU provisions to utilities which are regulated due to being public undertakings or having special or exclusive rights. As previously discussed in Chapter 5, Article 106 TFEU prohibits Member States from enacting any measure which breaches a Treaty provision in connection with a public undertaking or a private entity with special or exclusive rights. As discussed in that chapter, Article 106 clearly prohibits a breach of a Treaty provision by an undertaking or body with special or exclusive rights where that breach results directly from a State measure.<sup>521</sup> It is unclear, however, if the Article is limited to such situations. Under one interpretation, Article 106 only applies where the Member State is directly involved in the breach by influencing the actions of the relevant entity.<sup>522</sup> It has also been argued, however, that the Article goes further and prohibits undertakings and entities with special or exclusive rights from taking any action which breaches the TFEU, preventing Member States from "evading their obligations by hiding behind the apparently independent behaviour of their public or privileged undertakings".<sup>523</sup>

If the Treaty does cover public undertakings and private entities with special or exclusive rights, then utilities must consider those Treaty rules for all procurements, including those below the Directive's threshold and procurement excluded from the Directive such as services concessions. Equally, utilities who have gained an exemption from the

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<sup>520</sup> Arrowsmith, S. 'A taxonomy of horizontal policies in public procurement', Ch. 3 in Arrowsmith, S. and Kunzlik, P. (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions*, (2009, Cambridge: CUP).

<sup>521</sup> See, for example, Case C-475/99, *Firma Ambulanz Glockner v Landkreis Sudwestpfalz* [2001] ECR I-08089, para. 40.

<sup>522</sup> Arrowsmith, S. *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> Ed), (2005, London: Sweet and Maxwell), at p.236.

<sup>523</sup> See Buendia Sierra, J. *Exclusive Rights and EC Monopolies under EC Law*, (1999, Oxford: OUP), at p.192-194 and the literature cited there.

Directive under Article 30 of that Directive must still comply with the Treaty rules, which may limit the freedom they have in practice, especially in light of the transparency requirements introduced in *Telaustria* (see further below and section II.3, Chapter 5). If, however, the Treaty is not applicable, procurement which does not fall within the Directive will be completely exempt from any regulation.

It has also been suggested that problems may be caused by the number of regulatory regimes which may apply to utilities. Arrowsmith and Maund argue that liberalisation of the utility sector in recent years has led to utilities consolidating into fewer, much larger companies, which often operate in several countries both within the EU and beyond.<sup>524</sup> This liberalisation has also led to utilities diversifying out of their traditional areas of activity, meaning that different sections of the same utility may be subject to different procurement regulation, for example where one activity has an exemption from the Utilities Directive.<sup>525</sup> Arrowsmith and Maund argue that the EU rules may prevent utilities from implementing CSR policies which cover more than one country or activity, or from co-operating with other entities which operate in other countries/activities to design or implement a joint CSR initiative.<sup>526</sup> They also note that the variation in regulatory regimes may confuse both utilities and suppliers.<sup>527</sup> If this argument is correct, it may limit the ability of utilities to create their own industry-wide labour codes of conduct.

### **III. Procurement under the TFEU**

As previously discussed in Chapter 5, several provisions in the TFEU regulate public procurement, with the most important being the free movement provisions. The Treaty rules have become more important in recent years due to the principle of transparency set out by the CJEU in *Telaustria*.<sup>528</sup> This states that all contracts – even those not subject to the rules under the Directive – need to be advertised and must be conducted

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<sup>524</sup> Arrowsmith, S. and Maund, C. 'CSR in the utilities sector and the implications of EC procurement policy: a framework for debate', Ch. 11 in Arrowsmith and Kunzlik, above n. 520, section 6.

<sup>525</sup> *Ibid.*, at p.473.

<sup>526</sup> *Ibid.*, at p.474.

<sup>527</sup> *Ibid.*

<sup>528</sup> Case C-324/98, *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria AG* [2000] ECR I-10745.

in a sufficiently transparent manner as to ensure compliance with the free movement provisions.<sup>529</sup>

The Treaty provisions apply to all procurement contracts, both those covered by the Utilities Directive and those which are outside the Directive, for whatever reason.<sup>530</sup> As discussed in the previous section, the application of the Treaty provisions to private utilities is debated but this section will proceed on the assumption that the provisions do indeed apply. In either case, the Treaty provisions are applicable to utilities which are classed as public authorities.

### III.1. Technical Requirements and Contractual Conditions

One of the first opportunities a utility has to consider labour issues in procurement is when setting out the technical requirements of the contract – what precisely the utility wishes to buy – and when setting out any contract conditions which must be complied with by the firm completing the contract. This method will be crucial for most utilities complying with one of the international labour codes discussed in the previous chapter. As seen in that chapter, most of those codes set out certain minimum standards to be met by firms and contract conditions which must be accepted in their entirety are the easiest way for a utility to ensure this minimum is met.

#### *III.1.1. Compliance with legal requirements*

One of the most common requirements in the codes examined in the previous chapter was compliance with the relevant national law.<sup>531</sup> The ‘national law’ that the codes refer to appears to refer to the law which is applicable in the country where the contract is performed. Depending on what the contract is for, this may be either the law of the

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<sup>529</sup> For further discussion of the free movement provisions and the transparency principle, see Chapter 5, section III.2.

<sup>530</sup> With the exception of contracts which fulfil the requirements of a Treaty exception, such as contracts for hard defence material, which are exempt under Article 296 EC.

<sup>531</sup> The requirement to comply with national law was found in all international codes examined in the previous chapter and is also the second most common requirement in individual and industry codes, found in 65.5% of codes dealing with labour issues: OECD, *Codes of Corporate Conduct: Expanded Review of their Contents*, (2001), available at <http://www.oecd.org/dataoecd/57/24/1922656.pdf> [accessed 14/04/09], at p. 10.

awarding state or the law of the home state of the contractor. The arguments relating to each scenario are essentially identical and will be examined together.<sup>532</sup>

As discussed in Chapter 5, for the free movement provisions of the TFEU to apply, the condition in question must create a hindrance to trade. The requirement to comply with national law appears to be non-discriminatory, affecting national and foreign suppliers equally. It was argued in Chapter 5 that even non-discriminatory conditions appear to be classed as hindrances to trade which require justification for services and works contracts, though the situation is less clear for supply contracts since the case of *Keck*.<sup>533</sup> Arrowsmith and Kunzlik take the contrary view that non-discriminatory provisions are to be treated in the same way as "selling arrangements" under *Keck* and are not automatically hindrances to trade.<sup>534</sup> Under this view, requiring compliance with the law is not caught by the free movement rules at all and utilities are free to include such a condition in their contracts.

However, even presuming that justification is required in all cases, it is arguable that requiring compliance with the law would be justifiable for public policy reasons. Arrowsmith argues that public bodies may justify such contract conditions by the need to disassociate themselves from criminal behaviour, the desire to set a good example and also to ensure that companies which do not comply with the law do not gain an unfair advantage over compliant companies.<sup>535</sup> These arguments appear equally applicable to utilities. In addition to this, utilities may wish to ensure compliance with the law and avoid association with unethical suppliers for commercial reasons, allowing the company to present themselves as socially responsible to their various stakeholders.

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<sup>532</sup> This discussion will only consider the issues raised under EU procurement law, but it may be noted that there may be an issue with only requiring legal compliance under English contract law due to an absence of consideration, see McCrudden, C. *Buying Social Justice: Equality, Government Procurement and Legal Change*, (2007, Oxford: OUP), at p. 525.

<sup>533</sup> Cases C-267 and 268/91, *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097, ("Keck"), at paras. 15-17. See further Chapter 5, sec. III.

<sup>534</sup> Arrowsmith, S. and Kunzlik, P. 'EC regulation of public procurement', Ch. 2 of Arrowsmith and Kunzlik, above n.520, at pp.67-72.

<sup>535</sup> Arrowsmith, above n.520, pp.112-113.

In this respect, it is notable that the Utilities Directive seems to assume that requiring compliance with national law is allowable since Article 39 allows Member States to require a utility to state where information on national obligations relating to, *inter alia*, working conditions may be obtained by a tenderer. Equally, Directive 2004/18/EC<sup>536</sup> ("the Public Sector Directive") allows procuring entities to exclude firms which have committed certain criminal offences from tendering.<sup>537</sup> This may suggest that the EU considers that ensuring compliance with the law is a legitimate concern for authorities.<sup>538</sup> Requiring compliance with national law is a low-risk option for utilities.

### *III.1.2. Contract conditions going beyond the law*

The international labour codes discussed in Chapter 3 generally saw compliance with the relevant national law as a bare minimum. The codes generally set out specific requirements going beyond this such as minimum wages for the workforce or prohibition of child or forced labour. This section will examine the possibility of including contract conditions going beyond legal compliance in procurement contracts, focusing on requirements commonly mentioned in the labour policies examined in the previous chapter.

#### *III.1.2.1. Conditions relating to contract performance*

The utility may wish to set out certain conditions which the contractor must comply with when the contract is being performed. This section will first set out the general issues which must be considered when setting out such conditions, before considering the issue in several specific situations arising from the policies in the previous chapter.

### **General issues**

As discussed in the previous section, for a policy to be subject to the free movement provisions it must be classed as a hindrance to trade. The CJEU jurisprudence on

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<sup>536</sup> Directive 2004/18/EC of the European Parliament and of the Council on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts, OJ 2004 L132/114.

<sup>537</sup> Art. 45 Public Sector Directive.

<sup>538</sup> Arrowsmith, S. 'Application of the EC Treaty and directives to horizontal policies: a critical review', Ch. 4 in Arrowsmith and Kunzlik, above n.520, at p.162.

services suggests that any policy which restricts trade in any way needs to be justified.<sup>539</sup> This is supported in the context of labour policies by the case of *Beentjes* in which the CJEU held a condition requiring that 70% of the contract workforce should be recruited from the long-term unemployed would be unlawful if "tenderers from other Member States would have difficulty complying with it".<sup>540</sup> This was also the approach taken in the recent case of *Rüffert* where a requirement to pay contract workers a certain wage was held to cause an additional burden to firms from Member States with lower prevailing wage rates and to require justification.<sup>541</sup>

Since in all these cases the policy created an extra burden for foreign suppliers the policy appears to have been classed as indirectly discriminatory. The issue of a labour policy which is non-discriminatory in its effects has not been considered by the CJEU. Some of the issues in the labour codes examined may affect both national and foreign firms equally, for example being training the contract workforce in a particular skill (presuming a national qualification is not specified). As noted in the previous section, Arrowsmith and Kunzlik suggest that non-discriminatory measures should not generally be classed as hindrances to trade and should fall outside the scope of the free movement provisions.<sup>542</sup> If a labour policy can be formulated to be non-discriminatory, this is probably the lowest risk option for a utility since, even if classed as a hindrance to trade, it is more likely to be justifiable.

Should a policy be classed as a hindrance to trade, it may still be allowable if the hindrance can be justified under a Treaty exception or under an objective justification recognised by the CJEU.<sup>543</sup> As a general rule, for a measure to be justifiable it must be intended to fulfil a genuine social aim of the utility, be suitable for obtaining its objective and must not go beyond what is necessary to achieve that objective.<sup>544</sup> Several specific

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<sup>539</sup> See, for example, Case C-384/93, *Alpine Investments BV v Minister van Financien* [1995] ECR I-1141.

<sup>540</sup> Case C-31/87 *Gebroeders Beentjes BV v Netherlands* [1988] ECR 4635, ("Beentjes"), para. 30. See also Case C-225/98, *Commission v France* [2000] ECR I-7445, ("Nord Pas De Calais").

<sup>541</sup> Case C-346/06, *Rüffert v Land Niedersachsen* [2008] ECR I-01989, para. 37.

<sup>542</sup> Arrowsmith and Kunzlik, above n.534.

<sup>543</sup> For further discussion of justification, see Chapter 5, sec. II.

<sup>544</sup> Case C-234/03, *Contse SA, Vivisol Srl & Oxigen Salud SA v Instituto Nacional de Gestión Sanitaria (Ingesa)* [2005] ECR I-9315, ("Contse"), at para. 25.

justifications relevant to labour policies have been recognised by the CJEU, for example protection of workers.<sup>545</sup> Worker protection is the main aim of the majority of the requirements in the labour codes examined in the previous section, especially those concerned with health and safety and employment conditions such as holiday entitlement, so this possible justification is important. The CJEU also recognised addressing long-term unemployment as a legitimate concern in *Beentjes*.<sup>546</sup> Equal opportunities is also a key aspect of EU law, as shown by Article 18 of the TFEU, so policies prohibiting discrimination are likely to be justifiable.

It has been argued by Arrowsmith and Maund that labour policies adopted to comply with one of the international labour codes discussed in the previous chapter may be more likely to be justifiable than policies designed by the utility independently.<sup>547</sup> Policies which rely on external norms may be considered less open to abuse by the CJEU since the requirements cannot be changed by the procuring entity. Equally, policies designed by international organisations may be more likely to be known by firms throughout the EU, helping to prevent any discrimination for national firms which might occur if national standards are used.

Arrowsmith and Maund note that the requirement to show that a policy is suitable to achieve its objective before it can be justified may be problem for some policies.<sup>548</sup> As discussed in Chapter 2 on Corporate Social Responsibility, a utility may adopt a social policy for two main reasons. Firstly, the utility may wish to obtain the direct benefit of the labour policy, for example the abolition of child labour in the companies they are associated with. Secondly, they may implement the policy for commercial reasons, due to the demands of their stakeholders and/or in the belief that such a labour policy will improve their profitability.

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<sup>545</sup> Case C-113/89, *Rush Portuguesa v Office national d'immigration* [1990] ECR 1417 ("Rush Portuguesa"), para. 18.

<sup>546</sup> Above n.540, at para. 37.

<sup>547</sup> Arrowsmith and Maund, above n.524, at pp.448-449.

<sup>548</sup> Arrowsmith and Maund, above n.524, at p.447.

Where a utility relies on the social benefit of the policy for justification, the issue of proving that benefit becomes relevant. It is unclear whether, where a utility is relying on an externally designed labour code or has designed its own code to support external standards, that code will be accepted by the CJEU as suitable simply because it supports those standards, or whether it will have to be proved that the code actually has a real impact on labour standards.<sup>549</sup> If the utility must prove actual benefit from the code, the degree of monitoring provided for in the code may be relevant. Some standards, such as the UN Global Compact, provide for virtually no monitoring, making the actual impact of the code hard to measure and suggesting that the code is often no more than a PR exercise. Others, such as the OECD Guidelines for Multinational Enterprises and the Ethical Trading Institute Base Code, make provision for some external enforcement of the code provisions and so may be more easily justified.<sup>550</sup>

There are two possible problems where a policy is adopted for commercial reasons. Firstly, the CJEU has held in several cases that economic objectives cannot justify a hindrance to trade.<sup>551</sup> Arrowsmith, however, argues that this general principle is too broad and needs to be nuanced, noting that when the principle was first adopted, it was only used to prevent policies which were clearly incompatible with the Treaty.<sup>552</sup> She argues that economic policies which are not incompatible with the principles of the single markets should not be automatically unlawful, but the issue of justification should be judged for each specific policy on the facts.<sup>553</sup> Where a policy is adopted by a private entity for genuine commercial reasons, it would appear that there is no incompatibility with the Treaty principles, and it may be that the CJEU would consider such a policy justifiable.

Secondly, even if an economic objective may be a justification, the link between CSR and profit has not been proved, making it hard to claim that a labour policy is suitable for

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<sup>549</sup> Arrowsmith and Maund, above n.524, at p.447.

<sup>550</sup> See OECD Guidelines for Multinational Enterprises 2000, p.32 and Ethical Trading Institute Principles of Implementation, Principle 2.1.

<sup>551</sup> See, for example, Case C-353/89, *Commission v Netherlands* [1991] ECR I-4069 and Case C-398/95, *Syndemos ton en Elladi Touristikonkai Taxidiotikon Grafeion v Ypourgos Ergasias* [1997] ECR I-3091.

<sup>552</sup> Arrowsmith, above n.538, at p.156.

<sup>553</sup> *Ibid*, at p.157.

achieving a commercial aim.<sup>554</sup> It is also unclear whether it will be sufficient for a utility to show it has been subject to pressure to include such policies from its stakeholders, or whether they must demonstrate somehow that there is actual commercial benefit from its compliance with stakeholder demands.

### **Requiring a certain mark or certification**

A utility may wish to require a product with a certain mark, for example the Fair Trade mark, so they can be easily sure of the labour standards of the workforce who produced that product. Equally, they may wish to require that any suppliers they contract with are certified to a certain standard such as SA 8000, discussed in the previous chapter. Requiring a product mark or certification by an external body reduces the procedural burden on the utility, which would otherwise have to examine all the evidence themselves for each supplier.

It appears, however, that under EU law a utility cannot require a certain product mark or certification to a particular scheme, but must accept a tender from any supplier who can show they can meet the substantive requirements of the utility in any other way. This was first suggested in the case of *UNIX*, where the CJEU stated that a requirement that an information technology system use a UNIX operating system was held to form a hindrance to trade since it excluded other operating systems which were equally able to meet the authority's functional requirements.<sup>555</sup> This has the possible benefit of increasing competition by including non-certified suppliers and products, but also increases the procedural burden on utilities. The EU rules have the effect of preventing a utility from balancing the possible benefits against the burden themselves, and requiring certain certification must be seen as a very high-risk option.

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<sup>554</sup> See Chapter 2 on Corporate Social Responsibility, sec. III.1.

<sup>555</sup> Case C-359/89, *Commission v Netherlands* [1995] ECR I-157 ("UNIX"). See also Case 45/87, *Commission v Ireland* [1988] ECR 4929, ("Dundalk").

## **Regulating activities outside the awarding state**

The labour policies examined in the previous chapter are designed with firms operating in high-risk countries abroad in mind and so one possible issue is the extent to which EU law lets utilities regulate activities which take place outside their home state. The EU law on this area varies slightly depending on whether the state in which the contract is performed is also an EU Member State or whether it is a third (non-EU) country. This issue is more likely to arise in supply contracts, where the goods may be manufactured outside the awarding state and shipped to the utility.

Where the country in which the contract is performed is also an EU Member State the opportunities for implementing worker protection policies seem limited since it must be shown that the protective measures of that country are inadequate, a requirement which is very hard to meet in practice.<sup>556</sup> It may also be noted that the European Commission appear to take a narrow view of what is allowable in relation to regulating matters in another state. In an Interpretive Communication in this area, it states that contractual clauses relating to the manner in which supply contracts are executed may create a hindrance to trade, given the changes to the organisation of an undertaking established in another Member State which may be required.<sup>557</sup> This may suggest that the Commission is concerned with the inability to identify precisely which work is the work done under the contract (since the contract supplies will often be manufactured alongside other products) and so it will be difficult for a company to comply with the contractual conditions for only the goods under the contract. The supplier may thus be required to change all of their business to comply with the contract, creating a greater restriction on trade.

More often, however, the relevant firms will be based in a non-EU state. Unlike with EU Member States there is probably no presumption that the worker protection regulation of

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<sup>556</sup> See, for example, Case C-76/90, *Manfred Säger v Dennemeyer & Co. Ltd*, [1991] ECR I-4221.

<sup>557</sup> European Commission, *Interpretive Communication of the Commission on the Community Law applicable to public procurement and the possibilities for integrating social considerations into public procurement*, COM(2001) 566, ("Commission Communication on Social Issues"), sec. 1.6.

these countries is adequate, and so the policy will fail to be justified under the general rules for justification discussed above. Arrowsmith suggests that in these cases the policy may be justifiable not only by the protection which it offers the contract workers, but also possibly by a firm's desire to disassociate itself from exploitative behaviour.<sup>558</sup> As discussed previously in section III of Chapter 2 on Corporate Social Responsibility, utilities are often under pressure from a variety of sources, such as consumers, employees and investors, to be socially responsible, and given this, a utility may need to disassociate itself from poor labour practices in order to satisfy these commercial pressures. If such a commercial justification is allowable (see the discussion on economic justification above), this would enable utilities to implement labour policies where the precise impact of the policy is hard to determine. The Commission Communication on Social Issues does not consider the possibility of regulating activity outside the EU, but if, as argued above, the concern is with the restriction on trade which may be caused by regulating activity going beyond contract performance, the argument may equally apply to non-EU firms.

### **Production Methods**

The majority of the labour codes examined in the previous chapter required that companies ensure that their workforce have certain minimum labour standards.<sup>559</sup> This section will examine the possibility of a utility setting standards relating to the workforce producing the product they are purchasing. This situation will also include utilities who wish to purchase products which are made under fair trade conditions.

The Commission's view on the legality of conditions relating to production methods was noted in the previous section, where it was seen that the Commission argue that the possible effects on the supplier's whole business structure mean that such conditions may be considered a restriction on trade.<sup>560</sup> In addition to this, in its Communication

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<sup>558</sup> Arrowsmith, above n.538, at p.174.

<sup>559</sup> See, for example, Principles 5 and 6 of the Ethical Trading Institute Base Code and Sections 7 and 8 of SA 8000, setting out minimum wage rates and maximum working hours.

<sup>560</sup> Commission Communication on Social Issues, above n.557, sec. 1.6.

relating to Environmental Considerations, the Commission suggests that production matters may only be considered where they impact on the actual characteristics of the product.<sup>561</sup> This would appear to rule out the possibility of including production conditions relating to the workforce since these would generally have no impact on the product itself.

The view of the Commission has been criticised, however. The Commission states that a requirement that electricity is sourced from environmentally friendly sources would be acceptable.<sup>562</sup> Kunzlik argues that this claim contradicts the Commission's own requirement that production conditions have an impact on the characteristics of the product, since "green" energy is indistinguishable at the point of consumption from energy generated from fossil fuels.<sup>563</sup> It has been suggested that the example of green energy was included by the Commission because it would not have been politically acceptable to suggest that EU law prevented authorities from considering green issues given the importance of environmental matters to the EU.<sup>564</sup> It could be argued, similarly to this, that it would be politically unacceptable to prevent utilities from excluding firms with unethical labour practices. If this is the case, and contrary to the Commission's argument there is no requirement that production methods affect the characteristics of the product, it will be possible for utilities to include such conditions.

### **Local Labour**

One common aspect of labour codes is the requirement to improve the welfare of the local community in which the company is operating. In order to do so, labour codes may include a requirement to favour national firms for contracts, or to hire national labour for

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<sup>561</sup> European Commission, *Interpretive communication of the Commission on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, COM(2001) 274, at Part II, section 1.2.

<sup>562</sup> *Ibid.*

<sup>563</sup> Kunzlik, P. 'The procurement of 'green' energy', Ch. 9 in Arrowsmith and Kunzlik, above n.520, at p.395. See also Kunzlik, P. 'Making the market work for the environment: acceptance of (some) "green" contract award criteria in public procurement' 15 *Journal of Environmental Law* 175.

<sup>564</sup> Arrowsmith, above n.522, at p.1275.

their workforce on the contract.<sup>565</sup> The requirement is to favour labour which is local to the area of the contract performance, leading to three possible situations depending on where that contract is performed: (1) favouring labour based in the home state of the awarding utility; (2) favouring labour based in another EU member state; or (3) favouring labour based in a non-EU state. This section will discuss both the possibility of including a contract condition requiring that the workforce of the contract be recruited from the local area and the possibility of favouring local firms for contracts.

- Labour based in home state

Of the three possible scenarios identified, a policy favouring labour recruited in the home state of the utility is the highest risk. The TFEU free movement provisions prohibit any condition which requires a company to recruit their workforce from the awarding state, or from any specific area therein. Such conditions are harder to meet in practice by foreign firms, forming an indirectly discriminatory hindrance to trade.<sup>566</sup> Connected to this, any condition which prevents a firm from bringing its own workforce to the host state to perform the contract is also prohibited, preventing a utility from including such a condition in the hope that this will force the supplier to recruit a workforce in the home state.<sup>567</sup>

As regards set-asides for local firms, the CJEU in *Du Pont de Nemours* has stated that policies which reserve contracts for firms in certain areas are directly discriminatory, creating a hindrance to trade contrary to the free movement principles.<sup>568</sup> Policies are also caught by the free movement rules when they are indirectly discriminatory, as in the case of *Commission v Italy*, in which a preference was given to companies which had

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<sup>565</sup> See, for example, OECD Guidelines for Multinational Enterprises, General Principles 3 and 4, which require a firm to encourage local employment and local capacity building, and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (2006), p.6, which states that a company should promote employment opportunities, giving priority to nationals of the state in which they are operating.

<sup>566</sup> Case C-243/89, *Commission v Denmark* [1993] ECR I-3353.

<sup>567</sup> Case C-113/89, *Rush Portuguesa v Office national d'immigration* [1990] ECR I-1417.

<sup>568</sup> Case C-21/88, *Du Pont de Nemours Italiana SpA v Unita Sanitaria Locale No. 2 di Carrara* [1990] ECR I-889, at para. 14.

their main operations in the area of the contract performance, a criterion more likely to be satisfied in practice by Italian firms.<sup>569</sup>

- Labour based in another EU state

EU law is less clear on the situation where the contract is performed in another EU member state and the workforce of that state is preferred. Such a policy is not discriminatory in the sense that it is usually used, since it does not favour parties based the awarding state in any way. As discussed in sec. III of Chapter 5, however, non-discriminatory hindrances to trade are also generally prohibited by the free movement provisions, so the question becomes whether recruiting local labour or setting aside contracts for local firms does indeed form a hindrance to trade. Set-asides certainly restrict trade, limiting contracts only to certain firms. A requirement to recruit local labour also appears to be a hindrance to trade, preventing firms from other countries who wish to use their existing workforce from completing the contract.

- Labour based in a third country

As with labour based in an EU state, the law is unclear over whether favouring labour based in a non-EU state is allowable. Again, such a policy is not discriminatory, but would form a hindrance to trade, as with labour recruited in another EU state, discussed above. It may also be noted that EU law generally prefers EU states to non-member states in its law, as shown, for example, in Article 58 of the Utilities Directive which allows a utility to prefer EU goods over non-EU goods where the tenders are equivalent. Given this, it appears that the CJEU would likely regard a policy favouring labour in a non-EU state to be a hindrance to trade under the free movement provisions.

- Justification

As discussed previously, utilities may use two possible justifications for labour policies: the social benefit of the policy to the workforce and/or local community, and the

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<sup>569</sup> Case C-360/89, *Commission v Italy* [1992] ECR I-3401, at para. 12.

commercial benefit to the utility. The social benefit of the policy in this case would be the benefit to the local industry of the country in which the utility is operating. This justification, however, is contrary to the basic principle underpinning the EU free trade regulation that free cross-border trade is more beneficial to all states involved than states operating individually.<sup>570</sup> Given this, it seems unlikely that such a justification would be accepted by the CJEU.

If it is not possible to justify the policy on its intrinsic social benefit, then the utility must rely on the commercial benefits to its business for a justification, for example, improved relations with the local community, or the benefit obtained from complying with the pressure from its various stakeholders to include such labour policies in its business. The problems with relying on commercial justification were discussed above in the section on "General Issues". If economic justifications are allowable in principle, the question becomes whether the CJEU will accept that the commercial interests of a utility are sufficient justification for a policy which, as noted above, goes contrary to the general principle behind free trade. Given the lack of clarity in this area, including local labour policies should be seen as a high risk approach.

As regards set-asides, it may be noted that set-asides are one of the most restrictive methods of promoting labour policies, preventing any competition outside of the firms which meet the criteria and so it may be arguable that other methods, such as a preference for local firms in award criteria, would be a more proportionate method to use.<sup>571</sup> Setting aside contracts for local firms thus appears to be one of the most high-risk options available.

### **Employment conditions: *Rüffert* and the Posted Workers Directive**

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<sup>570</sup> For discussion of the principles behind EU free trade, see Barnard, C. *The Substantive Law of the EU: The Four Freedoms*, (2<sup>nd</sup> Ed), (2007, Oxford: OUP), Ch.1.

<sup>571</sup> Arrowsmith, above n.538, at p. 183.

Utilities may also have to consider the impact of Directive 96/71/EC<sup>572</sup> ("the Posted Workers Directive") when they are setting conditions which will apply to a workforce of an undertaking established an EU Member State who are posted to the host Member State in order to perform a contract.<sup>573</sup> The directive applies to maximum work levels and minimum rest periods; minimum holidays; minimum levels of pay; the conditions of hiring-out of workers; health and safety; protection of pregnant workers, children and young people; and non-discrimination rules.<sup>574</sup> For these activities, Member States are required to ensure that the local terms and conditions of employment are applied to the posted workers.<sup>575</sup>

In the recent case of *Rüffert*, the CJEU held that, where the Posted Workers Directive applies, a procuring entity cannot require a higher standard of employment terms than the minimum provided for in the directive.<sup>576</sup> The Court held that requiring compliance with national law creates an extra burden on firms from Member States where the employment conditions are generally lower and so is a hindrance to trade contrary to Art. 56 TFEU.<sup>577</sup> It was held that the restriction could not be justified by reference to worker protection given that the condition in question went beyond the requirements of the Posted Workers Directive and this Directive set out the EU level of protection deemed necessary for workers.<sup>578</sup> The argument that an entity cannot request a higher level of protection where an EU standard exists is supported by the case of *Medipac*, in which the CJEU suggested that a public authority had to accept sutures of a standard compatible with Directive 93/42/EEC.<sup>579</sup> In the specific circumstances covered by the Posted

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<sup>572</sup> Directive 96/71/EC of the European Parliament and the Council concerning the posting of workers in the framework of the provision of services, [1997] OJ L18/1.

<sup>573</sup> Art. 1(1) Posted Workers Directive.

<sup>574</sup> Article 3(1) Posted Workers Directive.

<sup>575</sup> *Ibid.*

<sup>576</sup> *Rüffert*, above n.541.

<sup>577</sup> *Ibid.*, at para. 37.

<sup>578</sup> *Ibid.*, at para. 33. The Court also stated that the condition went beyond what was necessary since it only applied to workers on public contracts and there was no evidence that this protection was necessary only for public workers and not also for workers in the private sector (para. 40). This will not be an issue for most utilities since they operate in the private sector, but may affect utilities which are public authorities. For further discussion on the implications for the public sector see Arrowsmith and Kunzlik, 'Editors' Note – the decision in *Rüffert v Land Niedersachsen*' in Arrowsmith and Kunzlik, above n.520, at pp.1-8.

<sup>579</sup> Case C-6/05, *Medipac-Kazantzidis v Venizelio-Pananio* [2007] ECR I-4557, ("Medipac").

Workers Directive therefore, a utility may need to limit themselves to conditions requiring compliance with the national law.

### *III.1.2.2 Conditions going beyond contract performance*

A utility may wish to ensure that its contractor does not only comply with certain labour standards on its contract work for that utility but also more generally in its business, preventing the utility from being associated with an unethical supplier. Several of the obligations contained in the labour codes examined previously may require policies which are not linked to the contract performance in order to be effective. For example, the majority of the labour codes examined contained an obligation to work towards the abolition of child labour. Prohibiting child labour on a utility's contract work may not be effective in practice, simply pushing children into other, possibly more dangerous work. Auxiliary policies aimed at, for example, educating children may also be needed. This need is acknowledged in Principle 4.2 of the Ethical Trading Institute Base Code, which requires companies to "develop or participate in and contribute to policies and programmes which provide for the transition of any child found to be performing child labour to enable her or him to attend and remain in quality education until no longer a child".

The position of conditions which go beyond contract performance under the TFEU rules is unclear. As previously discussed in the section on production effects, the Commission Communication on Social Issues suggests that conditions going beyond performance form a hindrance to trade which it would be difficult to justify given the greater burden on the supplier.<sup>580</sup> This view is possibly supported by the case of *EVN*.<sup>581</sup> In this case, one award criterion was the amount of electricity over the amount required for the contract which could be supplied from renewable sources (the ability to supply the contractual amount from renewable sources being a qualification condition). The criterion was unlawful under the Public Sector Directive since it was not linked to the subject

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<sup>580</sup> Commission Communication on Social Issues, above n.557.

<sup>581</sup> Case C-448/01, *EVN AG v Austria* [2003] ECR I-14527, ("EVN").

matter of the contract as required by that Directive<sup>582</sup>, but the CJEU also stated that the criterion favoured larger suppliers over small suppliers who would also be able to supply the contractual amount and so was discriminatory.<sup>583</sup> This may suggest that conditions going beyond contract performance will not be accepted by the CJEU. Arrowsmith disagrees with this view, however, arguing that the decision simply shows that the criterion in question was not proportional to its aim.<sup>584</sup> Equally, the decision is concerned with the equal treatment principle under the directives and, while that principle was breached in this case given that the directives prohibit criteria not linked to the subject matter of the contract, the same prohibition may not apply under the Treaty.<sup>585</sup>

It may therefore be possible for a utility to include non-performance related conditions in their procurement. Such policies will probably be considered hindrances to trade, but may be justifiable for policy reasons, including the need to avoid association with unethical suppliers and also the possible need for such auxiliary policies for a policy to be effective. Where the policy can be formulated so that it is non-discriminatory, there is probably a lower risk of challenge.

### III.2. Exclusion

Where a utility has set out contract conditions relating to its labour policies, it may wish to exclude any firm which it does not believe will comply with the condition, or who has failed to comply in the past, from the tendering process. The relevant considerations here appear to be the same as for deciding whether a particular contract condition is lawful, looking at whether the exclusion conditions create a hindrance to trade and, if so, whether it can be justified. As with contract conditions, exclusion relating simply to compliance with the law appears to be the lowest risk and exclusion for matters going beyond the contract, such as exclusion for using child labour in factories which are not completing the utility's particular order being the highest risk. It may be noted that the

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<sup>582</sup> And also by the Utilities Directive, see below in sec. IV.2.

<sup>583</sup> EVN, above n.581, at para. 69.

<sup>584</sup> Arrowsmith, above n.538, at p. 181.

<sup>585</sup> *Ibid.*

Utilities Directive appears to allow a broad discretion in this area (see further below), allowing exclusion for any “objective reasons”, and it seems unlikely that the TFEU rules would narrow this discretion.

### III.3. Award Criteria

It is possible to implement labour policies through a preference in the award criteria, for example, through a criterion evaluating a firm’s non-discrimination policy, under which firms with better policies receive a higher score. This method allows a utility to balance the importance of the policy against other factors, including the possible cost of implementing that policy. Arrowsmith and Maund have suggested that award criteria are not generally used for implementing labour policies by utilities, given that such policies are often intended to ensure a certain minimum standard of labour conditions, and it is not considered appropriate to balance this minimum against commercial concerns.<sup>586</sup> Because of this, if award criteria are to be used, they may be best combined with contract conditions, where the conditions set out the minimum conditions which must be accepted by any supplier and the award criteria may be used to determine the most ethical supplier, or to implement other policies going beyond the minimum. Award criteria may be useful for evaluating different firms’ methods for implementing a particular policy, for example, for setting out their plan for training workers.

The principles relating to award criteria under the TFEU are the same as discussed previously for contract conditions and exclusion. An award criterion will be caught by the free movement rules where it forms a hindrance to trade and, where caught, it must be justified by policy reasons. In regards to justification, it may be relevant that award criteria are one of the least restrictive methods to use when implementing labour policy, given that the cost of the policy is weighed against other matters, making such criteria a lower risk option.<sup>587</sup>

## **IV. Procurement under the Utilities Directive**

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<sup>586</sup> Arrowsmith and Maund, above n.524, at p.463.

<sup>587</sup> Arrowsmith, above n.538, at p.190.

This section will examine the impact of the Utilities Directive on the possibility of including labour policies in procurement.<sup>588</sup> If the Treaty rules do apply to private utilities, they must also consider the principles discussed in the previous section for each procurement.

It may first be noted that Recital 13 of the Directive states that nothing in the Directive:

“should prevent the imposition or enforcement of measures necessary to protect public morality, public policy, public security, health, human and animal life or the preservation of plant life, in particular with a view to sustainable development, provided that these measures are in conformity with the Treaty.”

McCradden, examining the comparable provision in Recital 6 of the Public Sector Directive, argues that this forms a Treaty-based exception to the provisions of the Directive.<sup>589</sup> If this argument is correct, it would allow a utility to derogate from the requirements of the Utilities Directive where the particular policy is necessary for protection of one of the interests listed in Recital 13. Labour policies of the kind discussed here and in the previous chapter may fall within the definition of public policy.<sup>590</sup> Arrowsmith, however, does not believe the Recital has the effect of creating such a Treaty-based exception, arguing the directives’ provisions are designed to balance the various policy interests and exhaustively regulate this area, removing utilities’ discretion to decide the importance of those interests.<sup>591</sup> The issue has not been examined in the case law and so the correct interpretation is unclear.

#### IV.1.Techical Specifications

The technical specifications of a contract set out precisely what it is that the utility wishes to buy. The distinction between these specifications and “special conditions” set out as contract conditions is key under the public sector rules where an entity can

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<sup>588</sup> For discussion of the rules under the Utilities Directive more generally, see Chapter 5, Section IV.

<sup>589</sup> McCradden, above n.532, at pp.531.

<sup>590</sup> See, for example, the *Rush Portuguesa* case, discussed above, in which protection of workers was accepted as legitimate policy aim. For further discussion, see McCradden, above n.532, at pp.532-535.

<sup>591</sup> Arrowsmith, above n.538, at p.194.

probably only exclude suppliers for non-compliance with technical specifications, not for other special conditions. The distinction may be less crucial for utilities, which may be able to exclude for non-compliance with contractual conditions also (see discussion below, section IV.3). Even if utilities can exclude for non-compliance with contractual conditions, one interpretation of allowable award criteria also refers back to the notion of technical specifications, with only matters linked to these specifications being lawful criteria (see below, section IV.4). This section will examine whether labour issues may be included in the technical specifications of a contract.

The definition of technical specifications is set out in Annex XXI of the Utilities Directive. For supply or service contracts, a technical specification is a specification "defining the required characteristics of a product or service".<sup>592</sup> For works contracts, the specification is "the totality of the technical prescriptions ... defining the characteristics required of a material, product or supply, which permits a material, a product or supply to be described in a manner such that it fulfils the use for which it is intended by the contracting entity".<sup>593</sup>

It is unclear whether issues relating to the workforce performing the contract may be included in the technical specifications, for example whether a utility can specify that products were produced under fair trade conditions.<sup>594</sup> Arnould, examining the identical definitions in the Public Sector Directive, argues that the reference in the works definition to the specification describing the product in a manner "such that it fulfils the use for which it is intended" implies that production methods are only relevant where they have an impact on the use of that product or service.<sup>595</sup> This also appears to be the view of the European Commission who state that a particular production process may be used only if it affects the "performance characteristics (visible or invisible) of the product

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<sup>592</sup> Annex XXI, sec. 1(a) Utilities Directive.

<sup>593</sup> Annex XXI, sec. 1(b) Utilities Directive.

<sup>594</sup> See section III 1.2.1 above for discussion of whether workforce criteria relating to the production of products are lawful under the EC Treaty.

<sup>595</sup> Arnould, J. 'Secondary Policies in Public Procurement: The Innovations of the new Directives' (2004) 13 PPLR 187, at 191.

or service".<sup>596</sup> If this argument is correct, it would appear to rule out the possibility of including workforce issues in the technical specifications as the performance of a product will not be affected by the make-up or conditions of the workforce producing that product.

McCradden makes the case for a wider view of specifications, arguing that so long as the specifications are transparent, do not reduce competition and are non-discriminatory, then any social matters which affect the subject-matter of the contract may be included in the technical specifications if these define what the authority wishes to buy.<sup>597</sup> Under this interpretation, criteria such as requesting fair trade products would be allowable though criteria which operate post-award and are not linked to the subject-matter of the contract would not, for example hiring a proportion of the workforce from the unemployed as in the *Beentjes* case.<sup>598</sup> If correct, this interpretation offers much greater flexibility to utilities.

#### IV.2. Contract Conditions

The Utilities Directive does not generally set any limits on what contractual conditions may be set by a utility where those conditions are limited to compliance with legal requirements and/or to the performance of the contract. In connection to compliance with legal requirements, it may be noted that the Utilities Directive appears to assume this is allowable, given Article 39 which allows Member States to require a utility to state where information on the obligations under local law may be obtained. The possibility of including other social contract conditions going beyond legal compliance is set out in Article 38, which states:

Contracting entities may lay down special conditions relating to the performance of the contract, provided that these are compatible with Community law ... The

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<sup>596</sup> European Commission, *Interpretive communication of the Commission on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, COM(2001) 274, ("Commission Communication on environmental considerations"), at para. 1.2., sec. II(1).

<sup>597</sup> McCradden, above n.532, at p.542.

<sup>598</sup> McCradden, C. 'EC public procurement law and equality linkages: foundations for interpretation', Ch. 6 in Arrowsmith and Kunzlik, above n.520, at p.297.

conditions governing the performance of a contract may, in particular, concern social and environmental considerations.

Under this Article, conditions will be lawful so long as they do not breach general EU law, and so the principles discussed above for the TFEU will be relevant. As discussed above in Section I, there is a question mark over how far, if at all, the Treaty obligations apply to private utilities. If the obligations do not apply at all, private utilities would appear able to set any contract conditions they felt necessary for their business, as is the case with other private entities. Arrowsmith and Maund argue, however, that the Utilities Directive appears to be designed to ensure that utilities are subject to the same regulation as public bodies under the Treaty, and suggest that the CJEU might interpret the Directive as following the same principles as under the Treaty.<sup>599</sup>

While including contract conditions requiring compliance with the law and which are limited to contract performance is probably allowable, including a condition which goes beyond performance is a higher risk option. Article 38 states that conditions "relating to the performance of the contract" are allowable. The provision parallels Article 26 of the Public Sector Directive, and this provision is generally taken to imply that conditions which do not relate to the performance of the contract are thus not lawful.<sup>600</sup> Given that the provisions are identical, the same argument may apply to the utilities provision also. Arrowsmith and Maund suggest, however, that the different context of the Utilities Directive might imply a more flexible interpretation.<sup>601</sup> They note that if utilities cannot include conditions going beyond performance they will also be unable to exclude firms for reasons unrelated to contract performance, an interpretation which would limit the effect of the seemingly flexible exclusion provision of the Utilities Directive. The authors argue that Article 38 may simply clarify that provisions relating to performance are allowable, without limiting the use of other provisions. If this argument is correct, utilities would have much more flexibility, but the option appears very high-risk.

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<sup>599</sup> Arrowsmith and Maund, above n.524, at p.448.

<sup>600</sup> See, for example, Arrowsmith, above n.522, at p.1280.

<sup>601</sup> Arrowsmith and Maund, above n.524, at p.458.

#### IV.3. Exclusion

As discussed in the previous section looking at the Treaty, a utility may wish to exclude certain firms from the possibility of tendering. The Utilities Directive states that firms may exclude firms "in accordance with objective rules and criteria".<sup>602</sup> Article 54(4) states that these objective criteria may include the criteria allowable under the Public Sector Directive. Under the public sector rules, a procuring entity may exclude a firm for lack of financial standing, lack of technical or professional ability, or for certain other specified reasons relating to the professional conduct of the firm, including holding any criminal convictions or being guilty of "grave professional misconduct".<sup>603</sup> It may also be noted that where the utility is classed as a public authority, they are *required* to exclude firms for the reasons set out in Article 45(1) of the Public Sector Directive, which covers convictions for certain criminal offences such as corruption or money laundering. It is unclear, however, whether the discretion for excluding firms extends beyond the matters covered by the Public Sector Directive and, if so, how far it extends. Trepte argues that, given the purpose behind the Utilities Directive was to provide more flexibility for entities operating in this area than is available in the public sector, the discretion available to utilities is indeed wider.<sup>604</sup> This is supported in the Commission's Communication on Social Issues, which notes that utilities have a wider discretion than the public sector when excluding firms, though they do not discuss precisely how wide that discretion is.<sup>605</sup> The issue has not been examined by the CJEU and so remains unclear.

The Utilities Directive does not define what is meant by "objective rules and criteria". Arrowsmith and Maund suggest that an objective criterion is "a criterion suitable to achieve a legitimate policy of the utility".<sup>606</sup> They also suggest that, as with the rules concerning award criteria (discussed below), objective criteria should be capable of

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<sup>602</sup> Art. 54.

<sup>603</sup> Art. 45 Public Sector Directive. For further discussion of the rules relating to exclusion under the public sector rules, see Arrowsmith, above n.522, Ch.12.

<sup>604</sup> Trepte, P. *Public Procurement in the EU: A Practitioners' Guide*, 2<sup>nd</sup> Ed, (2007, Oxford: OUP), p.364.

<sup>605</sup> Commission Communication on Social Issues, above n.557, sec. 1.3.

<sup>606</sup> Arrowsmith and Maund, above n.524, p.451.

verification and should not confer an excessive amount of discretion on the utility.<sup>607</sup> The authors set out eight possible interpretations of what is covered by "objective criteria"<sup>608</sup>:

1. A firm may be excluded under any criterion related to the particular contract, where the exclusion is done for reasons of commercial procurement.
2. A firm may be excluded under any criterion related to the particular contract, where the exclusion is done for any legitimate procurement policy reason.
3. A firm may be excluded under any criterion related to the particular contract, where done for commercial reasons.
4. A firm may be excluded under any criterion related to the particular contract, where done for any legitimate policy reason.
5. A firm may be excluded for any commercial procurement reason.
6. A firm may be excluded for any legitimate procurement policy reason.
7. A firm may be excluded for any commercial reason.
8. A firm may be excluded for any reason linked to a legitimate policy of the utility.

Several of these interpretations would allow a utility to exclude a firm for a labour policy reason. Interpretations 2, 4, 6 and 8 are the most flexible possible approaches, allowing a utility to exclude firms for any reason connected to a legitimate labour policy, regardless of whether or not the policy is intended to bring any commercial benefits to the utility. Interpretations 3 and 7 would allow a utility to exclude a firm for a labour-related reason where that reason is linked to their overall business aims, which may rely on the ability to show a link between CSR and profitability which, as noted above and in Chapter 2, is very hard to do in practice. Interpretations 1 and 5 are the least flexible, requiring any exclusion criteria to relate to commercial procurement policy, a requirement which seems hard to meet for labour policies given that they generally reduce competition, increase the costs of the procurement and do not provide any commercial benefit to the utility specifically linked to the procurement. The case of

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<sup>607</sup> *Ibid.*

<sup>608</sup> *Ibid.*, at pp.451-453.

*Concordia Bus* may be seen to support a more flexible approach.<sup>609</sup> In this case the CJEU rejected an argument by the Commission that any award criteria used had to provide a commercial benefit to the procuring entity, stating that non-economic factors may also influence the value of a tender and may be considered.<sup>610</sup> It is arguable that the same argument should apply also to contract conditions and exclusion criteria and a utility should not have to prove a direct commercial benefit for any policy they adopt.

As noted in the section on the Treaty rules, a utility may wish to exclude a firm from tendering where that firm has breached a labour condition in a previous contract. Doing so prevents further breach and the threat of such future exclusion may also create an incentive to firms to comply with the relevant conditions.<sup>611</sup> Excluding a supplier on the grounds of previous non-compliance appears to be possible under the Public Sector Directive where that non-compliance can be classed as "grave misconduct" and, since the Utilities Directive allows all the grounds allowable under the Public Sector Directive, such exclusion would also appear possible for utilities.<sup>612</sup> The Public Sector Directive does not define what behaviour would class as "grave misconduct", but Advocate General Gulman stated in his Opinion for *Commission v Spain* that a deliberate violation of a contract condition would be covered.<sup>613</sup> Arrowsmith and Maund argue that limiting exclusion to deliberate violations may catch direct violations of social obligations in the main contract but could fail to catch violations further down the supply chain.<sup>614</sup> The authors argue that in order to avoid having to accept a new tender by the firm whose breach terminated the previous contract, all violations should be grounds for exclusion, whether deliberate or not.<sup>615</sup> Even if such violations are not classed as grave misconduct for the purposes of the Public Sector Directive, exclusion may still be allowable for utilities if their discretion to exclude is indeed wider.

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<sup>609</sup> Case C-513/99, *Concordia Bus Finland Oy Ab (formerly Stagecoach Finland Oy Ab) v Helsingin Kaupunki* [2002] ECR I-7213 ("Concordia Bus").

<sup>610</sup> *Ibid.*, at para. 55.

<sup>611</sup> Arrowsmith and Maund, above n.524, at p.454.

<sup>612</sup> Art. 45 Public Sector Directive, applied to utilities by Art. 54(4) Utilities Directive.

<sup>613</sup> Case C-71/92, *Commission v Spain* [1993] ECR I-5923, Advocate General's Opinion, at para. 95.

<sup>614</sup> Arrowsmith and Maund, above n.524, at p.456.

<sup>615</sup> *Ibid.*

Many of the considerations a utility will wish to exclude potential suppliers for if they are following one of the labour codes discussed previously will be unrelated to the performance of the contract, for example the use of child labour throughout a supplier's business. As discussed in the previous section, it appears that the use of contract conditions which go beyond the performance of the contract is prohibited by the Utilities Directive. If so, the possibility of excluding suppliers based on such conditions is also presumably prohibited since, as Arrowsmith and Maund note, it is unlikely the Directive allows utilities to exclude for a condition they are not legally allowed to include.<sup>616</sup> If this is the case, it appears that a utility will be unable to exclude firms for violations of their labour code when that violation will not directly affect the particular contract work.

One possible way of dealing with this restriction would be to class a violation of a labour code as "grave professional misconduct" which, as discussed above, generally allows exclusion. Arrowsmith and Maund note two difficulties with this approach, however. Firstly, if violations which class as grave misconduct is limited to violations of codes accepted by the supplier in question, this could lead in practice to more suppliers refusing to accept such codes.<sup>617</sup> On the other hand, if grave misconduct is not limited to codes accepted by the supplier, it may be difficult to establish which considerations may be classed as "objective" in order to allow exclusion.<sup>618</sup> Overall, it appears that excluding firms for considerations unrelated to the performance of the contract is a high-risk option.

#### IV.4. Award Criteria

As previously discussed in the section on the Treaty rules, labour-related award criteria may not be appropriate for most obligations under labour codes, since the method is not appropriate for ensuring minimum standards. The method may, however, be used where the utility wishes to implement any policies which go beyond setting minimum standards.

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<sup>616</sup> *Ibid*, at p.459.

<sup>617</sup> *Ibid*, at p.460.

<sup>618</sup> *Ibid*.

The rules relating to award criteria are set out in Article 55 of the Utilities Directive. Article 55(1)(a) sets out a list of allowable criteria. This list does not mention labour issues, but this list was expressly stated to be non-exhaustive in *Concordia Bus* and so a utility is *prima facie* free to use other criteria, including labour-related criteria, in its contracts.<sup>619</sup> The main area of uncertainty relating to the use of labour policies in award criteria comes from the requirement in Article 55(1)(a) that any criteria must be "linked to the subject-matter of the contract". This raises the issue of what precisely is meant by "the subject-matter of the contract".

McCradden argues that the phrase is narrower than the reference to "relating to the performance of the contract" which limits the use of contract conditions, requiring a "closer nexus" between the award criteria and the subject-matter of the contract than is required between contract conditions and performance of the contract.<sup>620</sup> Arnould agrees, taking a narrow view of subject-matter which seems to link it to the technical specifications of the contract.<sup>621</sup> If this argument is correct, most labour policies will not be able to be included as award criteria since, as discussed above, it is unlikely that they can be considered part of the technical specifications of the contract. Arrowsmith disagrees, however, arguing that award criteria may be used whenever contract conditions on that policy might be included.<sup>622</sup>

The broader interpretation put forward by Arrowsmith seems to be supported by the case of *Nord Pas de Calais*.<sup>623</sup> In this case French authorities had included a firm's ability to combat local unemployment as an award criterion and the CJEU held that a criterion such as this was lawful so long as it was non-discriminatory (a requirement this criterion appeared to fail, given its reference to local employment).<sup>624</sup> This ruling specifically shows that workforce criteria can be included in award criteria. The case may also support a wider reading of the subject-matter of the contract since, as Arnould notes,

<sup>619</sup> *Concordia Bus*, above n.609, at para. 54.

<sup>620</sup> McCradden, above n.532, at p.564.

<sup>621</sup> Arnould, above n. 595, at 192.

<sup>622</sup> Arrowsmith, above n.538, at p.238.

<sup>623</sup> Case C-225/98 *Commission of the European Communities v France* [2000] ECR I-7445 ("Nord Pas De Calais")

<sup>624</sup> *Ibid*, at para. 54.

the criterion here was not relating to subject-matter in the narrow view of technical specifications.<sup>625</sup> The ruling has been criticised as the CJEU relied on *Beentjes* to support their finding, a case which was concerned with contract conditions rather than award criteria. Equally, however, it has been argued that this could be taken as support of the principle that award criteria may be used whenever contract conditions may be included.<sup>626</sup> The Commission has interpreted the case as allowing workforce criteria only when other aspects of the tender are equal, but, while this was the case on the facts, there is no mention of this fact in the CJEU's judgement, and so there does not appear to be any reason to limit the use of such criteria in this way.<sup>627</sup>

Any labour issue which is included as an award criterion must also be capable of verification by the authority.<sup>628</sup> This may cause problems in supply contracts where the policy affects the whole supply chain, as it may be hard to check the standards of each contractor in that supply chain, especially for complex goods which have a long supply chain, for example, electrical goods.

#### IV.5. Proving compliance with labour considerations

Setting conditions relating to labour considerations in the contract and having the ability to exclude those who cannot comply will not aid the utility in practice if they cannot request the relevant information from the supplier in order to determine whether they can in fact comply. Unlike the rules under the Public Sector Directive, the Utilities Directive does not set out an explicit list of the types of evidence which may be requested. This suggests that a utility may request any evidence which may reasonably be used to determine compliance with a legally included labour policy. Arrowsmith and Maund argue that a utility may not request any information beyond that which is necessary for determining compliance as this would impose an unnecessary burden on

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<sup>625</sup> Arnould, above n.621, at 195

<sup>626</sup> Arrowsmith, above n.538, at p241.

<sup>627</sup> Commission Communication on Social Considerations, above n.557, at para. 1.4.1.

<sup>628</sup> EVN, above n.581, at para. 51

suppliers.<sup>629</sup> They also note that requesting such information creates a presumption that this irrelevant information has been taken into account when determining the result of the tendering process.<sup>630</sup>

The Directive does, however, state that utilities may not impose any "administrative, technical or financial conditions" on certain companies but not others.<sup>631</sup> Arrowsmith and Maund note that this may cause issues for utilities who operate in high-risk countries.<sup>632</sup> Utilities may wish to request additional evidence from firms operating from high-risk areas, which would appear to be prevented by this requirement. Equally, however, if utilities respond by requesting large amounts of evidence from all suppliers, they may be seen as imposing an unnecessary burden on companies which operate in low-risk areas.<sup>633</sup>

Utilities are also forbidden from requesting any specific evidence which duplicates evidence already available.<sup>634</sup> Connected to this, it is stated for technical specifications that, where a utility has set their specifications by reference to a particular standard, they must accept any product which can be shown to be "equivalent".<sup>635</sup> This requirement supports the principle discussed above under the Treaty section that a utility may not generally require specific standards or registration under a certain scheme, but must accept any alternative which can be proved to fulfil its functional requirements, the problems relating to which were discussed above.

#### IV.6. Qualification Systems

Unlike bodies in the public sector, utilities have the option of choosing possible tenderers on the basis of a qualification list. Under this system, possible suppliers are chosen on the basis of certain advertised criteria and future contracts may be limited to suppliers on the qualification system. In the same way that utilities may use labour criteria to

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<sup>629</sup> Arrowsmith and Maund, above n.524, at p.466.

<sup>630</sup> *Ibid.*

<sup>631</sup> Art. 52(1)(a) Utilities Directive.

<sup>632</sup> Arrowsmith and Maund, above n.524, at p.466.

<sup>633</sup> *Ibid.*

<sup>634</sup> Art. 52(1)(b) Utilities Directive.

<sup>635</sup> Art. 34(3) Utilities Directive.

exclude firms for individual procurements, utilities may also use these criteria to exclude firms from the qualification system. Utilities may also choose to collect information from suppliers at the registration stage and exclude suppliers only for particular procurements. In addition to the general issues which may arise for exclusion (see above, section 3), there are also several possible issues specific to qualification systems, and this section will examine these.

Arrowsmith and Maund suggest that problems may arise from the fact that many qualification systems cover all contracts for those utilities, not only those which are regulated under the Utilities Directive's rules.<sup>636</sup> Even if utilities may exclude firms for labour-related considerations (see above, section 3), it is unclear whether they may do so for registration to a scheme where it is possible that those criteria will only be relevant for a proportion of the contracts awarded under the system. Arrowsmith and Maund argue that, while it is unlikely that utilities may exclude firms only for reasons relevant to a particular type of contract, it is equally unrealistic to expect firms to ensure that every exclusion criterion is relevant to every procurement.<sup>637</sup> Equally, where utilities do not exclude suppliers at registration but merely collect information for later exclusion, it is unclear whether utilities may request information which will only be relevant for a proportion of the contracts.<sup>638</sup>

## **V. Conclusion**

This chapter has attempted to set out the possibilities for including labour concerns in utilities procurement under the EU regime. It can be seen that there is fundamental uncertainty running through the EU procurement regime. There is a lack of clarity over the application of the TFEU to the private utilities at all, creating uncertainty right from the beginning of the procurement process. The chapter has also shown that while some potential labour policies, notably the possibility of favouring local labour, are clearly prohibited under the EU regime, for the majority of policies the precise scope available

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<sup>636</sup> Arrowsmith and Maund, above n.524, at p.469-471.

<sup>637</sup> *Ibid.*, at p.470.

<sup>638</sup> *Ibid.*

under the EU legal regime is unclear. The chapter has highlighted the possible points in the procurement process at which labour policies could be included in procurement and noted the issues which might arise at each point, attempting to evaluate the level of risk associated with each method. The actual use of labour policies in utilities procurement and the impact, if any, of the EU legal regime and its lack of clarity will be evaluated in Part II of the thesis. Prior to that, however, the next chapter will offer a discussion of potential regulatory issues relating to the EU legal regime and the use of CSR policies, including the potential impact of the lack of clarity in the law.

## **Chapter 7 - Regulatory Theory**

### **I. Introduction**

This chapter examines various theories relating to regulation, focusing on compliance with and enforcement of regulation. The chapter aims to determine why companies comply with regulation and, specifically, whether the fact that the precise requirements of that regulation are unclear, as is the case with the EU utilities procurement regulation's requirements relating to corporate social responsibility, has an impact on compliance with that regulation. These theories will then be examined in the empirical research examining procurement practitioners' experiences applying the law.

The chapter begins with an examination of the various types of regulation available to regulatory bodies, focusing on the advantages and disadvantages of command and consensus techniques, the categories most appropriate to the procurement regulation and the labour codes examined in this thesis. The chapter then examines indeterminacy in the law, looking at what precisely is meant by "indeterminacy" and the problems caused by lack of clarity in the law. The next section examines compliance theory, first examining the general reasons a party complies with regulation and the factors which can influence that decision before examining the impact of indeterminacy on the decision to comply with regulation in more detail. Finally, the chapter examines theories on enforcement of regulation, providing a basis on which to examine the effectiveness of the EU regime.

### **II. Types of Regulation**

#### **II.1. Definition of Regulation**

The concept of regulation is generally considered to be hard to define. Baldwin and Cave identify three common uses of the word "regulation".<sup>639</sup> Firstly, regulation may be seen as a specific set of commands, applied by a particular body devoted to this purpose. This

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<sup>639</sup> Baldwin, R. and Cave, M. *Understanding Regulation: Theory, Strategy and Practice*, (1999, Oxford: OUP), at p.2.

definition covers, for example, rules set out for the electricity transmission sector under the Electricity Act 1989 and regulated by Ofgem. This definition also covers most classic “command and control” regulation, (the term commonly used for regulation formed of rules prohibiting certain actions backed up with sanctions should those rules be breached, see further below), and is the most common understanding of regulation.<sup>640</sup> Secondly, regulation may be seen as any deliberate state influence on social or industrial behaviour. This definition includes forms of influence other than command and control measures, such as economic incentives. Finally, regulation may be seen as any form of social control or influence, whether that influence is intentional or not. This includes not only measures emanating from the state but also those from other sources, such as the market. Black notes yet another common definition of regulation, limiting the term to the use of legal instruments created by government.<sup>641</sup>

The views of regulation above focus on the source and scope of a regulatory measure. In contrast, other definitions take a more functional approach. Hood, Rothstein and Baldwin set out a “cybernetics perspective”, arguing that any control system needs three main components:

There must be some capacity for *standard-setting* to allow a distinction to be made between more and less preferred states of the system. There must also be some capacity for *information-gathering* or monitoring to produce knowledge about current or changing states of the system. On top of that must be some capacity for *behaviour-modification* to change the state of the system.<sup>642</sup>

Black, however, criticises this definition on the grounds that it does not distinguish between systems of control involving intentionality and those which do not.<sup>643</sup> Intentionality is crucial, she argues, to distinguish regulation from all other forms of

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<sup>640</sup> See further Black, J. *Critical Reflections on Regulation*, (2002, London: Centre for Analysis of Risk and Regulation), p.8 and Ogas, A. *Regulation: Legal Form and Economic Theory* (2004, Oxford: Hart), at Ch.1.

<sup>641</sup> *Ibid*, at p. 9.

<sup>642</sup> Hood, C., Rothstein H. and Baldwin, R. *The Government of Risk: Understanding Risk Regulation Regimes*, (2001, Oxford: OUP), at p.23. [Emphasis in original]

<sup>643</sup> Black, above n.640, at p.18.

social control.<sup>644</sup> She also notes that the cybernetics definition "assumes a level of effectiveness which may in practice be absent".<sup>645</sup> Under the functional definition, Black argues, identifying a measure as regulation requires an empirical investigation into its effectiveness under the three grounds set out, rather than simple analytical investigation. Taking these criticisms of the cybernetics approach into account, Black suggests the following definition of regulation:

[R]egulation is the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes, which may include mechanisms of standard-setting, information-gathering and behaviour-modification.<sup>646</sup>

The EU procurement rules satisfy any of the above definitions of regulation. In addition, the labour codes examined in Chapter 3 also satisfy the broader definitions set out by Black and Hood et al. Under these definitions, then, utilities are subject to two different forms of regulation when considering the possibility of including labour considerations in their procurement. The next section will consider these different forms of regulation in more detail.

## II.2. Types of Regulation

Morgan and Yeung identify five classes of regulation: (1) Command; (2) Competition; (3) Consensus; (4) Communication, and (5) Code.<sup>647</sup> Command techniques are the most common understanding of regulation, covering legal regulation, and will be discussed in more detail further below. Competition based techniques include economic instruments such as taxes and subsidies.<sup>648</sup> Consensus techniques rely on the consent of the parties involved, and most self-regulation techniques involve aspects of this category of regulation along with some command influences. Self-regulation, such as the labour

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<sup>644</sup> *Ibid*, at p.19.

<sup>645</sup> *Ibid*, at p.8.

<sup>646</sup> *Ibid*, at p.20.

<sup>647</sup> Morgan, B. and Yeung, K. *An Introduction to Law and Regulation: Text and Materials*, (2007, Cambridge: CUP), at p.80.

<sup>648</sup> *Ibid*, at pp.85-92.

codes considered in this thesis, will be discussed further below. Communication techniques focus on providing information to the public about the relevant issue, covering techniques such as public education campaigns.<sup>649</sup> Code based techniques aim to eliminate certain behaviour by “designing out the possibility for its occurrence”, for example software code designed to prevent certain cyber crimes.<sup>650</sup>

#### *II.2.1. Command and Control Regulation*

Command and control regulation covers “the state promulgation of legal rules prohibiting specified conduct, underpinned by coercive sanctions (either civil or criminal in nature) if the prohibition is violated”.<sup>651</sup> It is this form of regulation which the EU has chosen to regulate procurement, with the procurement rules based under the TFEU, the Utilities Directive and the relevant case law falling under this category as binding legal rules created by the legislative bodies of the EU and enforced by civil sanctions through the courts of the Member States. Baldwin and Cave note that the strengths of command and control regulation lie in the ability to impose fixed standards on society, which operate immediately.<sup>652</sup> The authors also note that command and control regulation is useful as a political tool, as the state is seen to be taking action against undesirable behaviour forcefully.<sup>653</sup>

Command and control regulation has increasingly been criticised, however. Baldwin and Cave note four possible problems which may arise with this type of regulation. Firstly, it is argued that where there is a close relationship between the regulator and the regulated, there is a risk of “capture”, under which the regulator focuses on the interests of the regulated area over the interests of society.<sup>654</sup> A second possible problem is excessive legalism.<sup>655</sup> It has been argued that the legalistic approach required by

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<sup>649</sup> *Ibid.*, at p.96-102.

<sup>650</sup> *Ibid.*, at p.102-105.

<sup>651</sup> *Ibid.*, at p.80.

<sup>652</sup> Baldwin and Cave, above n.639, at p.35.

<sup>653</sup> *Ibid.*

<sup>654</sup> *Ibid.*, at p.36. There is now an extensive literature on regulatory capture, see, for example, Dal Bó, E. ‘Regulatory Capture: A Review’ (2006) 22(2) *Oxford Review of Economic Policy* 203 and the literature cited there.

<sup>655</sup> *Ibid.*, at p.37.

command and control regulation and the recent proliferation of legal rules increases the financial costs imposed on all parties and can stifle innovation.<sup>656</sup> Thirdly, Baldwin and Cave note that it can be hard in practice to determine the appropriate level at which to set the legal standard.<sup>657</sup> Finally, enforcement of command and control regulation is expensive and often uncertain (see below in the sections on compliance and enforcement).<sup>658</sup>

#### *II.2.2. Self-regulation*

Corporate social responsibility codes generally belong to the category of self-regulation. Codes such as the labour codes examined in Chapter 3 have elements of both consensus regulation and traditional command regulation. The requirements of the codes are established by the parties regulated, possibly with negotiation with other parties such as non-governmental organisations such as the UN or the OECD, and so are based fundamentally on the consent of the parties, unlike the command based regulation discussed above under which rules are created for the relevant bodies and enforced by third parties. However, once the parties have consented, those codes which contain monitoring provisions and sanctions for breach operate in a similar manner to command regulation. Self-regulation such as these codes thus appears to be a hybrid of command and consensus regulation.<sup>659</sup>

Ogus notes several possible benefits of self-regulation as opposed to traditional command and control regulation.<sup>660</sup> Firstly, since self-regulatory agencies will usually have a greater knowledge of the area than the state, the information costs involved in setting and interpreting the regulatory standards will be lower. Secondly, monitoring and enforcement is also likely to be cheaper and more effective since the relationship between the regulator and the regulated is based on trust. Thirdly, since the processes involved in creating self-regulation are usually much more informal than those involved

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<sup>656</sup> See, for example, Stewart, R. 'The Discontents of Legalism: Interest Group Relations in Administrative Regulation' [1985] *Wisconsin Law Review* 655, at 680.

<sup>657</sup> Baldwin and Cave, above n.639, at p.38.

<sup>658</sup> *Ibid*, p.38.

<sup>659</sup> For further discussion of the hybrid nature of self-regulation , see Morgan and Yeung, above n.647, p.106.

<sup>660</sup> Ogus, A. 'Rethinking Self-regulation' (1995) 15 *Oxford Journal of Legal Studies* 97, at 97-98.

in command-based regulation the financial costs and delay involved in amending the standards are lessened. Finally, the administrative costs of the regulation are generally borne by the parties involved rather than the taxpayer, though corporations may pass that cost down to the consumer.

There are also several criticisms of the self-regulation method, however. Baldwin and Cave note that the rules created by the parties involved in the self-regulation may be self-serving and fail to deal with the actual issues which society needs to be regulated.<sup>661</sup> They also note that the procedures used to create the relevant standards may lack transparency and accountability.<sup>662</sup> There may also be a possible issue of the general public lacking trust in the parties to apply the standards properly and wishing to see the state take responsibility for certain issues.<sup>663</sup>

### **III. Indeterminacy in the Law**

The command and control regulatory technique used by the procurement regulation relies on the use of rules, that is, general statements prohibiting certain conduct. Black notes three main problems associated with the use of rules: a tendency to over- or under-inclusiveness, issues of interpretation and problems with indeterminacy.<sup>664</sup> Black argues that these problems stem both from the nature of rules as "anticipatory, generalised abstractions [which] when endowed with legal status are distinctive, authoritative forms of communication" and from the nature of language, which will affect how parties interpret and understand those rules.<sup>665</sup> Problems of inclusiveness arise from the fact that rules are generalisations built up from certain specific instances of conduct which the state wishes to prevent. Over- or under-inclusiveness will occur where the generalisation does not intersect precisely with the properties of the event or individual which the regulation aims to cover.<sup>666</sup> Problems of interpretation occur where the parties applying, or subject to, the regulation have different understandings of the terms in the

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<sup>661</sup> Baldwin and Cave, above n.639, at p.40.

<sup>662</sup> *Ibid.*

<sup>663</sup> *Ibid.*, at p.41.

<sup>664</sup> Black, J. *Rules and Regulators*, (1997, Oxford: Clarendon Press), at p.6.

<sup>665</sup> *Ibid.*

<sup>666</sup> *Ibid.*, at pp.7-8.

regulation.<sup>667</sup> This section will examine the third problem, indeterminacy in the law, in more detail, looking at how a lack of clarity such as that present in the utilities procurement law relating to CSR might impact on parties in practice.

MacNeil sets out two possible sources of legal indeterminacy. Firstly, the law may be uncertain where some doubt over the correct interpretation of the law remains over a significant period of time, such as where an unclear legal provision is never raised in litigation.<sup>668</sup> Secondly, law may be uncertain where a previously settled view of the law is overturned by the courts.<sup>669</sup> This thesis is mostly concerned with the first type of uncertainty, indeterminacy arising from lack of clarity in the legal provisions themselves rather than the courts' interpretation of those provisions but will also consider the effect of any case law which has changed the view of the applicable law, such as the *Telaustria* case establishing the principle of transparency and the need for advertisement in contracts covered only by the TFEU.<sup>670</sup>

### III.1. Identifying Legal Indeterminacy

Identifying a problematic level of indeterminacy in legal provisions may cause an issue since there is a certain level of indeterminacy present in all law. Hart described legal rules as having a "core" of certainty and a "penumbra of uncertainty", i.e. every law will have a "core" set of factual circumstances to which it certainly applies, but as the circumstances vary from that core, the application of the law becomes more and more uncertain.<sup>671</sup> Indeterminacy arises simply because it is impossible for the legislator to anticipate all possible future events to which the law might need to be applied.<sup>672</sup> As MacNeil notes, this means that a certain amount of litigation in order to reduce the penumbra of uncertainty of a law is inevitable.<sup>673</sup> However, while a certain amount of indeterminacy is normal for a law, in some cases the indeterminacy may be much

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<sup>667</sup> *Ibid*, at pp.12-13.

<sup>668</sup> MacNeil, I. 'Uncertainty in commercial law' [2009] 13(1) *Edinburgh Law Review* 68, at 70.

<sup>669</sup> *Ibid*.

<sup>670</sup> Case C-324/98, *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria AG* [2000] ECR I-10745. See further Chapter 5, Section III.2.

<sup>671</sup> Hart, H.L.A. *The Concept of Law*, (2<sup>nd</sup> Ed), (1994, Oxford: Clarendon Press), at p.124-128.

<sup>672</sup> *Ibid*, at p.128-129.

<sup>673</sup> MacNeil, above n.668 at 78.

stronger, indicating "that the core itself may be indeterminate".<sup>674</sup> The question thus becomes how to determine this level of indeterminacy in a law.

Kress defines indeterminacy as the situation in which "the correct theory of legal reasoning fails to yield a right answer or permits multiple answers to legal questions".<sup>675</sup> Under this approach, a law will be indeterminate if it is impossible to reach a single correct answer when operating within the core of that law.<sup>676</sup> In order to test for this level of indeterminacy, Kress examines the number of dissenting judgements given in appellate courts, under the premise that the more uncertain a law is the more disagreement there will be over its interpretation in the courts.<sup>677</sup> Another method for testing for indeterminacy is used by Maggs, who identifies a legal provision as uncertain where it would be litigated by a lawyer in court.<sup>678</sup> Both tests suffer from the flaw that reasons other than uncertainty may often inform such actions.

MacNeil criticises both these approaches on the grounds that they only deal with cases which go to court and thus do not include other cases where the uncertainty is resolved through other methods.<sup>679</sup> In order to deal with this, MacNeil defines indeterminacy as existing "in circumstances in which one or more of a range of actions (which are in essence responses to the presence of uncertainty) is routinely employed."<sup>680</sup> This method allows consideration of how parties deal with uncertainty when they are planning what action they should take. Given the scarcity of litigation over procurement decisions in the UK this method of determining indeterminacy is the most suitable for use in this research.

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<sup>674</sup> *Ibid*, at 78.

<sup>675</sup> Kress, K. 'Legal Indeterminacy' [1983] 77 *California Law Review* 283, at 320.

<sup>676</sup> MacNeil, above n.668, at 78.

<sup>677</sup> Kress, above n.675, at 324-325.

<sup>678</sup> Maggs, G. 'Reducing the Costs of Statutory Ambiguity: Alternative Approaches and the Federal Courts Study Committee' (1992) 29 *Harvard Journal on Legislation* 123, at 125.

<sup>679</sup> MacNeil, above n.668, at 79.

<sup>680</sup> *Ibid*, at 79.

### III.2. The Importance of Certainty in the Law

The main reason certainty in the law is seen to be important is the need for the law to be predictable. As Black argues:

[I]ndeterminacy matters because rules, particularly legal rules, are entrenched, authoritative statements which are meant to guide behaviour, be applied on an indefinite number of occasions, and which have sanctions attached for their breach. It is thus important to know whether this particular occasion is one of those in which the rule should be applied.<sup>681</sup>

If a particular law is unclear, parties cannot use that law to guide their behaviour and thus have no way of determining whether their planned conduct is legal or illegal. Because of this, MacNeil argues that certainty in the law is crucial for markets to operate efficiently.<sup>682</sup> Under this argument, in order for markets to operate properly, the participants in the market must be able to make fully informed decisions. Where the law concerning a particular issue is unclear to the extent that the result of a certain action cannot be predicted, the market participant cannot make a fully informed decision about that issue.<sup>683</sup>

Another problem caused by uncertainty in the law is increased cost.<sup>684</sup> Maggs sets out nine costs imposed on society due to legal indeterminacy:<sup>685</sup>

1. Increased legal research costs: indeterminacy in the law increases the number of legal cases and other sources that a lawyer must consider in order to understand the law.
2. Litigation costs: Parties will take disputes to court more often where the correct interpretation of the law is unclear. Cases where there is ambiguity over the law will also reach the appellate courts more often, adding to the legal costs.

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<sup>681</sup> Black, above n.664, at p.10.

<sup>682</sup> MacNeil, above n.668, at 71.

<sup>683</sup> *Ibid*, at 72.

<sup>684</sup> *Ibid*, at 72.

<sup>685</sup> Maggs, above n.678, at 126-130.

3. Judicial system costs: Increased litigation due to lack of clarity in the law not only adds to the costs of the parties directly concerned, as discussed in the previous point, but also those of the taxpayer, who funds the judicial system.
4. Increased unlawful activity: As discussed above, lack of clarity in the law makes it harder for an individual to predict whether a particular action will be lawful or not. Maggs argues that this imposes costs on society from a person failing to abide by the law, and also on the individual, who will suffer unexpected consequences from that breach of the law.
5. Decreased lawful activity: Parties may prefer to err on the side of caution and refuse to take any action when faced with unclear legislation, preventing productive action.
6. Discrimination: Lack of clarity in the law may allow those enforcing the law to apply it in a biased manner.
7. Separation of powers problems: Lack of clarity in legislation may result in the court effectively creating the law when interpreting it, causing legitimacy issues (see further below).
8. Replacement costs: Amending unclear legislation or a mistaken interpretation of that legislation by the courts will impose costs on the state.
9. Diminished utility and justice: Where legislation is unclear, a court may interpret the rule in a less useful or just way than that intended by the legislature.

MacNeil notes that the costs imposed by lack of clarity in the law will fall over time as the courts interpret the law to reduce the uncertainty, but that the process of interpretation itself creates substantial costs.<sup>686</sup>

Finally, another reason certainty in the law is seen as important is due to the link between certainty and legitimacy in the law. It has been argued that indeterminacy may affect the legitimacy of law since legitimacy "depends on judges applying the law and not creating their own ... judicial decisions are legitimate only if judges are constrained

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<sup>686</sup> MacNeil, above n.668, at 72.

either completely or within narrow bounds".<sup>687</sup> The greater the indeterminacy of a piece of regulation, the greater the discretion judges have when interpreting that legislation. This discretion allows judges to effectively make law themselves, usurping the role of the state and its legitimately elected representatives.<sup>688</sup> Under this view, then, certainty is crucial for limiting "arbitrary judicial decision-making".<sup>689</sup>

### III.3. Responses to Indeterminacy in the Law

MacNeil notes four possible ways in which a party may respond to indeterminacy in a legal provision.<sup>690</sup> The first two methods deal with the indeterminacy using contract law. Firstly, parties may include terms in their contract specifically dealing with the uncertainty, though this still leaves those parties open to the risk that the courts will interpret the law in a different manner to the interpretation they chose. Secondly, parties may transfer the risk arising from legal indeterminacy through contract terms.

The third way in which parties may respond to indeterminacy is through taking advantage of that indeterminacy through creative compliance.<sup>691</sup> Creative compliance involves a formalistic approach to the law where strict compliance with the precise requirements of the law is used "in a manipulative way to circumvent or undermine the purpose of regulation".<sup>692</sup> Where the law lacks clarity, parties are more likely to discover loopholes which they can use to their advantage. MacNeil notes that creative compliance in this situation is likely to improve the clarity of the law over time as loopholes discovered are examined in the courts.<sup>693</sup>

Finally, indeterminacy in the law leads to greater reliance on methods of clarification such as "clearance decisions", official guidance and legal opinions.<sup>694</sup> Clearance decisions are a decision by a regulator confirming that a proposed action does not breach any

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<sup>687</sup> Kress, above n.675, at 285.

<sup>688</sup> *Ibid*, at 287.

<sup>689</sup> *Ibid*, at 71.

<sup>690</sup> MacNeil, above n.668, at 81-85.

<sup>691</sup> *Ibid*, at 82.

<sup>692</sup> McBarnet, D. and Whelan, C. 'The Elusive Spirit of the Law: Formalism and the Struggle for Legal Control' (1991) 54(6) *Modern Law Review* 848, at 849.

<sup>693</sup> MacNeil, above n.668, at 83.

<sup>694</sup> *Ibid*, at 83-84.

regulation. Guidance documents from a particular body indicate that body's interpretation of the law, with examples in the procurement field being guidance from the Office of Government Commerce and the European Commission's Interpretative Communications. It has been noted that when dealing with uncertainty in procurement in the area of public-private partnerships, official guidance was seen as very influential by practitioners, often treated as authoritative.<sup>695</sup>

#### **IV. Compliance with the Law**

One of the aims of this thesis is to determine the level of compliance with the utilities procurement legislation, given the lack of clarity in that law and the possible commercial pressures on utilities to include CSR policies in procurement. This section examines theories of compliance, beginning with an examination of what precisely is meant by compliance. Following this, general theories examining why parties comply with regulation will be examined before the section concludes with an examination of the effect of indeterminacy on compliance.

##### IV.1. Definition of Compliance

It is often stated that the aim of regulatory enforcement is to ensure compliance with the regulation, but as Yeung notes, it is rarely stated precisely what parties are supposed to comply with.<sup>696</sup> Yeung distinguishes between "rule compliance", which covers technical compliance with the precise requirements of the regulation and "substantive compliance", which covers compliance not only with the rules but also with the collective goals behind those rules.<sup>697</sup> While the two types of compliance are often coextensive so that compliance with the rules will bring about compliance with the overall goals of the regulation this is not always the case. In some cases it may be possible, for example, for parties to technical comply with the requirements of a law in such a way as to defeat

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<sup>695</sup> Braun, P. 'Strict Compliance versus Commercial Reality: The Practical Application of EC Public Procurement Law to the UK's Private Finance Initiative' (2003) 9(5) *European Law Journal* 575, at 582.

<sup>696</sup> Yeung, K. *Securing Compliance: A Principled Approach*, (2004, Oxford: Hart Publishing), at p.11.

<sup>697</sup> *Ibid.*

the object of that law ("creative compliance").<sup>698</sup> It is also possible for a law to be poorly designed so that compliance with the requirements of the law does not in fact help to achieve the overall goal of that regulation.<sup>699</sup>

In order to comply substantively with the overall goals of a piece of regulation, a party must understand clearly what those goals are. For the EU procurement legislation, the overall goal is the opening up of the procurement market to competition (see section II, Chapter 5). The provisions in the procurement directives allowing social and environmental criteria to be included in procurement, however, do not appear to be based explicitly on this overall goal, but on a political need to include such considerations. When determining what action to take in relation to a particular procurement then, a utility should consider these differing goals and make a judgment on how best to meet the needs of those goals.

The following sections will consider the factors that parties consider when deciding whether to comply with regulation in the traditional sense of "rule compliance". Compliance in the case of utilities procurement will be taken to be compliance with the rules relating to labour policies in procurement under both TFEU and the Utilities Directive as discussed in Chapter 6. The first section will consider the situation in which the requirements of those rules are clear, and the second section will consider the situation where the requirements are indeterminate.

#### IV.2. General Compliance Theory

The classic approach to modelling compliance is based on the work of the philosopher Jeremy Bentham.<sup>700</sup> Under Bentham's argument, individuals naturally seek to pursue pleasurable activities, but this tendency is constrained by rational decisions evaluating the possible negative consequences of any action. Bentham's argument was expanded

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<sup>698</sup> For further discussion of creative compliance, see McBarnet and Whelan, above n.692.

<sup>699</sup> Yeung, above n.696, p.11.

<sup>700</sup> Bentham, J. *The Principles of Morals and Legislation*, (1988, Buffalo, NY: Prometheus Books).

into an economic model by Becker, setting out compliance decisions as a cost-benefit evaluation:

The approach taken here follows the economists' usual analysis of choice and assumes that a person commits an offence if the expected utility to him exceeds the utility he could get by using his time and other resources at other activities. Some persons become "criminals", therefore, not because their basic motivation differs from that of other persons, but because their benefits and costs differ.<sup>701</sup>

Many factors are thought to influence a party's evaluation of the costs and benefits of committing an offence. Classically, it was argued that the probability of punishment, the severity of that punishment and the time between the offence and the punishment being applied were the most important factors.<sup>702</sup> However, in recent years several authors have noted that, contrary to Becker's model, many companies comply with regulation which has very low penalties and a low conviction rate and consideration of other factors has been included in the economic models to account for these findings.<sup>703</sup> Sutinen and Kuperan, for example, examine psychological and sociological theories with the aim of constructing a model which better fits the available empirical evidence.<sup>704</sup> The authors conclude that moral factors and the desire to improve one's social reputation need to be integrated into the economic model.<sup>705</sup> Notably, a party is more likely to be non-compliant if other members of that community are non-compliant.<sup>706</sup> When examining an individual utility's compliance with the procurement regulation then, it is important to consider also the compliance standard of the industry as a whole.

Rather than simply amending the classic economic model, however, other authors have argued that the economic model is critically flawed and completely new models are

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<sup>701</sup> Becker, G. 'Crime and Punishment: An Economic Approach' (1968) 76(2) *Journal of Political Economy* 169, at 176.

<sup>702</sup> Simpson, S. *Corporate Crime, Law, and Social Control*, (2002, Cambridge: CUP), at p.23.

<sup>703</sup> See, for example, Harrington, W. 'Enforcement Leverage When Penalties are Restricted' (1988) 37 *Journal of Public Economics* 29 and Raymond, M. 'Regulatory Compliance with Costly and Uncertain Litigation' 26(2) *Journal of Regulatory Economics* 165.

<sup>704</sup> Sutinen, J. and Kuperan, K. 'A socio-economic theory of regulatory compliance' (1999) 26 *International Journal of Social Economics* 174.

<sup>705</sup> *Ibid*, at 178-182.

<sup>706</sup> *Ibid*, at 181.

needed to explain compliance. Simpson, for example, examined empirical studies of perceptual deterrence (the relationship between parties' subjective views of punishment risk and criminal activity) and observed that the impact of legal sanctions on the decision to offend varies depending on whether the party is criminally uncommitted, committed or marginally committed, with sanctions only being significant for the latter group.<sup>707</sup> Those uncommitted to crime are unaffected by the threat of legal sanctions "because the idea to commit a criminal act simply never occurs to them".<sup>708</sup> Conversely, the criminally committed are not deterred by the threat of legal sanctions since they view them simply as a professional risk and, while they may plan their criminal activity in such a way as to minimise this risk, they are not deterred from committing crime totally. It would appear, therefore, that the empirical research should also consider the view towards legal compliance held by the individual procurement practitioners interviewed.

It is also possible that an individuals' overall view of the legitimacy of the legal system is key when determining whether or not that individual will comply with a given law. Tyler conducted empirical research in this area on a sample of Chicago citizens, examining the impact of legitimacy in comparison to three other main factors on compliance with the law; deterrence (covering the issues discussed in the classic economic model above relating to punishment and risk), peer opinion, and personal morality.<sup>709</sup> The broad concept of legitimacy was broken down into two factors; individuals' perceived obligation to obey the law and their overall support for legal authorities.<sup>710</sup> The research found legitimacy to be a key factor influencing compliance, operating both strongly and independently of the other factors considered.<sup>711</sup> Within the overall concept of legitimacy, it was also found that peoples' personal opinions of their obligation to comply with the law was the major factor, though support for legal authorities still produced a statistically significant result.<sup>712</sup> Legitimacy, while important, was not found to be the

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<sup>707</sup> Above, n.702, at pp.28-32.

<sup>708</sup> *Ibid*, at p.29.

<sup>709</sup> Tyler, T. *Why People Obey the Law*, (Rev. Ed.) (2006, Princeton: Princeton University Press) at pp.42-50.

<sup>710</sup> *Ibid*, at p.45.

<sup>711</sup> *Ibid*, at p.63.

<sup>712</sup> *Ibid*, at p.62.

only relevant factor, however. The research also found that personal morality was key, with individuals' personal views on whether or not the law accorded with their own views of right and wrong being an important factor when determining their compliance with that law.<sup>713</sup>

Given that utilities are corporations, the balance of factors to be considered when considering whether to breach the law may vary from those considered by an individual. Cullen, Maakested and Cavender suggest that corporate criminal acts are much more likely to be deliberate actions than crimes of passion.<sup>714</sup> Under their argument, breaching the law in a corporate setting is likely to be seen as a simple business decision to be taken where the benefits outweigh the possible costs, and so is even more likely to follow the rational economic models set out by Becker and others. Compliance with the law is often seen by corporations as a simple matter of risk management, with compliance reducing the risk of legal challenge and the corresponding costs of that challenge, but not being strictly necessary.<sup>715</sup> Given this, it is possible that the factors in the classic economic model of deterrence will be more relevant when determining compliance with the law by corporations than issues such as personal morality and legitimacy.

For any of the factors examined above to be relevant, the parties involved must be fully aware of the requirements of the law and this may not always be the case in practice, even where the requirements are clear and precise. Baldwin, conducting empirical research into punitive risk management, noted a relatively low level of knowledge on punitive risks in the companies surveyed with, for example, only 38% of respondents feeling their board of directors were knowledgeable on company law risks and only one in eight respondents being sure where the responsibility for managing such risks lay in

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<sup>713</sup> *Ibid*, at p.64.

<sup>714</sup> Cullen, F., Maakested, W. and Cavender, G. *Corporate Crime Under Attack: The Ford Pinto Case and Beyond*, (1987, Cincinnati, Ohio: Anderson), at p.342.

<sup>715</sup> Laufer, W. 'Corporate Liability, Risk Shifting, and the Paradox of Compliance' (1999) 52 *Vanderbilt Law Review* 1343, at 1397-1402.

their company.<sup>716</sup> Lack of compliance can clearly be based on ignorance and confusion over the law, and the level of knowledge of the law held by the procurement practitioners interviewed will be considered in this research.

#### IV.4. Compliance with Indeterminate Law

The deterrence theory examined above relies on the assumption that the party subject to the regulation knows precisely what is required of them. Calfee and Craswell note that where the requirements of a law are unclear, a party does not face the usual binary choice between legal and illegal actions.<sup>717</sup> Rather, there is a distribution of probabilities ranging from certain liability to no risk of liability at all, with the actual legal standard sitting somewhere in that range (but without it being clear precisely where). For utilities, the distribution would appear to run from including no social aspects in procurement at all (no possibility of challenge), to considering only social matters when procuring (almost certain chance of challenge). If the correct legal standard is seen as centred between these two extremes, a move towards including no social criteria may be seen as "over-compliance", and a move towards emphasising the importance of social criteria may be seen as "under-compliance".

Calfee and Craswell argue that where the correct legal standard is unclear, parties will generally tend to over-comply.<sup>718</sup> They note that whatever standard the party chooses to comply with, there is always a chance that the party will not be challenged, or if challenged, will not be found liable.<sup>719</sup> The authors argue that while this factor alone would lead to under-compliance, this analysis disregards the fact that should a party get challenged, the expected penalty is lower the more a party has over-complied. Equally, the probability of challenge decreases as a party approaches the over-compliance end of

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<sup>716</sup> Baldwin, R. 'The New Punitive Regulation' (2004) 67(2) *Modern Law Review* 351, at 363-364.

<sup>717</sup> Calfee, J. and Craswell, R. 'Some Effects of Uncertainty on Compliance with Legal Standards' 70 *Virginia Law Review* 965, at 969.

<sup>718</sup> *Ibid*, at 979-981.

<sup>719</sup> *Ibid*, at 979.

the probability spectrum. Over-compliance thus not only reduces the possible costs of breach, but reduces the chance of having to pay any costs at all.<sup>720</sup>

Calfee and Craswell also note, however, that this conclusion only stands where the level of uncertainty is moderate.<sup>721</sup> Where a legal provision is extremely uncertain, a change in the standard that the party chooses to comply with has less effect on the chance of challenge and, given this was the main factor leading to over-compliance as set out above, the result is that the party tends towards under-compliance.<sup>722</sup> The authors note that a tendency to under-comply is strongest where the amount that a party can save in private costs through lack of compliance is relatively high and the likelihood of not being found liable is also high.<sup>723</sup>

## **V. Enforcement Strategies**

Baldwin and Cave note that officials who enforce regulation often use a variety of techniques, ranging from formal punitive techniques such as legal prosecution to more informal techniques such as persuasion and negotiation.<sup>724</sup> A distinction may be drawn between "deterrence" approaches which use penal techniques to enforce regulation and "compliance" approaches which use the more informal methods.<sup>725</sup> Baldwin and Cave note that compliance approaches hold conformity with the law to be the central aim of enforcement while deterrence approaches often have a stronger emphasis on retribution.<sup>726</sup> The procurement regulation is enforced by punitive civil sanctions, with remedies for breach including damages.<sup>727</sup> This section will examine the benefits and disadvantages of such deterrence approaches and examine various alternative enforcement methods.

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<sup>720</sup> *Ibid*, at 981.

<sup>721</sup> Craswell, R. and Calfee, J. 'Deterrence and Uncertain Legal Standards' (1986) 2(2) *Journal of Law, Economics and Organisation* 279, at 286.

<sup>722</sup> *Ibid*.

<sup>723</sup> Calfee and Craswell 1984, above n.717, at 981.

<sup>724</sup> Baldwin and Cave, above n.639, at pp.96-97.

<sup>725</sup> *Ibid*, at p.97.

<sup>726</sup> *Ibid*.

<sup>727</sup> For further discussion of remedies, see Chapter 5, Section IV.4.

Baldwin argues that recently there has been a growing focus on the use of punitive sanctions in the UK, with the emphasis much more on deterrence approaches than compliance.<sup>728</sup> The main benefit of such deterrent approaches rests on the fact that punitive sanctions show clearly that such behaviour is seen as unacceptable, reinforcing "social sentiments of disapproval and [enhancing] social pressures to comply".<sup>729</sup> Punitive sanctions should not only deter the relevant party from re-offending, but also deter other parties from offending. They also have a political purpose, allowing the state to be seen by the public taking action against the undesirable behaviour.

Baldwin notes, however, that deterrence approaches suffer from several drawbacks when applied to corporations.<sup>730</sup> Individuals within companies are often confused over the balance between corporate and individual liabilities and are unaware of the various risks to themselves and their company.<sup>731</sup> Baldwin also notes that companies are often poorly organised to anticipate and deal with punitive risks and directors are also often poorly prepared to supervise risk-management amongst their staff.<sup>732</sup>

It has also been argued that deterrent approaches are inefficient since formal legal proceedings will usually cost much more and create much more delay than informal compliance approaches.<sup>733</sup> Deterrent approaches are also usually much more inflexible than compliance approaches, preventing the individual circumstances of the case to be considered.<sup>734</sup> Baldwin also argues that there is no guarantee that punitive sanctions will result in compliance by companies.<sup>735</sup> While compliance is one method of avoiding a sanction, companies may also deal with the problem by putting pressure on the regulator, shifting the blame to other individuals or companies in the corporate group or concealing breaches of regulation from regulators.<sup>736</sup> This may partly be explained by the fact that punitive approaches focus on punishment and promote negative expectations of

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<sup>728</sup> Baldwin, R. 'The New Punitive Regulation' (2004) 67(2) *Modern Law Review* 351, at 352-360.

<sup>729</sup> Baldwin and Cave, above n.639, at p.98.

<sup>730</sup> Baldwin, above n.728, at 370.

<sup>731</sup> *Ibid.*, at 367-370.

<sup>732</sup> *Ibid.*, at 370.

<sup>733</sup> Baldwin and Cave, above n.639, at p.98.

<sup>734</sup> *Ibid.*

<sup>735</sup> Baldwin, above n.728, at 371.

<sup>736</sup> *Ibid.*

the regulated company, and this may result in the company resenting the regulator and rebelling against their influence.<sup>737</sup>

Because of these possible problems with deterrence approaches, several authors have set out alternative enforcement strategies, usually with a greater focus on compliance approaches. Ayres and Braithwaite set out a model of "responsive regulation" under which parties are subject to increasingly formal and punitive methods the more they continue to breach the regulation.<sup>738</sup> The regulating agency should spend most of its time working with parties with the least interventionist methods of enforcement but should also have significant punitive sanctions available to it. Ayres and Braithwaite argue that the threat of these significant sanctions should help an agency convince a party in breach that operating with the agency through the less interventionist methods is to its advantage.<sup>739</sup> Yeung criticises the responsive regulation method, however, on the grounds that it punishes parties for failure to co-operate with regulators, arguing that "[i]n the absence of specific legislative proscription, it is not unlawful to decline to co-operate with state authorities".<sup>740</sup> She also notes that the method results in companies which commit serious breaches of the regulation but which have previously co-operated with the regulator being treated better than companies which commit minor offences but which have not previously co-operated.<sup>741</sup>

In addition to the responsive regulation method, Ayres and Brathwaite also present the option of "enforced self-regulation", under which companies design specific regulation and monitoring methods themselves, but the operation of this system is overseen by state agencies.<sup>742</sup> This method is also examined by Ogus, who notes that the advantages would include the fact that the standards are likely to be better tailored to the circumstances of that industry and the regulated parties will be able to participate in the

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<sup>737</sup> Ayres, I. and Braithwaite, J. *Responsive Regulation* (1992, Oxford: OUP), at p.25.

<sup>738</sup> Ayres and Braithwaite, above n.737, at Ch.2.

<sup>739</sup> *Ibid.*, at p.40.

<sup>740</sup> Yeung, above n.696, at p.168.

<sup>741</sup> *Ibid.*

<sup>742</sup> Ayres and Braithwaite, above n.737, at Ch.4.

regulation process.<sup>743</sup> Ogus notes, however, that this form of regulation may not be suitable where the risks give rise to particularly drastic consequences or information regarding the risks is hard to find.<sup>744</sup> He also notes that the model relies on the companies involved in designing the regulation being well-informed and well-intentioned and this is not always the case in practice.<sup>745</sup>

Similar to the enforced self-regulation techniques outlined above, Parker suggests a method of "meta-regulation" under which legal authority is used to increase a company's commitment to its self-regulation.<sup>746</sup> This may be done by adjusting a company's precise liabilities depending on the status of their self-regulation, for example linking liability to the existence of an effective self-regulatory code, or by legally requiring a company to implement a self-regulatory code where a regulatory breach has occurred.<sup>747</sup> Baldwin criticises this approach, however, noting that the approach relies on corporate parties viewing their responsibilities in the same way as regulators and this is not the case in practice, a criticism which also applies to the enforced self-regulation approaches above.<sup>748</sup> Baldwin also notes that the variation in the matters which must be regulated and lack of clarity over which body should take the lead in any regulatory negotiations means that such regulation is likely to result in confusion and conflict between the various parties.<sup>749</sup>

## **VI. Conclusion**

This chapter has examined the notion of regulation, examining the form of regulation taken by both the EU procurement regime and voluntary CSR policies, noting that utilities are thus subject to two, potentially competing, types of regulation. The chapter has then discussed the potential problems caused by regulation which, like the EU legal regime, lacks clarity, and the impact of such lack of clarity on compliance with the law.

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<sup>743</sup> Ogus, above n.660, at 101-102.

<sup>744</sup> *Ibid.*, at 102.

<sup>745</sup> *Ibid.*

<sup>746</sup> Parker, C. *The Open Corporation*, (2002, Cambridge: CUP), at p.246.

<sup>747</sup> *Ibid.*, at p.256.

<sup>748</sup> Baldwin, above n.728, at 377.

<sup>749</sup> *Ibid.*

The chapter has finally discussed the formal punitive method used by the EU procurement regime for enforcement of the regulation and noted the problems with such 'compliance' approaches, along with possible alternatives to such punitive measures. Part II of the thesis will evaluate the reactions of UK utilities to the EU legal regime, using the theory set out in this chapter as a base for the empirical research to determine the response of interviewees to uncertainty in the law and compliance with the procurement regime.

## **Chapter 8 - Methodology**

### **I. Introduction**

Building on the overview of methodology in Section IV, Chapter 1, this chapter sets out the detail of the methodology applied in the empirical aspect of this thesis. The chapter aims to set out both the reasons why the particular methodology was chosen and the practical methods used throughout the project. Section II begins by setting out the theory behind qualitative research and the reasons such methodology was seen to be appropriate for this project. The chapter then examines sampling methods and sets out the process by which the sample for the project was chosen in Section III. Section IV sets out how the interview guide used in the research was designed. Section V concludes by setting out the data analysis methods used throughout the project.

### **II. Qualitative Methodology**

#### II.1. Choice of qualitative methodology

There are two broad categories of methodology in the social sciences; qualitative and quantitative. Quantitative methodology is associated with positivist theory, which for a long time was the dominant philosophy within the natural sciences. Qualitative methodology, by contrast, is generally associated with interpretivist theory. This section will first briefly examine positivism and quantitative research before looking at interpretivism and qualitative research and setting out why qualitative methodology was felt to be the more suitable methodology for this thesis.

The term “positivism” was first used by the social scientist Comte who applied statistical techniques to the study of social phenomena, arguing that sociology should follow the methodology and principles of the natural sciences.<sup>750</sup> Black states that traditional positivist theory is based on three principles: (1) science can only know physical phenomena; (2) every scientific idea must be based on empirical evidence; (3) value

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<sup>750</sup> Comte, A. (trans. Martineu, H), *The Positive Philosophy of Auguste Comte*, vol. 1-3, (2000, Kitchener: Batoche Books).

judgments cannot be measured empirically and thus cannot be investigated scientifically.<sup>751</sup> A key belief of positivism is that research must be fully objective. The values of the researcher should not influence the research in any way.<sup>752</sup>

Quantitative research follows the beliefs of positivism, emphasising the use of a deductive approach through which theory is tested through empirical scientific research, most often through the collection of statistical information. The topic of research must be "conceptualised", a process through which the social concepts being studied are reduced to categories which may be statistically investigated.<sup>753</sup> Quantitative research is concerned with measuring the social phenomenon accurately and generally aims to find causal relationships between phenomena.<sup>754</sup> Probability sampling is generally used with an aim to ensuring that the results of the study can be generalised to the whole population (see further below in section III on sampling). Quantitative research is best suited to broad investigation of a social phenomenon, examining statistical trends over a wide population.

The main criticism aimed at positivism and quantitative research by interpretivist researchers is the argument that human action cannot be measured and explained in the same way as natural phenomena and research methods should take account of this fact.<sup>755</sup> In contrast to positivism, interpretivist approaches emphasise the subjective nature of social research. Interpretivist researchers argue that, unlike the natural world, social reality has no objective truth but is created purely by people's subjective understandings of phenomena. If social phenomena are to be understood, these subjective views of the phenomena must be examined.<sup>756</sup> The aim with interpretivist research is generally not to *explain* social phenomena, but to *understand* them.<sup>757</sup>

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<sup>751</sup> Black, D. 'The Boundaries of Legal Sociology' (1971-1972) 81 *Yale Law Journal* 1086, at 1092.

<sup>752</sup> Bryman, A., *Social Research Methods*, (2<sup>nd</sup> Ed), (2004, Oxford: OUP), at p.11.

<sup>753</sup> *Ibid*, at p.65.

<sup>754</sup> *Ibid*, at p.76-77.

<sup>755</sup> Banaker, R and Travers, M. 'Law, Sociology and Method', Ch. 1 in Banaker, R. and Travers, M, (eds), *Theory and Method in Socio-Legal Research*, (2005, Oxford: Hart Publishing), at p.15.

<sup>756</sup> Flick, U. *Designing Qualitative Research*, (2007, London: SAGE Publishing), at p.13.

<sup>757</sup> Bryman, above n.752, at p.13.

Bryman notes that interpretivism is a general term often used to cover various philosophies critical of positivism.<sup>758</sup> The broad field of interpretivism has been heavily influenced by hermeneutic-phenomenological philosophy.<sup>759</sup> Hermeneutics is based on the work of Max Weber, who set out the concept of *verstehen* in research.<sup>760</sup> Benton and Craib define the concept of *verstehen* as "an understanding of the logical and symbolic systems – the culture – within which the actor lives".<sup>761</sup> The aim of hermeneutic social research is to gain this empathetic understanding of social culture. Hermeneutic phenomenology is based on the concept of *verstehen* and focuses on researching "lived experience", examining peoples' experiences of a certain phenomenon in their life and the meaning they attach to that phenomenon.<sup>762</sup>

Creswell notes that qualitative methodology is fragmented, with the term covering various methods.<sup>763</sup> This fragmentation can make it hard to give a good definition of qualitative research, but Mason notes some common themes throughout most qualitative research.<sup>764</sup> Firstly, qualitative research methodology follows interpretivist philosophy in emphasising understanding over explanation and focusing on subjective interpretation. Secondly, qualitative research uses methods "which are both flexible and sensitive to the social context in which data are produced", as opposed to the strict statistical methods used in quantitative research.<sup>765</sup> Thirdly, qualitative research aims to examine a particular phenomenon in great detail, focusing much more on depth of data rather than examining broad trends as quantitative research does. In addition to these themes, Bryman notes that qualitative methodology generally takes an inductive approach to

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<sup>758</sup> Bryman, above n.752, at p.13.

<sup>759</sup> *Ibid*, at pp.13-16.

<sup>760</sup> For more on Weber and hermeneutics, see Benton, T. and Craib, I. *Philosophy of Social Science: The Philosophical Foundations of Social Thought*, (2001, Houndsills: Palgrave), Ch.5.

<sup>761</sup> *Ibid*, at p.79.

<sup>762</sup> Creswell, J. *Qualitative Inquiry and Research Design: Choosing Among Five Approaches*, (2<sup>nd</sup> Ed), (2007, London: SAGE Publishing), at p.59.

<sup>763</sup> *Ibid*, at p.4.

<sup>764</sup> Mason, J., *Qualitative Researching*, (2<sup>nd</sup> Ed), (2002, London: SAGE Publications), at pp.3-4.

<sup>765</sup> *Ibid*, at p.3.

research, building a theory from the data collected rather than testing a pre-existing theory.<sup>766</sup>

Choice of methodology should be guided by the research questions and aims of the research.<sup>767</sup> This thesis aims to examine procurement practitioners' practical experiences with applying the EU legal regime on procurement to the area of labour policies. The thesis aims to further understanding on how the regime is applied in practice; it does not aim to measure the regime's effectiveness in any objective way. Ultimately, the project aims to build up a theory of the ways in which procurement practitioners react to law which conflicts with commercial need, and also how they react to lack of clarity in the law. These areas have no real existing theory behind them which could be used to guide deductive research and this lack of theory would make a quantitative study hard to design effectively since the relevant concepts to measure are not clear. Given this and the aim of the study to understand rather than measure, qualitative research seems the most appropriate methodology for this thesis.

## II.2. Semi-structured interviewing

Various qualitative research methods exist, with some of the most prominent being ethnography, conversation and discourse analysis and in-depth interview techniques. In the same way that the choice of overall methodology should be governed by the aims of the research project, these aims should also govern the choice of the specific methods to be used.<sup>768</sup>

As noted above, the aim of this research is to understand practitioners' experiences in applying the law. In order to achieve this aim, it is necessary to have detailed focused discussion with the practitioners operating in the utilities sector and in-depth interviewing appears the most applicable method to achieve this. The other main possible method is a quantitative self-completion questionnaire, in which questions on

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<sup>766</sup> Bryman, above n.752, at p.266.

<sup>767</sup> Charmaz, K. *Constructing Grounded Theory*, (2006, London: SAGE Publications), at p.15.

<sup>768</sup> Mason, above n.764, at p.59.

specific issues are set out with along with set responses and the research participants choose the response most applicable to their situation.<sup>769</sup> Such a method has the advantage that data can be collected from a larger sample than is generally possible with the more time-intensive qualitative interviews. However, in addition to the reasons noted in the previous section on why quantitative methodology was not appropriate for this project, a questionnaire alone is not as well suited to understanding experiences as a method which allows detailed discussion with the research participants directly. Mason notes that qualitative interviewing is ideal for understanding people's experiences in full, offering a much deeper understanding of the issues than the superficial overview which might be gathered through a quantitative survey on the same issue.<sup>770</sup> In-depth qualitative interviewing also allows for more investigation of the overall context of the phenomenon which is being investigated than is possible with survey techniques.<sup>771</sup> The relatively short length of an interview as compared to other qualitative techniques such as ethnography also means that a wider sample of practitioners can be studied, allowing more detailed investigation throughout the utilities sector.

Bryman identifies three types of interview: structured, semi-structured and unstructured.<sup>772</sup> Structured interviewing is generally identified as a quantitative technique. Under this method, an interview schedule setting out the questions to be asked is created before the interview process begins. The schedule should set out the precise wording of the questions as well as the order in which they are to be asked and this should not be varied from at all during the interview process. The aim is for each interviewee to be given the exact same interview so that the responses can be accurately quantified.<sup>773</sup>

In semi-structured interviewing the interviewer has an interview guide setting out questions or topics to be covered in each interview, but the wording and order of the

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<sup>769</sup> For more on quantitative surveys, see Bryman, above n.752, at Ch.6.

<sup>770</sup> Mason, above n.764, at p.65.

<sup>771</sup> *Ibid.*

<sup>772</sup> Bryman, above n.752, at p.318-319.

<sup>773</sup> *Ibid.*, at p.110.

questions may be varied during the interview. Certain questions may also be skipped and issues which are not on the guide may be covered in response to issues raised by the interviewee. Semi-structured interviews have the advantage of flexibility, allowing interviewees to focus on the issues which they personally feel are the most important rather than being confined to the issues raised by the interviewer, which may not in fact be all that important in practice.<sup>774</sup>

Unstructured interviews have no kind of interview guide or schedule to guide the progress of the interview. The interview operates much like a conversation, with the interviewer simply starting the general topic and then responding to what the interviewee says. In these cases the focus is generally much more on what the interviewee wishes to say than what the interviewer wishes to get from the interview and this method is best suited to highly sensitive or subjective issues.<sup>775</sup>

For this thesis, semi-structured interviews have been chosen as the most appropriate method of data collection. Semi-structured interviews are generally the approach favoured where the research has a clear focus, since the structure of the interview guide allows that focus to be discussed without the possibility of the interview wandering off track, as is possible with unstructured interviews.<sup>776</sup> In this case, specific issues have been highlighted for discussion through the literature review and using an interview guide can ensure that all these issues are covered in the interviews while unstructured interviews, being driven more by the interviewee than the interviewer, may not allow discussion of all issues. Equally, having a common framework of questions in each interview allows the data to be compared and analysed much more easily than is possible with fully unstructured interviews.

The flexibility of semi-structured interviews also appears to make them more suitable for this project than fully structured interviews. It is possible that the issues which have been highlighted in the literature review are not in fact commonly encountered or

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<sup>774</sup> *Ibid.*, at p.321.

<sup>775</sup> *Ibid.*

<sup>776</sup> *Ibid.*, at p.323.

considered important by those applying the law, and the flexibility of semi-structured interviews allows interviewees to raise the issues they feel are important. Structured interviews would not necessarily allow these issues to be raised and thus might fail to discover important aspects of the research.

Having determined the method of data collection, the next section discusses how the interview subjects were chosen.

### **III. Sampling**

#### III.1. Sampling Introduction

Mason defines sampling and selection as "principles and procedures used to identify, choose, and gain access to relevant data sources".<sup>777</sup> The term is generally associated with probability sampling, which aims to take a representative sample from a large population, allowing the results gained from analysis of the sample to be generalised to that population.<sup>778</sup> Probability sampling faces problems when applied to qualitative research, however. As Bryman argues, the mutability of qualitative research means that it can be hard to state the precise population that is being studied at any one time, making it impossible to determine what the random sample should be based on.<sup>779</sup> Also, probability sampling often results in large samples, which makes in-depth qualitative interviewing very time-consuming and expensive.<sup>780</sup> While large probability samples are able to indicate general trends in an area they are not suitable for discovering the complex detailed data that most qualitative research searches for.

Given these problems and the choice of qualitative methodology for this research, probability sampling will not be used in this thesis. Instead, a form of purposive sampling will be used, based on the theoretical sampling used in grounded theory

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<sup>777</sup> Mason, above n. 764, at p.120.

<sup>778</sup> Bryman, above n. 752, at p.95.

<sup>779</sup> *Ibid*, at p.304.

<sup>780</sup> Mason, above n.764, at p.126.

research.<sup>781</sup> Under this method, rather than the sample being definitively decided at the beginning of the research, the sample evolves as the research is conducted. Potential interviewees will be originally chosen based on their relevance to the research questions and the developing theory.<sup>782</sup> Theoretical sampling leads to an iterative process of data collection and data analysis in which the data analysed leads to refinement of the theory guiding future data collection. While the potential sample is very broad in the early stages of data collection when the theory is still fairly general, sampling will become more specific and focused as data collection continues.<sup>783</sup> Sampling stops when the point of "theoretical saturation" is reached, which is when the particular category or theme being investigated has been well-defined and the interview data is only confirming the information already gained rather than offering new insights.<sup>784</sup>

One of the practical problems theoretical sampling raises is that of defining the initial sample. Since the grounded theory method is an inductive method (a method in which the theory is created from the data, as opposed to a deductive method which uses data to test a pre-existing theory), at this early stage there is no defined theoretical framework which may be used to guide the data collection. Instead, the sample must be determined by the issues raised by the research questions and by practical considerations such as available resources and access issues.<sup>785</sup> The next section will discuss the initial sample in this research and the reasons why that sample was chosen.

### III.2 Utilities Sample

Directive 2004/17/EC<sup>786</sup> ("the Utilities Directive") covers entities which conduct certain activities in the energy, water, transport and postal services sectors.<sup>787</sup> As set out in Chapter 4, the UK utilities sector as a whole covers well over a thousand companies.

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<sup>781</sup> For more on grounded theory, see Strauss, A. and Corbin, J., *Basics of Qualitative Research Techniques and Procedures for Developing Grounded Theory*, (2<sup>nd</sup> Ed), (1998, Thousand Oaks, Calif: SAGE Publications).

<sup>782</sup> Mason, above n.764, at p.124.

<sup>783</sup> Strauss and Corbin, n.781 above, at p.203.

<sup>784</sup> *Ibid*, at p.212.

<sup>785</sup> *Ibid*, at p.204.

<sup>786</sup> Directive 2004/17/EC of the European Parliament and of the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 No. L134/1.

<sup>787</sup> For further discussion see Chapter 4 on the UK utilities sector and Chapter 5 on the EU procurement regime.

Given the limited time and resources of this research, it was not feasible to interview the whole population, making it necessary to choose a sample in order to conduct qualitative research. Equally, the utility population includes many companies not subject to, or not fully subject to, the EU procurement regime making them of less relevance to the research question of this thesis. The size of the regulated utilities sector, i.e. those covered fully by the Utilities Directive, was discussed previously in Chapter 4. Given the lack of clarity in the Directive over precisely which organisations are covered, the precise number of regulated utilities in the UK is somewhat uncertain but, as suggested in Chapter 4, is probably no larger than 100 companies.

The sample has been chosen on the basis of two main criteria. Firstly, to include at least some companies which have an interest in including CSR policies in their procurement. Secondly, companies have been chosen based on the need for diversity in the companies covered by the sample. This covers several requirements:

1. The need to cover entities which operate in more than one region, including companies which operate in more than one EU member state and also companies which operate in countries outside the EU.
2. The need to cover both public and private companies.
3. The need to include companies which have moved from the public sector regime to the utilities regime.
4. The need to ensure that the sample reflects the population in terms of variance in the size of the companies included.
5. The need to include both companies which use the joint qualification lists operated by Achilles Information Ltd, and companies which operate their procurement individually.

The rest of this section will examine the reasons behind these criteria and how the sample deals with each of them in more detail. It was originally intended to cover also

utilities in various legal regimes, i.e. including utilities in the oil and gas sector which have a partial exemption under Art. 3 of the previous directive and companies which have a full exemption under Art. 30 of the current directive. This would have allowed investigation into the way in which the legal regime impacts on the use of labour policies through a comparison with similar companies which are not subject to the same regime. Unfortunately, due to both time constraints and a difficulty in identifying and contacting such interviewees, this was not possible in this project and this research studies only the core sample of fully regulated utilities.

The initial sample chosen covers utilities in the electricity and gas transmission and distribution sectors, the water and sewerage sector, the postal services sector and the transport sector. The sample covers 22 companies, with 5 in the energy sector, 7 in the water sector (including one company which also operates in the UK energy sector), 9 in the transport sector and 1 company in the postal services sector. Unfortunately, due to a very low response rate from companies in Scotland and Northern Ireland (no companies from Northern Ireland replied to requests for interview and only one company from Scotland did so), the sample does favour English and Welsh companies.

### *III.2.1. Variance in legal regimes*

The energy companies chosen for the sample cover the electricity transmission and distribution operators and the gas transport companies operating in the UK. These companies have been chosen since, unlike companies operating solely in the electricity generation or electricity/gas supply sectors and companies operating in the oil and gas extraction sector, they have no exemption from any part of the Utilities Directive. They are thus the companies in the energy sector most suited to research examining the effects of the rules under that directive on CSR policies. Within the transport sector, the sample includes those companies which do not have an exemption from the directive, covering mostly rail and airport utilities. The water companies and the postal services

company included in the sample are also fully covered by the Utilities Directive when performing a regulated activity.

Utilities' procurement may also be affected by the Treaty on the Functioning of the European Union (TFEU). The Treaty rules on free movement are relevant for procurement, including the obligations set out in the case law of the Court of Justice of the European Union (CJEU). This includes the recent transparency obligation set out in the case of *Telaustria*<sup>788</sup> (see Chapter 5), which requires that all procurement contracts are advertised. The Treaty rules apply to every procurement which does not have a specific exemption from the Treaty, such as defence procurement covered by Art. 346 TFEU. This means the rules apply to utilities' procurement where it is under the threshold for the Utilities Directive, where the contract is exempt from the Directive or subject to a limited regime, and where the relevant sector has an exemption from the Directive under Art. 30. As with the rules under the Directive, these Treaty requirements limit the ability of companies to include certain CSR policies.

These Treaty rules also add an extra layer of uncertainty to utilities' procurement. Firstly, while the Treaty applies to utilities which are public authorities or public undertakings, it is unclear whether the requirements also apply to private utilities operating on the basis of special or exclusive rights (see Chapter 5). Even where the Treaty requirements do apply, the precise nature of those requirements is very uncertain since the CJEU has yet to set out the required level of advertisement.

### *III.2.2. Variance in region and activity*

Many utilities have changed the way in which they operate in recent years. The growth in privatisation and deregulation throughout the utilities sector has given utilities the ability to merge with and takeover other utilities. This has led to companies becoming generally much larger and operating internationally, with activities both in the EU and globally. Equally, companies now often operate over more than one utility activity and

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<sup>788</sup> Case C-324/98 *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria AG* [2000] ECR.I-10745.

can also operate in both regulated and unregulated sectors. This means that their different activities are subject to different procurement rules depending on whether the activity is covered by the Utilities Directive and on the jurisdiction in which the activity takes place. This may prevent utilities from implementing policies covering more than one of the sectors or jurisdictions in which they operate since any policy would have to comply with the most restrictive relevant procurement regulation, limiting its overall use.<sup>789</sup> The impact of these different regulatory regimes may also hinder the ability of utilities to co-operate with other companies in other jurisdictions, for example, to run a joint qualification list. These different activities and different regulatory regimes also mean that a utility may have difficulty determining which rules should be followed for each procurement, especially any procurement which may cut across sectors.<sup>790</sup>

In order to examine the effect of these different regulatory regimes in practice, the sample has been designed to include companies operating in various sectors and in various different geographical regions. The sample includes one company which operates over two utility sectors; water and energy. In addition to this, the sample includes four companies in the energy sector which not only operate distribution networks but also have branches which operate in the non-regulated generation and supply areas. The postal services company included in the sample also completes a variety of activities including both regulated activities such as letter delivery and non-regulated activities such as certain licensing activities performed by one of its subsidiary companies.

### *III.2.3. Public and private companies*

The water, transport and postal services sectors all have a small number of public utilities operating within them, along with a greater number of private utilities. The need to make a profit may place private companies under more pressure to include CSR

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<sup>789</sup>Arrowsmith, S. and Maund, C. 'CSR in the utilities sector and the implications of EC procurement policy: a framework for debate' in Arrowsmith, S. and Kunzlik, P. (eds), *Social and Environmental Policies under the EC Procurement Rules: New Directives and New Directions*, (2009, Cambridge: CUP), at sec. 6.

<sup>790</sup>*Ibid*, at sec. 6.

policies in their procurement.<sup>791</sup> Equally, however, public companies face public pressure, being subject to the need to have a good social reputation and to set an example to other companies. Including both public and private companies in the sample allows an examination of whether the public or private status of a company influences its choice to include CSR policies in practice.

#### *III.2.4. Move from one legal regime to another*

It was decided to add the postal services company to the sample because, uniquely among the UK utilities, this company was until recently regulated under the Public Sector Directive. The public sector rules are generally much less flexible than the utilities regulation and this may have influenced the previous use of CSR policies. Including this postal services company in the sample allows the consequences of the move from the public sector rules to the more flexible utilities rules to be examined.

#### *III.2.5. Variance in company size*

As with the implementation of any business policy, the size and funds of the company may have an effect on the decision to implement a CSR policy and on the precise way that policy is formulated since larger companies will simply have more money available for both the policy and any legal advice felt necessary to ensure the policy is compatible with EU law. In order to examine the effect the size of the company has on the use of CSR policies in more detail, it is important that the sample covers not only large multinational firms, but also small and medium sized businesses. This ensures that while enough large firms are included that the sample covers a significant proportion of the utility market in economic terms, the possible effects of a company's size can also be analysed and the sample is not biased towards large firms. For this research, the size of a company is defined by reference to its annual turnover.

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<sup>791</sup> For more on the commercial pressures on companies leading to the inclusion of CSR policies and the link between CSR and profit, see Chapter 2 on Corporate Social Responsibility.

As previously mentioned, the sample of energy companies chosen for this research focuses on the utilities operating in the gas and electricity transmission and distribution sectors. In this sector, the companies which operate the regional monopoly networks (the Distribution Network Operators (DNOs) and Gas Distribution Networks (GDNs)) do show some variation in size, with some such as E.ON being large multinational firms and others, such as Electricity North West Ltd, being much smaller firms operating solely in the UK.<sup>792</sup> However, the sector does significantly favour very large utilities. It was also decided that, for the water sector, the English and Welsh water only companies would be included as well as the monopoly water and sewerage companies, since these companies are generally much smaller than both the water and sewerage companies and the energy companies. The transport sector covers mostly relatively small companies operating individual transport networks, offering a different perspective to the mostly larger water and energy companies. This offers a variation in size throughout the sample.

### *III.2.6. Companies on and off the Achilles Database*

Many utilities in the UK use a qualification list operated by the firm Achilles Information Ltd, the Utilities Vendor Database (UVDB). The UVDB qualifies suppliers using a number of criteria, ranging from general financial and technical criteria to looking at certain CSR practices of the supplier. Several utilities also use the Verify service run by Achilles which examines a supplier's health and safety record. Given that the information collected for the UVDB and Verify may impact on how a utility designs its CSR policies, the sample aims to include both companies who use the list and those who operate their procurement independently. The sample does significantly favour companies using the database, with all the energy distribution and transmission and the water and sewerage companies listed as using the UVDB. The use of the database is, however, low amongst transport companies, and the postal services company also does not use UVDB. Even within the sample of those companies using the UVDB, however, there is variance in the

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<sup>792</sup> For more information, see Chapter 4 on the UK utility sector.

precise usage of the list, with many companies also running independent procurements for certain contracts rather than relying on the qualification list for every procurement. This will allow the precise impact of the UVDB criteria on the usage of CSR policies to be examined in more detail.

## **IV. Interview Guide**

### IV.1. The topics covered

The topics which were to be investigated in this project were determined by the literature review set out in the previous chapters. From this review, eight areas of interest were identified for further investigation.

#### *IV.1.1. Decision to address labour issues in procurement and the structure of labour policies*

The empirical research first aimed to examine the decision over whether or not to include any labour issues in their procurement at all and, if labour issues were included, what kind of issues. This general knowledge provided the base for evaluating the later more specific issues examined.

As discussed in Chapter 2, section III, utilities may face various pressures to consider labour issues throughout their business, most notably from their shareholders, consumers and employees.<sup>793</sup> The impact of these pressures along with arguments that companies which are more socially responsible are intrinsically more profitable may mean that utilities see adopting labour policies to be commercially necessary.<sup>794</sup> On the other hand, the EU regime governing the use of labour criteria in procurement is complex, with some issues such as the recruitment of local labour being clearly prohibited and the legality of other issues such as the exclusion of firms with poor labour

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<sup>793</sup> Vogel, D. *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (2005, Washington DC: Brookings Institution Press), at p.46. For further discussion, see Chapter 2 on Corporate Social Responsibility.

<sup>794</sup> The "business case" for CSR, see further Chapter 2 on Corporate Social Responsibility at Section III.1.

practices being unclear.<sup>795</sup> The empirical research aimed to determine what factors influence utilities' decision whether or not to include labour issues in their procurement and, more specifically, the extent to which the EU legal regime is a factor in their decision.

For those utilities which took the decision to include labour considerations in their procurement, the empirical research aimed to determine which labour issues are most commonly included. Reviewing the most commonly used labour codes raised several possible issues which could be included:<sup>796</sup>

- Prohibition of child labour
- Prohibition of discrimination
- Prohibition of forced labour
- Minimum wage rates
- Maximum working hours
- Health and safety in the workplace
- Skills training for employees
- Freedom of association
- Recruitment of local labour

Utilities were asked which, if any, of these policies they included. They were also able to discuss other policies not mentioned on the list.

The research then attempted to determine the methods through which the issues were most commonly integrated into a utility's procurement policy. The literature suggested that social issues could be included at several stages in the procurement process:<sup>797</sup>

1. Deciding what to procure
2. Setting the technical specifications

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<sup>795</sup> For detailed discussion of the possibility of including labour issues in procurement under the EU regime, see Chapter 6.

<sup>796</sup> See Chapter 3 on Corporate Social Responsibility: Labour Policies.

<sup>797</sup> See further Chapter 6.

3. Setting contractual conditions to be complied with during the performance of the contract
4. Setting the minimum standards for tendering and selection of tenderers in restricted/negotiated procedures
5. Award criteria relating to labour issues

Several considerations could influence a utility's choice of structure. From the literature review it became apparent that most issues included in labour codes concerned minimum standards to be reached. These are best dealt with through setting contract conditions for performance and setting minimum standards to be met before a supplier is eligible to tender, suggesting that these would be the most common approaches. On the other hand, commercial reasons may lead to approaches involving award criteria being favoured, as these best allow a company to determine the costs of a particular social policy and weigh it against other relevant factors. The empirical research aimed to discover what factors were most important when a utility was planning the procurement structure and, as with the decision to include labour issues at all, whether the EU regime had an impact upon the choice.

#### *IV.1.2. Contract conditions*

Following the general discussion of the area of labour policies in procurement as a whole, the rest of the areas of interest covered in the interview guide all dealt with specific areas of concern. Firstly, for those utilities which used contract conditions in order to implement labour policies, certain specific problem areas from a legal perspective in the field of contract conditions were identified. As with the types of policies, the identified problems are a starting point for discussion but interviewees may also highlight other areas.

- The use of contract conditions relating to matters beyond the performance of the contract.

Inclusion of contract conditions which do not relate to the performance of the contract are prohibited for contracts governed by the Utilities Directive under Article 38. However, it has been noted that many labour policies would be ineffective if limited solely to the performance of the contract without the inclusion of auxiliary supporting policies as well, for example, policies for the education of child labourers who have been prevented from working for the utility.<sup>798</sup> The requirements of the labour codes studied generally required certain minimum standards to be required in the utility's workforce and that of its suppliers and could generally be complied with through only performance related conditions. However, there were some exceptions, again generally related to child labour.<sup>799</sup> The questions on this area aimed to determine whether Article 38 was generally complied with or if other considerations led to a utility including non-performance related criteria despite the requirement.

- Compliance with national law

Compliance with the national law of the country in which the contract is performed is required by all labour codes examined and is usually seen as the base level of compliance with the code. It is also one of the lowest-risk approaches to implementing labour considerations into procurement, with the Utilities Directive appearing to assume that requiring compliance with national law is allowable in Article 39, which allows a utility to set out where information on the national obligations relating to the workforce may be obtained. The empirical research in this area aimed to determine whether compliance with national law was commonly required and if so, whether this was the only requirement or whether the utility also added extra requirements beyond this, along with the reasons for the choice.

- Labour certification marks (Fair trade product marks and supplier certification)

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<sup>798</sup> See section III.1.2.2. in Chapter 6 on Utilities Procurement and Labour Policies.

<sup>799</sup> The most notable of these exceptions was Principle 4.2 of the Ethical Trading Institute Base Code, which requires companies to "develop or participate in and contribute to policies and programmes which provide for the transition of any child found to be performing child labour to enable her or him to attend and remain in quality education until no longer a child".

Product marks and certification schemes provide an easy and cost-effective way for a utility to see that the product it is purchasing or the supplier it is working with has satisfactory labour standards. Given the recent rise to prominence of fair trade products, it is also possible that a utility may feel pressure from its employees to ensure that products used by the company bear the Fairtrade label wherever possible. However, under the EU regime it appears that a utility must accept any product or service which satisfies its functional requirements.<sup>800</sup>

For fair trade products, there is also an issue over whether a utility can set contract conditions governing the labour standards of the workforce which is producing that product. There is no case law on the topic and, while the Commission suggests that production methods cannot be considered where they have no impact on the actual characteristics of the product, this view has been heavily criticised.<sup>801</sup> The empirical research aimed to determine whether requirements were set regarding production along with whether specific marks were required and the reasons for the choice.

- Local labour

A common requirement in the labour codes examined was the requirement to improve the welfare of the local community in which the utility was operating, often by favouring local labour or firms.<sup>802</sup> Depending on the location of contract performance, this could require a utility to favour local labour in either the utility's home state, another EU Member State or a third country. Favouring local labour or firms in the utility's home state has been declared by the CJEU to be contrary to the free movement provisions.<sup>803</sup> There is no case law discussing favouring local firms or labour in either other EU Member

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<sup>800</sup> Case C-359/89, *Commission v Netherlands* [1995] ECR I-157 ("UNIX").

<sup>801</sup> See European Commission, *Interpretive communication of the Commission on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, COM(2001) 274; Kunzlik, P. 'Making the market work for the environment: acceptance of (some) "green" contract award criteria in public procurement' 15 *Journal of Environmental Law* 175; and the discussion at sec.1.2.1 of Chapter 6 on Utilities Procurement and Labour Policies.

<sup>802</sup> See, for example, OECD Guidelines for Multinational Enterprises, General Principles 3 and 4, which require a firm to encourage local employment and local capacity building, and the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (2006), p.6, which states that a company should promote employment opportunities, giving priority to nationals of the state in which they are operating.

<sup>803</sup> See Case C-243/89, *Commission v Denmark* [1993] ECR I-3353 on favouring local labour and Case C-21/88, *Du Pont de Nemours Italiana SpA v Unita Sanitaria Locale No. 2 di Carrara* [1990] ECR I-889 on setting aside contracts for local firms.

States or third countries, though it seems likely that it would be considered a hindrance to trade which must be justified under the free movement provisions.<sup>804</sup> The empirical research here aimed to determine whether local labour clauses were included in contracts in any of the three scenarios given above and, if so, whether the decision to include them was weighed against the risk of challenge under the EU rules.

- Posted workers

Finally, the empirical research aimed to determine what impact, if any, the case of *Ruffert* had had on the utilities sector when posted workers were involved in a contract.<sup>805</sup> This case suggests that where workers are posted from one member state to another, the host member state cannot require higher working conditions than are provided for in the Posted Workers Directive.<sup>806</sup> The empirical research aimed to determine whether utilities were content to stick with the labour standards of their supplier in these cases or preferred to demand higher standards despite the *Ruffert* requirements.

#### *IV.1.3. Award Criteria*

It was noted above that one possible method of including labour considerations in procurement was through the use of award criteria. The European Commission suggests that award criteria considering labour issues may only be included where the criteria are only considered if all other aspects of the tender are equal.<sup>807</sup> The empirical research here aimed to determine whether utilities accepted this view or whether they included award criteria examining labour issues in other ways.

#### *IV.1.4. Qualification and selection of tenderers*

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<sup>804</sup> See further discussion at sec.1.2.1 of Chapter 6 on Utilities Procurement and Labour Policies.

<sup>805</sup> Case C-346/06, *Rüffert v Land Niedersachsen* [2008] ECR I-01989

<sup>806</sup> Directive 96/71/EC of the European Parliament and the Council concerning the posting of workers in the framework of the provision of services, [1997] OJ L18/1.

<sup>807</sup> European Commission, *Interpretive Communication of the Commission on the Community Law applicable to public procurement and the possibilities for integrating social considerations into public procurement*, COM(2001) 566, at sec.1.4.1.

Under the Utilities Directive, utilities may exclude and select tenderers for a shortlist based on "objective rules and criteria".<sup>808</sup> There is no guidance given on what precisely is meant by objective rules and criteria beyond the statement that it includes all the possible grounds for exclusion and selection which are allowable under the Public Sector Directive.<sup>809</sup> The empirical research in this area aimed to determine what kind of criteria are commonly used for qualifying and selecting tenderers, with emphasis on whether labour criteria are used and if so, how those criteria are structured.

#### *IV.1.5. Qualification Systems*

Utilities may choose to limit their contracts to suppliers on a qualification list. In the same way that minimum standards may be set before a firm is eligible to tender for a particular contract, standards may also be set for firms wishing to join the qualification system. The empirical research aimed to determine what kind of criteria utilities used to qualify firms for the system and whether those criteria were chosen to be applicable for all possible contracts under the system or just a proportion.

#### *IV.1.6. Evidence and monitoring*

The Utilities Directive does not set out any explicit list of the evidence which may be required from firms in order to prove they can comply with the minimum qualification standards and the contract conditions, suggesting utilities may request any evidence related to those standards and conditions. The Directive does, however, require that utilities must request the same evidence from all suppliers, regardless of how high or low risk the utility judges them to be.<sup>810</sup> The empirical research here aimed to determine what kind of evidence to prove compliance with labour issues was commonly requested by utilities, if indeed they requested anything at all.

#### *IV.1.7. Procurement outside the Utilities Directive*

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<sup>808</sup> Art. 54 Utilities Directive.

<sup>809</sup> Art. 54(4) Utilities Directive.

<sup>810</sup> For further discussion, see Chapter 6, Section IV.5.

As noted above in the sampling section, the applicability of the TFEU rules to private sector utilities with special or exclusive rights is unclear. The empirical research in this area aimed to determine whether the private utilities considered themselves bound by the Treaty rules. It also aimed to determine whether and how labour policies were included by utilities in their procurement outside the Directive, whether they felt the Treaty rules were applicable or not.

#### *IV.1.8. Cross-regime procurement*

As noted above in the sampling section, in recent years utilities have expanded out of their traditional sectors and countries, and this has made them subject to differing legal regimes for different parts of their business. The empirical research here aimed to determine what impact being subject to so many regimes had on their overall procurement policy, if any.

#### IV.2. Formulating the interview guide questions

The questions in the original interview guide were based on the topics above. This original interview guide was amended over the research process to take account of any other issues raised by the interviewees which are not covered in the guide and which it is felt appropriate to research further. This section sets out how the interview questions in the guide were worded and structured and sets out the reasons behind those choices.

Interview questions may be split into two categories: open questions and closed questions.<sup>811</sup> With open questions, interviewees may answer the question in any way they wish, using whatever wording they choose. With closed questions, interviewees choose their response from options given by the interviewer. Closed questions have several advantages. Firstly, the answers are easier to process since the relevant categories are pre-determined by the researcher, whereas for open questions the answers must be evaluated in detail after the interview and the common themes identified at that later stage. Equally, closed questions "enhance the comparability of the

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<sup>811</sup> Bryman, above n.752, at p.145.

“data” unlike open questions where the variation in answers can create a difficulty in determining when interviewees’ answers are referring to the same thing.<sup>812</sup> Bryman also notes that closed questions are often easier to understand by interviewees since the availability of answers helps to clarify any ambiguity in the wording of the question.<sup>813</sup>

There are also several disadvantages to closed questions, however. Closed questions do not allow interviewees to raise issues not mentioned in the interview guide, something which was noted above as an aim in this research and one of the reasons semi-structured interviewing was chosen as the main research method. Connected to this, Bryman notes that it can be difficult to make closed questions exhaustive, offering every possible answer as an option.<sup>814</sup> The difficulty in covering every possibility added to the inability of the interviewee to raise issues which might have been missed means that certain important factors may be missed entirely from the research.

Open questions are generally preferred in qualitative research. Open questions place more emphasis on the views of the interviewee rather than the interviewer, allowing their subjective views to shape the research, a core belief of qualitative research (see above, Section II). Given that, as discussed previously, the aim of this research is to determine the practical experiences of the interviewees and the need to allow avenues of research not highlighted in the research to be explored, open questions will generally be preferred in this research. However, the benefits of closed questions discussed above mean that some closed style questions will be included, though an “other” category will also be given to enable interviewees to raise options not included in the possible answers.<sup>815</sup> In particular, the questions which aim to gather general data on the types of labour policy included and the methods by which these policies are structured will offer suggestions on possible policies and methods of structuring those policies, both to

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<sup>812</sup> *Ibid*, at p.148.

<sup>813</sup> *Ibid*.

<sup>814</sup> *Ibid*, at p.150.

<sup>815</sup> The option of using an “other” category in closed questions to enable questionnaires to be more exhaustive is suggested by Bryman, above n.752, at p.150.

enable the data to be more easily compared and also to aid understanding of the question.

While generally the law concerning the use of labour policies in procurement is unclear and thus equally the legality of the approaches taken by the interviewees is uncertain, for some of the topics covered, the use of labour policies is clearly unlawful, for example the use of local labour clauses in the home state of the utility. In this case, the interview questions had to be formulated carefully to deal with this sensitivity. The questions which were perceived to be the most sensitive were mixed in with other questions of less sensitivity.<sup>816</sup> A statement of context was also given, which gave reasons why companies might take the particular action and gave the expectation that the interviewee had also taken this action. For example, the local labour question read:

Many institutional labour codes such as the OECD Guidelines and the ILO Tripartite Declaration have clauses promoting the use of local labour: have you ever favoured local labour or firms, either here in the UK or elsewhere? Why/why not?

The aim here was that the context provided would allow the interviewee to feel confident enough in their actions despite the sensitivity of the issue and to provide an honest response. Without this context, it was feared that many interviewees would refuse to discuss the issue given the unlawfulness of the action.

Generally questions such as the one above which contain such expectations are criticised for leading the interviewee to their answer, adversely affecting the overall quality of the interview data by ensuring that the researcher only receives the answer they are looking for.<sup>817</sup> In this case, however, the possible benefits of the contextual information for allowing the sensitive issue to be approached would appear to outweigh the possible disadvantages of using a leading question.

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<sup>816</sup> Bradburn, N., Sudman, S. and Wansink, N. *Asking Questions: The Definitive Guide to Questionnaire Design*, (Rev Ed), (2004, San Francisco: Jossey-Bass), at p.81.

<sup>817</sup> Kvale, S. and Brinkmann, S. *InterViews: Learning the Craft of Qualitative Research Interviewing*, (2<sup>nd</sup> Ed), (2009, London: SAGE Publishing), at p.171.

## **V. Conduct of Interviews**

The 22 interviews were conducted between January and April 2010, taking between 30 and 80 minutes each. The majority of the interviews took place at the interviewees' offices, allowing face to face discussion. Four of the interviews, however, were conducted by telephone due to time constraints on the part of the interviewees. There are differing opinions on the utility of telephone interviews as compared to face-to-face interviews. One of the commonly mentioned drawbacks of using a telephone interview is that the interviewer cannot see the body language of the interviewee, which can make it harder for the interviewer to know when an interviewee is confused by a question.<sup>818</sup> Another possible problem is that the length of a telephone interview can usually only be at most 20-25 minutes, whereas a face-to-face interview can be sustained for much longer, allowing more in-depth investigation of the issues.<sup>819</sup> Sturges and Hanrahan dispute this, however, noting that in their research comparing telephone and face-to-face interviews they obtained approximately the same amount of data from both forms of interview.<sup>820</sup> They also found that the nature and depth of responses to their questions also did not vary depending on the medium of interview.<sup>821</sup> Telephone interviews were thus deemed an adequate alternative to face to face interviews where it was not feasible to meet in person.

The majority of the interviews were audio-recorded using a digital voice recorder. Boeije argues that recording interviews is greatly advantageous for qualitative research, improving the quality of the data by ensuring the interviewer does not have to choose what to take notes on, allows discussion of the data with colleagues, and provides verbatim quotes which may be used in the final report, helping readers judge the accuracy of the researcher's interpretation.<sup>822</sup> Recording the interview also means that extensive notes do not need to be taken at the time, which can interrupt the flow of the

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<sup>818</sup> Creswell, above n.762, at p.132.

<sup>819</sup> Bryman, above n752, at p.115.

<sup>820</sup> Sturges, J. and Hanrahan, K. 'Comparing Telephone and Face-to-Face Qualitative Interviewing: A Research Note' (2004) 4 *Qualitative Research* 107, at 112.

<sup>821</sup> *Ibid*, at 112.

<sup>822</sup> Boeije, H. *Analysis in Qualitative Research*, (2010), (London: SAGE Publications), at p.72.

interview.<sup>823</sup> Seven of the interviewees were unwilling to be recorded and in these cases notes were taken during the interview and then written up as soon as possible after the interview finished.

Those interviews which were recorded were later transcribed. The precise level of transcription needed is always affected by the purpose of the research.<sup>824</sup> Given that the focus of this research is on the content of the interviews rather than the speech and intonation of the interviewees, it was felt that a detailed verbatim transcription was not needed and the transcription edited the interview responses into a formal written style, removing hesitations and repetitions when possible. Where information was included which was irrelevant to the research, it was omitted from the transcription, but for the majority of the interviews there was a full transcription with no omissions.

## **VI. Data Analysis**

Following transcription, the process of data analysis began. Qualitative data analysis generally involves discovering the main themes of the interview data through a process known as coding.<sup>825</sup> Coding is the process whereby the researcher "attach[es] one or more keywords to a text segment in order to permit later identification of a statement".<sup>826</sup> Kvale and Brinkmann note that coding may be either concept-driven or data-driven.<sup>827</sup> Concept-driven coding uses codes designed by the researcher prior to the data analysis, usually by examining existing literature in the area, while in data-driven analysis the codes are developed solely through examining the data collected.<sup>828</sup> Data-driven coding is more commonly used in qualitative research and is generally associated with the use of grounded theory approaches, where the aim of the data analysis is to build up a theory based on the data collected.<sup>829</sup> Under this approach, coding should be done iteratively with the data collection, with initial data analysis guiding subsequent

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<sup>823</sup> Kvale and Brinkmann, above n.817, at p.179.

<sup>824</sup> McLellan, E., MacQueen, K and Neidig, J. 'Beyond the Qualitative Interview: Data Preparation and Transcription' (2003) 15 *Field Methods* 63, at 67.

<sup>825</sup> Creswell, above n.762, at p.148.

<sup>826</sup> Kvale and Brinkmann, above n.817, at p.202.

<sup>827</sup> *Ibid*, at p.202.

<sup>828</sup> *Ibid*.

<sup>829</sup> See Strauss and Corbin, above n.781.

data collection.<sup>830</sup> Given the lack of developed theory in this area, as discussed previously in section II, it was felt that concept-driven coding was inappropriate. A data-driven coding approach was thus taken when analysing the data. All coding for the project was completed using the qualitative data analysis software NVivo 8.

Under a data-driven approach, codes should begin as simple descriptive statements in order to define the experience of the interviewee. Following this, the codes should be compared in order to form steadily more theoretical codes, which may lead to expanding the sample in order to better investigate certain codes.<sup>831</sup> The process should generally stop when the point of theoretical saturation is reached (see above, in section III.1), that is, when the sampling and analysis process "no longer sparks new theoretical insights, nor reveals new properties of your core theoretical categories".<sup>832</sup>

Richards distinguishes between three types of codes which may arise from interview data; descriptive, topic and analytic codes.<sup>833</sup> Descriptive codes look at the attributes of cases, for example the size of the interviewee's organisation, and are the type of codes more commonly used in quantitative research.<sup>834</sup> Information was collected in the interviews on issues such as the jurisdictions the company operated in and procurement procedures of subsidiaries/parent companies, but in general descriptive codes were rarely used in this research.

Topic coding was the first stage of the analysis. Topic coding refers to the simple process of identifying the issue the interviewee is talking about at each stage.<sup>835</sup> It is a necessary preliminary step to more detailed analysis, collecting all the data on the specific research issues in one place so that they can be more easily compared and contrasted. For this project, the use of the interview guide as a common framework meant that each interview covered essentially the same topics, with only minor variations where

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<sup>830</sup> *Ibid.*

<sup>831</sup> Kvale and Brinkmann, above n.817, at p.202.

<sup>832</sup> Charmaz, above n.767, at p.113.

<sup>833</sup> Richards, L. *Handling Qualitative Data: A Practical Guide*, (2<sup>nd</sup> Ed), (2009, London: SAGE Publications), at p.96.

<sup>834</sup> *Ibid*, at p.99.

<sup>835</sup> *Ibid*, at p.100.

interviewees raised their own issues, and so these question topics were taken as the base themes for analysis. Any topic raised by interviewees which did not fit into one of the interview guide topics was given its own topic code.

Analytical coding is the stage in which overarching themes are identified in the data and codes are determined based on "interpretation and reflection on meaning".<sup>836</sup> This was the main stage of the analysis. Interviewees' opinions and thoughts were examined and common statements were analysed to identify broad themes. Many of the themes identified were then combined into larger overarching themes. The themes identified range from practical discussion on how labour policies had been included in certain ways to more general themes such as common conceptions of the EU legal regime. They will be discussed in detail in the substantive data analysis chapter, Chapter 9.

## **VII. Validity, Reliability and Generalisability of the Results**

It is important for empirical research to be designed and conducted in such a way as to ensure that the findings can be trusted. The traditional requirements for testing the quality of empirical research are the measures of validity and reliability, with generalisability sometimes included as a third criterion, but also sometimes included as part of validity.<sup>837</sup> Reliability is concerned with the consistency of a measure of a concept, including whether the measure is stable over time and whether the measure is objective or affected by subjective judgement.<sup>838</sup> Validity looks at whether the measure used in the research does in fact measure the concept examined.<sup>839</sup> Generalisability is concerned with whether the results of the research can be generalised out to the population.<sup>840</sup>

These measures, however, were primarily designed for quantitative research and their applicability to qualitative research has been questioned. Both reliability and validity in

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<sup>836</sup> *Ibid*, p.102.

<sup>837</sup> See Seale, C. *The Quality of Qualitative Research*, (1999), (London: SAGE Publications), at Ch. 4.

<sup>838</sup> Bryman, above n.752, at p.71.

<sup>839</sup> *Ibid*, at p.73.

<sup>840</sup> *Ibid*, at p.76.

the traditional sense set out above are concerned with the accuracy of measures, which is a key issue in quantitative research but of less use for qualitative research where the research ideas are not measured or conceptualised in the same manner. This has led to many commentators proposing their own methods of testing the credibility of qualitative research.

The majority of the proposals suggest entirely new criteria for judging validity. Cho and Trent analysed the main proposals for determining validity in qualitative research and identified two general approaches, which they term the "transactional approach" and the "transformational approach".<sup>841</sup> Methods taking the transactional approach are "grounded in active interaction between the inquiry and the research participants" and use techniques such as triangulation. The transformational approach is more radical, challenging the notion of validity and "judges work to be valid only if it signals that validity achieves an eventual ideal".<sup>842</sup> Within both approaches, however, there are a large number of possible criteria and methods for testing validity which have been suggested, and there is no consensus on which approach is the most appropriate.<sup>843</sup>

A different tactic, however, is to simply use the classic tests of validity, reliability and generalisability but to edit the methods by which these concepts are tested to make them more applicable to qualitative research. This is the approach taken by Mason, who argues that the broad notions of validity, reliability and generalisability are not problematic in themselves so long as the specific technical procedures which have become associated with them in quantitative research are not transferred over to qualitative research.<sup>844</sup> Seale also argues that the classic tests are a necessary starting point when looking at assessing quality, though some of the newer criteria build usefully on the core concepts.<sup>845</sup> Bryman notes that using these traditional criteria has had a resurgence in popularity in recent years due to a feeling by some bodies that the newer

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<sup>841</sup> Cho, J. and Trent, A. 'Validity in Qualitative Research Revisited' (2006) 6 *Qualitative Research* 319, at 320.

<sup>842</sup> *Ibid.*

<sup>843</sup> See Seale, above n.837, at p.43.

<sup>844</sup> Mason, above n.764, at p.38.

<sup>845</sup> Seale, above n.837, at p.49.

approaches, especially those which reject the notion of validity, show a lack of concern for rigor and quality in research.<sup>846</sup> The approach of using the classic criteria also has the benefit of giving clear aims against which to test the quality of research and, because of this, is the approach taken in this research.

### VII.1 Validity

As noted above, the traditional definition of validity examines whether the measures used in the research correctly measure the concept the researcher intended to examine. This presupposes the use of measurements, but Kvale and Brinkmann argue that for qualitative research the definition can be reframed to "the degree that a method investigates what it is intended to investigate", taking the emphasis off statistical measurements.<sup>847</sup> The authors note that the issue of validity is an ongoing one and should be considered throughout the entire research process, beginning with justifying the choice of theoretical background and research methods and ending with the way in which the data results are presented.<sup>848</sup> The reasons behind the choice of qualitative methodology and, in particular, the use of semi-structured interviews were discussed above in section II. The methods used to ensure validity through the other stages of the research process will be discussed below.

During the interview stage, the issue of validity relates to "the trustworthiness of the subjects reports and the quality of the interviewing".<sup>849</sup> For this project, the validity of the interviews was enhanced by sending the interview guide to all interviewees a week prior to the interview, allowing the interviewees the chance to query any topic or question they were unsure about. Interviewees' responses were also cross-checked by asking similar questions with different phrasing and, where responses were unclear, setting out my interpretation of their response to questions to the interviewee and asking them whether that interpretation was correct.

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<sup>846</sup> Bryman, above n.752, at p.383.

<sup>847</sup> Kvale and Brinkmann, above n.817, at p.246.

<sup>848</sup> *Ibid*, at pp.248-249.

<sup>849</sup> *Ibid*, at p.249.

As regards data analysis, Creswell and Miller set out some of the most common methods for establishing validity in qualitative research.<sup>850</sup> One of these is the search for disconfirming or negative evidence.<sup>851</sup> Using this method, once the main themes are identified in the data, the researcher goes through the data thoroughly to identify and analyse in detail any cases which contradict the theme in order to test the researcher's assumptions. This method was used throughout this research with all negative cases examined carefully and discussed in the data analysis chapter.

## VII.2. Reliability

Kvale and Brinkmann state that reliability in qualitative research relates to the "consistency and trustworthiness of research findings".<sup>852</sup> A distinction is often drawn between internal and external reliability.<sup>853</sup> Internal reliability relates to whether, in studies in which there are multiple researchers, those researchers agree on the measures used.<sup>854</sup> This was not an issue in this project which only had one researcher.

External reliability is concerned with the replicability of the research. Given the in-depth data and focus on subjective opinions in qualitative research, true replicability is hard to achieve since repeating the research would be incredibly time-consuming and costly and there is no guarantee that the personal experiences of the interviewees would not have changed since the first study, resulting in new data. Nonetheless, LeCompte and Goetz argue that external reliability in qualitative research can be improved by providing a full and detailed account of the research process. This should include, where relevant, information about the researcher and the interviewees, the theories informing the research and the methods used for data collection and analysis.<sup>855</sup> This chapter has aimed to provide a full account of the information needed to replicate the project, with

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<sup>850</sup> Creswell, J. and Miller, D. 'Determining Validity in Qualitative Inquiry' (2000) 39(3) *Theory into Practice* 124.  
<sup>851</sup> *Ibid*, at 127.

<sup>852</sup> Kvale and Brinkmann, above n.817, at p.245.

<sup>853</sup> See Seale, above n.837, at p.140 and Le Compte, M. and Goetz, J. 'Problems of Reliability and Validity in Ethnographic Research' (1982) 52(1) *Review of Educational Research* 31.

<sup>854</sup> *Ibid*, at 41.

<sup>855</sup> *Ibid*, at 36-40.

the sections above setting out the details of and reasons behind the choice of methodology.

### VII.3. Generalisability

Generalising the results of qualitative research out from the specific case studied to other situations can be problematic given the small samples used in such research. Generalisation is not necessarily important for qualitative research since cases may be of interest in their own right, regardless of whether the findings can be related to any other situation.<sup>856</sup> Nonetheless, as Seale notes, research is obviously of greater benefit if it can be related to other areas and thus generalisability should be enhanced wherever possible.<sup>857</sup> Generalisability here was improved by ensuring the research sample was as representative of the general utilities sector as possible, see the discussion above in section III. The findings of the research may thus safely be generalised beyond the sample to the general UK utilities sector.

Caution should be used when generalising out further to utilities based in other EU member states, however, given the difference in application of the EU rules throughout the EU. In particular, while the UK has simply adopted the Utilities Directive without significant amendment, many EU member states expand on the directive rules, providing additional regulatory requirements for utilities to meet when procuring. These additional requirements also sometimes include specific requirements relating to the inclusion of CSR issues in procurement, which will have a direct impact on the operation of utilities in this area and may mean the factors identified in relation to the UK utilities are of less significance.

Caution should also be used when generalizing other EU member states given the high number of utilities operating in the private sector in the UK. Utilities operating the public sector are more clearly regulated by the Treaty requirements and also often have parts of their operation covered by the public sector directive, which may impact on their

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<sup>856</sup> Seale, above n.837, at p.107.

<sup>857</sup> *Ibid*, at p.107.

overall procurement practice. They are also often less subject to competitive pressures, which may impact on the use of CSR in procurement (see discussion in Chapter 2 on Corporate Social Responsibility) The research results may thus not reflect the practice of utilities in jurisdictions with a higher proportion of utilities in the public sector.

Equally, Chapter 5 on the EU Legal Regime highlighted the key differences between the utilities and public sector rules, showing that generally the utilities rules are more flexible, though there is less certainty over the correct interpretation of the rules. Many of the options for including CSR issues in procurement which are potentially allowable under the utilities rules are clearly prohibited under the public sector rules. Given this, the results of this research should not be generalised out to companies operating in the public sector.

## **Chapter 9 - Data Analysis**

### **I. Introduction**

This chapter will set out the results of the qualitative interviews and analyse the data in light of the literature review and the issues raised in previous chapters. The findings examine CSR and labour issues first before going on to examine the legal issues relating to the use of such labour policies in procurement. As discussed in Chapter 8, all interviewees have been anonymised and are represented by a code showing the utility sector they operate in; WA for water, EN for energy, TR for transport and PO for postal services. Where a company operates in more than one sector they have been given the code for the sector in which the majority of their business takes place. The chapter attempts to summarise the findings of the data, setting out the numbers of interviewees who agreed on certain topics in order to illustrate the prevalence of a certain view. However, as discussed previously in the methodology chapter the analysis is qualitative and the numbers shown do not represent the result of any statistical analysis. Where appropriate the analysis also includes verbatim quotes from those interviewees who agreed to be quoted.

The chapter begins with an overview of interviewees' views on CSR generally, providing a background for the following sections (Section II). Section III examines the factors which impact upon interviewees' decision over whether or not to include labour policies in procurement, paying particular attention to the impact of the legal regime. Section IV briefly considers the types of labour policy most commonly included. Section V sets out interviewees' opinions of the EU legal regime generally and their thoughts on its impact in this area. The bulk of the chapter is taken up by Section VI, which examines in detail the methods interviewees used to structure labour policies within procurement, reflecting back on the issues identified in Chapter 6. Section VII examines the use of labour policies by interviewees in procurement which is not covered by the Utilities Directive.

The chapter finishes with a discussion of the importance of evidence and monitoring techniques to interviewees and the impact of the EU regime in this area (Section VIII).

## **II. Impressions of CSR**

This section will examine interviewees' views of CSR generally and labour policies particularly. It will first discuss interviewees' opinion of the importance of CSR to their company and how that impacts on their procurement policy before going on to consider interviewees' views of the impact and utility of CSR and labour policies.

### II.1. Importance of CSR to the company

Interviewees were asked to indicate the importance of CSR to their company on a scale.

Table 1 below sets out the results:

<b>Importance of CSR</b>	<b>Number</b>
Essential	1
Very important	16 <sup>858</sup>
Quite important	1
Somewhat important	2
Not important at all	3

It can thus be seen that the most common response was to state that CSR was very important to the company. Interviewees often noted that CSR had become much more important in recent years, consistent with the findings in Chapter 2. The importance given to CSR by interviewees would suggest that the use of CSR policies in procurement was common, but in fact the use of labour policies in procurement was relatively low and often confined to simple requirements such as compliance with UK labour law. This may

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<sup>858</sup>Includes two interviewees who placed their company between essential and very important.

be connected to the emphasis given to environmental issues over labour issues, noted by five interviewees. It may also be that the importance given to CSR generally by the company has not been carried down to the procurement level, with CSR and procurement being seen as separate issues.

So, how important are labour related policies to us in [WA#5]? I would say on the whole, very important, but whether that is replicated in our actual practices, I don't know. In the business, sort of sustainability, environmental practices are all very high on the agenda, often talked about, you know, something that is clearly part of the culture. Important to the directors and the board. But having said that, yeah, it'll probably come out when you look at what we actually do to show that and I'm not sure, perhaps, our actions would agree with our thinking on the subject.<sup>859</sup>

There is also the possibility that, for all the condemnation given by interviewees towards suppliers who treated CSR as a public relations exercise (see below), this was also in play for the utilities:

I'm a bit of cynic when it comes to these things. Because you hear people say, we value these things, and then you look at their award criteria for contracts and it doesn't appear anywhere. So, you say one thing, you do another.<sup>860</sup>

## II.2. Views about CSR

Interviewees often had ideas about CSR and labour policies which affected their use of those policies in procurement. Two such views came up often; (a) that CSR was only really useful when purchasing products rather than works or services; and (b), that CSR was only relevant when purchasing from a developing country.

The argument that CSR and labour policies particularly were more relevant to the purchase of products was the less common of the two ideas, being stated by nine

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<sup>859</sup> WA#5.

<sup>860</sup> WA#6.

interviewees out of twenty-two. Interviewees appeared to associate the notion of labour-related CSR with high profile issues such as child and slave labour and the production of products in sweatshops using such labour. Any requirements which were included in service contracts were generally limited to those services where the pay was likely to be low and dealt mostly with wage related issues. CSR policies going beyond compliance with national law appeared to be mostly restricted to product purchases.

I think if you're in a more kind of manufacturing or retail type background, then I think obviously you've got a more direct link. Given what we buy and where we kind of procure it from, there are areas such as cleaning, for example, cleaning contracts, where we have put some kind of labour policy considerations into the initial tender process, but we don't for example have a detailed policy linked to our CSR.<sup>861</sup>

This belief was also possibly connected to the second preconception in that interviewees noted that most service providers were based in the UK, so requirements for service contracts tended to be limited to compliance with UK law. This notion that CSR issues were only relevant for contracts with countries outside the UK and EU was prevalent amongst interviewees, expressed in some form by eighteen out of the twenty-two interviewees. Prior to the research it was thought that utilities had begun procuring from developing countries regularly but in fact this was rare and all interviewees noted that their suppliers generally came from the UK and the EU. Procurement outside the UK was especially rare in the transport sector, with interviewees in that sector often stating that 90-99% of their procurement went to UK-based suppliers. This meant that CSR was less of a concern than if they operated elsewhere:

The view we have at the moment is our supply chains are mainly restricted to the domestic market and also Western Europe, so there's a belief in the organisation that they're not as relevant as if our supply chains were spreading out to enter

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<sup>861</sup> TR#7.

areas such as the Far East and other parts of the world. So we think at the moment [CSR is] not something that our business sees as a priority.<sup>862</sup>

The eighteen interviewees who felt that CSR was mainly useful for contracts outside the EU believed that UK and EU law set out high standards of labour conditions and were also happy that these were complied with in all EU countries. Ensuring compliance with certain minimum standards was the main concern of interviewees (see further below, Section V), so if the law set out such standards, interviewees felt that examining them again during the procurement process would be unnecessary. Labour policies unrelated to the law which could be used in the UK, for example training and apprenticeship schemes, were rarely considered by interviewees.

### **III. Factors Impacting on the Decision to Include Labour Policies in Procurement**

This section examines the factors which had an impact on interviewees' decisions over whether or not to include labour policies in procurement, in particular the impact of the EU legal regime, if any. The section first considers the factors which led interviewees' to include labour policies. The impact of commercial reasons such as avoiding adverse publicity or gaining new business is first examined. The impact of stakeholder and external pressure on the company to examine labour issues will then be considered before concluding with the impact of moral concerns. The section then examines factors which led interviewees to either not include labour issues at all or to limit their use. This section considers the impact of the legal regime, cost issues, belief that CSR and labour issues were not relevant and lack of knowledge about the use of CSR and labour issues in procurement.

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<sup>862</sup> TR#2.

### III.1. Factors leading to the adoption of labour policies in procurement

#### *III.1.1. Commercial Reasons*

When asked whether their decision to include labour policies in procurement had been influenced by the desire for commercial gain of any kind<sup>863</sup>, almost all interviewees denied this. Only two interviewees out of the total twenty-two answered the question in the affirmative, expressly stating that commercial concerns had been a factor in their decision to include labour policies in procurement.<sup>864</sup> For both companies the main desire was to portray the company as “responsible”, creating a brand image of sustainability for the company (see further below in ‘Adverse Publicity’). WA#5 argued that a commercial element to labour and environmental policies was ultimately a benefit for those policies, since it improved a company’s commitment to them:

It was a commercial, there was a commercial angle to it, yeah. I think that's probably not a bad thing, I think if there's a commercial angle then we're probably more likely to keep up on some of the authorities as well, otherwise it's almost a bit more difficult to sustain.

Generally, however, admitting to commercial reasons for labour policies was rare, with most interviewees emphasising moral reasons for the adoption of CSR policies in their company. Despite this disavowal of commercial concerns, many companies mentioned factors which could be seen as commercial when discussing the reasons for their use of labour policies when answering other questions in the interview. The most prominent factors mentioned by these interviewees were avoiding adverse publicity, improving the quality of suppliers’ performance, and gaining new business, all of which will be discussed in more detail below. The other factors discussed as influences below in ‘External Pressures’ and ‘Internal Pressures’ may also have commercial aspects, for example, aiming to get better performance from employees by acting on their CSR

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<sup>863</sup> See discussion of the possible commercial benefits of CSR in Chapter 2, Section III.1.

<sup>864</sup> PO#1 and WA#6.

concerns, but no interviewees discussed this side, preferring to focus on moral obligations.

- Adverse Publicity

The fear of adverse publicity should the company not check its labour standards was the most common reason given for including labour policies in procurement, mentioned as a key factor by fifteen interviewees. The commercial impact of adverse publicity on private companies appears to have had an impact on the operation of the utility sector, with three companies expressly mentioning the high-profile campaigns against Primark and Nike as examples of situations they wished to avoid.<sup>865</sup>

For those companies which had built up a reputation based on sustainability, the discussion of adverse publicity was often couched in the terms of "brand management". For other firms, the issue was simply, as WA#4 phrased it, "avoidance of disaster". In both cases the concerns were fundamentally the same – avoiding stories about the company in the newspapers:

A: I think the threat of not doing it [CSR] is fairly severe now. You don't want to be on the front of the newspaper, ah...

B: For anything, really.

C: It's never going to be a good news story. It's not good PR.<sup>866</sup>

The risk of adverse publicity was the main risk considered not only when a company was determining whether or not to include labour policies in procurement generally, but also when deciding whether certain types of labour policies should be included and which particular contracts should include labour policies.<sup>867</sup> The higher the risk of poor labour standards being discovered in the supply chain and the more high-profile those risks were (child labour was the main fear, see Types of Labour Policy), the more likely labour

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<sup>865</sup>WA#4, WA#7 and TR#4.

<sup>866</sup>TR#5.

<sup>867</sup>See further below in Section VI, Structure of Labour Policies in Procurement.

would be covered in the procurement beyond the national law level. One company referred to this as "the Daily Mail test":

[Our company] did things like the Daily Mail test which was, so, are we going to be on the front page of the Daily Mail with some horrendous five year Bangladesh boy making our CEO's fleece or something like that, his hard hat or something. So we ask ourselves those kinds of questions, what are we going to be at risk of?<sup>868</sup>

- Quality of suppliers' performance

Five interviewees noted that including strong labour policies in procurement had the added benefit of ensuring the company was working with a reliable supplier. It was argued that poor labour standards led to a high turnover of staff and "a disgruntled staff", which in turn led to poor performance on the part of the supplier.<sup>869</sup> There was a strong belief that if a company wanted to ensure that it got high quality goods or services from a supplier, checking to ensure that company had good labour standards was a key step in the process. Overall it was felt that the procuring company would simply have a better working relationship with a company which looked after its staff:

We do believe that things that are produced in better working conditions will be better items, such as uniforms. We do believe we'll get better products if the conditions in which they're being produced are better, are good. And we do, the board, it's hard to quantify these things but there is a broad understanding that suppliers that look at these sorts of things are probably better suppliers, they're focusing on customer services, we're probably going to have a better interaction with them all along the way.<sup>870</sup>

Connected to these arguments was the issue of security of supply. Four interviewees noted that they would be uncertain about the reliability and long term prospects of a

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<sup>868</sup> EN#4.

<sup>869</sup> TR#3.

<sup>870</sup> TR#8.

supplier with poor labour standards.<sup>871</sup> Firms with low labour standards were generally seen as less financially stable by procuring companies and there was a sense of fear that contracting with such a company would simply lead to the company collapsing part way through the contract.

- CSR useful for gaining new business

Finally, four interviewees noted that bidding for work in the private sector had had an impact on the inclusion of labour policies in their procurement.<sup>872</sup> It was noted that many private sector bodies examined supply chain issues in their own procurement and in order to win business from those companies, companies in the utility sector had to ensure they could meet all the requirements. It was also noted that going beyond requirements set by the private sector body and/or having higher standards on CSR issues than competitors was seen as a benefit when attempting to win new business, and this in turn impacted on the inclusion of labour policies in the utility's procurement.

### *III.1.2. External Pressure*

Interviewees were asked about the impact of consumers, investors and employees on their decision to look at CSR issues, following Vogel's identification of these three groups as the main drivers of the CSR movement.<sup>873</sup> The impact of consumers and investors is discussed in this section and the impact of employees in the following section on internal pressures. Three interviewees also identified pressure from the government as an additional pressure leading to the adoption of CSR policies and this is also discussed below. Overall, as with commercial issues, interviewees were keen to declare external pressure as secondary to moral reasons for adopting CSR policies.

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<sup>871</sup> WA#6, TR#3, TR#8, and PO#1.

<sup>872</sup> TR#3, TR#5, PO#1, EN#4.

<sup>873</sup> Vogel, D. *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (2005, Washington DC: Brookings Institution Press), at p.46. See also Chapter 2, Section III.

- Consumer

Only four interviewees felt that consumer demand had an impact on their decision to include labour policies in procurement.<sup>874</sup> Of these four, two felt that pressure from individual consumers had influenced their company, noting that CSR was becoming much more of a public concern and feeling that their company had to react to that concern.<sup>875</sup> The other two interviewees stated that the pressure came much more from corporate consumers:

It's more the large commercial consumers like the banks or the bigger companies who are working through their own CSR policies, and if we want to win business from them then we need to be better in that area than people like [competitor name]. So, they'll sometimes want to sit down with us and talk about CSR issues. But the average individual consumer isn't really that concerned.<sup>876</sup>

The majority of interviewees, however, stated that they had felt no pressure from consumers at all, whether individual or corporate, stating that the push towards the use of labour policies came from within the company rather than outside. Three interviewees were openly dubious about the actual commitment of consumers to CSR.<sup>877</sup> There was a belief amongst these interviewees that the main driving concern of consumers was simply the price of the product and any CSR policies completed by the company would always come second to that:

I've never seen much demand from consumers, they seem to just want low prices more than anything. I mean, you hear people talking about how they want decent labour standards but I don't think they actually act on that when it comes down to it.<sup>878</sup>

Overall, consumer demand appears to have had a low impact on the use of labour

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<sup>874</sup> PO#1, EN#4, WA#5, TR#9.

<sup>875</sup> EN#4 and WA#5.

<sup>876</sup> PO#1.

<sup>877</sup> EN#3, WA#3, TR#3.

<sup>878</sup> WA#3.

policies in procurement by utilities.

- Investor

Investors appear to have had even less of an impact than consumers on the use of labour policies. Only two companies stated that investors had had any impact at all on their decision to include labour policies in procurement.<sup>879</sup> One company noted that after a takeover by a company with a much higher concern for CSR issues, they had felt pressure from the shareholders (and the new board, see below in Corporate (Board and Parent Company) Influence) to improve the CSR policy in their company in order to meet the standards of the rest of the corporate group. The other company noted that some potential investors did look at CSR issues, though the impact of that on the actual decision to invest was low:

We did have, we did get a lot of enquiries from potential investors, which was more about requesting information rather than we believe you're unsustainable therefore we're not going to invest, it was more requests for information.<sup>880</sup>

Overall, then, pressure felt from investors was rare and had little impact generally on a company's decision to look at CSR.

- Government/Public Funding

Three interviewees (two public sector bodies and one private sector body heavily subsidised by public funds) identified pressure from the government and a feeling of responsibility from receiving public funding as a factor in adopting labour policies within their company.<sup>881</sup> Interviewees noted that their actions reflected on the government as a whole and because of this they felt a responsibility to ensure that their labour standards were acceptable. There was also a general feeling that the government would take action against a company should poor labour standards be discovered, though the interviewees were unspecific as to what action that would be in any detail.

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<sup>879</sup> TR#5 and EN#4.

<sup>880</sup> EN#4.

<sup>881</sup> PO#1, TR#1, TR#8.

### *III.1.3. Internal Pressures*

This section discusses influences on the decision over whether or not to include CSR issues in procurement which came from within the company itself. In addition to the influence of employees, identified by Vogel as a key influence (see above), the section also discusses the impact of a company's board of directors and/or parent company, identified by 8 interviewees as a driving force for CSR issues. These factors generally did not impact upon the procuring officer directly, but determined the company's overall CSR policy, which in turn impacted on the procurement decision.

- Employees

Six interviewees agreed that employees had had an impact on the labour policy within their company. Interviewees noted that general interest in CSR issues had increased throughout their staff over recent years and some committed individuals attempted to improve the company's policy on these issues:

We also had an employee base who said that they didn't particularly think that the company treated, didn't particularly think that we behaved responsibly, meaning sustainably.<sup>882</sup>

[W]e do get pressure from our staff on issues like recycling, on issues like waste, on issues like fair trade products, the whole gamut really, they're interested and we want to engage with them as well.<sup>883</sup>

In addition to the impact of individual employees, three interviewees noted the impact of trade unions on including labour policies in procurement, stating that there had been pressure from their employees' unions to check labour standards through their supply chain and ensure there had been no exploitation of workers at any point.<sup>884</sup> One company also noted that CSR policies provided a useful area on which the company could work with the union, aiding relations between the two:

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<sup>882</sup> EN#4.

<sup>883</sup> TR#9.

<sup>884</sup> PO#1, EN#3, TR#9.

CSR is an issue that the management and the union can work together on. It helps to strengthen the stakeholder influence in the company, which is important to us.<sup>885</sup>

Of the three main possible drivers identified during the previous literature review, then, employee pressure appears to be the factor which has had the most impact.

- Corporate (Board and Parent Company) Influence

Ten interviewees felt that the push to include CSR policies in procurement had come primarily from higher up in the company structure. Often interviewees admitted that they were unsure as to the precise reasoning behind the decision to push CSR, though four interviewees felt that it was driven by a personal commitment on the part of their CEO or other board members to CSR (see further below, in Moral Reasons).<sup>886</sup> Interviewees generally emphasised that the decision to include CSR policies throughout the company was a purely internal decision:

Well, we have a very strong CEO, the CEO is very connected to sustainability, so it came from internal.<sup>887</sup>

Three companies also noted the influence of their parent companies.<sup>888</sup> In two of those cases the push towards CSR followed a corporate takeover by a company with a stronger commitment to CSR, which then imposed its values on its new subsidiary. In the third case, a decision was taken by the parent company to join the UN Global Compact and this decision was then imposed on all subsidiary companies.<sup>889</sup>

#### *III.1.4. Moral Reasons*

Moral and ethical reasons for undertaking labour policies were the most commonly given by the interviewees, with seventeen citing moral reasons as a factor in their decision. Interviewees emphasised that labour policies were included in procurement because "it

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<sup>885</sup> PO#1.

<sup>886</sup> TR#1, TR#3, TR#8, EN#4.

<sup>887</sup> EN#4.

<sup>888</sup> WA#5, EN#2, TR#5.

<sup>889</sup> See Chapter 3 for discussion of the UN Global Compact.

was the right thing to do<sup>890</sup> and seemed to be based simply on a feeling that something was ethical rather than any detailed consideration of the reasons behind CSR policies:

I was the one who pushed for labour concerns – I just felt it was something we had to do.<sup>891</sup>

Just wanting to do it, really. Just believing it's the right thing to do.<sup>892</sup>

Interviewees often appeared to feel a sense of duty to be socially and environmentally aware. There seemed to be a general notion that looking at CSR issues was a key part of being a “responsible company”. In the particular area of labour policies, this feeling of responsibility was particularly strong when it came to health and safety policies with interviewees wanting to ensure that workers were as safe as possible:

[W]e feel we have a duty of care to our contractors to ensure that the staff are at least given the minimum protection that legislation requires.<sup>893</sup>

People's lives are at stake so we have a duty to do as much as we can.<sup>894</sup>

Two interviewees also mentioned a desire to give something back to the local community that they were based in.<sup>895</sup> One noted that the local community had to pay the utility for their service since they had a monopoly in that area and argued that this imposed on them a duty to help that community as much as they could. The other noted the deprived area they were based in and argued that it was the responsibility of the company as one of the few employers and purchasers in the area to improve the conditions of the people there. In both cases, this led not only to the general desire to look at labour issues, but also the interviewees stated their desire to favour the use of local labour (see further below, in ‘Local labour policies’).

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<sup>890</sup> TR#1.

<sup>891</sup> WA#4.

<sup>892</sup> TR#8.

<sup>893</sup> TR#2

<sup>894</sup> EN#3.

<sup>895</sup> TR#7 and WA#6.

### III.2. Factors leading to not including labour policies in procurement

#### *II.2.1. Impact of the EU Legal Regime*

One of the main aims of this thesis is to determine the extent to which the EU Directives influenced the use of labour policies. In line with this, one of the questions in the interview guide related to the impact of the legal regime, if any, on the decision to include labour policies in procurement. The responses showed that the legal regime had relatively little impact, with only five interviewees out of twenty-two stating the EU rules had had an impact on their decision.<sup>896</sup> The remaining interviewees had either not considered the rules at all or decided that they would have no impact on the use of labour policies in procurement.

Of the five interviewees who considered the EU law, all ultimately decided that labour policies could be completed legally under the regime, though the considerations influenced the precise manner in which those labour policies were included in procurement. All five examined the legal requirements in detail before choosing the method which they felt was the least open to legal challenge (though it is notable that the actual methods chosen varied widely, ranging from contract conditions demanding compliance simply with national law to prequalification standards on a range of labour issues, see further below in Structure of Labour Policies in Procurement). Crucially, however, the EU legal regime does not appear to have acted as a deterrent to including labour policies in procurement at all. The concern was simply how best to integrate labour concerns into procurement:

We went over it quite carefully with our legal team ... I mean, the risk that it might not be relevant to the subject matter of the contract is our big issue. The risk obviously being that we do something that might not be legal, we get a challenge and the challenge is upheld. So, it's whether the relevant processes

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<sup>896</sup> TR#3, TR#6, TR#8, PO#1, EN#4.

actually cover that and it's very difficult, it's actually probably more difficult in this area than any other areas of sustainability.<sup>897</sup>

The remaining interviewees, who either did not consider the EU rules at all or felt that they would pose no problem to labour issues generally simply assumed that labour issues were legal within the EU procurement directives without considering the actual directives in any detail. This appears to be linked with the common view amongst interviewees that the EU law required nothing more than a competitive procedure with publication (see further below in Section V):

A: I don't think we consulted the EU rules. We put in there something that we considered to be compliant, but do they reflect the EU rules, the answer, to be honest...

B: I think it's just common sense though, isn't it?<sup>898</sup>

Overall then, the EU legal regime appears to have had a minimal impact on interviewees' decisions over whether or not to include labour policies in procurement, with only a minority considering the EU rules at all and no interviewees ultimately being deterred from using labour policies completely due to those EU rules.

### *III.2.2. Cost and Resource Issues*

One of the main reasons given by interviewees for either not including labour policies in procurement at all or for limiting the use of labour policies in some way was cost and resource issues, with ten interviewees citing such issues as a factor. Contrary to the arguments that CSR improves a company's profitability as set out previously in Chapter 2, most interviewees believed that CSR issues would generally increase cost to a company and would not bring in economic benefit (see further above, section II):

You tend not to benefit commercially if you do buy ethically. It tends to be you spend more if you buy ethically and that's something that our business is

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<sup>897</sup> TR#8.

<sup>898</sup> TR#5.

reluctant to ever agree on, what price do you pay for more sustainable ethically procured goods, and there is no answer forthcoming, you know?<sup>899</sup>

Interviewees noted that, generally speaking, economic issues would win out against CSR issues in their company, limiting the use of labour policies. Connected to this, four interviewees noted the impact of the recent recession, arguing that the general economic climate in the UK in recent years had increased the importance of cost as compared to CSR issues:

I think it's just our priorities at the moment, I think that with the recession ... they have targets that were set before the recession really hit and those targets haven't been met. Right now the biggest challenge is to achieve some more investment, you know, returns basically. The problem for us is that CSR doesn't really pay, to be honest.<sup>900</sup>

Cost and resource issues also had a major impact on the choice of method for including labour policies in procurement, as well as on the evidence and monitoring completed to check suppliers' compliance with those policies. This impact will be discussed in more detail in those sections below.

### *III.2.3. Belief that CSR is irrelevant in a certain area*

The most common reason given by interviewees for not including labour policies, whether in certain cases or more generally, was that they did not believe that CSR was relevant. This was linked strongly to the two ideas about CSR discussed above in Section II, that CSR was only useful when purchasing products and/or when operating outside the EU.

Ten interviewees indicated that they did not include labour policies in their procurement because they did not feel that labour policies were necessary or relevant in a certain type of contract, most often because the contract did not contain any product purchases.

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<sup>899</sup> WA#5.

<sup>900</sup> TR#4.

Eighteen interviewees also indicated that they either did not include labour policies at all in procurement or limited their use due to a belief that such policies were only relevant where the contract was performed outside the EU and such contracts were very uncommon in the company. These beliefs were discussed in more detail in Section II.

#### *III.2.4. External Pressure*

While rare, some interviewees mentioned influences from sources external to their company being a factor towards not including labour policies in procurement. The two factors highlighted were the dislike of CSR policies by some suppliers and, unique to the water sector, the impact of the sector regulator.

- Suppliers

Three interviewees mentioned that they were cautious about including labour policies in procurement for fear of how their suppliers would react to such policies, believing that suppliers would react poorly to being evaluated on labour issues.<sup>901</sup> Interviewees were also afraid that competition might drop badly if they either rejected suppliers based on labour issues or the suppliers themselves chose to leave due to dissatisfaction with the use of labour policies:

There's also a fear that competition will drop if we include ethical conditions – we don't have many suppliers as it is and we don't want to lose any. Given how suspicious they seem of ethical issues, if we include them they might just walk.<sup>902</sup>

- Regulator

Two interviewees in the water sector felt that OFWAT's regulation of the sector required them to take a purely economic approach to procurement and limited their possible use of labour policies.<sup>903</sup> They argued that the five year funding periods led to a short term view which did not lend itself to examining labour and wider CSR issues. It was also

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<sup>901</sup> EN#1, WA#4, TR#8.

<sup>902</sup> WA#4.

<sup>903</sup> WA#1, WA#4.

noted that OFWAT could directly lower a company's prices and when this was done, it had a direct impact on the company's procurement, driving emphasis towards price over sustainability issues.

### *III.2.5. Lack of Awareness of CSR*

Five interviewees stated that the main reason that labour policies were not used, or were not used in a certain area, was simply because the idea of including labour issues had never occurred to them.<sup>904</sup> General awareness of CSR was usually low and, even where the concept of CSR was familiar, there was little awareness of how CSR could be used in procurement:

So [CSR is] sort of, it's on the radar in the background, but it's never really translated into a more clear structured policy. So, it's a principle, accepted, but how it manifests itself, it's difficult to say, it's not, it's not been developed to that extent.<sup>905</sup>

### III.3. Conclusions: Impact of the legal regime

Overall, the legal regime appears to have had no real impact on a company's decision on whether or not to include labour policies in procurement, with only five interviewees feeling that the legal regime was relevant to their decision. Instead, the main reason for including such policies was a feeling of moral obligation and the main reason for not including labour policies being a belief that they were simply irrelevant.

## **IV. Types of Labour Policies**

### IV.1. Types of labour policy included in procurement

Those interviewees who had stated that they included any labour policies in procurement, however regularly, were asked to indicate whether or not they considered the eight forms of labour policy set out below, along with being asked to indicate any

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<sup>904</sup> TR#1, TR#7, WA#2, WA#6, EN#5.

<sup>905</sup> WA#6.

labour issues they considered which were not mentioned. In total, twenty interviewees answered this question. Interviewees were mixed between relying on national law to guide their decision, relying on external labour codes and taking the decision independently. The sections below examine the types of policy chosen and the reasons behind that choice, with emphasis on the impact of the EU legal regime. This is followed by an examination of the impact of national law and external labour codes on the decision over which types of labour policy to include.

#### *IV.1.1. Prohibition of Child Labour*

Twelve interviewees stated that they had included prohibition of child labour as a requirement in previous contracts, though five of those interviewees stated this was not a common policy to include and was covered only where there was felt to be a particular risk of the use of child labour. These interviewees emphasised that the majority of their procurement was completed within the UK where child labour was prohibited under law and there was thus no need to examine it in detail in procurement.

No interviewees felt that there could be any issues under EU law preventing policies prohibiting child labour generally, though interviewees made clear that the policy was limited to preventing child labour – there were no auxiliary measures included in the contract designed to aid the children since interviewees noted that this might be legally unsound (see below in Methods of structuring labour policies in procurement). Three interviewees expressed dissatisfaction with this, noting that often child labour was relied upon by families in developing countries and simple prohibition might not be the best approach to take.<sup>906</sup>

#### *IV.1.2. Prohibition of Forced Labour*

Eight interviewees mentioned that they included prohibition of forced labour in their procurement though, as with child labour above, this was generally limited to specific contracts where there was felt to be a specific risk of forced labour (generally those

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<sup>906</sup> TR#4, TR#5, WA#7.

contracts which were performed outside of the EU). No interviewees felt there could be any legal restrictions over including prohibition of forced labour in procurement.

#### *IV.1.3. Prohibition of Discrimination*

Nine interviewees stated that they included prohibition of discrimination in their procurement, though two of these stated that discrimination was not covered separately but was simply covered because their contracts required compliance with national law, thus leaving discrimination uncovered in cases where the contract was performed in a country with no or minimal discrimination law. Again, no interviewees mentioned any concerns over compliance with EU law when considering prohibition of discrimination.

#### *IV.1.4. Minimum Wage Rates*

Eleven interviewees included some consideration of minimum wage rates in their procurement. For nine interviewees, a requirement to comply with minimum wage rates was made explicit but for two interviewees, the requirement was generally implicit in a requirement to comply generally with national law and only made explicit in cases where it was felt that there was a specific risk of noncompliance. In all cases this was limited to the minimum wage rate applicable in the country in which the contract would be performed; no companies set their own wage rates to require anything higher. Often this was linked to a belief that it was their suppliers' right to set the wage rates for their own employees.

#### *IV.1.5. Maximum Working Hours*

Nine interviewees stated that they considered the issue of maximum working hours in their procurement. As with minimum wage rates, discussed above, this was in all cases limited to compliance with the relevant national law. In two cases the condition was simply implicit in a general requirement to comply with all relevant national law.

#### *IV.1.6. Health and Safety Policies*

Health and safety policies were the most commonly included labour policy, with seventeen interviewees including such policies in procurement. In all cases the interviewees stated that they went beyond health and safety issues required by national law, setting out detailed standards to be complied with. Interviewees noted that the utility sector required a lot of engineering work to be completed, often working on dangerous areas such as on railway tracks or electricity pylons and, given this, health and safety was a key priority. Health and safety policies included in procurement were often very extensive, including issues such as intensive staff training on health and safety issues and drugs and alcohol tests for workers. In no cases did any interviewees feel there could be any issue with including these policies under EU procurement law.

#### *IV.1.7. Skills Training for Employees*

Nine interviewees stated that they included requirements relating to skills training for employees in their procurement. These skills training programmes not only include the health and safety training mentioned in the previous section, but also issues such as looking at whether suppliers provide apprenticeship schemes and basic literacy and numeracy training for unskilled service providers. For non-health and safety related skills training, interviewees noted the commercial benefit of skills training improving the attitude of staff and also resulting in a lower staff turnover.

#### *IV.1.8. Local Labour Policies*

Favouring local labour is recommended in most international labour codes, helping to improve both the skills of the local workforce and the local economy.<sup>907</sup> As was noted previously in Section III.1.2.1, Chapter 6, this may result in three situations: (1) favouring local labour in the home member state (the UK in this case); (2) favouring local labour in another EU member state and; (3) favouring local labour in a non-EU state. Of these three scenarios, favouring local labour in the home state is the highest risk, being clearly unlawful following the *Storebaelt* case, but it seems likely that all

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<sup>907</sup> See further Chapter 3.

three scenarios breach the free movement rules of the TFEU.<sup>908</sup>

Recruitment of local labour was the area in which the impact of the EU legal regime could be seen most. Only three interviewees admitted to favouring local labour in procurement, but the issue of favouring local labour and the EU restrictions relating to that were discussed in a further seventeen interviews.<sup>909</sup> For those three interviewees who stated they had favoured local labour, the preferred method was to require a local office and management, which would generally lead to local recruitment, but one interviewee stated that on occasion they had also favoured local suppliers in the prequalification questionnaire (see further below in Structure of Labour Policies in Procurement). None of the three interviewees who included local labour policies felt that there could be any issue with including such policies under EU law and thought that their actions were perfectly lawful.

The majority of interviewees, however, stated that such policies could be considered unlawful under the EU rules. Of those seventeen interviewees who discussed local labour policies but did not include such policies in their procurement, only three stated the EU law had not been a factor in their decision not to include local labour policies. For these interviewees, policies favouring local labour worked counter to the market forces which generally decide where labour comes from and were unnecessary. The remaining fourteen interviewees felt that the EU legal regime had been the main factor in the decision not to include such policies. Interviewees noted that, under EU law policies favouring the use of local labour were seen as discriminatory and thus unlawful, which led to a much higher chance of legal challenge than for any other labour policy:

Local labour's an interesting one because we do consider it but often through kind of an EU procurement route. It's ... how do you have that as a criteria when, you know, it could be seen as a discriminatory criteria under the procurement regs?<sup>910</sup>

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<sup>908</sup>Case C-243/89, *Commission v Denmark* [1993] ECR I-3353 ("Storebaelt").

<sup>909</sup>The three interviewees who favoured local labour were WA#6, WA#7 and TR#1.

<sup>910</sup>TR#7.

Interviewees were generally in favour of the inclusion of local labour policies and discussion of such policies was the area in which the EU legal regime was criticised the most (see further below, Impressions of the EU legal regime). Interviewees noted that favouring local labour would be a useful method for regenerating the areas in which they were based, important given that interviewees often also felt a duty to repay their customers in some way (see above, Factors leading to the adoption of labour policies). Interviewees also noted commercial benefits of using local labour, including faster response times and a generally better relationship with a supplier based close by. There may also be an element of public pressure involved when considering local labour; one interviewee mentioned the Lindsey Refinery incident of 2009, noting the negative public reaction which resulted in that case to the use of foreign labour.<sup>911</sup> Overall, interviewees indicated that, were the EU law not so restrictive in this area, they would prefer to favour local labour in their contracts to some extent:

[W]e wouldn't want to be too parochial, you know, we wouldn't want to sort of cut ourselves off and become an island state, we certainly can see the benefit of working with a large amount of suppliers over a national and international level, but there's no doubt if the law allowed us to even put a quota or a proportion amount [for local labour], we would certainly do it.<sup>912</sup>

The majority of interviewees stated that they did not include any policies related to local labour at all due to the EU restrictions. Two interviewees stated that they considered response times when looking at service contracts, noting that this might be considered indirect favouring of local labour and expressing uncertainty over the legality of such actions under EU law.<sup>913</sup> One interviewee turned to non-legally binding methods of aiding local labour, talking to suppliers awarded contracts about the possibility of advertising

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<sup>911</sup> EN#1. For further discussion of the Lindsey Refinery protests and their possible implication for the EU public procurement regime, see Barnard, C. "British Jobs for British Workers": The Lindsey Oil Refinery dispute and the future of local labour clauses in an integrated EU market' (2009) 38(3) *Industrial Law Journal* 245.

<sup>912</sup> TR#8.

<sup>913</sup> WA#2 and WA#5.

work in local newspapers and working with local colleges, without any policies actually being required to be completed by the supplier.<sup>914</sup>

The focus amongst interviewees was on favouring local labour within the home state, with both the interviewees who had actually favoured labour and those who had considered doing so referring to favouring labour in the area of the UK in which they were based. Consistent with the identification of this approach as the highest risk, the majority of interviewees stated that they did not include conditions favouring local UK labour in their contracts due to the legal restrictions.

No interviewees stated that they favoured local labour in any contracts which were performed outside the UK. This included interviewees who used external labour codes to inform their labour policies, who generally edited the code so as to ensure compliance with EU law (see above, External Labour Codes). This appears to be due to a mixture of factors. Firstly, most interviewees stated that they had very few contracts which were performed abroad, meaning that this issue had not had to be considered. Secondly, as with recruitment of UK labour, interviewees felt it was clearly contrary to EU law. Interviewees did not appear to feel the same pressure to recruit locally abroad as they did when the contract was performed in the UK, giving rise to less pressure to defy the EU rules.

Overall, it appears that recruitment of local labour is an area which utilities generally regard as important and is a policy which the majority of utilities wish to implement. Equally, it is the area in which the EU legal regime has had the most impact, heavily restricting the use of such policies.

#### IV.2. The impact of national law

As can be seen in the discussion of the types of labour policy included in procurement above, many interviewees focused on the requirements of UK national law to guide their labour policies. This was especially true for eight interviewees who noted that ensuring

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<sup>914</sup> TR#8.

compliance with UK national law was their main aim when looking at labour issues in procurement. The main concerns were compliance with minimum wage requirements, the Working Time Regulations 1998<sup>915</sup>, the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE)<sup>916</sup> and immigration law. Interviewees emphasised the cost risk associated with non-compliance with these laws and thus focus on compliance was part of a commercial decision. In every case, these eight interviewees noted that the vast majority of their contracts were concluded with UK based suppliers, making UK law the natural focus. There may also be a link here with the common belief that CSR policies are generally only relevant when dealing with suppliers outside the EU (see above, Section II).

#### IV.3. Use of external labour codes

Reliance on external labour codes was low, with only four interviewees using external labour codes to guide their decision over which labour policies they would include in procurement.<sup>917</sup> Of these, one used the UN Global Compact, one the ETI Base Code, one the ILO Tripartite Declaration and finally, one relied on the CIPS CSR principles.<sup>918</sup> A further three interviewees stated that they were members of the UN Global Compact and that this had influenced their general approach to CSR but had not directly impacted on their decision over which types of labour policy to include in procurement.

The four interviewees who did use external labour codes relied heavily on those codes, generally looking only at the labour issues included in that code without expanding on those requirements in any way. Two of the interviewees (those using the ETI Base Code and the ILO Principles) noted that the codes had been edited slightly to ensure compliance with the EU legal regime, though they emphasised that the changes were minimal. Notably, both the ETI Base Code and the ILO Principles require favouring local

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<sup>915</sup> SI 1998 No. 1833.

<sup>916</sup> SI 2006 No. 246.

<sup>917</sup> See further Chapter 3 for discussion of these external labour codes.

<sup>918</sup> EN#2, TR#8, WA#4 and WA#1, respectively.

labour and this requirement was not included by either interviewee (see discussion of local labour above).

#### IV.4. Conclusions: Impact of the legal regime

Overall the EU legal regime appears to have had minimal impact on the types of labour policy chosen, with most interviewees choosing to focus on compliance with national UK law. The EU procurement directives were generally seen as not limiting the types of policy which could be included in any way. The major exception to this was the use of policies favouring local labour, which were generally viewed favourably by interviewees but used in only a minority of cases due to the restrictions under EU law.

### **V. The EU Legal Regime**

This section examines interviewees' general views of, and compliance with, the requirements under the Utilities Directive relating to labour policies, providing the background for a more detailed discussion of the use of various methods of including labour policies in the following section. The section will first briefly consider interviewees' impressions of the EU regime and their knowledge of the requirements of the law in this area. It will then go on to look at interviewees' overall view of the impact of the EU legal regime on the use of labour policies in procurement and whether the right balance has been met in the law, looking in detail at interviewees' opinions on the clarity of the law and how it could be improved. The section will conclude with a look at compliance with the directive and whether interviewees have felt the need to evade the requirements of the directive in any way and, if so, why.

#### V.1. General impressions of the EU regime and awareness of the law

Interviewees' knowledge of the requirements of the Utilities Directive was generally fairly low. There was a sense that the directive required that a procurement be fair and open but relatively little knowledge of the specific requirements of the directive. Often this was simply because the possibility of completing a labour policy via a certain method in

procurement had never been thought of by an interviewee and thus they had had no reason to consider the legality of that method. There was also a strong belief on the part of a minority of interviewees that the EU Utilities Directive did not require anything more than an open competitive procedure and labour policies would be lawful so long as they were compatible with that:

What the EU is concerned with, what the directives are trying to do is ensure you have effective competition and you have clearly identified criteria for award and award on those criteria. That is what it's saying. ... obviously you can interpret it as you like but I'm just reading what the EU procurement law says and as far as I'm concerned that's just fair competition and evaluation criteria.<sup>919</sup>

Awareness of the law was lowest when discussing the requirements applicable under the Treaty (see below, section VIII). However, it is reasonable that knowledge would be low in this area given the lack of clarity over whether or not the Treaty provisions apply to private sector bodies or not and so a lower level of knowledge was anticipated here. Interviewees appeared to feel most confident discussing the legality of local labour policy, an area where the law seems to be clearer and which also appears to be an area of high importance to interviewees.

Overall, interviewees were positive about the EU legal regime both in the specific area of labour policies and more widely, with fifteen interviewees out of twenty-two stating that they supported the regime. Interviewees felt that the EU requirements ensured that procurement was as competitive as possible, including a wide range of suppliers from various countries.

B: I think the EU regulations are, yeah, no problem. There's a lot of people think that, that aren't in procurement think that it's there to slow the process down and I think the complete reverse.

A: It gives you a far bigger negotiating arm and it gives you a far bigger

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<sup>919</sup> EN#2.

competition, which is always good.<sup>920</sup>

Interviewees also liked the clear structure provided by the EU regime, which aided them in planning procurement so that the appropriate issues were considered and applied in a clear and consistent manner. Interviewees generally felt also that the EU regime provided the appropriate amount of flexibility in procurement, allowing the utility the freedom to consider issues important to that company (including CSR), whilst still maintaining the clear structure interviewees wanted:

I think it's pretty reasonable, at least in the utilities sector. This sector has quite a bit of flexibility, especially with negotiation, which is very useful. I've looked at the rules that the public sector have to follow and I don't think they'd let you get the best deal, to be honest, but we don't have that problem in the utilities sector.<sup>921</sup>

Consistent with the finding above that the majority of interviewees were happy with the EU regime, the majority of interviewees felt that the legal regime had no real negative impact on the use of labour policies in procurement. Only seven interviewees out of the total twenty-two stated that, overall, they considered the EU legal regime to be too restrictive in relation to labour policies. These interviewees were generally those who had spent the most time considering the potential legal issues relating to labour policies in procurement and/or had attempted the most wide-reaching labour policies, suggesting that the legal regime limits the use of more ambitious labour policies. Notably this group also included all the interviewees from utilities operating in the public sector, who were also subject to the more restrictive Public Sector Directive for some of their procurement.

The remaining interviewees felt that while there were negative aspects of the EU regime relating to the use of labour policies, they were minor and outweighed by the other benefits of the regime. Interviewees generally emphasised that they felt that CSR was

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<sup>920</sup> TR#5.

<sup>921</sup> WA#3

the company's responsibility and an issue separate from the EU regime, which had little impact and, indeed, should have little impact upon the use of such policies:

I think what we would say is that it's our responsibility to balance all these matters and the EC regime gives us the flexibility to do that, but it isn't the driving factor and the reason why we do it.<sup>922</sup>

Well, I've never seen it as a barrier to be able to look at CSR. It, you know, I would say a lot about the EU process but actually sort of prohibiting you from looking at CSR is not one of them. I've never really considered that it stops you from doing that.<sup>923</sup>

One of the main criticisms of the EU legal regime from all the interviewees was the inability to consider local labour issues in procurement (see discussion above, section IV). The other main criticism, noted by nine of the interviewees, was the lack of clarity over what precisely could be included in procurement:

It both makes it hard to include CSR and also it's not clear how much can and can't be included. There must be a better way to enforce the spirit of the EU and fair trade across the whole union with, as I see it, a massively increasing [desire] across countries to implement CSR more and more.<sup>924</sup>

Interviewees noted that the possibility of including labour and other CSR issues in procurement did not seem to have been envisaged by the directive, making it hard to fit such issues in whilst complying with the rules. One interviewee in particular noted that CSR was considered an economic issue in their company and the directive made an "artificial distinction" between economic and social policies which was not practical and hard to understand.

As a result of this lack of clarity, guidance and advice on the law from external sources was key, with interviewees noting that they generally relied on consultants outside the

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<sup>922</sup> TR#9

<sup>923</sup> WA#5

<sup>924</sup> TR#8.

utility such as Achilles Information Ltd to answer queries on the law and to keep them up to date. A few interviewees (mostly the larger utilities and utilities in the public sector) had their own legal team which sent guidance on the directives to the procurement team. More general guidance such as that produced by the European Commission and the OGC was also relied upon. Interviewees were often dissatisfied with the level and quality of guidance available however, with eight interviewees stating a desire for better guidance in this area.

[W]e're not helped because a) there's a lack of clarity in the actual regulations, b) we've got our own OGC who issue very useless, ah, unhelpful guidance and don't really help us a great deal so we spend a lot of time trying to interpret the laws.<sup>925</sup>

Interviewees noted that it could be hard to find information about the law, expressing a desire that guidance be publicised more and be more easily accessible. Another issue which was highlighted was cost; interviewees noted that training courses were available but were often expensive meaning that many people had to do without professional training. There was thus a strong need for better free resources and guidance in this area.

I think there could be more readily available information on how the regime works. It's not very well explained at all. I mean, we follow it because we have to, but help isn't really forthcoming. Why should I have to pay a consultant or go on a dozen courses just to find out how to do something which we are being forced to do?<sup>926</sup>

Another complaint interviewees had about the current available guidance in this area was that it focused too much on what it was not possible to include in procurement and the unlawfulness of various methods. Interviewees noted that it would be more useful

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<sup>925</sup> *Ibid.*

<sup>926</sup> WA#3.

for their planning if guidance was given showing what could be done and giving case studies of successful ways of including labour policies in procurement.

## V.2. Compliance with the Directive

This section will examine the general level and approach to compliance with the directive by interviewees. It was noted previously in Chapter 7, Section IV, that there are a variety of theories behind compliance with the law, from economic theories based on risk-benefit analysis to more social theories based on peoples' views of the legitimacy of the law. It was also noted that where the legal provisions lack clarity, there is a general tendency towards over-compliance. Given the relatively low level of challenges brought against procuring entities in the UK combined with the possible pressures on companies to be seen as socially responsible, it was thought that utilities may be relatively prone to non-compliance in this area, though the lack of clarity in the law might impact upon that.<sup>927</sup>

In fact it was discovered that utilities generally did their best to be compliant to the level that they understood the law to require. The main reason appeared to be the overall approval of the EU rules (see above). Interviewees were happy to follow the rules as best they could because they genuinely felt that they were the best rules for the situation.

"We would, it would be highly unlikely for us to not follow the Utilities Directive procedure because they're fairly moral standards \*inaudible\*, so I think law-abiding would come first."<sup>928</sup>

This finding matches the theory discussed in Chapter 7 above set out by Tyler that compliance with the law depends on a party's view of the legitimacy of the law, with a

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<sup>927</sup> See further Chapter 7, sec. IV.

<sup>928</sup> WA#6.

feeling of personal obligation to obey the law being a key factor, along with the extent to which the law accords with that party's own view of whether or not the law is just.<sup>929</sup>

Another possible reason for this strong desire to comply with the directive was that, despite the low number of cases in the UK, the possibility of challenge was a big consideration for interviewees. Eight interviewees in particular highlighted the fear of challenge as being an important factor in their decisions over whether and how to include labour policies in procurement. There appeared to be a general feeling amongst interviewees that suppliers were becoming more litigious and the risk of challenge was thus increasing, leading to a more risk-averse approach to procurement amongst utilities.

I mean luckily we haven't had any actual upheld challenges but we're very mindful of it and very, we try to follow OJEU regulations quite rigidly. I think you sort of need to nowadays, more and more companies are getting so sort of litigious, and I think also because of the economic climate, a lot of companies are, you know, fearful that they're not going to be around in a few years time or something, and they think, sod 'em, what have I got to lose, and they're all sort of launching challenges left right and centre, you need to be squeaky clean at the moment.<sup>930</sup>

One interviewee also noted that, while challenges were rare, the damages which could be awarded if the challenge were successful were "momentous"<sup>931</sup> suggesting that in this situation the high sanction might outweigh the low chance of a breach being discovered. There was also the consideration that any challenge, even if ultimately not successful, involved high legal advice costs and a demanding commitment of time and resources to deal with on the part of the procurement team which interviewees wanted to avoid.

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<sup>929</sup> See further Chapter 7, sec. IV.2. and Tyler, T. *Why People Obey the Law*, (Rev. Ed.), (2006, Princeton: Princeton University Press).

<sup>930</sup> WA#5.

<sup>931</sup> TR#3.

Consistent with this high level of compliance, only four interviewees stated that they felt the strict nature of the directive might lead to utilities evading the requirements to include labour issues, and of those four, only two stated that they personally attempted to evade the requirements of the directive. One interviewee noted that strict compliance with the law might cause issues with monitoring and evidence and lead to labour policies with little practical effect (see further below, section IX):

You've really got to balance sticking within the law and doing something which actually has some teeth and actually has a requirement for a supplier, because it's quite easy to end up with something that's quite weak and it's just, oh, would you mind thinking about the ETI base code and maybe joining SEDEX if you get time, sort of thing.<sup>932</sup>

Another interviewee noted that the EU rules simply meant that they changed their justification for their policies but the actual policies remained the same no matter what the directive required. In particular they noted that environmental justifications were now used for policies which would also have social benefits since such justifications were seen as easier to fit within the rules:

[O]ur offer used to say that it was Wensleydale cheese and the eggs would be from a local supplier ... now it's been turned around, exactly the same suppliers but we're reducing our air miles and food miles. So it's a different slant, exactly the same, but it's now targeted saying it's a local supplier because we're reducing our miles.<sup>933</sup>

Overall, then, it appears that interviewees generally aimed to comply with the legislation as best they could, both because of fear of legal challenge but also because they genuinely believed the rules were fair. The actual level of compliance is hard to measure given the lack of clarity in the law. This makes it difficult to determine what the correct approach would be but it seems that the majority of the non-compliance by interviewees

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<sup>932</sup> TR#8.

<sup>933</sup> TR#5.

would be through a mistaken interpretation of the law rather than a deliberate attempt to evade the directive.

Given this lack of deliberate breach, it may be that the current compliance approach taken by the EU regime towards enforcement of the regime may not be the most appropriate. It was noted in Chapter 7 that these approaches suffer from the problem when applied to companies that those companies are often poorly organised to anticipate and deal with such punitive measures and those within the company are often unaware of the potential risks. Where a breach is committed by accident, a high punitive measure is unlikely to prevent future breach from that company or others subject to the same regulation. It was also noted that such approaches are expensive and often cause a great deal more delay than informal approaches. It may thus be that the EU legal regime would be better enforced in the UK by a method such as Ayres and Braithwaite's 'responsive regulation' model. Under this method, regulatory bodies would begin by working with companies which breach regulation to ensure no further breaches take place, but there would also be increasingly formal and punitive methods available for repeated breaches.<sup>934</sup> This method would offer support to those utilities which are aiming to comply but failing due to lack of knowledge but would also keep the punitive methods for repeated breach, preventing creative compliance by those utilities currently complying due to fear of challenge.

## **VI. Structure of Labour Policies in Procurement**

This section examines the methods chosen by interviewees to include labour policies in procurement, given the influence of the EU procurement directives over the procurement process. It sets out the various methods used by interviewees, examining the issues highlighted in the previous literature review in Chapter 6 and the interviewees' opinions of the importance of these issues and their approach towards them in practice.

### VI.1. Methods of structuring labour policies within procurement

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<sup>934</sup> See further Chapter 7, sec. IV.2 and Ayres, I. and Braithwaite, J. *Responsive Regulation*, (1992, Oxford: OUP).

#### *VI.1.1. Contract Conditions*

Examining labour issues through inclusion in contract conditions was popular amongst interviewees, with sixteen stating that they had included some labour aspects in their contract conditions at some point. Contract conditions were generally used in combination with other methods of including labour issues in procurement rather than as the sole method, often covering the same issues as were looked at elsewhere in the process.

##### *Contract conditions limited to legal compliance*

It was noted in Chapter 6 that contract conditions concerning labour issues may be divided into two types: conditions simply requiring compliance with national law and conditions going beyond the law. As discussed in Section III.1.1, Chapter 6, conditions requiring compliance with the law are probably one of the lowest risk options for a utility to take, with Article 39 of the Utilities Directive appearing to assume that compliance with local law may be required.

The most common use of contract conditions was indeed to require compliance with UK national labour law requirements, with interviewees often having a general clause in their contracts requiring compliance with all relevant law and also including specific clauses for any areas of law where it was felt there was significant risk of breach.<sup>935</sup> This was consistent with compliance with labour law issues generally being the most popular types of labour criteria to include (see above, Section IV) and reflects the importance interviewees attached to complying with UK law.

Of the sixteen interviewees who included contract conditions requiring compliance with UK law, only six stated they also regularly included conditions which went beyond legal compliance (see below, section VII.1.2). The EU legal regime appears to have had little impact on the decision of the remaining ten interviewees to limit their conditions to UK

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<sup>935</sup> Contract conditions requiring compliance with UK law, whether directly or indirectly by requiring compliance with a labour code which in turn required compliance with national law, were included by 16 interviewees.

law, with the main factor in the decision rather being their view that UK labour law set a high standard which they did not feel the need to improve upon.

[T]here's a part which says this contract is governed by the laws of this, this, this and this in the UK, so we don't look any, sort of deeper if you like, because we feel that is probably sufficient for what we do.<sup>936</sup>

[W]e've just not felt the need [to go beyond legal compliance] really. It's not a conscious decision not to and I guess the law is quite strict in terms of what you must comply with anyway.<sup>937</sup>

For those contracts which included labour clauses and were performed outside the UK, compliance with the national law of the country of performance was also a common requirement, with eight of the interviewees who included such conditions stating that they regularly required compliance with national law. Of these eight, five usually limited the conditions imposed to compliance with national law and did not impose any conditions going beyond the law.<sup>938</sup>

[W]e would normally limit it to national law because it would be unreasonable to ask companies who are performing within their own country to go outside of that.<sup>939</sup>

Interviewees who limited conditions to legal compliance noted that generally national laws offered satisfactory labour standards; the problem was that the legal standards were not complied with.

Well, the laws are one thing. The actual standards can be something different. So we'd want to satisfy ourselves that the practices in place support the welfare, safety, environmental considerations.<sup>940</sup>

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<sup>936</sup> TR#3.

<sup>937</sup> TR#7.

<sup>938</sup> TR#5, EN#2, PO#1, WA#5, WA#7.

<sup>939</sup> EN#2.

<sup>940</sup> WA#7.

Only one interviewee stated that the EU procurement law had impacted on their decision over whether to limit the use of labour-related contract conditions to compliance with national law.<sup>941</sup> Consistent with the legal analysis set out in Chapter 6, this interviewee noted that compliance with national law appeared to be the safest type of contract condition which could be completed under EU law. The interviewee also noted that requiring legal compliance was also the lowest risk approach when it came to the possibility of challenge by supplier since any supplier challenging would be claiming an unwillingness to comply with their national law, a fact most suppliers would be unwilling to admit.

#### *Contract conditions going beyond compliance with the law*

As noted previously, contract conditions which require more from suppliers than simply compliance with the relevant national labour laws are a higher risk option under EU procurement law compared to conditions which only require legal compliance. Conditions going beyond the law may be limited to issues relating to contract performance or may be wider than this. Interviewees' use of both types of condition is discussed below.

- Contract conditions limited to contract performance

Contract conditions which set out requirements going beyond compliance with national law were used relatively rarely, with only six of the sixteen interviewees who included labour-related contract conditions stating that they had required more than legal compliance in their contract conditions.<sup>942</sup> The possibility for including social conditions in a procurement contract, including labour conditions, is set out explicitly in Article 38 of the Utilities Directive, which allows the inclusion of "special conditions relating to the performance of the contract". As discussed previously in section IV.2, Chapter 6, such conditions are lawful so long as they are lawful under wider EU law, a requirement which requires that any conditions included in a procurement contract are compatible with the

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<sup>941</sup> PO#1.

<sup>942</sup> WA#1, TR#1, TR#2, TR#8, TR#9, EN#4.

free movement provisions of the EU Treaty.<sup>943</sup> Following this, it would appear that labour conditions are hindrances to trade which must be justified in order to be lawful.<sup>944</sup> This section discusses the findings of the data in relation to the particular issues highlighted in the previous literature review as discussed in Section III, Chapter 6.

### **Use of external labour codes**

It was noted in the literature review that contract conditions which refer to external labour codes are more likely to be justifiable than conditions designed by the utility itself. This is due to the fact that independently designed conditions are more likely to be objective and are also less open to abuse by the utility. It was noted that external codes were not used often by interviewees, with only four of the sixteen interviewees using codes to inform their decisions relating to labour conditions. Of these four, only two actually included contract conditions in the procurement contract based on the external code they favoured, with the other two preferring to examine the requirements of their labour code through other methods. Despite this method being one of the lowest risk methods of including labour policies in procurement under the EU rules, it appears to be very rarely used in practice.

### **Labour certification marks**

Including a condition requiring that a product complies with a certain labour certification mark was noted previously to be a high risk method, given the requirements in the Utilities Directive governing technical specifications, which may prevent utilities from setting requirements impacting on the production process of a good where that process does not impact on the ultimate performance characteristics of the product.<sup>945</sup> It was also noted that this was an area in which utilities might feel the most pressure to include labour criteria, given the rise in importance in recent years of labour certification marks

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<sup>943</sup> See further Chapter 6, Section III.1.2.1. The impact of this requirement may also depend on the applicability of the EU Treaty to private utilities, see discussion at Section II, Chapter 6.

<sup>944</sup> See discussion at Chapter 6, Section III.1.2.

<sup>945</sup> See Chapter 6, Section III for further discussion.

such as Fairtrade, and this might lead to utilities being more willing to take a risk in this area.

Labour certification marks were relatively rarely required by interviewees, with only three stating that they had awarded contracts where compliance with a mark was a requirement.<sup>946</sup> For two of these, a requirement that products should be compliant with a labour certification mark was common, included in all contracts for certain products. For the remaining interviewee the requirement was only included where it was felt that a certain product posed a high risk of being made using labour working under poor conditions.

Three main reasons were given by interviewees for their decision not to require compliance with labour certification marks; (1) simply never having considered the possibility of using labour marks; (2) a feeling that there were no relevant labour marks which could be referred to; and (3) the difficulty of doing so under EU law.

The first and second of the reasons given are linked to a lack of awareness on the part of utilities as to the range of labour certification marks available. Interviewees tended to associate labour certification marks generally with the most famous mark, Fairtrade, and conclude that such marks were not relevant due to their low level of product purchasing (this is also linked to the common belief that labour criteria generally are only useful when purchasing products, see above Section II):

We don't believe [Fairtrade is] applicable to the types of contract that we negotiate and so it's not applicable to the supply chains. We'd probably deal with it on a case by case basis if we were buying products in from abroad, but most of the time we are buying goods that are manufactured within the UK.<sup>947</sup>

For those interviewees who had evaluated the possible benefits of labour certification marks and decided that such marks would be worth including in the contract

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<sup>946</sup> TR#5, EN#2, TR#6.

<sup>947</sup> TR#2.

requirements, the EU legal requirements then became a concern. Three interviewees included a requirement of compliance with a labour mark and these interviewees admitted they had not considered the law in this area or were unaware of the legal restraints under the Directive. Three further interviewees, however, noted that they did not include a requirement that a particular labour mark should be complied with because the EU legal regime prevented such a requirement. The interviewees noted that they often included statements that they would look favourably on the supply of products compliant with a certain mark, but did not require compliance:

[W]e put that our caterers should be able to supply Fairtrade, or a proportion of Fairtrade, but we can't require that they're solely Fairtrade. ... So they're available and they're promoted but we can't make them the only option.<sup>948</sup>

- Contract conditions going beyond contract performance

Given the wording of Article 38 of the Utilities Directive which allows the inclusion of social and environmental contract conditions "relating to the performance of the contract", it is generally presumed that contract conditions which go beyond performance are unlawful.<sup>949</sup> Consistent with this, no interviewees stated that they had ever included contract conditions relating to anything beyond the performance of the contract. However, the main reason given for not including such conditions was not the legal restraints but simply because the possibility of doing so had not occurred to interviewees and they had seen no reason to include such conditions. One interviewee did note, however, that suppliers sometimes mentioned in their tenders that they looked at CSR issues beyond the contract such as training and education for workers unrelated to the contract,, suggesting that this area may become more relevant in future:

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<sup>948</sup> TR#8.

<sup>949</sup> See further discussion at Chapter 6, Section IV.2.

We haven't done [included conditions going beyond performance] up until now. A lot of people I notice on a lot of the tender returns we get are making quite a big thing about that's what they do. But we don't explicitly ask for it.<sup>950</sup>

*Reasons for using labour related contract conditions*

Contract conditions were primarily used by interviewees for issues which they felt would be on-going throughout the contract performance and which interviewees wished to be able to check that a supplier was complying with even after contract award. This was a common theme throughout the discussion of contract conditions. Two interviewees in particular noted that they preferred contract conditions to other methods of including labour issues in procurement due to the power they gave over suppliers during contract performance.<sup>951</sup> These interviewees noted that contract conditions gave them leverage over the supplier should there be a dispute during performance, ensuring that labour issues could not simply be ignored once suppliers had won the contract. Interviewees also noted that contract conditions were the best method for encouraging suppliers to improve their labour standards over the course of the contract, as opposed to methods such as prequalification criteria which simply checked compliance with set standards. Setting out contract conditions which require the supplier to work with the utility over time to improve standards in certain areas has the benefit of not only improving those standards but also giving the utility a closer working relationship with its supplier, which was considered commercially beneficial.

[O]k, so we get a supplier through the process and award them the contract, but we don't rest on our laurels, so ok, so they might have some reasonable compliance to some sustainability matters. We want them to be great in three, four, five years, and for so many of our suppliers, let's say our top fifty suppliers, which represent something like 80% of all our spend, why wouldn't we want to get really close to them and start improving their performance, not let them sit

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<sup>950</sup> TR#1.

<sup>951</sup> PO#1, EN#4.

back and get complacent for five years while they've got our contract.<sup>952</sup>

The previous sections examined the impact of the legal regime on the decision over whether to include contract conditions limited to compliance with the law or going beyond the law. Overall, the legal regime had little impact over the decision to use contract conditions generally, as opposed to other structures for including labour issues in procurement. Only one interviewee out of the sixteen including labour-related contract conditions stated the law had any impact on their decision, noting that they felt contract conditions were legally one of the safest methods to choose for evaluating labour issues, being less likely to be challenged by suppliers:

[Y]ou're less likely to get challenged on that kind of thing because tenderers can read that at the tender process and they just have to decide whether they comply with it or not, whereas when they are evaluated on it and they don't win the bid they request the evaluations and they see they dropped on that, they'll think challenge.<sup>953</sup>

#### *VI.1.2. Prequalification Criteria*

##### *Use of labour related prequalification criteria*

Prequalification standards were the most popular method for examining labour issues, with seventeen interviewees stating that they included labour issues in their prequalification questionnaire. The labour criteria included in interviewees' prequalification questionnaires covered the whole range of labour policies, from child labour down to health and safety. As in other areas health and safety and issues required under UK law were the most commonly included and usually the main focus of the questionnaire.

The main query for prequalification criteria highlighted in the previous literature review was what precisely was meant by the Utilities Directive's statement that a utility can

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<sup>952</sup> EN#4.

<sup>953</sup> TR#8.

exclude a firm "in accordance with objective rules and criteria".<sup>954</sup> As discussed in Chapter 6, there appears to be a general acceptance that the discretion for utilities is wider than that allowed to the public sector, but there is no further information on precisely how wide. Confirming that general acceptance of wider discretion, none of the interviewees thought that they were limited to the technical and financial criteria which are set out in the Public Sector Directive. Indeed only two of the seventeen interviewees thought there were any legal restrictions on the types of criteria which could be examined at prequalification at all and notably both were utilities based in the public sector which were subject to the Public Sector Directive for some proportion of their procurement.<sup>955</sup>

The discussion in Chapter 6 also examined the possible interpretations of "objective rules and criteria" set out by Arrowsmith and Maund.<sup>956</sup> Following these interpretations, it may be relevant if (a) the criteria are directly related to the particular contract or are wider in scope; (b) the criteria are linked to the commercial aims of the utility; and (c) the criteria are linked to the overall procurement policy of the utility. These considerations will be discussed below.

As regards the criteria being relevant to the particular contract, the majority of interviewees stated that their prequalification criteria focused on the general status of the suppliers rather than looking at issues directly relating to the specific contract.<sup>957</sup> Interviewees usually had a standard questionnaire which they issued to every supplier for every procurement, with only a minority editing the questionnaire to take into account the specific circumstances of the particular contract.

Ah, it's a general, they look at the company and it's sort of more broad brush  
how they're used to doing things rather than how it affects this particular

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<sup>954</sup> Art. 54 Utilities Directive.

<sup>955</sup> PO#1 and TR#8.

<sup>956</sup> Arrowsmith, S. and Maund, C. 'CSR in the utilities sector and the implications of EC procurement policy: a framework for debate', Ch. 11 in Arrowsmith, S. and Kunzlik, P. (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions*, (2009, Cambridge: CUP), at p.451. See further Chapter 6 at section IV.3.

<sup>957</sup> Fourteen interviewees stated that they usually examined the firm generally in their PQQ, with five of these stating that they also sometimes set out criteria relating to the particular contract.

contract.<sup>958</sup>

Having a standard questionnaire has the benefits of being simple, efficient and time and resource-friendly. It is also a good way of checking that minimum standards of labour criteria are met by suppliers, given that those issues which interviewees were most commonly considering (health and safety and legal compliance) are unlikely to vary much by contract. Only one interviewee (PO#1) felt that there could be any legal problems with non-contract specific criteria, with the rest feeling such criteria were lawful under the EU rules. Whether the "objective rules and criteria" the prequalification criteria are based on have to be connected to the particular contract under EU law is unclear (see Chapter 6, section IV.3). The Utilities Directive does not mention the issue but Arrowsmith and Maund argue that a connection with the contract is required in the case of contract conditions. It is possible that this implies a similar restriction for prequalification criteria, since it would be odd for a utility to be able to exclude a firm on the basis of a criterion which it could not lawfully include in the contract.<sup>959</sup> If this interpretation is correct, it is inconsistent with the general practice of the interviewees in this research and would appear to be highly restrictive.

As to the other concerns - whether the criteria are linked to the commercial or procurement policy of the utility - as was noted above (see section III), interviewees were reluctant to state that their decision to include labour concerns in procurement generally was related to commercial policy in any way. This was equally true for the specific area of prequalification standards, making it hard to argue that such criteria are linked to any commercial policy of the company. In addition, given that moral concerns were the main reason given by interviewees, it cannot be said that the inclusion of labour policies was an issue of procurement policy. This suggests that in order for the types of labour related prequalification standards used by the interviewees to be lawful, the EU would have to take one of the more flexible interpretations of "objective rules and criteria" discussed earlier.

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<sup>958</sup> TR#1.

<sup>959</sup> Arrowsmith and Maund, above n.956, at p.459.

### *Reasons for choosing prequalification criteria*

Three main reasons were given by interviewees for using prequalification criteria as a method for including labour policies in procurement. One was simply that, given the preference for looking at legal compliance in relation to labour issues amongst interviewees, prequalification criteria were the easiest method for checking such minimum criteria given their focus on compliance with set standards.

The second reason given was that it enabled a company to discard poor suppliers early in the process, allowing the bulk of the procurement process to be completed based on cost and technical issues without the fear of contracting with a supplier which had unsatisfactory labour standards. The main desire appeared to be to exclude poor suppliers completely to ensure there was no association between the utility and those suppliers. This is linked with the focus on compliance with legal minimum standards which was discussed previously and contrasts with the views of those interviewees who favoured contract conditions who wished to work with suppliers to improve standards.

Finally, prequalification was judged to be the most cost and resource friendly method of examining labour issues. Interviewees, especially from the larger utilities, noted that their supplier pool was large, with some utilities having a base of over 1000 suppliers. Considering labour issues at the prequalification stage allowed the utility to create a simple set of questions which could then be applied to all suppliers in a questionnaire, requiring far less work than labour related award criteria or contract conditions, both of which require the utility to design the labour criteria specifically to relate to the particular contract and suppliers on a level not needed for prequalification. This was also linked to the previous issue of not wishing to work with poor suppliers, with interviewees noting that the investment of time and energy involved in procurement once the prequalification stage was over was much greater and they preferred to work only with sound companies at that stage:

[W]e can use sustainability as a filter, so the pre-qualification stage is usually where you're working, you're having to deal with lots of potential suppliers at that stage, so it's kind of a neat stage to introduce this topic. If we've already selected the bank of suppliers and they're in the tendering stage and we find out something horrific about them at that stage, you know, they've got one of our sensitive documents, you know, there's a lot of investment of our time from our buying community into that. So we probably don't want to do that.<sup>960</sup>

#### *VI.1.3. Tender Evaluation (Award Criteria)*

##### *Use of Labour Related Award Criteria*

Labour related award criteria were included in procurement relatively often by interviewees, with twelve interviewees evaluating labour issues at this stage. Of these twelve, four set out specific labour related criteria and eight examined labour issues as part of more general CSR and sustainability criteria. Health and safety issues were the area most commonly considered at the award criteria stage.

It was noted in Chapter 6 that award criteria relating to issues such as sustainability generally are lawful, following the ruling by the CJEU in *Concordia Buses* allowing environmental award criteria. The main issue relating to the inclusion of labour related issues in award criteria was the requirement that award criteria be "linked to the subject matter of the contract" and the extent to which that was possible for labour issues.<sup>961</sup> The uncertainty over the meaning of "subject matter" which was highlighted in Chapter 6 was shared by some interviewees with the fact that many labour issues could not be classed as linked to the subject matter of the contract being one of the reasons cited for the decision not to include labour issues in award criteria, though the majority felt sustainability criteria were lawful and this included labour issues. The main reason given by interviewees for not including labour issues at this point was a belief that the award criteria stage was an inappropriate point at which to look at CSR issues.

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<sup>960</sup> EN#4.

<sup>961</sup> Art. 55(1)(a) Utilities Directive. See further Chapter 6, Section IV.4.

With regards to the legal constraints, only two interviewees who had rejected the idea of considering labour issues through award criteria felt that such concerns could not be considered material to the contract and thus could not be included legally.<sup>962</sup> There was a feeling amongst these two interviewees that the requirement that award criteria be linked to the contract had become more important recently:

Award criteria have to be based on the tender, there's been a real push for that recently, so we only look at commercial concerns that are linked to the tender.<sup>963</sup>

This feeling may be related to the recent cases evaluating the appropriate use of award criteria such as *Lianakis*.<sup>964</sup> These cases have raised questions over the appropriate areas for examination by both prequalification and award criteria and may result in more procuring entities following the example of these two interviewees and rejecting labour related criteria for fear of breaching EU law in the future.

The concern over the link to the subject matter of the contract felt by these two interviewees was related to the main reason given by interviewees for rejecting the use of labour criteria at this stage: a belief that labour issues should have been evaluated fully at previous stages.<sup>965</sup> Interviewees argued that by the award stage of the procurement, the most important concerns for them were cost and technical issues:

I think as an engineering company we would always take the technical and engineering aspects as the most critical, because that's actually what we're interested in, we're interested in their technical and engineering ability to do the work. ... I'm not sure it's something that we would look at to say all these people are being employed in the right manner, more so than supplier B and therefore supplier A is going to win. I'm not sure we'd do that because it would come down more in our industry to technical competence.<sup>966</sup>

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<sup>962</sup> WA#1 and PO#1.

<sup>963</sup> WA#1.

<sup>964</sup> Case C-532/06, *Emm G Lianakis AE v Dimos Alexandroupolis* [2008] ECR I-00251.

<sup>965</sup> This was given as the reason for not evaluating labour issues as award criteria by seven interviewees.

<sup>966</sup> EN#1.

Those interviewees who did not include labour policies in award criteria often examined labour issues at the prequalification stage. These interviewees noted that doing so enabled them to be sure that any suppliers which did not have satisfactory labour standards had been cut out of the procurement process by the time they were determining award, allowing the utility to focus on the cost and technical issues which had been highlighted as most important at this stage. This approach is also linked to the finding that compliance with minimum labour law requirements was the main concern of most interviewees (see discussion above, section IV) and was consistent also with the argument that prequalification standards were the most appropriate method for checking compliance with minimum standards. Interviewees generally did not seem to have considered the possibility of using award criteria to determine relative standards of labour issues outside the area of health and safety and there was some uncertainty about the use of award criteria in this way:

I mean, award criteria favouring firms with higher labour standards, well so what, if they're supplying widgets which everyone's getting from the same place, it doesn't mean anything ... if it was a very big, a specific concern with labour, and it's difficult to see what that could be, where we are going to put in an award criteria, where we're going to say we'll award x percent if you've got say a 90% score versus a 70% score then, but we don't do that yet. And I think it's nearly impossible to do, in my view it's a yes/no situation.<sup>967</sup>

#### *The Commission Communication*

Another issue highlighted in Chapter 6 relating to the use of labour-related award criteria arises from the statement in the Commission's Communication on Social Issues that labour issues may only be considered as award criteria where all other aspects of the tender are equal.<sup>968</sup> The interpretation of the law set out in the Commission

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<sup>967</sup> EN#2.

<sup>968</sup> European Commission, *Interpretive Communication of the Commission on the Community Law applicable to public procurement and the possibilities for integrating social considerations into public procurement*, COM(2001) 566, ("Commission Communication on Social Issues"), at para. 1.4.1.

Communication is based on the facts of the case of *Nord Pas de Calais* and, as noted previously in Section IV.4, Chapter 6 has been criticised as implying a requirement which is not in fact mentioned in the CJEU judgement in that case.<sup>969</sup>

Interviewees were asked whether they agreed with the Commission's interpretation of the law in this area. The majority of interviewees noted that they had been unaware of the Commission Communication and this interpretation of the law concerning award criteria prior to the interview. The statements given thus represent the interviewees' personal opinion of the Communication and were made based on consideration between the time the interview guide was sent out and the interview taking place (usually a week) rather than any detailed consideration. Some interviewees declined to comment due to lack of knowledge in this area, but thirteen interviewees responded to the question.

The majority of interviewees disagreed with the interpretation set out in the Commission's Communication on Social Issues.<sup>970</sup> The main concern of interviewees was the autonomy of their company, with even those interviewees who stated they did not include labour related award criteria arguing that they should be free to do so if they wished, emphasising that it was not the role of the EU to decide that labour was an inappropriate area. The arguments reflected interviewees' perceptions of EU law as concerned primarily with ensuring fairness (see further discussion above, section V), with interviewees arguing that so long as labour related criteria were set out clearly and openly and used in a fair and non-discriminatory manner, they should be lawful:

I think the whole point of award criteria is that you weight them depending on how important they are for you as a business and for your delivery. So long as you assess the different companies, but they're all being assessed in the same

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<sup>969</sup> Case C-225/98 *Commission of the European Communities v France* [2000] ECR I-7445 ("*Nord Pas De Calais*").

<sup>970</sup> 10 interviewees disagreed with the statement.

manner, that's the important thing.<sup>971</sup>

The three interviewees who agreed with the statement in the Commission Communication did so on the basis that the Commission was attempting to emphasise that labour issues were not generally appropriate for consideration at the award stage. The interviewees felt that the idea behind the statement was that by the award stage labour issues should have little impact, with award criteria being primarily based on cost and technical factors, and only allowing labour issues to be considered when other aspects of the tender were equal clearly showed procuring entities that the emphasis should be on commercial issues at this stage.

#### *Reasons for using labour related award criteria*

As noted previously, health and safety issues were the most commonly considered at this stage. Other labour issues were considered less often and, if at all, commonly as sub-criteria within a general sustainability criterion. Use of labour related award criteria was generally limited to contracts where a specific labour risk had been identified, for example with products generally produced in developing countries. The main reason given by interviewees for considering such labour issues at the award criteria stage was that it enabled a certain issue to be considered and evaluated in depth during the procurement process where interviewees felt that issue needed to be evaluated beyond the level of detail allowed at the prequalification stage. Given the lower number of suppliers in the procurement process at this stage, utilities could evaluate more detailed evidence from each supplier allowing for more effective monitoring of labour issues (see further below, section IX).

#### VI.2. Labour Criteria in Company Supplier Lists

As discussed previously in Section IV.6, Chapter 6, utilities can choose to set up a supplier list under the EU procurement regime, from which they can then choose suppliers for specific contracts without having to go through any further tendering

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<sup>971</sup> TR#4.

process. The main issue relating to the use of labour issues here is whether a utility can include labour criteria when choosing which suppliers are qualified for the supplier list (which will probably rely on the interpretation of the general qualification rules, see discussion above) and whether, if labour issues are included, such labour criteria have to be relevant for all contracts which could possibly be awarded using that supplier list.

Six interviewees out of the twenty-two used a supplier list for procurement covered by the Utilities Directive with one further interviewee using a supplier list solely for procurement which was outside the directive. The lists varied from those which covered all procurement performed by the interviewee to those which only covered certain types such as engineering contracts. Of the six interviewees who operated a supplier list under the Utilities Directive, five examined some labour issues when determining which suppliers would be accepted onto the list.

Interviewees generally felt that the labour criteria which they set for acceptance onto their supplier list would be relevant for all contracts which were awarded under that list. Each interviewee took a different approach to ensuring applicability. One possibility was limiting either the use of the supplier list or the type of labour criteria. For example, one interviewee only used a supplier list for one specific type of contract and noted that the criteria had been specifically designed so that they would be relevant for that type of contract.<sup>972</sup> Another interviewee limited labour criteria use to only health and safety issues which would be relevant for all contracts.<sup>973</sup> These methods avoid the issue of ensuring applicability for all contracts, but do not aid utilities which wish to operate a general supplier list examining a wide range of labour issues. A possible solution was offered by one interviewee who operated a sliding scale approach to supplier list qualification, with different criteria and levels of evidence required for suppliers operating in different areas.<sup>974</sup>

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<sup>972</sup> PO#1.

<sup>973</sup> TR#2.

<sup>974</sup> TR#5.

Only one interviewee had a system requiring compliance with set labour criteria for access to a general supplier list.<sup>975</sup> The system, requiring compliance with the ten principles of the UN Global Compact, was still being designed and worked on by the procurement and legal team at the utility and was not currently in operation at the time of the interview. The interviewee felt that the criteria would be relevant for all contracts awarded under the system, arguing that the criteria examined the supplier's general compliance with set standards of labour issues and thus were not contract specific.

#### VI.3. Conclusions: Impact of the legal regime

Overall, the impact of the EU legal regime on utilities' decision over how to structure labour issues within procurement was relatively low. While the legal regime was a factor in interviewees' decisions over which method would be most appropriate for considering labour issues, other factors such as cost and also simple awareness of the possibility of including labour issues in certain ways were also key. Interviewees were reluctant to consider labour issues in ways which were clearly unlawful under the EU rules, for example with local labour clauses and contract conditions which go beyond the performance of the contract being very rarely used. Where the legal regime governing a certain approach was less clear, interviewees tended to assume that that approach was lawful and their main concern was with more practical issues. Interviewees tended not to consider the potential impact of the legal regime on the use of labour criteria in any depth and thus they felt little restriction on their actions.

### **VII. Labour Criteria in Procurement outside the Directive**

Procurement which is outside the coverage of the Utilities Directive, for example, because it is below the threshold, is subject to far fewer restrictions under EU law. Procurement outside the directive may still be covered by the Treaty provisions, which have become more important in recent years since the CJEU set out the principle of transparency which applies under the Treaty. This principle requires that all contracts

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<sup>975</sup> EN#2.

which might be of cross-border interest are advertised and conducted in a transparent manner. Procurement will also have to be fully compliant with the free movement provisions, a requirement which may have considerable impact on the use of labour criteria in contract conditions. The applicability of the Treaty provisions to private utilities is uncertain and should the correct interpretation be that private utilities are not covered then there are no legal restrictions at all on the use of labour criteria in procurement outside the directive. This section will examine both interviewees' knowledge of the Treaty provisions and their personal opinion over whether or not they are covered as well as their use of labour criteria in procurement outside the directive.

### VII.1. The Treaty Rules

Interviewees working in private sector utilities who had stated that they included labour issues in procurement were asked about their familiarity with the requirements of the TFEU and whether they considered themselves bound by the rules set out in that Treaty. Interviewees operating in the public sector, i.e. those classed as contracting authorities under the Utilities Directive, were not asked this question, since the public sector is more clearly covered by the Treaty, but their use of labour criteria in procurement and the impact, if any, of the Treaty rules there was discussed (see section below). In total sixteen interviewees were asked about the applicability of the Treaty rules.

Knowledge of the Treaty rules and the principle of transparency as set out in *Telaustria* and subsequent cases amongst private sector interviewees was moderate, with six of the sixteen interviewees stating that they had some familiarity with the requirements. Amongst these six, opinion was mixed over whether or not they were covered by the Treaty law. Only one interviewee stated that he did consider that the company was bound, and only one interviewee stated that they did not.<sup>976</sup> The rest were unsure over the legal position but appeared to err on the side of caution, noting that they followed procedures close to those required under the Utilities Directive in all cases so the procurement should also be compatible with the Treaty:

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<sup>976</sup> WA#7 and TR#9 respectively.

I'm aware of the debate in this area. But we consider all our procurement to be covered by the directives to a greater or lesser extent. So if it's below threshold, ok, we may not advertise but we do expect there to be tenders in a competitive way, to the same rules and criteria that we do above threshold.<sup>977</sup>

The remaining ten interviewees stated that they were unaware of any procurement rules stemming from the Treaty and consequently did not attempt to comply with those rules for their procurement:

[W]e're in a bit of a funny situation because although we are a private body we are, I mean clearly we're publicly funded and therefore subject to all of the usual utilities regulation and OFWAT regulations, so it could well apply to us. Gosh, if it does we're not doing it, whatever it is.<sup>978</sup>

The data collected in this research thus suggest that awareness of the implication of the Treaty rules for procurement is low amongst private sector utilities. Even amongst those who are aware of the rules, the applicability of those rules is uncertain. The majority of interviewees were operating on the basis that no Treaty rules applied to procurement which, if true, opens up the possibility of use of labour criteria significantly, not only in procurement outside the directive but also via contract conditions under the directive given that most restraints on such conditions are based on the free movement provisions.

#### VII.2. Use of labour criteria in procurement outside the directive

Due to the lower level of restrictions covering procurement outside the directive, even should the Treaty rules apply to private utilities, it seemed reasonable that utilities would take advantage of this flexibility to include labour criteria more extensively outside the regulated areas. In fact, the majority of interviewees indicated that there was no difference in the use of labour criteria in procurement within or outside the directive,

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<sup>977</sup> EN#4.

<sup>978</sup> WA#5.

with the same issues being considered in either case. There were no cases in which a utility which did not consider labour issues in procurement covered by the directive considered such issues in procurement outside the directive.

Fourteen of the twenty-two interviewees stated that they had at some point included labour issues in procurement which was outside the directive. Of these fourteen, eight noted that they routinely considered labour issues in all procurement which was outside of the directive. These eight all noted that they structured labour issues in the same way irrespective of whether the procurement was covered by the directive or not, following the same set of procedures for all procurement. These interviewees generally had positive opinions of the EU legal regime, feeling that it set out good standards for ensuring competitiveness and fairness in procurement and felt that they wanted to extend the principles to their non-regulated procurement because of this:

All of the procurement we do, we try and follow EU procurement law anyway, irrespective of it is covered or it is not covered. My view is EU procurement law is merely a mechanism for ensuring that we do procurement in a fair, competitive way and my view is, why would I not want to do it like that?<sup>979</sup>

Interviewees also noted that it was simpler for the procurement team to only have one set procedure to follow for procurement, regardless of the value or legal coverage of that procurement. The team thus only had to learn one set of rules and did not have to spend time determining whether or not the legal rules applied before beginning the procurement.

The six interviewees who stated that they occasionally included labour criteria in their procurement noted that they only did so where they felt that there was a special labour concern which needed to be considered in a particular contract. Interviewees generally noted that contracts which were outside the coverage of the directive were most commonly outside since they were below the threshold. Such contracts of low value were

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<sup>979</sup> EN#2.

more likely to be awarded to a UK based supplier due to lack of cross-border interest and this resulted in interviewees feeling that few labour issues would be relevant beyond ensuring compliance with national law. This was also the main reason given by those interviewees who stated that they never included labour issues in procurement which was outside the directive.

## **VIII. Evidence and Monitoring of Labour Policies**

This section will first look at the background to the need for evidence and monitoring of labour policies by discussing interviewees' thoughts on the impact of CSR policies in practice. It will then discuss the types of evidence required by interviewees to prove compliance with the labour criteria set out in procurement, taking a specific look at the possible use of labour standard certification such as SA 8000.<sup>980</sup> The section will conclude by considering the type of monitoring systems which interviewees use to check on the compliance with labour criteria post-award, when the contract is actually being performed, along with their responses to a breach of labour related conditions.

### VIII.1. Actual impact of CSR

Interviewees often had concerns about the actual impact and utility of CSR policies in practice, with the most common concern (given by twelve of the twenty-two interviewees) being that CSR was often nothing more than window dressing in a company. Suppliers might set out policies which looked strong but very little was done to follow through on those policies and they had little practical impact. Interviewees worried that companies would simply give the answer which they felt was wanted during the tender process and then would ignore CSR issues when the contract was performed, and there would be few methods of checking up on this.

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<sup>980</sup> SA 8000 and other forms of labour standard certification are discussed in more detail in Chapter 3.

[I]t would need to be something that was quite -- information which was in the public domain and universally measured, otherwise if it ends up being subjective then it wouldn't have any teeth would it? It would be a token gesture really.<sup>981</sup>

We could ask about labour issues like anything else, but obviously companies will just give you the answer they think you want, so you can't just trust what they say. You have to go check for yourself<sup>982</sup>

Given this strong desire to ensure that any labour issues considered were treated seriously by suppliers, monitoring and evidence were a key issue to interviewees (see further below, Section IX).

A minority of interviewees also had doubts about the utility and impact of CSR policies more widely. One issue (connected with the belief that CSR was only relevant for developing countries and the high use of UK suppliers) was that all suppliers would meet the minimum standards required by the utility so that CSR issues would rarely, if ever, have any real impact on procurement issues in practice. Two interviewees were also uncertain about the supposed commercial benefits of CSR (discussed previously in Chapter 2):

[The directors of the company are] mostly accountants and they're suspicious of anything that's not related to the bottom line and this isn't really – I know you see loads of claims that these policies will make you more profitable, but I don't think it's true.<sup>983</sup>

#### VIII.2. Types of evidence required to prove ability to comply with labour policies

In order to combat interviewees' concerns about CSR policies being 'window dressing' then,, it is essential for utilities to require evidence from suppliers to show that they can comply with the labour policies included in procurement. As discussed in Chapter 6, Section IV.5, the Utilities Directive, unlike the Public Sector Directive, does not set out

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<sup>981</sup> WA#6.

<sup>982</sup> WA#3.

<sup>983</sup> WA#4.

an explicit list of the types of evidence which may be requested from a supplier, suggesting that any suitable evidence may be allowable. Utilities may not impose any ““administrative, technical or financial conditions” on certain companies but not others, which would appear to prevent companies from requesting extra evidence from companies which they judge to be high risk.<sup>984</sup>

The majority of interviewees stated that they required some form of evidence to prove compliance with the labour policies that they included in their procurement. Only three interviewees out of the twenty who included labour conditions in procurement noted that they did not routinely require any form of supporting evidence from their suppliers. The reason given by these three interviewees was primarily the time and cost involved in completing detailed checks on labour issues:

[I]t's a resource thing, we haven't got the resources to go into the detail of auditing the supply chain so we just basically rely on the declarations that we're given.<sup>985</sup>

For the majority of interviewees who did require evidence, the trend was towards not being prescriptive over the type of evidence required from suppliers but to accept anything which the supplier could provide to prove compliance.

It's difficult to be prescriptive but we set out a range of possible evidence which can be provided – certification, health and safety policies or audit results, but it's not required that people provide that – they can prove they comply with the requirement in any way.<sup>986</sup>

One common approach was to ask for a copy of the supplier's CSR policy, along with any other relevant policies such as health and safety and then also ask for specific examples of how that policy was complied with in practice:

We always want evidence for everything. We never just say... give us your policy,

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<sup>984</sup> Art. 52(1)(a) Utilities Directive.

<sup>985</sup> TR#2.

<sup>986</sup> PO#1.

that's not good enough for us. We want to know how you've used the policy, give us an example of how it's been put into practice.<sup>987</sup>

Relying on this type of "paper evidence" such as policy statements, case studies and accreditation was the most popular approach to collecting evidence, used by seventeen interviewees. Seven interviewees also conducted audits of their suppliers in addition to requiring paper evidence, going to the suppliers' sites and checking labour standards (amongst other issues) first-hand. Of these seven, three audited suppliers for every contract (though one only audited the winning supplier) and the rest only conducted audits for labour issues on contracts where there was judged to be a high risk of labour standard problems due to the high cost of such audits.

It's a bit of a pain but actually ... it's the only real way of substantiating your initial tender response where we asked about a hundred and twenty questions for the initial tender, all sorts of questions, and then we score that and use the visit almost as a sort of verification to see are they actually telling us the truth or are they actually telling us what we want to hear but there's no evidence to back it up.<sup>988</sup>

#### *VIII.2.1. Labour Standard Certification (SA 8000)*

Interviewees rarely required labour standard certification. Only one interviewee out of the twenty who included labour policies stated that certification was asked for (in this particular case it was the SA 8000 certification) and, as usual, suppliers were free to prove compliance through other means.<sup>989</sup> One further interviewee stated that SA 8000 was included on their list of possible evidence but was neither required nor preferred over any of the other possible evidence.<sup>990</sup>

The most common reason given by interviewees for the lack of use of any labour standard certification was simple lack of awareness of any such certification.

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<sup>987</sup> WA#5.

<sup>988</sup> EN#1.

<sup>989</sup> TR#1.

<sup>990</sup> PO#1.

Interviewees often noted that they asked for environmental certification such as the ISO certification and would be interested in a labour version, suggesting that the main problem was the lack of publicity for and awareness of labour certification schemes.

### VIII.3. Types of monitoring used to assess compliance with labour policies post-award

The degree of monitoring given to labour issues may be relevant under EU law when considering whether a contract condition is justifiable under the Treaty rules. Monitoring post-award is also key for ensuring that CSR policies are actually effective, which was a key concern for interviewees.

Post-award monitoring was used less often by interviewees than evidence during the procurement process. Eight interviewees out of the twenty who included labour issues in procurement stated that there was generally no specific monitoring for compliance with labour issues (excluding health and safety) during the performance of the contract.<sup>991</sup> These interviewees noted that there was an assumption that the evidence which they had checked during the procurement process would remain valid throughout the contract performance period:

[A]s far as actually auditing that, or following it up, we don't. We just assume that it happens and nothing, as far as I know, has ever come to light, to me anyway. Not that it would, I suppose, contractors wouldn't necessarily volunteer that information to us.<sup>992</sup>

Two of the eight interviewees who stated that monitoring for labour issues did not take place did note that they monitored the contract for other technical issues. They felt that any labour issues which might arise would in all likelihood be caught during that more general monitoring process.<sup>993</sup>

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<sup>991</sup> One of the eight (TR#6) noted that there was only no monitoring for contracts under three years; longer contracts had the prequalification criteria rechecked regularly.

<sup>992</sup> WA#2.

<sup>993</sup> EN#1 and EN#5.

The remaining interviewees monitored contracts through either site audits or contract management meetings, or a mixture of the two. Interviewees generally set out key performance indicators (KPIs) in the contract, including some on health and safety and more general labour issues, and these would then checked regularly, whether by qualified auditors or by discussion in regular contract meetings with the contract manager.

[I]n every contract there are a set of KPIs and if we thought it was relevant then there would be one around the labour conditions if appropriate. ... Procurement are generally, where it's a high value or, slash, high risk contract, procurement get involved in regular review meetings, measuring and monitoring KPIs. Low value contracts or low risk we'd generally leave to the business to deal with.<sup>994</sup>

#### VIII.4. Breach of labour conditions

Prior to the interviews, this research hoped to examine the approaches taken by utilities to breach of labour conditions on their contracts. In fact, only two interviewees reported experiencing a breach in a previous contract and one of these noted that it was only a suspected breach. In that case, the utility had had some concerns about the labour on the contract but had also had problems with poor quality and had terminated the contract on that basis without investigating the possible labour issues in any more detail.<sup>995</sup> The one interviewee who had experience with breach of labour conditions noted that they tended to take a remedial approach, favouring setting out an action plan for removal before terminating the contract.<sup>996</sup>

## **IX. Conclusions**

This chapter has assessed the impact of the EU legal regime on the use of labour policies in procurement. Based on the results of the empirical interviews, the impact of the law appears relatively low. The main factors which impacted upon the decision over whether

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<sup>994</sup> WA#5.

<sup>995</sup> WA#4.

<sup>996</sup> PO#1.

or not to include labour policies were overwhelmingly commercial and moral. It is hard to rank the factors in any order, but the key reason interviewees adopted labour policies in procurement appeared to be in order to avoid any adverse publicity which would occur should poor labour standards be associated with the utility. The next most important factor appeared to be moral concern and a feeling that ensuring high labour standards was "the right thing to do". Conversely, the main reason interviewees did not include labour policies in procurement was due to ignorance of the possibility of CSR and labour policies or a belief that such policies would not be relevant to the type of procurement their company focused on. The potential cost of such policies was also an issue. In comparison, legal issues were rarely considered when companies looked at whether labour policies were appropriate for their company. Where legal issues were considered, they did not appear to prevent a company from adopting labour issues in principle in any case.

Once a utility had taken the decision to include labour policies in procurement, legal issues began to have more importance. The EU legal regime impacted upon interviewees' decision over what types of issue they would include in their labour policy and also how they would structure that policy within their procurement. The most obvious area of impact was relating to the use of policies favouring local labour or firms which interviewees identified as one of the areas which they would most like to pursue but which they were prevented from doing by the EU legal regime. The legal regime also appeared to be one of the factors in interviewees' preference for including labour policies through the methods of contract conditions and prequalification standards rather than other methods such as award criteria, though other factors were also key such as a belief that the award stage was simply too late in the process to consider labour issues.

Overall, interviewees were positive about the EU legal regime and felt that it had very little impact on the use of CSR and labour policies, nor should it, with such issues being a matter for the procuring entity alone. It was generally felt that the legal regime gave utilities enough flexibility to include such issues in procurement should they wish to do

so. It is notable however that a minority of interviewees which were those which were attempting the more ambitious labour policies felt that the EU regime was too restrictive. It also appears that utilities are unclear over the law in this area and one of the major desires of interviewees was that the legal regime be clarified and more guidance provided to aid those companies which wish to look at labour issues.

## **Chapter 10 - Conclusions**

### **I. Introduction**

As set out in the Introduction (Chapter 1), this thesis aims to examine the practical impact of the EU procurement regime on the use of labour policies and criteria in procurement conducted under the Utilities Directive, focusing in particular on how procurement practitioners dealt in practice with regulatory requirements which were commercially restrictive and/or unclear. In order to do so, the thesis examines the impact of the EU procurement regime on four main areas; (1) the use of labour policies in utilities procurement; (2) the types of labour policy commonly included in procurement; (3) the structure of labour policies included in utilities procurement and; (4) overall regulatory and compliance issues.

Part I of the thesis set out the background to the research, determining the main areas of interest and setting out a doctrinal analysis of the EU legal regime's impact on labour policies in procurement. Part II then set out the methodology and results of a qualitative study using semi-structured interviews with a sample of procurement practitioners based in UK utilities, investigating the practical impact of the legal issues identified in Part I. This chapter sets out the overall conclusions of the research project in the four areas identified above.

### **II. Use of Labour Policies**

The first main area the thesis investigated was the level of use of labour policies in procurement by companies operating in the regulated utilities sector and the factors which impacted on companies' decision over whether or not to include labour policies in their procurement, with emphasis on the importance of the EU legal regime to this decision.

In order to aid this investigation, Chapter 2 examined the background to corporate social responsibility (CSR) generally and labour policies specifically, setting out the factors

which commonly led to the use of CSR policies in general business practice. In this chapter we saw that CSR, the process whereby companies integrate social and environmental concerns into their business practice, has become of increasing importance to all areas of business over recent years. It was shown that there were several main factors which led companies to include CSR policies in their business practice, with the main factor being the so-called "business case" for CSR. Under this argument, socially responsible companies will in fact be more profitable than their less ethical competitors. Following this position, companies face pressure from their stakeholders to be more socially responsible, with the main sources of pressure being investors, the company's employees, and consumers. It is argued that a company which satisfies the demands of these stakeholders will gain more custom than a company which does not.<sup>997</sup>

The existence of the business case for CSR appears to be accepted by the EU and is referred to in the Green Paper on CSR<sup>998</sup> but, as was also shown in Chapter 2, it has been difficult to prove this link between CSR and profit in practice, with the many studies in this area resulting in contradictory results. Nonetheless, regardless of the actual efficacy of the business case, it was argued that the pressure on utilities to include CSR issues in their business might lead to increased use of labour policies in procurement and the empirical research sought to investigate this issue.

Acting against these business pressures was the possible influence of the EU procurement regime. Chapters 5 and 6 set out an overview of the EU procurement regime and its possible impact on the use of labour policies in procurement. These chapters showed that the utilities procurement regulation both restricts the use of certain types of labour policies in procurement and also has significant grey areas where the legality of the use of labour policies is uncertain. The possibility was raised here that

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<sup>997</sup> See Chapter 2, Section I.2 of this thesis, based on Vogel, D. *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (2005, Washington DC: Brookings Institution Press), Ch. 3.

<sup>998</sup> European Commission, *Communication from the Commission concerning Corporate Social Responsibility: A business contribution to Sustainable Development* COM(2002) 347, ("Commission Communication concerning Corporate Social Responsibility"), at p.5.

these restrictions and ambiguities may outweigh the pressures on utilities to include labour policies in procurement such that utilities do not include such policies at all or limit their use to areas where they are clearly legal. The empirical research also sought to investigate this area.

### II.1 The Impact of the EU Regime

The overall conclusion of the empirical research was that the impact of the EU legal regime was minimal when compared to other factors. A majority of interviewees assumed that the types of labour policies that they looked at would be compatible with the EU regime without making any detailed consideration of the law but even those who did look at the law ultimately decided that labour policies could be legally included in procurement under the Utilities Directive. The research showed that the EU regime does not appear to act as a deterrent to the overall inclusion of labour policies in procurement. Instead, the major influence of the EU law was on how those labour policies would be structured in the procurement. There was one major exception to this, however, in the area of policies favouring local labour or firms, where interviewees felt heavily restricted, see further below, Section III.

### II.2 The business case for CSR

It was shown by the empirical research that the notion of the "business case" for CSR which was identified and discussed in Chapter 2 also had limited impact on the decisions of the procurement practitioners interviewed as to whether or not to include labour policies in procurement. A majority of those interviewees who included labour policies in procurement denied that commercial issues were key to their decision to include labour policies in procurement, with most arguing that the decision to include labour issues was a moral concern rather than a commercial one. The particular factors of investor, consumer and employee pressure which were identified by Vogel as a key part of the notion of the business case, as discussed in Chapter 2, were also felt to be relatively

unimportant by interviewees, with only a minority feeling those factors had been relevant to their labour policy decisions.

The correctness of the “business case” for CSR was also challenged directly by some of the interviewees. The main reason given by those interviewees who had chosen to either include no labour policies in procurement at all or to limit their use was that the inclusion of such policies created cost and resources issues. Contrary to the business case arguments, interviewees generally believed that CSR issues would cost a company and would not increase their profit or benefit them commercially in any meaningful way.

Despite this general feeling that commercial factors were of limited relevance, some interviewees did identify factors which arguably could be considered commercial. The most important of these was the fear of adverse publicity, with companies including labour policies in procurement with the aim of avoiding association with suppliers with poor labour practices which might later be revealed to the public, tarnishing their reputation and impacting on their relationship with stakeholders. Other factors mentioned, such as the belief that improving labour standards led to superior performance from suppliers and better security of supply, suggest that commercial reasons may be the motive behind CSR policies more often than interviewees were willing to admit.

Generally, it was shown that the main factor which determined whether or not a utility would include labour policies in procurement was the moral concerns of the procurement team or those higher up in the company. The attitude of the interviewees was reminiscent of the attitudes of the earliest social reformers discussed in Chapter 2, who did not believe that their work would benefit the company but felt they had a duty to improve the social community in which they operated. Similarly, the interviewees in this research reported feeling responsible for those who worked on their contracts. The research suggests that labour policies were primarily included in procurement because those involved thought it was the right thing to do.

This lack of concern for commercial factors is important since the business case for CSR is key to the EU's support of CSR, as discussed in Chapter 2. It was also shown in Chapter 6 that several of the arguments regarding the correct interpretation of the Utilities Directive's application to labour policies rely on whether or not CSR can be taken to be a commercial concern (see further below, Section IV). Should the CJEU take a strict approach to the use of labour policies and hold that such policies are only allowable if they provide commercial benefit, it seems that many utilities will thus find that their current use of such policies is unlawful under the procurement regulation given this lack of commercial motive.

### **III. Types of Labour Policies**

The next aim of the thesis was to determine which types of labour policy were included in procurement by utilities and if the EU legal regime had any impact on that decision. In order to aid this investigation, Chapter 3 set out an overview of the types of labour policy which were commonly included in labour codes, which was then followed by an in-depth examination of the requirements of the largest international labour codes.

In Chapter 3 it was shown that there were three main types of code, characterised by their level of coverage; (1) company codes, which were designed by the organisation themselves and only applied to that organisation; (2) industry codes, designed collaboratively by organisations operating in a particular industry and applying to a number of organisations in that industry; and (3) international codes, which are designed by international organisations or NGOs and apply to any companies which agree to abide by that code. It was noted that each type of code has a different aim and so covers different types of labour policies. Company codes are generally the most vague and least comprehensive of labour codes, setting out general aims but no set standards and often focusing on high-profile issues which are more likely to damage a company's reputation. International codes, in comparison, are generally the most stringent, setting out clear standards to be achieved and covering a broader spectrum of policies.

Examination of the most commonly used labour codes in Chapter 3 revealed nine main types of labour policy which might be included by utilities. These were:

- Prohibition of child labour
- Prohibition of discrimination
- Prohibition of forced labour
- Minimum wage rates
- Maximum working hours
- Health and safety in the workplace
- Skills training for employees
- Freedom of association
- Recruitment of local labour

The empirical research showed that only a minority of the utilities interviewed used an international code to guide their decisions relating to the use of labour policies, with the majority of procurement practitioners choosing the type of policy themselves or using the guidance of a company code. It was also shown by the empirical research that policies relating to health and safety in the workplace were the most commonly included by interviewees. Prohibition of child labour was the next most common, with the remaining types of policy (with the notable exception of recruitment of local labour, see further below) being included by approximately half of the interviewees. Generally, the choice over which types of labour policy were included in procurement was unrelated to the influence of EU law but reflected those areas in which the utility felt issues were most likely to arise in their contracts (so that, for example, firms which operated mostly in the UK were less likely to consider the issue of child labour in their contracts).

Consistent with the findings in Chapter 3 relating to company codes, the majority of interviewees did not set out any precise standards to be met, preferring to set general aims or require compliance with national law. For those that did set out precise requirements, the emphasis was on requiring suppliers to meet minimum standards

rather than working with suppliers towards higher labour standards. This was consistent with both the finding above that company codes generally focused on high-profile issues likely to damage reputation and also the emphasis on avoiding bad publicity found in the empirical research (see Section II above); utilities were more concerned with avoiding bad suppliers than improving suppliers' labour standards.

The most contentious type of labour policy was favouring local firms or labour. The analysis in Chapter 3 showed that favouring local labour is a relatively common requirement in labour codes, intended to improve the overall standard of living for the community in which the company is operating. As was shown in Chapter 6, favouring local labour is one of the areas which the EU procurement regime clearly restricts. There are three possible situations for favouring local labour; (1) favouring labour based in the home state; (2) favouring labour based in another EU state and; (3) favouring labour based in a third country. The first scenario is the most clearly unlawful but, as shown in Chapter 6 it is likely that all three scenarios are prohibited under the EU free movement rules.

The empirical research showed that the emphasis for interviewees was on the first scenario, favouring labour based in the home state and, in particular, favouring labour which was based in the specific local area in which the utility operated. This was consistent with the sense of duty towards the local area which interviewees cited as being their main motivation for including labour issues in their procurement generally (see Section II above). Interviewees also noted commercial benefits from using local labour, including closer relationships with the firms and faster response times.

Consistent with this emphasis on the first scenario, this was the area in which interviewees felt the most restricted by the EU legal regime and, despite the commercial benefits of favouring local labour set out above, the approach was rarely taken in practice. A majority of interviewees stated that they had considered favouring local labour but had chosen not to do so due to it being unlawful under EU law and overall, a

majority of interviewees indicated that if the law were relaxed in this area they would favour local labour to a certain extent. Some interviewees attempted to promote the use of local labour in a manner that they considered consistent with the Utilities Directive, most often by looking at response times specifically or using non-legally binding methods of promoting local labour. However, though the interviewees did not wish to breach the EU law using these methods and believed them to be lawful, such methods may in fact not be lawful under the Directive, opening up these utilities to the possibility of challenge. There was also a small minority of interviewees who felt that the issue was important enough that they favoured local labour regardless of the EU law, taking the chance that there would be no legal challenge.

Overall then, the area of favouring local labour is the area in which interviewees most favoured reform of the EU legal regime. The EU law in this area significantly restricts the commercial desires of utilities in the UK and is the main area in which the restriction was felt to be strong enough to push utilities to seek ways of working around the law.

#### **IV. Labour Policies in the EU Procurement Regime**

Where utilities had made the decision to include some labour policies in their procurement, this research then aimed to determine how those labour policies were structured and what impact, if any, the EU legal regime had had on that decision. Chapter 6 set out a detailed overview of the possible methods for including labour policies in procurement and analysed the potential legality of those methods under the EU procurement regime, calculating the risk of challenge for each method. Three main methods were identified; contract conditions, prequalification criteria, and tender evaluation.

##### IV.1 Contract Conditions

As discussed in Chapter 6, utilities may choose to include contract conditions that set out labour-related requirements to be completed by the supplier during the contract. Contract conditions are useful for ensuring labour issues are complied with throughout

the (potentially quite lengthy) contract performance period, unlike the other methods discussed below, which simply check the labour policies of the supplier at the time of the procurement. The empirical research showed that contract conditions were a relatively popular method amongst interviewees for including labour policies in procurement for this reason, though they were most commonly used in conjunction with other methods rather than as a sole method.

Contract conditions may be divided into two categories; conditions which require compliance with national law, and conditions which go beyond legal compliance. The former option is one of the lowest risk options for including labour conditions and its legality appears to be assumed in Article 39 of the Utilities Directive. The possibility of including contract conditions which set labour requirements going beyond compliance with the law is set out in Article 38 of the Utilities Directive. This allows utilities to "lay down special conditions relating to the performance of the contract" and also notes that those conditions "may, in particular, concern social and environmental considerations". Following this, it was shown in Chapter 6 that such conditions are also a relatively low risk approach provided that the conditions are designed to be compliant with the TFEU free movement provisions. The conditions must also be limited to the performance of the contract rather than looking at more general issues, such as ensuring that the labour standards of the entire firm meet a certain level, as opposed to just looking at the standards of the part of the firm working on the contract.

Consistent with the argument that it was the least risky approach, requiring legal compliance was the most common use of labour-related contract conditions. The empirical research also found, however, that the EU legal regime was not the main consideration of interviewees when choosing to limit conditions to legal compliance, with the main factor instead being a belief that national law set a high enough standard and any contract conditions going beyond this were unnecessary. Equally, while the empirical research found that no interviewees included contract conditions covering general labour issues unrelated to the contract performance, their decision not to do so was also

unrelated to the EU legal restrictions. Instead, the main reasons were either a lack of awareness on the part of the procurement practitioners that such conditions could be created or a belief that such conditions were unnecessary.

Overall, the EU legal regime had a very limited impact on the decision over whether or not to include labour-related contract conditions, suggesting that the legal regime offers utilities enough flexibility in this area to achieve their aims. No major restrictions or grey areas in the law were felt to exist in this area by interviewees.

#### IV.2 Prequalification

It was shown in Chapter 6 that utilities may also set prequalification criteria relating to minimum labour standards and then exclude those suppliers which do not meet those standards from the procurement process. Consistent with the finding discussed above (see Section III) that utilities were generally more concerned with avoiding poor suppliers than working to improve standards, the empirical research found that prequalification criteria setting minimum standards were the most popular method for including labour standards. Interviewees noted that this approach meant that poor suppliers could be removed from the process early on, allowing the focus for the rest of the procurement to be on cost and technical issues.

It was noted in Chapter 6 that the main query regarding prequalification criteria under the EU utilities regime was the precise meaning of the phrase "objective rules and criteria", which Article 54 of the Utilities Directive uses to describe acceptable prequalification criteria. It is generally accepted that there is greater flexibility for utilities to include prequalification criteria than there is for public sector bodies, but the precise extent of that flexibility is uncertain. Based on analysis by Arrowsmith and Maund, three criteria were identified as relevant in Chapter 6; (1) whether the criteria are directly related to the particular contract or are wider in scope; (2) whether the

criteria are linked to the commercial aims of the utility or not; and (3) whether the criteria are linked to the overall procurement policy of the utility or not.<sup>999</sup>

The empirical research showed that interviewees generally believe there is no restriction on the types of issues which they can consider at the prequalification stage. The majority of interviewees stated that their prequalification criteria looked at the supplier in general rather than being limited to criteria directly related to the particular contract. Consistent with the focus on moral reasons for including labour concerns rather than commercial reasons (see above, Section II), interviewees did not consider their labour-related prequalification criteria to be linked to the commercial aims or overall procurement policy of their company.

It appears, therefore, that the utilities interviewed generally did not conduct any detailed legal analysis into the meaning of "objective rules and criteria", taking the words at face value as meaning any criteria applied to all parties equally. The utilities thus operated on the basis that the most flexible of the potential interpretations of the phrase was the correct one. Given the emphasis on the commercial arguments for CSR by the EU, it is possible that this will not be the interpretation made by the CJEU should the issue ever go to the court, limiting the use of such criteria by utilities.

#### IV.3 Tender Evaluation (Award Criteria)

As discussed in Chapter 6, it is possible for utilities to evaluate labour issues through a preference in the award criteria. This method allows the utility to balance the importance of the labour issue against other issues such as cost and technical issues and is a useful method for determining the supplier who offers the best labour standards. It was also shown, however, that award criteria are unsuitable for the main concern of utilities - ensuring compliance with minimum standards - as there is no real way of weighting the issue (compliance is a yes/no issue). It is also generally considered unacceptable to

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<sup>999</sup>Arrowsmith, S. and Maund, C. 'CSR in the utilities sector and the implications of EC procurement policy: a framework for debate', Ch. 11 in Arrowsmith, S. and Kunzlik, P. (eds), *Social and Environmental Policies in EC Procurement Law: New Directives and New Directions*, (2009, Cambridge: CUP) at pp. 451-453

weigh up compliance with minimum standards against cost and technical issues. Consistent with this, the empirical research found award criteria were used less frequently than the methods previously discussed, though use was still relatively common.

As shown in Chapter 6, the main issue relating to the use of labour-related award criteria is the extent to which they can be "linked to the subject matter of the contract" as required by Art. 55(1)(a) of the Utilities Directive. It was shown that it is unclear whether the meaning is the same as "the performance of the contract" requirement for contract conditions or requires a closer link to the contract, with award criteria being directly related to the technical specifications of the contract. If the correct interpretation is the former, workforce criteria should be lawful. However, if the latter approach is the correct one, workforce criteria seem to lack the needed link since the standards of the workforce do not impact on the actual characteristics of the product in any way.

The empirical research showed that, overall, interviewees favoured the first approach, considering workforce criteria to be lawful so long as they were linked to the performance of the contract rather than looking at the workforce as a whole throughout the supplier's business. A majority of interviewees also disagreed with the Commission's interpretation of the law in this area, which states that workforce award criteria may only be lawfully considered where all other aspects of the tender are equal.<sup>1000</sup> Interviewees felt this was an unduly restrictive interpretation of the law which impacted negatively on the autonomy of their company to decide which factors were important enough to consider at the award stage.

Perhaps because of the general acceptance of the more flexible interpretation of the "subject-matter of the contract" and the legality of workforce award criteria taken by the majority of interviewees, there were no complaints about the EU law in this area and most interviewees stated it had little or no impact on their decision over whether or not

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<sup>1000</sup> European Commission, *Interpretive Communication of the Commission on the Community Law applicable to public procurement and the possibilities for integrating social considerations into public procurement*, COM(2001) 566, at para. 1.4.1.

to look at labour issues through award criteria. The main reason given by those interviewees who did not include labour-related award criteria was instead that they felt labour issues should be examined earlier in the process and the award criteria stage should focus on cost and technical issues.

#### IV.4 Overall Conclusions

Overall, the impact of the EU legal regime on the decision of how to structure labour policies in procurement was fairly low. Where there was a lack of clarity in the law, utilities tended to assume that an approach was legal, taking the most flexible interpretation of the law available. Perhaps because of this, very few interviewees felt that the legal regime was the key issue when they were looking at structure; rather, the main factors were practical issues, with interviewees determining which stage of the procurement process was the simplest and most effective point to include the labour issues they were concerned with. This led to most utilities seeking compliance with minimum labour standards to choose the prequalification stage, whereas those who were looking at ongoing concerns or wanted to encourage labour standards to be improved among their suppliers to choose contract conditions and/or award criteria.

### **V. Regulatory and Compliance Issues**

Finally, this thesis aimed to examine any regulatory and compliance issues caused by the restrictions and grey areas in the EU procurement regime. In order to do so, Chapter 7 set out an overview of the aims of regulation and the impact that overly strict approaches to regulation might have. It also looked at the impact of indeterminate and unclear regulation.

Chapter 7 discussed the economic model of deterrence, in which compliance with the law involves a cost/benefit analysis under which individuals will break the law where they feel the benefit to them of that breach outweighs the potential risk of being caught or the cost of punishment. It was shown that this economic model, while suffering from some flaws when applied to individuals, is applicable to corporations given the rational

economic basis of their actions. Following this, it was argued that if the commercial pressures on utilities to include CSR were strong enough, the economic model of deterrence suggested that they would breach the procurement law if necessary to meet those pressures.

As noted in Chapter 7, however, the economic theory of deterrence relies on the fact that the company is aware of the law and that the law is clear about what is prohibited. Given the grey areas in the utilities procurement law relating to the use of labour policies, the possibility was raised that the lack of clarity might have a significant impact on compliance in this area. It was shown that where a law is unclear, there is a spectrum of possible behaviour which ranges from behaviour certain to attract liability to behaviour certain to not attract liability, with the actual legal requirement being somewhere between the two extremes. It was shown that where this is the case, companies tend to err on the side of caution and there is in fact a general tendency towards over-compliance since this not only reduces the possibility of challenge but also increases the chance that any successful challenge will result in a low penalty. It was also noted, however, that this only applies to legal provisions with moderate levels of uncertainty; the more uncertain a legal provision, the greater the tendency to under-comply.

The empirical research showed that there was little "creative compliance" or evasion of the procurement rules by interviewees. In fact, interviewees generally did their best to comply with what they thought the legal requirements were. Consistent with the analysis discussed above, one of the reasons for this was to reduce the chance of legal challenge. Interviewees noted that the numbers of challenges in the UK had been increasing in recent years and imposed significant costs on the utility to defend, regardless of the ultimate result. It was also found that the majority of the interviewees complied with the EU legislation not because they were afraid of what would happen if they did not, but because they believed the legislation was fair and improved competition in procurement. In addition to these factors, the overall low level of knowledge of the law on the part of

the interviewees may also have been relevant. Interviewees did not attempt to evade the legal requirements and restrictions set out in the Utilities Directive often because they were simply unaware that those restrictions existed. While the actual level of compliance is hard to measure due to the lack of clarity in the law, it appears that the majority of non-compliance by utilities is due to ignorance of the law rather than deliberate wrongdoing.

The distinction between deterrence and compliance methods of enforcing regulation was also discussed in Chapter 7. It was shown that deterrence approaches use punitive measures and often hold retribution to be a key aim of the law. By contrast, compliance approaches focus on informal methods and emphasise conformity with the law as the main aim. While the procurement regime is currently enforced using deterrence methods, with punitive civil sanctions for breach, it was shown in Chapter 7 that this may be a less efficient approach than using compliance methods would be. Compliance approaches lead to less delay than deterrence approaches and also foster a better relationship between the company and the regulator. Given the finding above that most breaches of the procurement regulation are from a misunderstanding of the law rather than being deliberate breaches, the empirical research suggests that a compliance approach might work better in this area for utilities in the UK than the current deterrence approach. Given this, the possibility was raised that a responsive regulation approach to enforcing the procurement regulation such as that suggested by Ayres and Braithwaite might work well in this area.<sup>1001</sup> Under this method parties are subject to increasingly formal and punitive methods the more they continue to breach the regulation. Following this, those utilities which wish to comply but breach the law by accident would not be punished but helped to comply in the future. Equally, the punitive measures for repeated breach would continue to deter those utilities who stated they over-complied due to fear of challenge.

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<sup>1001</sup> Ayres, I. and Braithwaite, J. *Responsive Regulation* (1992, Oxford: OUP), Ch.4.

## **V. General Conclusions**

This thesis has set out the practical impact of the EU procurement regime on the inclusion of labour considerations in utilities' procurement in the UK. The data has shown that in fact the impact was relatively low, with most procurement officers interviewed feeling that they had enough scope to complete the labour policies that they wished to do. It is notable that most labour policies included in procurement were relatively simple and often based around compliance with national law, with few utilities attempting any of the policies identified as high risk. Procuring officers also rarely examined the requirements of the law in any great detail before including labour considerations in procurement, tending to simply assume that the approach they were taking was legal. Thus, while it appears that the scope for including labour policies in procurement is quite wide, the law may be more restrictive than many utilities assume.

The main area where it was felt that the EU regime was significantly restrictive was the area of local labour, with the majority of interviewees feeling constrained by the law in this area. It is in this area that many interviewees felt that reform of the law would be most appropriate, but this reform seems very unlikely to occur given the EU's strong focus on preventing national discrimination. Nonetheless, even here there was no real deliberate breach of EU law, with the vast majority of interviewees complying despite their feeling that the law was preventing their aims in this area.

Overall, it does not seem that utilities are being driven to breach the law due to restrictive procurement rules in this area, with no real risk of creative compliance on the parts of procurement officers in the UK in the field of labour considerations in procurement.

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