

**Edvins Danovskis**, Dr. iur., docent  
University of Latvia, Faculty of Law

## **ARGUMENTS AGAINST DAMAGES AS A LEGAL REMEDY IN PUBLIC PROCUREMENT PROCEEDINGS**

**Key words:** public procurement, lost profits, lost chance, damages

### **Summary**

The purpose of the article is to facilitate discussion regarding the lost profits as a legal remedy in public procurement cases. Although the issue regarding damages in public procurement procedure has been thoroughly researched before,<sup>1</sup> this article is intended to outline some robust arguments that have not been discussed before, as far as it is known to the author. The article outlines two main arguments against the usage of the lost chance doctrine in public procurement cases: 1) although the lost profit is a widely recognized type of damages in civil law, it is misused in public procurement procedure; 2) awarding lost profits in public procurement cases leads to unfair and even immoral results. The article presents several examples from the Latvian administrative court practice and therefore yields an insight into the existing situation on this matter in Latvia. Whereas the article produces arguments against the use of the lost profit as a type of damage, it is neither disputed nor elaborated that the search for other effective legal remedies should be considered instead of lost profits.

### **Introduction: Summary of the existing legal framework and practices regarding damages in public procurement proceedings**

Damages as a form of legal remedy in public procurement proceedings are relevant in cases when a contract has been concluded, but afterwards, as a result of review proceedings, it has been established that another tenderer has been illegally disqualified, or that other provisions have been breached and thus the contract has been awarded to the “wrong” tenderer. Since for practical reasons the concluded contract usually remains in force and is being performed, a question naturally arises: what should be an efficient legal remedy for the aggrieved tenderer, who, probably, would have been awarded the procurement.

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<sup>1</sup> Shebesta H. Damages in EU Public Procurement Law. Springer: 2016.

Since 1989, the EU directives have provided that damages should be included in the available legal remedies. Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts provided that among other legal remedies, the Member States should provide for an opportunity to “award damages to persons harmed by an infringement” (Article 2, Paragraph 1). The same provision has been continued in the Directive 2007/66/EC of 11 December 2007 amending Council Directives 89/665/EEC and 92/13/EEC with regard to improving the effectiveness of review procedures concerning the award of public contracts. However, the directive gives no further instructions regarding the concept of damages and preconditions of satisfying the claim for damages. The present situation has been summarized in the Judgment of the European Court of Justice in Case No. C568/08:

*Article 2(1)(c) of Directive 89/665 clearly indicates that Member States must make provision for the possibility of awarding damages in the case of infringement of EU law on the award of public contracts, but contains no detailed statement either as to the conditions under which an awarding authority may be held liable or as to the determination of the amount of the damages which it may be ordered to pay. [...] Therefore, [...] as regards State liability for damage caused to individuals by infringements of EU law for which the State may be held responsible, the individuals harmed have a right to redress where the rule of EU law which has been infringed is intended to confer rights on them, the breach of that rule is sufficiently serious, and there is a direct causal link between the breach and the loss or damage sustained by the individuals. In the absence of any provisions of EU law in that area, it is for the internal legal order of each Member State, once those conditions have been complied with, to determine the criteria on the basis of which the damage arising from an infringement of EU law on the award of public contracts must be determined and estimated, provided the principles of equivalence and effectiveness are complied with.<sup>2</sup>*

Before adoption of the Directive 2007/66/EC, the European Commission concluded that damages are a particularly problematic remedy: regarding the satisfied claims for damages “the figures collected, supported by the feedback from stakeholders during the consultation process, are so low as to be almost non-existent”.<sup>3</sup> Three main problems of damages as a legal remedy were identified: they have no real corrective effect, claims of damages are hampered by practical

<sup>2</sup> CJEU judgement of 9 December 2010 in Case No. C-568/08 *Combinatie Spijker Infrabouw/De Jonge Konstruktie, Van Spijker Infrabouw BV, De Jonge Konstruktie BV v. Provincie Drenthe*, para. 86; 92.

<sup>3</sup> Annex to the Proposal for a Directive of the European Parliament and of the Council amending Council Directives 89/665/EEC and 92/13/EEC CEE with regard to improving the effectiveness of review procedures concerning the award of public contracts {COM(2006) 195}. Available: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52006SC0557> [viewed 16.04.2024.].

difficulties, the process is lengthy and costly.<sup>4</sup> However, several publications regarding practices of the EU Member States regarding regulation of damages in public procurement proceedings show that during the last 15 years there have been a shift towards accepting the theoretical possibility to bring claims for damages in the form of lost profits. As has been concluded in a major contribution by Hanna Schebesta, “one may conclude that the specific public procurement factual constellations have forced all jurisdictions to accept the lost chance theory in the field of public procurement in order to make damages available.”<sup>5</sup> Somewhat similar conclusions can be drawn by responses to a questionnaire published in the book “Tort Liability of Public Authorities in European Laws”.<sup>6</sup>

To sum up the consequences of the doctrine of the lost chance and therefore existing practices in several EU Member States, a use of a simple example is in order. A local municipality has announced a procurement on building a local school. Three bidders (B, C and D) submit their bids. Bidder B is awarded the right to conclude the contract with the total amount of 10 million euros. Although C and D contests the results, the Public Procurement Bureau allows the contract to be concluded with B. The contract is concluded and the building has been built. However, later administrative court concludes that C was illegally excluded from the competition and given all the facts would certainly had been awarded with the contract instead of B. According to the doctrine of the lost chance C could claim damages in the amount of the actual profits from the contract, i.e., the total cost of the contract minus actual costs of performance of the contract. Let us assume that the total profit from the contract, if the C would have performed it, would be 1 million euros.

## 1. Damages even in the form of lost profits (lost chance) is a fiction

The existing legal reasoning allowing damages claims in public procurement is mainly based upon such civil law concepts as lost profits (*lucrum cessans*)<sup>7</sup> and the doctrine of lost chance.<sup>8</sup> However, this transplantation of civil law concepts in public procurement law and other tenders regulated by public law is evidently ill grounded.

<sup>4</sup> Annex to the Proposal for a Directive of the European Parliament and of the Council amending Council Directives 89/665/EEC and 92/13/EEC CEE with regard to improving the effectiveness of review procedures concerning the award of public contracts {COM(2006) 195}. Available: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52006SC0557> [viewed 16.04.2024.].

<sup>5</sup> Shebesta H., 2016, p. 216.

<sup>6</sup> Della Cananea G., Caranta R. (eds). Tort Liability of Public Authorities in European Laws. Oxford University Press: 2020, pp. 164–186.

<sup>7</sup> On the origins of the term “lost profits”, see: Zimmerman R. The Law of Obligations. Roman Foundations of the Civilian Tradition. Oxford University Press: 1996, p. 827.

<sup>8</sup> See comparative examples regarding the lost chance in: Van Dam C. European Tort Law. Oxford University Press: 2007, pp. 294–297.

Lost profit as a type of damages is relevant when due to illegal activity of another person there has been an active breach of already existing rights (status). Typical examples are failure to deliver parts needed to timely perform another already concluded contract, an illegal injury of a person losing his ability to continue work, etc. In the sphere of state liability the prospect of lost chance is also possible. For instance, Article 7 of the Latvian Law on Compensation for Losses Caused by State Administration Institutions<sup>9</sup> prescribes that “within the meaning of this Law, a material loss is a deprivation which can be materially assessed and which has been caused to a victim due to an unlawful administrative act or an unlawful actual action of the institution” (Paragraph 1). “When calculating a material loss, the unearned profit shall also be taken into account if a victim can prove that the profit would have been earned in the course of normal course of events” (Paragraph 2). For instance, if an authority unlawfully closes the only road leading to a country hotel, then the owner of the hotel is theoretically entitled to receive damages in the form of lost profits (however difficult it is to prove those). The reason to reimburse lost profit is because the illegal active interference in the person’s rights (status) has caused a person such a harm that has caused a loss of an income, which was promised (expected) before the illegal activity occurred.

However, in case of various competitions, including public procurement procedures, no person has the right to expect that he/she will win the competition. Even if a person has been illegally disqualified from the competition, his/her status after the competition is identical to the status before that. This is the main difference between the classical examples mentioned in the previous paragraph – in the case of a competition the illegalities of the competition itself does not cause any lost profits that would have been guaranteed before it. This simple observation can be generalized towards all competitions regulated by public law – whether they are competitions to public official positions, scientific grants or public procurements. It is rather clear that in those situations the contestants has no rights to claim lost profits, because there have been no active right that has been breached.

In Latvia the administrative courts were first confronted with the issue of lost profits in public procurement cases in 2014. In a case where a tenderer had been illegally disqualified and therefore claimed damages, the Supreme Court rejected the argument that the tenderer has no claim to damages. The Supreme Court ruled that it agrees “that legal provisions do not prescribe a person with whom a contract should be concluded and that the claimant had no legitimate expectations that the contract will be concluded with him. However, this could not be an unsurmountable obstacle in determining the causal link between the actions of the institution and the eventual damages. Otherwise the institute of damages in public procurement cases would be illusory, for in no instance the legal provisions provide for previously determinable winner and no one could have

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<sup>9</sup> Law on Compensation for Losses Caused by State Administration Institutions. Available: <https://likumi.lv/ta/en/en/id/110746-law-on-compensation-for-losses-caused-by-state-administration-institutions> [viewed 02.12.2023.].

expectations that other contestants will not win.”<sup>10</sup> However, as can be seen from this reasoning, the damages should be available not because they have occurred, but because otherwise they would not be available.

Therefore the concept of lost profits originally stemming from the civil law has been used in public procurement proceedings not because there is an active breach of already existing rights and thus a previously expected income is lost, but because otherwise there would be no other worthy legal remedies. However, as will be examined further, the existence of lost profits in public procurement procedure is not only fictional, but their reimbursement creates immoral results.

## **2. Unjustified enrichment and immorality of the use of lost profits in public procurement**

Lost profits in public procurement proceedings are usually awarded in a situation, where the contract has already been concluded with the “wrong” person. Since it would be impractical to cancel the concluded contract, lost profits are awarded to the person who, in retrospect, would have been entitled to receive the contract. The lost profit usually is calculated as the eventual profit from the contract, i.e., total amount of the contract minus calculated costs. However, such a solution creates unfair and even immoral situation. Again an example with building contracts illuminates this situation most vividly. If a local municipality has concluded a building contract worth 10 million euros, then the contractor, although wrongfully chosen, does indeed perform the contract and thus quite rightly receives the money for his efforts. His profit from the contract, for instance 1 million euros, is indeed earned for the added value he has created using his resources. Then, in turn, if lost profits in amount of 1 million euros are also awarded to the person, who has been wrongfully excluded from the competition but would have won it, it is apparent that this sum of money is given for no efforts at all.

If one compares the earned profit of the person who performed the contract and the lost profit of the person who receives it as a damage, then it is obvious that the latter receives it for doing virtually nothing – no counter-performance at all. If the earned profit has been received for actually performed contract and therefore created value, then the lost profit as a damages is paid merely because of an error in oftentimes complex public procurement regulations. The outcome is such that the unfairly treated person receives profit for doing nothing, but the person, who performed the contract has put all the effort and resources and managed all the risks. However unwelcome is the fact that a person has been treated unfairly in the public procurement procedure, the legal remedy cannot treat this person as if she had actually performed the contract. Such a generous award for doing

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<sup>10</sup> Judgment of the Department of Administrative Cases of the Supreme Court of the Republic of Latvia of 22 October 2014 in Case No. SKA-807/2014, para. 8. Available: <https://www.at.gov.lv/downloadlawfile/7447> [viewed 03.12.2023.].

nothing puts this market participant in an economically better position than his competitors and leads to another extreme – unjustified enrichment on the expense of public funds.

It should also be noted that the existing practice in awarding lost profit takes for granted that the person, who receives the damage, actually would have performed the contract. However, it is well known that contractors not always perform the contract according with the agreed standards or in a timely manner. Therefore the whole concept of the lost profit is based upon premise that the contract would have been performed faultlessly, but this assumption is a mere speculation.

Therefore awarding damages for the lost profit in public procurement procedure creates a result that is contrary to a simple moral standard – the person who has done nothing should not be granted the same profits that the person who has earned them.

Another disturbing issue in the theme of damages in public procurement procedure are the costs of the bid. If a person has been unlawfully excluded from the competition and would have been awarded with the contract, then costs of preparation of the bid are considered as damages. Such approach has been accepted in countries like Austria,<sup>11</sup> Germany,<sup>12</sup> Italy,<sup>13</sup> Poland,<sup>14</sup> Romania.<sup>15</sup> In turn, the Netherlands seem particularly averse to granting bid cost claims due to strong economic rationale: economic risk of participating in a tender procedure rests with the tenderer.<sup>16</sup> Indeed, the costs of the bid are expenses which are suffered by all participants of the public procurement procedure. Therefore there is no logic in paying damages in the amount of costs of the bid, because such costs would occur irrespective of the result of the public procurement procedure. The very logic is expressed in the Latvian law on Compensation for Losses Caused by State Administration Institutions: “causal link shall not exist in cases where the same loss would have arisen also if the action of the institution would have been lawful” (Article 6, Paragraph 2).

### **3. Intolerable speculation regarding the amount of the lost profit**

Notwithstanding the infamous troubles for the judiciary to evaluate the person with whom the contract should have been concluded, it has been well known that proving the amount of the lost profit is also an exceptionally difficult task. Although in Latvia administrative courts have dealt with claims regarding lost profits in public procurement cases since 2014, most of the cases dealt with

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<sup>11</sup> Della Cananea G., Caranta R. 2020, p. 165.

<sup>12</sup> *Ibid.*, p. 173.

<sup>13</sup> *Ibid.*, p. 178.

<sup>14</sup> *Ibid.*, p.180

<sup>15</sup> *Ibid.*, p.183

<sup>16</sup> Shebesta H. *Damages in EU Public Procurement Law*. Springer: 2016, p. 93.

theoretical issues regarding the preconditions of liability rather than calculating exact amount of the lost profit. However, quite recently first judgments in which an actual amount of damages have been judged upon, have been adopted and therefore give an insight into the speculative character of the lost profit.

The Supreme Court has ruled that “sufficient confidence on what the exact costs of the tenderer would have been if the contract had been performed is an essential element in determining the amount of the lost profit. Therefore it is expected that the court [...] explains its considerations [...] that with high probability the costs calculated in the estimate reflect the actual costs in the case of performing the contract. [...] It should be taken into account that there may be various circumstances related with the industry (for instance, rise of prices of building materials) that may lead to conclusion that the costs, which were estimated originally, actually would have been larger and therefore the profit would have been lesser.”<sup>17</sup> “[...] the fact that other participants in the case have not doubted the algorithm of calculating the lost profit submitted by the claimant and that all changes in the contract cannot be foreseen does not mean that the conclusions regarding profit and its amount can be based on assumptions. It should be noted that the burden of proof lies on the claimant [...]”<sup>18</sup>

From one hand, these thesis quite rightly point that the amount of the lost profit should not be based upon unproven speculation and therefore tends to limit the possibilities of proving the lost profit. On the other hand, the task of evaluating various factors that could affect the costs is speculative in itself. As can be seen from the first judgments in Latvia actually awarding the lost profit, the courts are either base their merits on the unproven estimates of claimants or are faced with an enormously difficult task to determine the exact costs of performing a contract that has never been nor will be concluded.

One of the few judgments which have awarded the lost profit and have actually come into force is judgment of the Administrative District Court. The court concluded that all preconditions have been met in order to determine that the claimant was illegally disqualified from the procurement procedure (construction supervision services) and should have won the procedure. The court based it merit solely upon the estimate presented by the claimant, which represented the total sum of the bid, estimated costs and estimated profit. The position of “costs” included such position as “administrative expenses” which were calculated as overall administrative costs of the company and evenly distributed between all objects/contracts.<sup>19</sup> To prove the correctness of this position alone would be an

<sup>17</sup> Judgment of the Department of Administrative Cases of the Supreme Court of the Republic of Latvia of 10 May 2022 in Case No. SKA-471/2022, para. 48. Available: <https://www.at.gov.lv/downloadlawfile/8525> [viewed 03.12.2023.].

<sup>18</sup> Judgment of the Department of Administrative Cases of the Supreme Court of the Republic of Latvia of 22 September 2017 in Case No. SKA-558/2017, para. 15. Available: <https://www.at.gov.lv/downloadlawfile/5587> [viewed 03.12.2023.].

<sup>19</sup> Judgment of the Administrative District Court of 11 March, 2022 in Case No. A420121421, para. 14. Available: <https://manas.tiesas.lv/eTiesasMvc/nolemumi/pdf/472955.pdf> [viewed 03.12.2023.].

insurmountable task. However, the main problem posed by such estimates is that regarding the lost profits the claimants naturally tend to minimize the estimated costs in order to prove that the profits from the contract would have been greater. Thus, the administrative district court has ruled that the estimate cannot be the only document proving the actual (estimated) costs: “Profits specified in the estimate is an eventual calculation based upon the total amount of the direct costs. However, it should be taken into account that the purpose of the claimant, as with any other bidder, is to conclude a contract, therefore, to try to bid the lowest price. Undeniably, the claimant hopes to receive profit, however, it is not proven whether the actual profit gained by the claimant would correspond to the calculated profit specified in the estimate. The claimant has not proven that the costs of performing the contract would have been exactly the same as specified in the financial offer, in other words, the financial offer has been drafted with the purpose of concluding the contract, but it does not prove the exact costs during the performance of the contract.”<sup>20</sup>

## Conclusions

1. Damages in the form of the lost profits are widely recognized as a legal remedy to compensate the rightful winner of the public procurement procedure for the fact that the contract has been illegally awarded to another person. However, the lost profit as a legal remedy in public procurement cases is ungrounded, unfair (immoral) and impractical legal remedy.
2. The transplantation of its use from the civil law in public procurement procedure has failed to pay sufficient attention to a significant difference – the public procurement procedure does not actively infringe already existing rights, therefore the legal status of the aggrieved person after the public procurement procedure is the same as before it. Therefore there has never been a previously expected income and hence the lost profit in public procurement cases is a mere fiction with the sole purpose of granting a legal remedy.
3. Awarding lost profits to the person in recompense for no effort at all in comparison to the person, who has actually performed the contract, is an unfair solution creating unjustified enrichment at the expense of public funds.
4. Lastly, the determination of the amount of the lost profit is based on nothing more than a speculation that the contract would have been performed precisely, and that all calculations regarding the costs would be identical to imaginary “actual” costs.

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<sup>20</sup> Judgment of the Administrative District Court of 31 May, 2022 in Case No. A420283421, para. 12. Available: <https://manas.tiesas.lv/eTiesasMvc/nolemumi/pdf/479654.pdf> [viewed 03.12.2023.].



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