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Direct action and direct payments in public works subcontracting

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The current Public Procurement Act 2017[1] (LCSP) has not recovered for the subcontractor the direct action it lost in the 2011 amendments, but rather created, under pressure from Directive 2014/24/EU of the European Parliament and of the Council of 26February 2014 on public procurement, a kind of downgraded direct action in the 51st Additional Provision. The wording of this provision is deliberately obscure, and an interpretation is here proposed to not diminish its value.

1. The disappearance of direct action in administrative contracting

The subcontractor's direct action against a contracting authority had already been removed from public procurement legislation with Act 24/2011 and then, in its recast version of 2011, under art. 227(8). This exclusion is repeated today by art. 215(4) LCSP. Civil case law has always recognised the appropriateness of this action in subcontracts generated in procurement procedures prior to those dates (cf. Judgment of the Supreme Court [STS] of 30 April 2017), and this appropriateness has been maintained even very recently (STS of 23 November 2014). Thus, nothing would have changed with the 2017 Act if it were not for the new regulation of "direct payments" to the subcontractor contained in the 51st Additional Provision, which will be the subject matter of this commentary.

[1] *Ley 9/2017, de 8 de noviembre, de Contratos del Sector Público.*

There is no clear reason for the elimination of the direct action under art. 1597 of the Civil Code (CC). If it is an attempt to not disturb the Public Administration and the public service with disputes generated in the contracting chain, we will see that this immunity can be shaken by other mechanisms. The continuity and normality of the course of public works may be altered by claims of the subcontractor outside direct action. For instance, in the extreme, the subcontractor may provoke the opening of insolvency proceedings for the main contractor, thus leading to a situation in which the contracting authority must terminate the contract (art. 211(1)(b)) and thereby surrender the normal provision of the public service or work. In addition, it is clear that, if the main contractor does not pay the subcontractor, the works will in any case end up suffering suspensions and eventually collapse, even if the subcontractor does not have a direct action, because *neither does the contracting authority have a direct action* against the subcontractor to impose the continuity of the work in such contingencies. Furthermore, I do not believe that the legislature should become an arbitrator for private parties and thereby seek to strengthen the financial stability of the main contractor at the expense of the subcontractor's own right. Nor would the contracting authority be permitted to have the justification that if the direct action "flies over the [main contractor's] insolvency proceedings" the contracting authority cannot raise in the same proceedings the set-off of its debt with the claims for damages caused by such contractor's repudiatory breach; because the contracting authority can always raise against the party bringing a direct action the defences that derive subjectively and objectively from the same works contract from which its obligation to pay the price arises.

2. The harmonised system of optional direct payments

A "sweetened" version of the rules on payments to subcontractors was encouraged, but not imposed, by Directive 2014/24/EEC. Recital 78 thereof states that Member States "should also be free to provide mechanisms for direct payments to subcontractors" and art. 71(3) provides that Member States may provide that the contracting authority "shall transfer due payments directly to the subcontractor" and that national provisions "may" include appropriate mechanisms permitting the main contractor to object to "undue payments".

3. Levy upon contractor claims

Irrespective of the 51st Additional Provision LCSP, the subcontractor may always proceed, subject to the appropriate procedural conditions, with a levy after judgment (art. 551(3)(1) of the Civil Procedure Act[2] [LEC]) or before judgment (art. 727(1) LEC) on the main contractor's claim against the contracting authority, thereby causing the withholding of such held by the contracting authority (art. 621(3) LEC). The levy (under a writ of execution or attachment) functions as a limited assignment of the claim, and its applicability to the contracting authority must follow the same rules as for the assignment provided for in art. 200 LCSP and also cover

[2] *Ley 1/2000, de 7 de enero, de Enjuiciamiento Civil.*

receivables under the terms of art. 200(5). Of course, this will be the case if the distraint procedure is carried out and the claim or part thereof is awarded to the subcontractor. The levy on receivables hardly differs from direct action in respect of the contracting authority. It is true that a levy does not grant the subcontractor's claim a "priority" such as that bestowed by direct action, but this is a problem of the levying party with third parties, although it is true that the elimination of a direct action displaces the conflict between contesting creditors in adverse claims and does not burden the contracting authority with the dilemma of settling priority disputes with the risk of undue payments. It is also true that a levy does not allow the subcontractor, in the face of a direct action (today with the limit of art. 50(3) of the Insolvency Act[3]), to elude the main contractor's insolvency proceedings. But the latter is something that can only positively or negatively affect the contracting authority indirectly.

4. 51st Additional Provision LCSP

Let us now examine the 51st Additional Provision LCSP. We leave out of our consideration articles 215 to 217, which determine the conditions for enforceability of subcontracting and various ex ante protection measures to strengthen the contractual position of subcontractors. For our purposes, the examination begins when, provided that the procurement is appropriate under art. 215, the contracting authority "provides for", in the tender documents, the possibility of direct payments to subcontractors. As this provision is optional ("may provide for"), the subcontractor does not have an acquired right to such payments. There are no objective criteria that can diminish this discretion, which cannot be controlled by the courts. In any case, as this "guarantee" would be excluded in advance if it were not included in the tender documents, it will be up to the subcontractor to adjust the price or to seek other guarantees at the expense of the main contractor.

Para. 5 provides for regulatory implementation of the provision. Between this and the broad discretion of the tender documents, there is little regulation left reserved for legislation.

From this point on, the interpretative problems of a provision that has been drafted carelessly, as if wanting to leave in the darkest darkness the terms to which the contracting authority will be bound to with the subcontractor.

5. The "approval"

According to para. 2, a subcontractor who "has the approval" to receive direct payments may assign his right in accordance with art. 200. To begin with, it is clear that it will still be able to assign them outside the limits of this article and the 51st Additional Provision. It may assign collection rights before the desired "approval" and we will have an ordinary *emptio spei* (expectation subject to a condition that the thing will come into existence) which is valid and

[3] *Ley 22/2003, de 9 de julio, Concursal.*

passes on the risk to the assignee if it is so agreed, but which for the contracting authority and indeed the drafter of the Public Procurement Act is a *res inter alios acta* (a thing done between others that cannot adversely affect the rights of those who are not parties to it).

Who should give “approval”? We assume that the contracting authority has already provided for these direct payments in the tender documents. Must it give its permission again? If so, will there be an adversarial procedure where the main contractor will be heard? On what is the contracting authority’s new approval contingent on? What if - as is to be expected - there is a dispute between the two companies? Will the contracting authority settle this dispute at its own risk (if it pays the person to which it should not have paid, it will be bound to pay principal and default interest to the claim holder!) or, better yet, should the risk be shaken off through a judicial deposit of funds under art. 1176 CC? Will the contracting authority be able to raise defences derived from the contractor-subcontractor relationship?

If it is the contracting authority that should provide this prima facie approval, the matter would be resolved in a manner other than that set out above. It would not be an approval in substance, but a “confirmation” of the right relied on by the subcontractor based on a verification of the Public Procurement Act and the tender documents. It could not be otherwise, since the contracting authority cannot be given a second area of discretion.

But a comparison with para. 4 seems to shed light on the problem. This refers to “approval of the main contractor” with the invoice submitted. This could be the only required approval or a second approval. We believe that the “approval” in para. 2 is the same as in para. 4, and that the contracting authority’s role prior to this approval debate is a mere confirmation of the meeting of requirements in light of the law and the tender documents. The decision is not naive: it shifts the burden of raising defences on the main contractor and releases (but also precludes) the contracting authority from scrutinizing such defences.

Therefore, we infer that it is the main contractor who must give its approval. Let us imagine that this controversy between companies continues. The law then tells us that this delay will not be attributable to the contracting authority. *A contrario*, in the event of approval and an obligation to pay, it would be implicit that the contracting authority is liable for the delay to the subcontractor in the ordinary terms of the anti-default rules of art. 198 LCSP.

How long can the controversy last? Will it be alright for the contracting authority to stand idly by and ordinarily pay the main contractor until things are cleared up? Not in my opinion. Subject to what is provided in the tender documents, the “direct action” under the 51st Additional Provision is triggered - like the genuine direct action of art. 1597 CC - when the subcontractor claims direct payment. Thereon, the claim against the contracting authority has been created, provided that the objective conditions underlying the subcontractor’s entitlement are also met. But the “direct” claim is only payable after obtaining the main contractor’s approval. Or, failing that, a civil judgment in which the main contractor and the contracting authority are sued as joined parties. Where determined, however, that the right to collect payment belongs to the subcontractor "in accordance with the tender documents", the contracting authority will not be sentenced to pay interest under the Late Payment of Commercial Debts Act 3/2004 of 29 December[4] or art. 198 LCSP, because in respect of the contracting authority, the payability of the claim was subject to a third-party approval or a judgement. If the dispute is settled judicially in favour of the subcontractor, there is no retroactive effect of payability that leaves the contracting authority in arrears from the commencement of the claim. That is the most important aspect of this provision.

The same shall apply if the main contractor definitely refuses its approval. The contracting authority cannot contradict this non-approval nor can it adduce evidence or arguments that tilt the balance in favour of the subcontractor because the law has wanted the contracting authority to not be an arbitrator of the approval, thereby being relieving of the risk of making undue payments.

6. Freezing of the claim after the claim?

However, although the subcontractor's claim (without "approval") does not generate late payment interest against the contracting authority, I contend that, if these payments are provided for in the tender documents - and always according to the terms of these tender documents - the subcontractor *freezes* the claim as from the out-of-court claim in which the contracting authority is called for direct payment. From this moment, if the contracting authority pays the contractor and pays who (it is ultimately determined) it should not have paid, it will have to make a new payment. This is a "vestige" of the direct action that I advocate, because otherwise the subcontractor will be exposed to strategic actions of the contracting authority and the main contractor, against which it could only react by obtaining a court injunction to withhold the claim.

Therefore, the contracting authority will not pay the main contractor as from the claim, even if the main contractor does not agree with the subcontractor's claim. But how long can this interim situation last? The same as when there was a direct action: when the subcontractor obtains a favourable judgment in a civil lawsuit in which it sues the main contractor and the contracting authority as joined parties.

But all this may well be otherwise. Let us imagine that it is clear from the tender documents that certain payments have to be made to the subcontractor because the claim to these payments is already initially attributed to it, even if subject to the "approval" of the other party. The "approved" claim arises from the moment when the right to collect payment accrues under art. 198 LCSP, not (after) with the direct claim. If the claim is thus created, para. 4 will again prevent

[4] *Ley 3/2004, de 29 de diciembre, por la que se establecen medidas de lucha contra la morosidad en las operaciones comerciales.*

the contracting authority from owing late payment interest in cases of dispute over approval. How is this different then? In one important point: if the “contingent” claim is already in the pocket of the “identified” subcontractor, no third party may gain priority by asserting a levy on the main contractor’s claim, or enforcing a pledge or assignment as security for this claim. There is also no doubt that the contracting authority will not be able to make payments during the interim period of non-approval. It does not matter that the law states that payments made to the subcontractor will be “on behalf of the main contractor”, because this does not prevent payments from being withheld.