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Contract – Probity and Procurement in  
Government

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## Introduction

Government procurement is like a courtship where government and the private sector gauge the merits of a future supply and purchase relationship through the tender process. Like a courtship, there are rules in place for the process. One of those rules is probity.

In this paper, we cover a government party's legal responsibility to act with probity when it tenders for the supply of goods and services. We detail recent case law where a government party has been the subject of litigation for failing to comply with probity requirements when tendering and current Victorian legislation and government policy that has been put in place to manage probity issues.

## What probity means

Probity is generally defined as acting with integrity, uprightness and honesty'.<sup>1</sup> In government procurement, the term 'probity' refers to the concept of procedural integrity and is used in a general sense to mean a defensible process which is able to withstand internal and external scrutiny. The tender process should achieve accountability and transparency, and provide participants in the procurement process with fair and equitable treatment. These requirements generally reflect what the law currently requires with respect to process contracts.

## Why probity is important to government procurement

Probity in procurement is essential for ensuring the integrity of public expenditure and sound procurement processes that accord equal opportunities for all participants. An examination of probity issues requires consideration of inter-related concepts including value for money, impartiality, avoiding conflicts of interest, confidentiality, and accountability and transparency.<sup>2</sup> To conduct a tender that breaches probity may undermine public confidence.

## Role of Ombudsman and Auditor General

Management of probity in procurement is important to government as evidenced by the statutory powers that parliament has given to the Ombudsman and the Auditor General to investigate complaints against a government party that has failed to comply with probity requirements.<sup>3</sup> Any government agency that fails to comply with probity requirements in its procurement not only puts the agency at risk of legal action from an unsuccessful tenderer but also of an investigation by the Ombudsman and/or the Auditor General, followed by an adverse report to Parliament as well as exposure in the media.

The Ombudsman and the Auditor General have been active in the investigation of complaints of failure by government parties to comply with probity requirements when conducting procurement. Recent examples include the investigation by the Ombudsman and the report to Parliament in August 2008 as to the lack of probity controls for the procurement of non-clinical goods and services<sup>4</sup> and the investigation and report by the Victorian Auditor General of 31 October 2007 on the New Ticketing System Tender.<sup>5</sup>

## Law of tendering and probity

To appreciate why probity is legally important to government procurement, it is necessary to look at the changes in the law on government procurement in Australia in the last 12 years.

Before the 1997 decision of *Hughes Aircraft Systems International v Airservices Australia*,<sup>6</sup> it was thought that government procurement would only be subject to legal challenge if an action could be brought for misleading conduct such as a breach of the *Trade Practices Act 1975* (Cth), a common law breach of confidentiality or on administrative law grounds such as conducting the tender in a way not authorised by the legislation or because of bias on the part of the decision maker.

## Contract Law and Pre-Award Period

In Hughes, Finn J held that the pre-award period of a government tender process is governed by contract law. Finn called this period the ‘process contract’, that is, it governed the process of receiving and considering tenders. Finn J held that the rules regarding the tender are an invitation to treat for the main contract and an offer by the Government party for the pre-award process contract. That offer is accepted by each tenderer that puts in a bid. The terms and conditions of the tender are contractually enforceable as part of the process contract. Finn J held further that an implied term of a process contract is that the government party will give the same opportunities to and treat all tenderers fairly and even-handedly.

An analysis of case law since the Hughes decision demonstrates that failure by a government party to conduct the tender with integrity, uprightness, and honesty or to give all tenderers access to the same information will leave the government party at risk of legal challenge.

## Victorian legislation on probity

In response to managing the risks for a government party when conducting a competitive tender, and consistent with other States and Territories, Victoria has legislation to promote probity when government procurement or a competitive licence process is being undertaken. The legislation is directed at the establishment of public offices, and the maintenance of integrity, trust, accountability and standards of behaviour of public officers.

An example of Victorian legislation in place to promote probity is the *Public Administration Act 2004* that requires public servants to act with integrity, make decisions on merit, act fairly and make decisions without bias, or self interest. Another is the *Gambling Regulation Act 2003* that provides power to a review panel to report to the Minister on whether applicants for a licence have been treated equally and given access to equal information, conflicts of interest have been adequately dealt with and that there

has been no bias in the preparation of reports and recommendations as to the licence.<sup>8</sup>

## VGPB guidelines

The Victorian Government Purchasing Board’s guidelines on probity in the conduct of tenders<sup>9</sup> are a best practice guide to procurement and set minimum probity standards for procurement of non-construction goods and services in Victorian government departments and some agencies.<sup>10</sup> These guidelines require government agencies when conducting any tender to have processes to achieve the key requirements of fairness and impartiality, consistency and transparency, promotion of security and confidentiality, identification and resolution of conflicts of interest and to develop and implement a probity plan for all tenders likely to exceed \$10 million in value.

The Department of Treasury and Finance has developed a Probity Risk Assessment Tool which is available on the VGPB website to assist procurement officers in assessing the probity risks of specific projects.<sup>11</sup>

## What case law tells us about probity requirements?

A review of recent Australian and New Zealand cases as detailed below that deal with probity indicate that the key allegations made by disgruntled tenderers against a government party running a tender process concern conflicts of interest, misuse of confidential information, not being provided with access to the same information as other tenderers and bias on the part of the decision makers in the award of the tender.

### **Cubic Transportation Systems Inc v New South Wales** <sup>12</sup>

Cubic Transportation Systems Inc (**Cubic**) was shortlisted as a potential tenderer for the creation of an integrated ticketing system for Sydney’s Public Transport System. Upon the award of the tender to a different company, Cubic sought to bring legal proceedings against the State of New South Wales to prevent it from

entering into a contract with the successful bidder.

Cubic alleged that the process that led to the selection of the preferred tenderer was not reached by following the requirements of the tender and that there was an implied obligation on the government to conduct its evaluation fairly and in a manner that would ensure equal opportunity to the tenderers. Cubic claimed that it was not given procedural fairness and that there was bias in the decision making process because of conflicts of interest of the government's legal adviser and the probity auditor. The alleged conflicts of interest centred on the fact that the legal adviser and the probity auditor were from firms that had provided services to related parties to the successful tenderer in relation to various matters unconnected with the tender process.

In relation to the allegations of unfair process, Adams J held that the terms of the tender document and the government's codes of tendering and practice gave rise to an implied term of fair dealing in connection with the assessment of the bids. However, the facts did not demonstrate that the government had breach any of the obligations it owed to Cubic.

In relation to bias, Adams J held that the crucial question was whether there was any actual unfairness or actual bias. There was no duty to ensure that a reasonable person would not apprehend the possibility of bias. The probity auditors had satisfied their obligations by investigating whether there was any evidence of actual bias. The government party had acted strictly in accordance with its obligations in the tender and was entitled to accept the probity auditor's views. With regard to the legal adviser, the probity auditor examined the arrangements put in place by the legal adviser, and considered that they were acceptable. Adams J found that in fact and law, there was no conflict of interest.

The probity auditor was found not to have a conflict of interest as the role did not require financial assessment of the bid and there was no suggestion that the individuals acting as probity auditors in relation to the tender had any

knowledge of information on the tax matters in any case.

### ***Pratt Contractors Ltd v Transit New Zealand*** <sup>13</sup>

Pratt argued on appeal to the Privy Council that Transit was in breach of the terms of a tender process contract it had entered into with Pratt, including an implied term that Transit would act fairly in considering Pratt's tender, that the internal manuals used by Transit were mandatory and that any departure from them was a breach of the pre-award contract. Pratt also claimed bias. Pratt's tender price was the lowest but it was rejected on non-price grounds. Some members of the tender evaluation committee knew of Pratt's past record of low bidding and demanding more money under the contract on account of alleged variations to the contract.

The court found that the request for tender did not incorporate internal government procedure manuals relevant to the evaluation of tenders, and although it was accepted that there did exist a duty to act fairly and in good faith in the tender process, the standard required of Transit had not been breached in relation to the tender process.

The Privy Council considered that:

At the centre of the dispute lies the question of the extent to which the procedure for competitive tendering should be judicialised. Tenderers naturally want to be judged independently on their merits by an impartial selector and given the opportunity to rebut any suggestions of demerit which they regard as unfair. The parties who invite tenders, even if they are public authorities like Transit, want to be able to choose in what they consider to be their best commercial interests and not be hobbled by quasi-judicial procedural rules.[3]

The judgement affirms that, in making the tender award decision, a government party is

entitled to act in its own interests. Although under a duty to act fairly, it will not be obliged to eliminate bias where it is relevant to the decision, or to provide an opportunity to a tenderer to put its side of the case forward where an adverse finding has been made against it.

### ***Dockpride Pty Ltd v Subiaco Redevelopment Authority***<sup>14</sup>

Subiaco Redevelopment Authority was established under the *Subiaco Redevelopment Act 1994* (WA) to plan, undertake and promote development, with responsibility for a development scheme. The Authority called for tenders to purchase 2.3 hectares of land and undertake a commercial and residential development on the land. Dockpride claimed that the contract was awarded to a tenderer whose design did not comply with the design guidelines that were included in the tender. The successful tenderer offered a bid for the land that was lower than Dockpride's.

Dockpride claimed damages for breach of a process contract and misleading and deceptive conduct, relying in part on contractual terms implied in the tender process and the verbal statements made to it by Dockpride's representative.

Dockpride alleged that the Authority breached the process contract by not communicating the same information to both tenderers. This information was that while the alignment of Rokeby Walk and Rokeby Road in special condition 3.1 of the design guidelines was the Authority's preferred position, tenders which did not comply with either the Rokeby Walk Guideline or the Tenancy Entrance Guideline would be considered.

Clause 6 of the tender provided that the Authority was not required to accept the highest or any tender or precluded from accepting any tender that was not in accordance with the tender documents (which included the design guidelines). Dockpride interpreted the tender documents as mandating that any development comply with the Rokeby Walk Guideline or the Tenancy Entrance Guideline. The Authority

contended that this would contradict clause 6 of the tender.

Le Miere J held that there should be implied in the process contract between the Authority and Dockpride a term to the effect that the Authority would not accept a tender that was unresponsive to the design guidelines, but that there was no implied term that only tenders that met the design guidelines would be accepted. There was no obligation on the Authority to communicate information on the guidelines to Dockpride, even if that information was provided to another tenderer. This was because clause 6 of the tender had the effect that the Authority could accept a tender that did not comply with the requirements.

### ***Diagnostic Medlab Limited v Auckland District Health Board***<sup>15</sup>

The Auckland District Health Board issued a request for proposal to choose a contracting party to provide community pathology services to the Auckland area. The contract was awarded to Lab Tests Auckland Ltd (**Lab Tests**) at the expense of the incumbent provider, Diagnostic Medlab Ltd (**DML**).

DML argued lack of probity in the decision making process and procedural unfairness on account of the conflict of interest of and the improper use of confidential information by a former board member, Dr Bierre, in the bid submitted by Lab Tests. Dr Bierre was a shareholder of Lab Tests and was instrumental in preparing its bid.

Conflict of interest was alleged on the basis that Dr Bierre was a shareholder and director in Lab Tests while at the same time serving as a member of the Auckland regional district health board. DML argued that as a board member Dr Bierre was an insider to board deliberations and policy developments, and generally had access to information concerning the wishes and concerns of the evaluation panel, information to which DML did not have access, thus enabling him to formulate a bid to fit the board's requirements. Dr Bierre was also a former senior executive of DML.

The alleged misuse of confidential information by Dr Bierre related to the Board's desire for open book accounting, the perception that DML was achieving super profits and was opposed to change, the desired level of savings that the Board was seeking through the tender and knowledge of the Board's willingness to contemplate radical change in the level of services from the contractor in order to achieve those savings.

Evidence was given that as a board member, Dr Bierre advocated 'open-book accounting' and had painted a picture of DML as taking exorbitant profits and refusing to co-operate with the Board to change the status quo. Dr Bierre knew that the Board was looking for savings to deliver pathology services in the vicinity of \$20 million from the tender and a new way of delivering the services. Lab Test's proposal, the formulation of which Dr Bierre contributed to, detailed how \$16 million savings could be achieved. Some of the information in the proposal on the savings reflected the work of the Board's consultants.

Evidence was also given that Dr Bierre's access to the confidential information was regarded as valuable by companies involved in the consortium bid. This was reflected in the 2006 decision by Healthscope, a member of the Lab Test consortium, to offer Dr Bierre a substantial share holding in the new company that would hold the tender contract.

Asher J, of the New Zealand High Court, considered that Dr Bierre's access to the confidential information gave his consortium a huge advantage. Asher J was also critical of the Board for failing to manage the conflict of interest by Dr Bierre and considered that any bid in which Dr Bierre had participated should have been rejected.

Asher J found in favour of DML as to lack of probity in the decision making process and procedural unfairness on account of the conflict of interest and the improper use of information by a former board member.

Lab Tests appealed to the Court of Appeal, which reversed the decision of the High Court on the

basis that Asher J had not given proper weight to the particular commercial context.<sup>16</sup>

In relation to the lack of probity or procedural unfairness in the decision making process the Court of Appeal accepted that judicial review is available where an insider with significant information and a conflict of interest has used that information to disadvantage its rivals in a tender process. But it considered that Asher J had not given proper weight to the particular commercial context.

The Court of Appeal differed in the factual assessment of the confidential information and found that there had been no improper use of inside information and no informational disadvantage for DML. It accepted that Dr Bierre had a conflict of interest while on the Board. Dr Bierre decided in late November or early December 2005 to put together a consortium to bid but before that time he had no relevant conflict of interest. Soon afterwards, he took leave of absence from the Board and suspended his board participation until after the tender process was completed.

The Court of Appeal found that DML knew about the Board's desire for open book accounting and the perception that DML was achieving super profits and was opposed to change so far as the Board was concerned. As to the level of savings to be obtained through the tender, the Court of Appeal found that the Board did not have a settled view and that DML knew that the Board was looking for savings. As to the Board's willingness to contemplate radical change, DML had been told as part of the tender briefing of the Board's desire for innovative solutions.

DML sought leave to appeal to the Supreme Court of New Zealand.<sup>17</sup> Leave was refused.

## Case law lessons on probity

In none of the Australian and New Zealand probity cases surveyed was the disgruntled tenderer successful in its allegations against the government party running the tender process. However, probity is a fast moving area of law, and in a competitive environment, probity issues

are a high risk in government procurement that government must manage carefully. This is particularly so given the investigative powers of the Ombudsman and Auditor General and the risk that legal proceedings may be issued for failure to comply with probity requirements.

The case law on probity issues arising out of government procurement demonstrates that government agencies must conduct the tender process with integrity, uprightness and honesty,<sup>18</sup> and must treat all tenderers fairly in connection with the assessment of bids.<sup>19</sup> However, although there is a duty to act fairly and in good faith in the tender process, this does not extend to the judicialisation of competitive tendering via the imposition of quasi judicial rules.<sup>20</sup>

Although there is an obligation to act fairly, a government party is entitled to act in its own commercial interests.<sup>21</sup> Clauses in tender documents reserving the right of the government party to choose between tenders are also likely to be effective to protect government's freedom to choose winning bids based on commercial interests.<sup>22</sup>

Government must ensure that all conflicts of interest arising during the tender process are dealt with properly and further that confidential

information is not improperly used. The obligation to address conflicts of interest includes not only the people conducting the tender, but also probity auditors, probity advisers and legal advisers.<sup>23</sup> With respect to legal advisers, the obligation to avoid conflicts extends to the entire firm, rather than just the individual partners or solicitors directly engaged.<sup>24</sup>

### For more information

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The VGSO is the primary source of legal services to the Victorian State Government and its statutory authorities, providing strategic advice and practical legal solutions.

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These notes are published with the permission of the presenter, Sue Nolen.

The notes are not to be regarded as legal advice.

<sup>1</sup> James Box and Michael Forde, *Probity and Managing Procurement: How to Avoid Corrupting the Process* (2007) 4.

<sup>2</sup> Ombudsman Victoria probity controls in public hospitals for the procurement of non-clinical goods and services, August 2008.

<sup>3</sup> The Auditor General's powers regarding probity are referred to at s 3A(2) of the *Audit Act 1994* (Vic) and the Ombudsman has general powers of investigation under s 13 of the *Ombudsman Act 1973* (Vic).

<sup>4</sup> Report to Parliament pursuant to s 25 Ombudsman Act 1973 (Vic) titled *Probity controls in public hospitals for procurement of non-clinical goods and services August 2008* following a complaint about procurement at a major public hospital.

<sup>5</sup> A request was made by the Minister for Transport to investigate an alleged leak of confidential information during the tender.

<sup>6</sup> 146 ALR 1.

<sup>7</sup> Section 7 requires public servants to act with integrity, making decisions on merit, acting fairly and making decisions without bias, self interest.

<sup>8</sup> s 10.2A.3

<sup>9</sup> Department of Treasure and Finance, *Best Practice Advice Probity* Victorian Government Purchasing Board <[http://www.vgpb.vic.gov.au/CA256C450016850B/WebObj/Probitybestpracticeadvice/\\$File/Probity+best+practice+advice.doc](http://www.vgpb.vic.gov.au/CA256C450016850B/WebObj/Probitybestpracticeadvice/$File/Probity+best+practice+advice.doc)> 14 January 2008.

<sup>10</sup> Section 54 of the *Financial Management Act 1994* (Vic) provides that VGPB policy and practices apply to all Government Departments, Victoria Police and the following Administrative offices defined under s 16(1) of the *Public*

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*Administration Act 2004* (Vic): Essential Services Commission, Office of Police Integrity, Office of Public Prosecutions, Office of the Chief Commissioner of Police, Office of the Commissioner for Environmental Sustainability, Office of the Legal Services Commissioner, Office of the Ombudsman, Office of the Privacy Commissioner, Office of the Special Investigations Monitor, Office of the Victorian Electoral Commission, State Services Authority, Victorian Auditor-General's office.

<sup>11</sup>[http://www.vgpb.vic.gov.au/CA256C450016850B/WebObj/DTFProbityTemplateNo3ProbityRiskAssessmentTool-10Feb2009/\\$File/DTF%20Probity%20Template%20No3%20ProbityRisk%20Assessment%20Tool%20-%2010%20Feb%202009.xls](http://www.vgpb.vic.gov.au/CA256C450016850B/WebObj/DTFProbityTemplateNo3ProbityRiskAssessmentTool-10Feb2009/$File/DTF%20Probity%20Template%20No3%20ProbityRisk%20Assessment%20Tool%20-%2010%20Feb%202009.xls)

<sup>12</sup> [2002] NSWSC 656.

<sup>13</sup> [2003] UKPC 83.

<sup>14</sup> [2005] WASC 211.

<sup>15</sup> See the original decision made in *Diagnostic Medlab Ltd v Auckland District Health Board* [2007] 2 NZLR 832, *Lab Tests Auckland Ltd v Auckland District Health Board* [2008] NSCA 385.

<sup>16</sup> *Lab Tests Auckland Ltd v Auckland District Health board* [2008] NZCA 385

<sup>17</sup> *Diagnostic Medlab Ltd v Auckland District Health Board & Ors* SC 80/2008 [12 February 2009]

<sup>18</sup> *Hughes* (1997)146 ALR 1.

<sup>19</sup> *Cubic* [2002] NSWSC 656.

<sup>20</sup> *Pratt* [2003] UKPC 83.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Dockpride* [2005] WASC 211.

<sup>23</sup> *Cubic* [2002] NSWSC 656.

<sup>24</sup> Gambling and Lotteries Licence Review Panel, *Report of the Gambling and Lotteries Licence Review Panel to the Minister for Gaming*, 11 March 2008, para 71.