

Scottish ferry services' procurement, post-Brexit: challenge or opportunity?

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Abstract

In the context of a very uncertain legal and constitutional future, the issue of lifeline ferry service provision in Scotland is considered. Some unintended, and negative, consequences of competitive tendering are set out, focussing particularly on the impact of tendering on the Scottish Government's Fair Work policy and the necessity to reduce carbon emissions. The range of possible constitutional and legal backdrops against which Scottish ferry services will be provided in the future are analysed in terms of the consequences for achieving these objectives and a road map is constructed. EU and Scottish public procurement legislation is described and their similarities are highlighted. Should competitive tendering ultimately be deemed no longer necessary, the need to develop a suitable regulatory regime for a public sector monopoly provider is noted. In an alternative scenario, where tendering continues, it is proposed that the use of Community Benefit clauses, as well as other legal instruments, could be used to align the outcomes of competitive tendering with specified economic and environmental objectives.

I Introduction

It is very unusual to be having to think about the economics of Scottish ferry transport services in the face of such constitutional and legal uncertainty, but such are the times in which we now operate. Here, we set out the various potential states of the world in which decisions around the delivery and financing of ferry transport to Scotland's island communities will have to be made. In doing so, we flag up at least one or more of the discussions which will necessarily have to take place at some unspecified time in the future. Moreover, we highlight options which have a number of desirable features and which might serve as a focus in any discussions which might take place between the EU and the UK, the UK and Scotland or Scotland and the EU in relation to ferry transport and to the wider issue of public procurement. National Audit Office officials have already begun to advise that companies should be considering the challenges / environment they will face post-Brexit and arguing for specific elements in any Brexit deal that is struck.¹

These are uncertain times, but, in fact, the legal position regarding the necessity or otherwise of having to undertake competitive tenders for Scotland's ferry routes has been a matter of uncertainty and debate for some time, in fact since 2005 and it remains so today. This

¹ Mark Taylor, Assistant Director, Audit Scotland speaking at a conference on Brexit in Edinburgh, 2nd March 2017, <http://www.mackayhannah.com/conferences/agenda/brexit-for-beginners>

particular discussion is addressed in detail in John Temple Lang's article in this issue and is the subject of the review into the tendering of ferry contracts which was announced by the Transport Minister² last month. The review, which has necessitated the delaying of the Gourock-Dunoon tender and will, in all likelihood, delay the process for the Northern Isles contract, has, as its focus the question of whether a public-sector company (in this case, CalMac) could be directed to provide this service without the need for any further tendering. That possibility could have been considered at any point over the past decade or so and is not related to the imminence of Brexit. It relies entirely on a known exemption from EU State aid rules, the Teckal exemption, which is referred to elsewhere in this issue. The outcome of the review, taking place, as it does, while the UK (and Scotland with it) moves towards exit from the EU, will remain relevant given that procurement regulations recently enacted into Scots law include reference to Teckal. If somehow Scotland manages to detach itself from the UK and re-attach itself to the EU, then EU law will retain its current primacy.

In order to bring some clarity to this matter we set out below as many of the considerations around ferry services as we can, under each of the possible states of the world which we can envisage at this point. We consider not only the matters currently under review by the Scottish Government, but the wider question of how to provide island communities with an efficient, safe, good-quality and affordable ferry service that promotes and develops the economic and cultural life of the islands; provides fair, good quality work for islanders and island and mainland communities and is environmentally sustainable. In other words, how do we avoid the unintended consequences of a system (competitive tendering) which is designed mainly to promote efficiency (more or less narrowly defined) and which can, and does, interact negatively with other well-established public policy aims of the current Scottish Government and all likely successors for some time to come.

II Background to tendering of ferry services in Scotland

It is not necessary here to rehearse the full history of competitive tendering of Scottish ferry services as this is well-known and documented in a variety of journal and newspaper articles. Central to our discussion here is the largely undisputed proposition that the existing service in the Clyde and Hebrides – the largest of the bundled routes - is a well-run, efficient and cost-effective service provided by the public-sector operator, CalMac (Findlay, J, 2005, 2010, 2016). Moreover, given the tightly-specified tender and the over-arching regulatory environment in which the service operates, there is very little scope for cost-saving. In particular, the vessels, timetable and staffing are largely pre-determined and any cost-saving could only come in terms of a deterioration in the terms and conditions of on and off-shore

² <http://www.transport.gov.scot/news/review-ferry-tendering>

CalMac employees. More up-to-date evidence will soon be provided by the National Audit Office, which will publish an audit of ferry services in Scotland in the autumn of 2017. This audit will ‘...examine spending on ferries and what this achieves, to help establish whether it provides value for money’.³

The role of previous tenders in achieving a well-run, cost-effective ferry service is arguable but, on any view, it is undisputed that tendering itself is an extremely costly affair (ibid) and that a continuation of the tendering regime is unlikely to provide any benefits to service users in terms of quality nor achieve any cost-saving in the running of the service. Moreover, as discussed elsewhere in this issue, it can have a negative impact on the achievement of environmental policy targets and, in practice, can cut across the Fair Work policy agenda by endangering the existence of the public operator (Findlay, J, 2016) or by forcing tendering authorities to shoehorn Fair Work into a process not primarily designed for this purpose and subject to a degree of uncertainty (Findlay, P, 2017).

As noted above, successive Scottish Governments (and the previous Scottish Executive) have not challenged these arguments but have, instead, indicated repeatedly that tendering is required by EU regulation and is not their preferred option. So the question arises as to which of the possible circumstances which might arise in the short to medium term would allow the Scottish Government to provide ferries without the need to put them out to competitive tender and thereby avoid the unintended, negative consequences referred to above - and outlined in more detail in this issue and elsewhere (Findlay, J, 2016, Rehmatullah, 2017). Furthermore, were such circumstances to arise, then how should such public monopolies be regulated to ensure quality of service, cost-effectiveness, environmental sustainability, fair work and any other policy objectives that may be set by the Scottish Government?

III Competitive tendering and Scotland's current position within the EU

The following discussion relates to the current status of the UK as an EU member state. Notwithstanding the UK Parliament's Article 50 vote, EU regulations are likely to apply in the UK for at least two years and probably longer. The decision by the First Minister to seek the approval of the Scottish Parliament to begin negotiations with the UK government on a second independence referendum, raises the possibility that Scotland may remain in the EU after Brexit and into the foreseeable future.

The requirement of EU member states to engage in a competitive tendering process is considered in detail in this issue by Temple Lang (2017). This includes the question of

³ <http://www.audit-scotland.gov.uk/report/ferry-services-in-scotland>

whether the Altmark judgement would have allowed the Scottish Government to direct CalMac, or to direct and subsidise a private operator, to run Scotland's ferry services without contravening the State aid rules. Temple Lang concludes that indeed it might have, if the public service obligation had been properly specified and the level of compensation had been transparently and objectively calculated. However, successive Scottish Governments have chosen not to attempt this and have relied instead on competitive tendering, with all its consequent costs.

The Scottish Government review of tendering which is currently underway is considering the question of whether or not another judgement, which gave rise to the Teckal exemption, applies in the case of Scottish ferry services. In plain speech, the Teckal exemption allows for a public authority in a member State to procure directly from a company which is solely directed by that authority (as though it were a department of that authority) and which carries out eighty percent or more of its activities for the procuring authority. If Teckal applies, then the Scottish Government could simply direct CalMac (which is wholly-owned by Scottish Ministers and is primarily engaged in servicing Scottish routes on their behalf) to provide ferry services on any or all of the current or future routes. Clearly such a finding would remove the need for a competitive tendering process, although some other method of regulation would presumably be required to replace that provided, in theory, by the forces of competition. We return to this question below when we consider the constitutional outcome preferred by the UK Government ie that Scotland remains in the UK and the UK leaves the EU.

IV Scottish / EU procurement legislation

In 2014, the Scottish Parliament introduced the Procurement Reform (Scotland) Act followed by two pieces of associated regulation in 2015 and 2016⁴. These implemented the relevant EU Directives on public procurement. It is important to state that neither the 2014 Act nor the Regulations mandate that the contracting authority award public contracts through competitive tendering. Section 14 of the 2014 Act, for instance, recognises that the Scottish Government 'may, by regulations, specify circumstances in which a contracting authority may ...award a regulated contract without seeking offers in relation to the proposed contract.' Regulation 6 of the 2016 regulations also specifies other circumstances in which contracts can be awarded without competition.⁵

⁴ *Procure Reform (Scotland) Act 2014; Public Contracts (Scotland) Regulations 2015 and The Procurement (Scotland) Regulations 2016* accessed at <http://www.legislation.gov.uk/>

⁵ Section 14 of the Act of 2014.

In another significant development, Regulation 13 of the 2015 regulations confirms the Teckal exemption referred to above.⁶

The 2015, 2016 Regulations and the 2014 Act apply to all new tender processes starting after the date on which these came into effect (April 2016) with the important provision that the law now embeds a strong theme of social responsibility. In the case of the provision of ferry services through competitive tendering, the Act provides several grounds on which this form of procurement can be challenged. This statutory intent is set out in Part 2 'General Duties and Procurement Strategies'. This is combined with detailed set of remedies that are available to challenge the decisions of the contracting authority in situations where it is not compliant with its general duties.⁷ This requires mandatory compliance with the 'sustainable procurement duty'⁸ which includes a duty to 'consider how in conducting the procurement process it can – improve the economic, social and environmental well-being of the authority's area.'⁹ Further, in any preceding financial year the procurement strategy developed by the contracting authority must 'set out how the authority intend to ensure that its regulated procurements will ...deliver value for money.. include a statement of the authority's general policy on the use of community benefit requirements, consulting and engaging with those affected by procurement, the payment of a living wage to persons involved in producing, providing or constructing the subject matter of regulated procurement...'.¹⁰ The 2015 Regulations also permit the contracting authority to refuse to award a contract to the tenderer submitting the 'most economically advantageous tender' in situations where 'the authority has established that the tender does not comply with applicable obligations in the fields of environmental, social and labour law established by EU law, national law, collective agreements or by the international environmental, social and labour law provisions.'¹¹ The Regulations have also incorporated a new ground for exclusion which deals with breaches of social, environmental and employment law obligations. In situations where 'a contracting authority can demonstrate by any appropriate means that a business has breached one of these obligations, it may, at its discretion, choose to exclude that business from bidding for contracts.'¹² So we can see that in many of the respects relevant to this discussion, Scottish procurement law mirrors existing EU law.

⁶ Regulation 13 of 2015 Regulations

⁷ Section 8 of the Act sets out the General Duties of a contracting authority.

⁸ Section 9 sets out the sustainable procurement duty

⁹ Section 9 (1)(a)(i) of the 2014 Act

¹⁰ Section 15 (5) of the 2014 Act

¹¹ Regulation 57 (2) of the 2015 Regulations

¹² Point 9.15 of the Policy Note accompanying the 2015 Regulations

In addition to the statutory provisions, the contracting authority may impose a community benefit requirement as a term of the contract relating to training and recruitment that is 'intended to improve the economic, social or environmental wellbeing of the authority's area in a way additional to the main purpose of the contract in which the requirement is included.'¹³ This is not a mandatory requirement and the Scottish Government reserves its right to publish guidance on the use of 'community benefit requirements'.¹⁴ This is discussed in more detail in relation to Fair Work in the paper by Patricia Findlay in this issue (Findlay, P, *op cit*).

The Future Islands Bill¹⁵, which is due to be introduced in the Scottish Parliament in Spring 2017 is likely, based on the consultation which was undertaken as part of the process for introducing the Bill, to include a requirement to have a National Islands Plan; to require 'island-proofing' of all legislation, policy and services and to provide a range of measures to 'empower island communities' in relation to, among other things, service delivery.

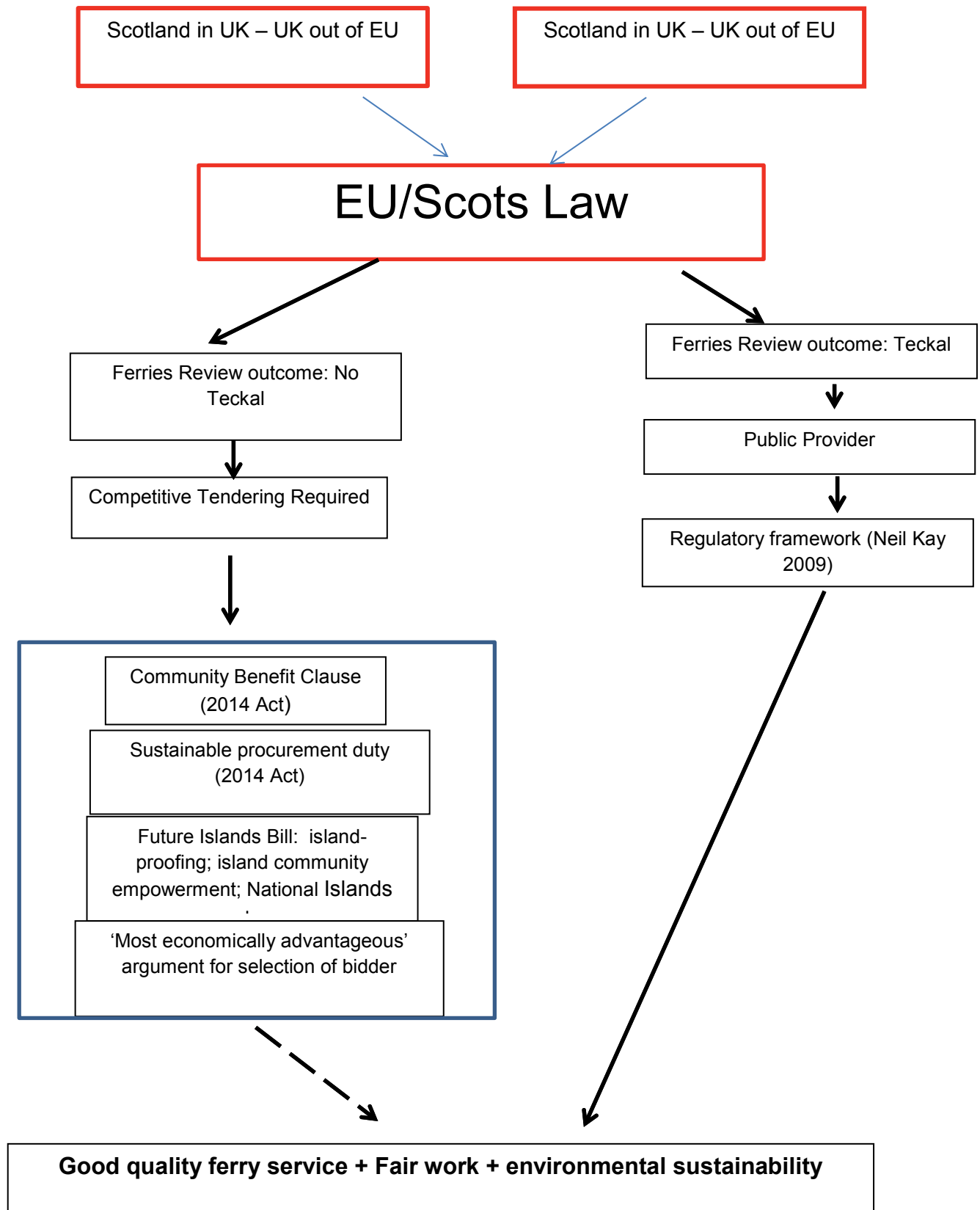
Taken together, this suite of legislation/regulation could form the basis of a new approach to the delivery of ferry services which is both compliant with EU and Scots Law and would allow a more direct approach to ensuring that ferry operator(s) not only provide a good quality, environmentally sustainable, service but also provide good quality employment conditions and thereby contribute to the strength of island economies. So where does that leave us now?

Figure 1 sets out a road map of possible outcomes conditional on whichever constitutional position Scotland finds itself. Based on current EU and Scots Law and in both of the circumstances currently envisaged, an important question is whether or not the Teckal exemption is deemed by the current Scottish Government review to apply to ferry services in Scotland.

¹³ Section 24 of the 2014 Act.

¹⁴ Section 26 of the 2014 Act.

¹⁵ <https://consult.scotland.gov.uk/islands-team/islands-bill-consultation/>



Firstly, we shall consider the state of the world in which the exemption is not deemed to apply (the left hand side of the diagram). In this case, competitive tendering is likely to still be required whether or not, Scotland remains in the EU. However, there are a number of routes whereby the tendering authority ie the Scottish Government, could incorporate other policy objectives, including the ones considered here, into a tender document. These include, but are not confined to, the use of Community Benefit Clauses, the Sustainable Procurement Duty and relevant elements of the Future Islands Bill when it becomes law. Moreover, in the selection of the successful bidder, the contracting authority could, as explained by John Temple Lang (2017), select the one which was deemed to be the ‘most economically advantageous’, which is not necessarily the lowest-cost bid. This could lead to the achievement of the relevant policy objectives, although that outcome is not certain, relies on the political will of the Scottish Government of the day and could be subject to challenge (we denote this in the diagram with a broken arrow connector).

If the review finds that the Teckal exemption applies to Scottish ferry services (the right hand side of the diagram), then this opens up the possibility of the contract being awarded permanently to an in-house operator (i.e. CalMac). In this situation, the Scottish Government could simply direct CalMac to comply with and meet all objectives set out by them. Clearly in this case, a system of regulation – over and above all other existing safety and environmental regulations – would have to be instituted. Neil Kay in a paper written in a previous Fraser Economic Commentary (Kay, 2009) discusses this very issue. He argued that Scottish civil servants were inexperienced in regulating public-sector monopolies because this particular task in the 1980s and 1990s fell under the remit of UK civil servants. However, a wealth of experience has now been accumulated in this area and it should be perfectly possible to devise a suitable regulatory framework and to find sufficient expertise in-house and externally to operate it. Work on developing such a framework should be a priority for Transport Scotland, and interested academics, given the strong possibility of it becoming necessary.

It should be noted that we have not taken into account another possible change in the rules which might affect this discussion. In April 2018, the European Single Procurement Directive will become mandatory in Scotland. This Directive provides an easier procedure¹⁶ for bidders throughout the EU to be short-listed for public contracts, provided they demonstrate their standing, technical capacity and experience. In previous ferry tendering exercises, there

¹⁶ Point 9.21 of the Policy Note to the 2015 Regulations

have been very few bidders from the UK or the EU. This new Directive may make such bids a more attractive proposition, but it is too early to be sure about the possible effects.

V Conclusion

The provision and financing of lifeline ferry services in Scotland is a matter of great importance to island communities and their fellow-citizens in the mainland port areas. The ferry industry provides much more than simply transport services; it provides employment opportunities and training and constitutes a vital lifeline connecting the fragile island economies to that of mainland Scotland. It is also the vehicle whereby policies as diverse as carbon reduction and fair work can be delivered to islanders and the wider Scottish labour market.

The considerable constitutional and legal uncertainties surrounding the future of the industry is likely to persist for some time. In an attempt to bring some clarity to the matter, we have set out the possible outcomes which will arise out of the current review of ferry tendering and, in particular, we map out the ways in which other policy objectives of the Scottish Government might be more effectively achieved in the short to medium term, conditional on the outcome of its current review of whether ferry services require to be competitively tendered.

While acknowledging the inherent uncertainties, it must also be acknowledged that opportunities are opening up to achieve a number of policy objectives in a more direct way. Should the review conclude that tendering is not necessary, the service can lawfully be provided by a public-sector provider under the direction of the Scottish Government. In such circumstances, policies such as fair work and the environmental objectives outlined in this issue (Rehmatullah, 2017) could be pursued as an integral part of the aims of the operator under a suitable – and new - regulatory regime.

However, should the review come to the opposite conclusion, there are still several mechanisms embedded in Scots and EU law which would provide the means to pursue those same objectives, albeit with less certainty of achieving them.

There are strong economic arguments for arranging matters in such a way as to utilise ferry services as a means to achieve a variety of desirable policy aims. As indicated here, there are likely to be legal avenues to pursue these aims under most states of the world we can envisage – subject always to there being the political will to do so. In the meantime, research and policy activity should be directed towards examining in greater detail the precise ways in which this can be implemented.

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Findlay, Kay, Temple-Lang and Rehmatullah (Fraser of Allander Economic Commentary, Vol. 41, No, 1

