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Withholding payments to main contractors – an attempt by Estonia to protect subcontractors in public works contracts

2019 no 1
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1 Introduction

The European public procurement legislation is focused firstly on the integration of the European market to promote the development of effective competition.¹ This represents the primary goal of public procurement – to get the supplies, services or works in the best competition situation and satisfy the needs of the contracting authority or entity in the most efficient way.² However, Directive 2014/24/EU arrived with a strong intention to emphasise horizontal (secondary) goals.³ Bearing that in mind, one of the main goals of Directive 2014/24/EU is to facilitate the participation of small and medium-sized enterprises (SME) in public procurement.⁴ According to European Commission, SMEs represent 99 per cent of all businesses in the EU.⁵

Article 71 of Directive 2014/24/EU regulates subcontracting thoroughly, compared to its predecessor, Article 25 of Directive 2004/18/EC.⁶ Article 71 has three purposes – transparency for contracting authorities, greater possibility to ensure the fulfilment of the contract according to stipulated requirements and lastly, increase the efficiency of public spending, facilitating in particular the participation of

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¹ Judgement of 3 October 2000, University of Cambridge, C-380/98, EU:C:2000:529, paragraph 17. See also opinion of Advocate General Léger in joined cases C-21/03 and C-34/03, Fabricom, EU:C:2004:709, paragraph 22.


SME’s in public procurement.\textsuperscript{7} Carried by the purpose to encourage the participation of SMEs, Member States are free to provide mechanisms for direct payments to subcontractors.\textsuperscript{8} Article 71 (3) of Directive 2014/24/EU states that Member States may provide such payments at the request of the subcontractor. Where the nature of the contract so allows, the contracting authority or entity shall transfer due payments directly to the subcontractor for services, supplies or works provided to the economic operator to whom the public contract has been awarded (the main contractor). Such measures may include appropriate mechanisms permitting the main contractor to object to undue payments. The arrangements concerning that mode of payment shall be set out in the procurement documents. Furthermore, Article 71 (7) of Directive 2014/24/EU allows Member States to go further under national law, for instance by providing for direct payments to subcontractors without it being necessary for them to request such payments.\textsuperscript{9}

The Commission considered that direct payments offers subcontractors, which are often SMEs, an efficient way of protecting their interest in being paid.\textsuperscript{10} In legal theory, however, there is doubt whether direct payments at all favour SME participation in public procurements or if the provision just adds costs and administrative burden for the contracting authorities. Furthermore, the opposition of prime contractors might imply a possible negative effect – detailed provisions on payments could interfere with the freedom of contract and thus might deter prime contractors.\textsuperscript{11} The Committee of the Regions found that the relationship between main contractors and subcontractors falls under competition law and national contract law and should not be affected by the procurement directives.\textsuperscript{12}

Different approaches of Member States are visible: out of 12 Member States asked, five have not transposed any rules regarding direct payments to subcontractors and seven have transposed the provision at least to some extent and/or had a similar provisions already in place regardless of Directive 2014/24/EU.

\begin{thebibliography}{9}
\bibitem{preamble} Preamble of Directive 2014/24/EU, paragraph 78.
\bibitem{identical} Identical provision is set out in Directive 2014/25/EU, Article 88 (3) and (7).
\end{thebibliography}
Withholding payments to main contractors

(considering that the Estonian provision transposes said EU provision).\textsuperscript{13} The fear of interfering too much with the contractual freedom and forcing a provision that might not smoothly fit the existing national regime, are the probable reasons why the provision on direct payments entails double discretion for the Member States. Firstly, whether to transpose any provision concerning payments in the prime contractor-subcontractor chain at all, and secondly, if a Member State decides to transpose said provision, Directive 2014/24/EU does not specify the exact method.

This article is divided into two substantial parts, chapter 2 and 3. Chapter 2 opens the nature of the discretion given to the Member States when transposing Directive 2014/24 into national law. Chapter 3 briefs about the nature of the payment provision in the works contracts recently entered into force in the Estonian Public Procurement Act (hereinafter PPA)\textsuperscript{14} and analyses the compliance of the new provision with EU law.

2 Direct payment in Directive 2014/24/EU and the discretion of the Member States

2.1 The implementation of EU directives

Directive 2014/24/EU is adopted having regard to the Treaty on the Functioning of the European Union (TFEU),\textsuperscript{15} and in particular Article 53 (1), Article 62 and Article 114.\textsuperscript{16} According to Article 114 (1) TFEU the European Parliament and the Council shall adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in the Member States, which have as their object the establishment and functioning of the internal market. Article 114 TFEU does however not specify the type of harmonisation to be made. Presumably, and if the type of harmonisation is not otherwise specified, the best method is maximum harmonisation, which means extensive replacement of national provisions.\textsuperscript{17} Maximum harmonisation does not mean that national

\textsuperscript{13} Treumer, S., Comba, M. (ed), Modernising Public Procurement: The Approach of EU Member States, Edward Elgar Publishing, Cheltenham, UK & Northampton, USA 2018. Denmark, Finland, Germany, Sweden and the United Kingdom have not transposed the direct payment provision (please refer to pages 31, 85, 127, 271 and 303), France, Poland and Slovenia already had relevant legislation (please refer to pages 109, 169, 226); Spain, Italy, Romania and Estonia transposed the provision (please refer to pages 43, 151, 188, 246).


\textsuperscript{16} Legal basis of Directive 2014/24/EU.

Variations are prohibited. However, the borders for variation are strictly limited.\textsuperscript{18} Article 288 TFEU states that a directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. According to settled case-law, each of the Member States to which a directive is addressed is obliged to adopt, within the framework of its national legal system, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective it pursues.\textsuperscript{19}

The duty of a Member State is to correctly transpose the EU directives, which, however, might not always be an easy task.\textsuperscript{20} Directive 2014/24/EU establishes rules on the procedures for procurement by contracting authorities with respect to public contracts whose value is estimated to be not less than the thresholds laid down in Article 4 of Directive 2014/24.\textsuperscript{21} The provisions in directives are not exhaustive. Despite the non-exhaustive nature of the directives, the reality is that the scope for national discretion is substantially limited.\textsuperscript{22} The purpose of EU law is to codify supranational administrative provisions, which have the aim to harmonise domestic legal regimes, public or private, which co-ordinate the award of public contracts. The codification has benefits of legal certainty and legitimate expectation, as well as implications such as legal efficiency and compliance discipline.\textsuperscript{23} Even if the procurement falls below international threshold, that contract is subject to the fundamental rules and general principles of TFEU, provided that it is of certain cross-border interest in the light, inter alia, of its value and the place where it is carried out.\textsuperscript{24} In regulating situations outside the scope of the EU measure concerned, if the national legislation seeks to adopt the same solutions as those adopted in that measure, it is clearly in the interest of the European Union that, in order to forestall future differences of interpretation, provisions taken from that measure should be interpreted uniformly.\textsuperscript{25} The principles of the TFEU have direct effect – they are binding on Member State

\textsuperscript{18} Ibid.
\textsuperscript{21} Article 1 (1) of Directive 2014/24/EU.
\textsuperscript{23} Bovis, C., The Law of EU Public Procurement, 2 ed., Oxford University Press, 2015, p. 64.
Withholding payments to main contractors
governments and enforceable against them.26 It is ingeniously stated, that the EU legislation (in this case, Directive 2014/24/EU) is the floor, the TFEU is the ceiling and Member States are free to operate between these borders.27

Two frequent problems in procurement contracts are long deadlines for payments set in the contract and delays in payments (breaches of contractual obligations), which could have serious consequences especially to SMEs, considering their lower liquidity and limited resources.28 Long payment periods, including delays in payments, hurt the money flow, create uncertainty, prevent on-time investments and the development of the enterprise. All of this influences the profitability of the enterprise and, worst case scenario, could be dangerous to its survival.29 Delayed payments are, in particular, sensitive to subcontractors, as they complete all the works as required by the contract, but due to prime contractor acting in bad faith, they might not be reimbursed for completed works.30 Therefore, the target of Directive 2014/24/EU is not to ensure payments to subcontractors in general, the real goal is to ensure payments to subcontractors on-time and in full. I see that the Estonian solution of stopping payments potentially breaches, bearing the goal of the direct payment provision in the Directive 2014/24 in mind, the discretion given to the Member States and the general principles of public procurement – the principle of proportionality and the principle of transparency.

2.2 Discretion of the Member States

Article 71 Directive 2014/24/EU offers double discretion to the Member States – whether to transpose the provision and if yes, then how. At the time of writing this article, there are no decisions of the European Court of Justice (CJEU) known to the author explaining the possible interpretation of the given discretion. Article 45 (2) of Directive 2004/18/EC, similarly to Article 71 (3) of the Directive 2014/24/EU, states that a Member State “may” do something that the provision allows. This means that the directive does not provide for uniform application at EU level, since the Member States may choose not to apply the provision or implement it into national law with varying degrees of rigour according to legal, economic or social considerations prevailing at national level. In that context, the

29 Ibid.
Member States have the power to make the criteria less onerous or more flexible.\textsuperscript{31} In the case of voluntary exclusion grounds, the European directives on public procurement limit the power of the Member States in the sense that they cannot provide for grounds of exclusion other than those mentioned therein. The power of Member States is also limited by the general principles of transparency and equal treatment.\textsuperscript{32} By analogy with the voluntary exclusion grounds, implementation of the provision on direct payment is left for the Member States to decide, considering the national need and suitability to domestic law. However, if a Member State decides that the subcontractors need more comprehensive protection regarding payments, it could not be done with random measures. It must be done with the measures found in the directive.

For example – a directive is not correctly transposed into national law if it requires equal pay for “work of equal value”, but the national law expresses it as equal pay for “the same work”.\textsuperscript{33} Although provisions of Directive 2014/24/EU may leave Member States the choice of the ways and means of ensuring that the directive is correctly implemented, that freedom does not affect the obligation imposed on all Member States to which the directive is addressed. Member States have to adopt, in their national legal systems, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective which it pursues.\textsuperscript{34}

2.3 The principle of proportionality

In accordance with the principle of proportionality, which is one of the general principles of EU law, the measures taken by national legislation transposing directives must be suitable for achieving the objectives of that legislation and must not go beyond what is necessary to attain them.\textsuperscript{35} European Union legislature must be allowed a broad discretion in areas which involve political, economic and social choices on its part, and in which it is called upon to undertake complex assessments.\textsuperscript{36}

Opting for a system which differs from that adopted by another Member State, cannot affect the assessment of the proportionality of the provisions enacted to

Withholding payments to main contractors

that end. Those provisions must be assessed solely by reference to the objectives pursued by the competent authorities of the Member State concerned and the level of protection which they seek to ensure.\(^{37}\) The principle of proportionality requires that a measure must be both suitable and necessary. The measure is suitable when it promotes the objective sought – there must be a reasonable connection between a measure and its objective. The measure must be necessary to achieve the objective and it can’t be more onerous than necessary.\(^{38}\)

When there is a choice between several appropriate measures, recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued.\(^{39}\) Usually, a third element is considered – the measure should not have an excessive effect on trade in light of the significance of the objectives sought – the disadvantages caused must not be disproportionate to the aims pursued (proportionality stricto sensu).\(^{40}\) However, the CJEU in practice does not always apply proportionality stricto sensu on its own, but only when one of the parties relies on the principle.\(^{41}\) Defining the objective sought by the provisions in Directive 2014/24/EU in general and more specifically the provision in Article 71 (3) and (7), is crucial for the correct application of the proportionality test. The objective sought by the payment provision in Directive 2014/24/EU is not to ensure the compensation of subcontractors in general. The objective is to ensure the compensation of subcontractors for properly completed works without any delay, as it is necessary for the subcontractor to reward the workers, contribute to development etc. Keeping that objective in mind, the provision must also facilitate the participation of SMEs.

The test for the suitability of the measure seems to be passable rather easily. The legality of the measure adopted can be affected only if the measure is manifestly inappropriate having regard to the objective which the competent institutions are seeking to pursue.\(^{42}\) This means that the measure is unsuitable only if it is manifestly inappropriate.\(^{43}\) However, national legislation is appropriate for guaranteeing attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner.\(^{44}\) If there is a


\(^{38}\) Arrowsmith, S. and others, EU Public Procurement Law: An Introduction, EU Asia Inter-University Network for Teaching and Research in Public Procurement Regulation, 2010, p. 38.


\(^{40}\) Judgement of 22 January 2013, Sky Österreich, C-283/11, EU:C:2013:28, paragraph 50.


\(^{44}\) Judgement of 30 April 2014, Pfleger and Others, C-390-12, EU:C:2014:281, paragraph 43.
reasonable connection between the measure and the objective, the measure used could be deemed as suitable.

Necessity of the measure is assessed by comparing the adopted measure to other potential measures. If several suitable measures are at hand, one should choose the measure, which limits the four freedoms – freedom of movement of goods, people, services and capitals over borders – the least.\textsuperscript{45} CJEU does not inevitably involve the four freedoms to the comparison, as the choice between suitable measures could be made in the favour of the least onerous.\textsuperscript{46} Alternative measure should, without any doubt, be at least as suitable as the “main measure” to reach sought objective. The Estonian Supreme court finds that, in addition to the previous, when assessing the necessity of a measure, one should take State’s expenses and onerousness to third persons into account as well.\textsuperscript{47}

### 2.4 The principle of transparency

The principle of transparency does not have a singular definition. In relation to procurement procedures, transparency has been defined through three elements – disclosure, publicity of the procurement procedure and monitoring function.\textsuperscript{48} Alternatively, transparency could functionally be divided into two: representative qualities (offering information, legitimacy of public institutions, demonstration of open leadership, creating trust towards public institutions) and monitoring functions (allowing the monitoring of all institutions, clarity of the individual rights, inclusion of the public and battling corruption).\textsuperscript{49} Disclosure could be described as the heart of transparency, as the potential tenderers find out about the procurement via a contract notice. A contract notice is the most important requirement of publication, because it helps to create transparent and common markets in Europe.\textsuperscript{50}

The obligation of transparency is intended to preclude any risk of favouritism or arbitrariness on the part of the contracting authority or entity. That obligation

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\textsuperscript{45} Harbo, T-I., The Function of Proportionality Analysis in European Law, Brill, 2015, p. 34.

\textsuperscript{46} Judgement of 22 April 2015, Tomana and Others v Council and Commission, T-190/12, EU:T:2015:222, paragraph 295.

\textsuperscript{47} Estonian Supreme Court 06.03.2002 decision no 3-4-1-1-02, p 15. Available in Estonian at: https://www.riigikohus.ee/et/lahendid?asjaNr=3-4-1-1-02. (read 23.02.2019). It must be noted, that to author’s knowledge, CJEU has not explicitly stated similar position.

\textsuperscript{48} Ojasalu, T., Euroopa Ühenduse asutamislepingu põhivabadused ja neist tulenevad põhimõtted riigihankeõiguses (Fundamental freedoms in Treaty establishing the European Community and general principles in public procurement law), Master’s thesis, supervised by A. Reinumägi, PhD., University of Tartu, 2006, pp. 70-78.


\textsuperscript{50} Bovis, C., The Law of EU Public Procurement, 2 ed., Oxford University Press, USA, 2015, p. 222.
imply that all the conditions and detailed rules of the award procedure must be
drawn up in a clear, precise and unequivocal manner in the contract notice or
specifications so that all reasonably informed tenderers exercising ordinary care
can understand their exact significance and interpret them in the same way.\textsuperscript{51} In
a situation where domestic law is contradictory to the information given in the
contract notice, the information given in the contract notice prevails.\textsuperscript{52} These
positions show, that if the procurement documents (especially the contract notice)
are contradictory to the domestic law, the provision set out in the procurement
documents should prevail. Article 71 (3) of Directive 2014/24/EU obliges the
contracting authority or entity to set out the arrangements concerning the mode
of payment in the procurement documents. It is understandable, as monetary
payments are economically the only reason for participation in public procure-
ment. Therefore, transparency of the provision concerning payments is of crucial
importance.

Transparency during the performance of the contract has not been as thor-
oughly analysed in literature or practice. It is found that the provision on direct
payment adds transparency to the contract performance part of the public pro-
curement, which so far has been rather overlooked.\textsuperscript{53}

3  Payment provision in public works contracts in Estonia

3.1  Overview of the payment provision in public works contracts

Directive 2014/24/EU should have been transposed into national law by 18\textsuperscript{th}
of April 2016 the latest.\textsuperscript{54} The Estonian Parliament (Riigikogu) processed the
proposals for the new PPA two times. Although Estonia was already late with the
transposition, the first proposal got rejected on 3\textsuperscript{rd} of May 2017. The main reason
for the rejection was the provision concerning payments to subcontractors added
at very late stage of the process. Riigikogu had not done any substantial analysis
on the potential effect of the provision, nor had it had any dialogue with the
relevant stakeholders. Irrespective of the first proposal’s failure, a new proposal
with identical wording was forced through the second time, although many of the
contracting authorities, potential tenderers, as well as members of the Riigikogu

\textsuperscript{52} Judgement of 14 December 2016, \textit{Connexion Taxi Services}, C-171/15, EU:C:2016:948, paragraphs
34-44.
\textsuperscript{53} Härginen, K., Simovart, M.A., Uued riigihankedirektiivid: revolutsioon või redaktsioon. (New
Public Procurement Directives: Revolution or Redaction). Juridica IX/2013, p. 632. Paid content,
kas_revolutsioon_v_i_redaktsioon_&_lang=en (read 23.02.2019).
\textsuperscript{54} Article 90 (1) of Directive 2014/24/EU.
were seriously opposing the controversial provision.\textsuperscript{55} The provision came into force on 1\textsuperscript{st} of January 2019 and is as follows:

\textit{§ 122 Subcontracting}

(9) \textit{In the case of a public works contract and works concession, the contracting authority or entity will not perform to the respective extent a financial claim submitted to it by the tenderer under the contract or concession if a subcontractor who participated in the performance of the contract or concession submits to it a reasoned application in connection with the groundless non-performance of the financial obligation by the tenderer under the subcontract concluded with the subcontractor. The contracting authority or entity will perform the financial obligation towards the tenderer once the financial obligation towards the subcontractor has been performed or evidence in proof of the groundlessness of the subcontractor’s claim has been submitted to the contracting authority or entity.}

(10) \textit{The non-performance of the financial obligation towards the tenderer based on the application of the subcontractor specified in subsection 9 of this section is not considered a breach of the public contract by the contracting authority or entity.}

As can be seen, the Estonian solution is not to allow direct payments to the subcontractors, but giving the subcontractors a tool, which enables them to force contracting authorities to withhold payments to the main contractors. The provision applies in works contracts and works concession contracts, where the estimated value of the contract is over the national threshold in the public sector (150 000 euros), over the international threshold in the water, energy, transport and postal services sector and over the international threshold in the field of defence and security procurement.\textsuperscript{56} The provision is obligatory to the first subcontractors of the chain. However, the contracting authority or entity could voluntarily apply the provision to supply and service contracts and even to the subcontracts concluded by subcontractors.\textsuperscript{57}

It is unclear if the intention of the Estonian legislator was to transpose the provisions in Article 71 (3) and (7) into PPA § 122 (9) and (10) at all. The provision in PPA does not, in any case, explicitly allow the contracting authority or entity


\textsuperscript{56} PPA § 15 (2), (5) and (9).

\textsuperscript{57} PPA § 122 (11).
Withholding payments to main contractors

to directly reward the subcontractor. Estonian public procurement specialists have considered that the provision at least follows the spirit of Article 71 (7) of Directive 2014/24/EU. The explanatory note to the proposal for PPA states that the option to pay the subcontractor directly already exists in Estonian law. The Law of Obligations Act (hereinafter LOA) § 80 (1) states that a contract may prescribe or the nature of an obligation may indicate that the obligation is to be performed for the benefit of a third party in lieu of the obligee (contract for the benefit of the third party). Therefore, in Estonia direct payments are already possible if the procurement documents would prescribe that the payments are to be made directly to the subcontractor.

The explanatory note to the proposal for PPA explains that for said reasons, the direct payment provision in Article 71 (3) of Directive 2014/24/EU would not solve the problem, where the main contractor wrongly does not pay the subcontractor and would only double the provision already set in LOA § 80 (1). It is hard to agree with the mentioned reasoning in whole. I agree with the part that the Estonian law does not prohibit making direct payments to subcontractors. However, the provision in LOA § 80 (1) is only applicable if the contracting authority or entity wishes to use it. The idea of Article 71 (3) of Directive 2014/24/EU is (if the Member State decides so) to make the provision of LOA § 80 (1) obligatory in contracts signed as a result of a public procurement. This means that a provision transposing Article 71 (3) of Directive 2014/24/EU as obligatory, would be substantially different from the provision in LOA § 80 (1). Still, the explanatory note for PPA states that the new obligatory rules of subcontracting “go further than the provision in the procurement directives”. This implies the intent and usage of the discretion given in Article 71 (7) of Directive 2014/24/EU, which expressis verbis allows Member States “to go further” under national law on direct payments to subcontractors. At the same time, withholding payments would not be “going further” – if anything, it is going sideways or in the other direction. Regardless of the motivational source for the legislator, both substantive and procedural rules in regard to public contracts must comply with all relevant provisions of the European law.

61 Ibid.
3.2 Uncertainty in dispute resolution

PPA § 122 (9) and (10) brought another problem. Even though the concern is rather national, it is a great example of how legislation lacking necessary analysis could potentially bring unwanted change of paradigm into national law, which is why it is worth mentioning here. According to Article 71 (3) of Directive 2014/24/EU, a direct payment provision may include appropriate mechanisms permitting the main contractor to object to undue payments. PPA does not explicitly set out rules to contest contracting authority’s or entity’s decisions to withhold payment. To solve any dispute, one must firstly qualify the legal nature of the relationship between the parties. The legal nature of the relationship – administrative or civil – decides the competent court to resolve disputes. The provisions of the EU public procurement directives mostly govern the procurement procedures. Contractual relationships are subject to the legislation of each separate Member State.

The Estonian legislation has followed the logic that although the relationship in procurement procedure is classified as public, the contractual relationship after the procedure is considered as civil. This means that the relationship in a public contract between the contracting authority or entity and the prime contractor is considered as civil. Therefore, any procurement contractual disputes are resolved in county courts like any regular civil contractual dispute. Disputes about procedural issues are handled firstly in a public procurement review committee as an obligatory pre-litigation procedure and after that in an administrative court. Due to PPA § 122 (9) and (10), a new question arises: if the contracting authority or entity decides to withhold payment to the prime contractor, which court would be competent should the prime contractor contest the decision of the contracting authority or entity. The public works contract would still be considered to be civil. However, there is no contractual relationship between the contracting authority or entity and the subcontractor. PPA § 122 (9), as a public law provision, gives the

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63 Estonian Supreme Court 03.05.2017 decision no 3-3-4-1-17, p 5. Available in Estonian at: https://www.riigikohus.ee/et/lahendid?asjaNr=3-3-4-1-17 (read 19.02.2019).
64 Simovart, M.A. Dissertation. Lepinguvabaduse piirid riigihankes: Euroopa Liidu hankeöigus mõju Eesti eraõigusele. (Limits to the freedom of contract: the influence of EU public procurement law on Estonian private law.) Supervised by C. Ginter, PhD and I. Kull, dr. iur. University of Tartu, 2010, p 33. Available at: https://dspace.ut.ee/bitstream/handle/10062/15148/simovart_mari_ann.pdf?sequence=5&isAllowed=y (20.02.2019). Of course, there are exceptions to the rule, as the directive 2014/24/EU regulates modifications of contracts (Article 72) and termination of contracts (Article 73).
Withholding payments to main contractors

right for the subcontractor to submit the application and thereby creates a legal relationship between the subcontractor and the contracting authority or entity. As the right to submit the application comes from public law, the relationship between the subcontractor and the contracting authority or entity should be deemed as public. Estonian Supreme Court has stated, that if a civil declaration of intent is formed due to a provision in public law, the procedure itself is public and the civil declaration of intent constitutes an administrative act.68 Therefore, the contracting authority’s or entity’s civil declaration of intent (to withhold the payment), could be viewed as an administrative act given in an overall civil relationship.69 This in turn would mean, that disputes about withholding payments between a contracting authority or entity and the main contractor should be settled in administrative courts, which would be a change of paradigm in Estonia.

The alternative way is to classify the relationship between the main contractor and the contracting authority or entity together with the rest of the contract as civil, but the relationship between the contracting authority or entity and the subcontractor as administrative. The latter approach could bring about a minor legal chaos, as the competent court would depend on the contracting authority’s or entity’s decision and who of the parties would contest it. If the main contractor files a claim at a court, because the contracting authority or entity withheld the payment, the competent court is civil. If the subcontractor files a claim at a court, since the contracting authority or entity did not withhold any payment, the dispute would be administrative. It could be a potential threat to the unreasonable differences in court practice about the application of the same provision. At the time of writing of this article, there is no certainty in this matter, as the provision is new and there are no known court cases. However, one definite lesson should be learned: the competent court (nature of the legal relationship) should be known and, if necessary, written in the act itself, before the actual enforcement of any new provision.

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3.3 Payment provision compatibility with the principle of proportionality

PPA § 122 (9) and (10) are not in accordance with the relevant Directive 2014/24 provision. Firstly, there is no adequate reason to believe that the opportunity to force the contracting authority or entity to stop the payment to the main contractor would facilitate the participation of SMEs as subcontractors. Secondly, subcontractors are not interested in formally sanctioning the main contractor for the potential wrongdoings. Subcontractors are interested in getting paid in compliance with the contract, without unjustified delays and disputes. PPA § 122 (9) and (10) do not protect the said interest, as it allows the contracting authority or entity to withhold payment for unknown time. Therefore, the stoppage of payments does not effectively pursue the objective it is supposed to. Consequently, Estonia has not followed the discretion given to Member States with the Article 71 of Directive 2014/24/EU.

PPA § 122 (9) states that the contracting authority or entity will perform the financial obligation towards the tenderer once the financial obligation towards the subcontractor has been performed or evidence in proof of the groundlessness of the subcontractor’s claim has been submitted to the contracting authority or entity. PPA § 122 (9) does not set any limitations to the period in which the contracting authority or entity is allowed to withhold the payment to the main contractor. As one of the ways of receiving the payment from the contracting authority or entity is to present proof that the subcontractor is properly rewarded, there is a connection between the objective sought and the measure used. The fact that there are no limitations on the time the payment could be held and there is no explicit bonus for the main contractor for completing the payment to the subcontractor, could mean that it will not motivate the main contractor to complete the payment to the subcontractor.70 Estonian authors have described the measure to be “rather inappropriate”.71 However, in the light of the “manifestly inappropriate” test, the measure used in Estonia should be deemed as suitable, because one could not say with absolute certainty that it does not help to reach the objective pursued.

There is no doubt that direct payments would be at least as suitable of a measure as withholding payments, as the goal is to ensure on-time payments to the

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70 The actual balance for the main contractor could not be negative nor positive. Contracting authority or entity could only withhold the payment in the exact sum, which the subcontractor allegedly has not received. Therefore, in this case, witholding the payment could not monetarily hurt the main contractor.

Withholding payments to main contractors

subcontractors. Direct payments are more effective, as it excludes (or at least should) a situation, where the contracting authority or entity must hold the payment for unknown time from all the parties. SMEs’ access to finance should be facilitated in a way, where legal and business environment is supportive of timely payments in commercial transactions. Public authorities have a special responsibility in this regard. Exclusion of the right to charge interest should always be considered to be a grossly unfair contractual term or practice and it is necessary to reverse this trend and to discourage late payments.72 If all the works are completed, but the contracting authority or entity is forced to withhold the payment from all parties, the measure has a harmful effect to the fulfilment of the contract. Undoubtedly it dangers the goal of ensuring timely payments in commercial transactions. Furthermore, PPA § 122 (10) states that the non-performance of the financial obligation on the basis of subcontractor’s application is not considered a breach of the public contract by the contracting authority or entity. Breach of the contract is a prerequisite to charge interest.73 Potentially, application of PPA § 122 (9) and (10) could be seen as using a grossly unfair contract term. Direct payments would lessen the administrative burden of SMEs, would ensure smoother money-flow, facilitate the goal to protect SMEs and would not be more onerous to main contractors. Therefore, withholding payments is not a necessary measure.

Both provisions on direct payment and on withholding payment strongly interfere with the main contractor’s contractual freedom74 rising from the freedom to conduct business given by Article 16 of the Charter of Fundamental Rights. As the provision on direct payment is not obligatory to transpose, no analysis on the proportionality stricto sensu of direct payment needs to be carried out in the context of EU law. It is a question of suitability to national law system and dogmatic. Finland has described it so that no provisions on direct payments is transposed due to the fact that such payments would breach the responsibilities and control within the contract chain. This could lead to difficulties when determining the scope of liability and the role of the main contractor under national contract law.76

Germany, whose legal system has been of great influence to the Estonian legal system, also refrained from taking the opportunities the Directive 2014/24/EU offered regarding direct payments.77 Spain had a direct payment provision

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73 LOA § 100 and 101 (1) 6).
arising from practice of the law. However, it was problematic, as the number of applications rose when the economy was down. The contracting authorities were not aware of all details of the contracts and had difficulties to decide which of the parties really had better right to the payment. This resulted in an explicit prohibition on the request of direct payments at the time.\(^7\) In this regard, I agree that interfering with the freedom to conduct contractual relationships between the main contractor and the subcontractor is problematic because of the complex of questions that might surface when the contracting authority or entity has to resolve the dispute between the main- and the subcontractor. For this reason, the measure of direct payments, as well as suspending payments, should be considered disproportionate to the aims pursued.

### 3.4 Payment provision compatibility with the principle of transparency

The provision in PPA § 122 (9) and (10) applies automatically. No provision in the PPA obliges the contracting authority or entity to disclose the arrangement given in PPA § 122 (9) and (10) in the procurement documents. If the arrangements concerning mode of payment is not mentioned in the procurement documents, it is complicated for the suppliers to make a rational and well-considered decision. Reasonably informed tenderers should know about the fact that the payments could be withheld via subcontractors’ application through the information given in the procurement documents. For this reason, a solution, where the payment arrangements are not published in the procurement documents, should be considered as breaching the principle of transparency.

Considering transparency during the performance of the contract, both direct payments and suspending payments should be seen as equal tools to combat misuse of rights or behaviour contradictory to the principle of good faith.

### 4 Conclusions

The European legislator has not made it obligatory to transpose the provisions given in Article 71 (3) and (7) of Directive 2014/24/EU. However, if a Member State opts to transpose the provisions concerning payment in the Directive to enhance the protection of subcontractors, the Member State does not have total freedom in doing so. Even though the provisions in the public procurement

\(^7\) Oliviera, R., Modification of Public Contracts: Transposition and Interpretation of the New EU Directives, European Procurement & Public Private Partnership Law Review, 1/2015, pp. 44-45. Although now Spain has a provision in place which allows direct payments under some circumstances – referral no 13, p. 246.
Withholding payments to main contractors

directives are not exhaustive, Member States still need to ensure the full effectiveness of the directive. The discretion given by the directive in accordance with the principles of TFEU needs to be followed.

The Republic of Estonia has chosen not to allow direct payments to subcontractors, as Directive 2014/24/EU foresees, but instead created a mechanism where the subcontractors could apply to the contracting authorities to stop contractual payments to the main contractor, if the main contractor has wrongfully not paid to the subcontractor. As a result, the legislation without substantial analysis has created confusion nationally how to correctly apply the new provision and, if necessary, to resolve disputes between the parties.

Furthermore, the provisions in PPA § 122 (9) and (10) is not within the discretion boundaries given to the Member States by Directive 2014/24. The provisions infringes the principles of proportionality and transparency. The chosen method does not ensure the objective sought by Directive 2014/24/EU – payments to subcontractors without any unjustifiable delay and in the exact amount foreseen by the contract with the main contractor. These provisions of the PPA should be thoroughly analysed. If it is still found that extra protection for subcontractors in public contracts is necessary, Estonia should choose measures in conformity with Directive 2014/24/EU – in other words direct payments.