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Sub-economic tendering: Developments and Best Practice

This paper considers the issue of sub-economic/abnormally low tendering in the awarding of public contracts from an international comparative perspective.

1 Introduction

This paper is intended to contribute to the Committee for Finance and Personnel's (CFP) interest in the issue of sub-economic tendering in public contracts. CFP most recently considered this issue in an evidence session with Officials from the Department of Finance and Personnel (DFP) on the 16 January 2013 where the Committee expressed concerns that "sub-economic tendering" resulted in adverse and unfair business conditions for sub-contractors.¹

This paper discusses the issue of sub-economic tendering and includes: a definition and outline of the issue in the context of Northern Ireland; a brief overview of the relevant European Union (EU) directives and United Kingdom (UK) legislation; information on the transposing legislation in other jurisdictions; an outline of new EU proposals in this area; and, some potential issues for consideration.

2 Sub-economic tendering

This section of the paper discusses the issue of sub-economic or "abnormally low" tendering. Although a separate issue to prompt payment, CFP have identified a causal relationship between the problem of sub-economic tendering and timely and complete payment to sub-contractors.

The recent advice issued by the CPD suggests that sub-economic tendering or abnormally low tenders refers to circumstances when:²

... firms are prepared to submit uneconomic or unsustainable tender prices to survive. Such practices significantly increase the risk of poor contract performance, create difficulties within supply chains and have a damaging effect on the industry.

This section includes: the existing EU and UK legislative frameworks in this area; the difficulties in defining an "abnormally low" tender; the current arrangement in Northern Ireland in a comparative context; a discussion of new EU proposals in this area; and, some potential issues for consideration.

¹ Official Report for the Committee for Finance and Personnel, 16th January 2013, <http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Committee-Minutes-of-Evidence/Session-2012-2013/January-2013/Prompt-Payment-and-Construction-Contracts--DFP-Briefing/>

² DFP, *Construction Procurement: Abnormally Low Tenders*, p. 1

2.1 Legislative Framework

This sub-section briefly addresses the relevant sections of the applicable EU directives and UK transposing legislation in the area of public procurement.

2.1.1 EU Directives

The main EU directives in the area of public procurement are *2004/17/EC which co-ordinates contracts in water, transport, energy and postal services* and *2004/18/EC which co-ordinates contracts in public works*. The directives apply to contracts on or above the European thresholds.³ The relevant articles that concern “Contract Award Criteria” are Articles 55 and 53 respectively. Both articles stipulate that the criteria used to award contracts can be either: the lowest price; or, MEAT (Most Economically Advantageous Tender), which uses various weighted criteria linked to the subject matter of the public contract. Such criteria may include quality, price, technical merit, environment, etc.

The directives, in Articles 57 in *2004/17/EC* and 55 in *2004/18/EC*, stipulate that contracting authorities can reject bids deemed to be abnormally low. To do so, contract authorities must request a detailed explanation of the tender and verify, in consultation with the tenderer, that the tender is abnormally low having considered all the evidence.⁴

The current directives do not stipulate how Member States should identify an abnormally low tender.

2.1.2 UK Transposing Legislative Framework

The transposing UK legislation in this area is the *Public Contracts Regulations 2006 (PCR 2006)* and applies to England and Wales. Public Procurement is a devolved policy area in Scotland and Northern Ireland. Scotland has chosen to implement subnational transposing legislation, the *Public Contracts (Scotland) Regulations 2006*. However, the legislation is substantively similar to that of the UK, particularly the sections relevant to this paper.⁵

³ Directive 2004/17/EC, Chapter II, Article 16, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:134:0001:0113:en:PDF> – The thresholds for supply or service contracts and public works contracts are 499,000Euro and 6, 242, 000Euro respectively. Directive 2004/18/EC, Chapter II, Article 7, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:134:0114:0240:EN:PDF> , - The thresholds for some supply and service contracts and public works contracts are 162,000Euro, 249,000Euro and 6,242,000Euro respectively.

⁴ Ibid, Articles 57 & 55.

⁵ Although not directly linked to the relevant sections, both the UK and Scottish Legislation has been amended by further legislation which includes: the *Public Contracts and Utilities Contracts (Amendment) Regulations 2007*; the *Public Contracts and Utilities Contracts (Scotland) Amendment Regulations 2007*; the *Public Contracts and Utilities Contracts (Postal Service Amendments) Regulations 2008*; the *Public Contracts and Utilities Contracts (Postal Service Amendments) Regulations 2008*; the *Public Contracts and Utilities Contracts (Scotland) Postal Service Amendments Regulations 2008*; and the *Public Contracts (Scotland) Regulations 2012*.

Although Northern Ireland has legislative competence in the area of the public procurement, it has chosen to follow the UK legislation.⁶

Regulation 30(1) of the *PCR 2006* stipulates that contracts can be awarded on the basis of: the lowest price; or, the Most Economically Advantageous Tender from the point of view of the contracting authority.⁷ Regulation 30(2)(3) indicates the potential criteria that can be used for MEAT, and the requirement to publish the criteria (and weightings where possible) in the contract notice and corresponding contract documents.

In addition Regulation 30(6) also states:⁸

(6) If an offer for a public contract is abnormally low the contracting authority may reject that offer but only if it has—

(a) requested in writing an explanation of the offer or of those parts which it considers contribute to the offer being abnormally low; .

(b) taken account of the evidence provided in response to a request in writing; and .

(c) subsequently verified the offer or parts of the offer being abnormally low with the economic operator.

2.2 Abnormally Low Tendering (ALT)

This sub-section discusses: the relationship between ALTs and contract award criteria; methods of identifying sub-economic tendering/abnormally low tenders; the procedures in place in Northern Ireland; procedures employed in other jurisdictions; potential methods of mitigating the risks of ALTs; the relevant provisions of the proposal for a new EU procurement directive; and, some issues for consideration.

2.2.1 Contract award criteria and abnormally low tenders

In a presentation entitled *Identifying and dealing with abnormally low bids* given by the at a National Procurement Service sponsored seminar, it was suggested that the number of ALTs and the risks associated with them could be mitigated if contracting authorities “develop detailed and appropriate specifications and use MEAT criterion over lowest price.”⁹

Section 3.7 of the *NI Public Procurement Policy Handbook* states:

⁶ For more information, NI Public Procurement Policy Handbook, Section 3.7, http://www.dfpni.gov.uk/index/procurement-2/cpd/cpd-policy-and-legislation/ni-pp-policy/cpd_policy_ni_public_procurement_policy_handbook/ni-ppp-handbook-v3-june-2011.pdf

⁷ PCR 2006, Reg 30(1), <http://www.legislation.gov.uk/ukssi/2006/5/regulation/30/made> - The relevant regulation in the Scottish legislation is also Reg 30(1) and is identical, <http://www.legislation.gov.uk/ssi/2006/1/regulation/30/made>

⁸ Ibid, Reg 30(6) – The same regulation is contained in the Scottish legislation.

⁹ A & L Goodbody, *Identifying and dealing with abnormally low bids*, <http://www.procurement.ie/publications/identifying-and-dealing-abnormally-low-tenders>

Award of Contracts on the Basis of Most Economically Advantageous

*Contracts should be awarded on the basis of objective criteria which ensure compliance with the TFEU Principles and which guarantee that tenders are assessed in conditions of effective competition. This permits the use of one of two award criteria: “the most economically advantageous tender” (MEAT) or “the lowest price”. The Procurement Board has determined that all procurements **should** (emphasis added) be on the basis of MEAT with exceptions approved by the Head of Procurement of the relevant CoPE.*

Similarly, guidance notes issued on procurement by the UK Government, Scotland Wales and the Republic of Ireland all suggest that “whole life costs” analysis, in the form of MEAT, should be used to achieve value for money.¹⁰ The Netherlands will implement a new procurement law on 1 April 2013 that will make the use of MEAT mandatory in awarding all the public contracts.¹¹

Issues for Consideration:

1. Whether the use of MEAT should be made *mandatory* in the awarding of all government contracts in NI?
2. Under what circumstances would the Head of Procurement in a Centre of Procurement Expertise (COPE) permit the use of the “lowest bid” criterion? On how many occasions has this criteria been used since the NI Procurement Policy Handbook was published?

3.2.2 Identifying abnormally low tenders: international comparisons

There is no method for defining an Abnormally Low Tender (ALT) identified within the EU directives or UK transposing legislation. In a paper entitled *Abnormally Low Tenders in Procurement Law* produced by the Procurement Lawyers’ Association, Nigel Giffen QC notes that:¹²

In the case of the United Kingdom, there is of course no domestic legislative definition to draw upon...

and,

¹⁰ See the following guidance notes: *Procurement Process for Works Contracts*, <http://constructionprocurement.gov.ie/guidance-notes/>, *Welsh Procurement Policy*, <http://wales.gov.uk/topics/improvingservices/better/vfm/wob/howdowebuy/ourcorevalues/?lang=en>, ¹⁰ SPD, *Tendering for Public Contracts: A Short Guide for Businesses*, http://www.publiccontractsscotland.gov.uk/guides/Guide_Download.aspx?id=802, Section 5, *Managing Public Money*, http://www.hm-treasury.gov.uk/d/mpm_annex4.4.pdf, Annex 4

¹¹ Email confirmation from PIANOO, the Dutch Centre of Procurement Expertise – in some limited cases of exceptional circumstances, the lowest bid criterion can be used.

¹² Procurement Lawyers’ Association, *Abnormally Low Tenders in Procurement Law*, <http://www.11kbw.com/articles/docs/PLAAbnormallyLowNigelGiffenQC.pdf> p. 2-4

It would appear that in this respect Member States have a reasonably free hand. It suggested that in the absence of national legislation a contracting authority should similarly enjoy considerable latitude in its approach to deciding whether a bid appear abnormally low.

This sub-section highlights the recent advice issued by CPD on ALTs and the arrangements in other jurisdictions.

Northern Ireland

In the recently published advice note *Construction Procurement: Abnormally Low Tenders*, CPD has issued guidance on how to identify ALTs. The note indicates that ALTs should be identified on the basis of the narrow average (an average that does not include the highest and lowest prices). On occasions where application of the narrow average would differentiate between tenders which are close in price, COPEs should apply a safety margin from the lowest qualifying price (the lowest price submitted that is 15% or less than the narrow average). If the tender price is 15% below the narrow average and outside the safety margin, it should be considered to be an ALT.¹³ See Box 1 for a working example.

Box 1: Narrow Average and Safety Margin: Working Example

Six Tenders; 2,000, 10,000, 15,000, 20,000, 25,000, 40,000

Narrow average = 10,000, 15,000, 20,000, 25,000/ 4 = **17,500**

17, 500 – 15% = **14,875**

ALTs: 2,000, 10,000

Safety Margin: 8,000 (lowest qualifying price = 15,000)

ALTs: 2,000

The advice note also indicates that CPD has agreed a 'voluntary arrangement' with industry representatives to exclude all ALTs for contracts below £4 million (approximately the EU threshold levels). For works above £4 million, ALTs should be considered on a case-by-case basis.

UK – England and Wales

The *PCR 2006*, which applies to England and Wales does not provide a definitive method that can be used to identify abnormally low tenders.

An email from the Procurement Policy Team of the Government Procurement Service (GPS) to RaiSe confirmed that an ALT may be defined if:

¹³ CPD, *Construction Procurement: Abnormally Low Tenders*, p. 2

*...the authority receives a tender which is much lower than others received (and here some judgment has to be applied given the circumstances of the procurement).*¹⁴

Scotland

Similar to England and Wales, the Scottish legislation does not provide a firm statutory method for identifying ALTs.

An email to RaISe from the Scottish Procurement Directorate (SPD) confirms that:¹⁵

The Scottish Government have not developed any guidance or policy around the issue of abnormally low tenders... this would be for each individual contracting authorities to determine, based on the individual procurement exercise.

Republic of Ireland

The Construction Procurement Reform Group, a sub-group with the Department of Public Expenditure and Reform, issue guidance for contracting authorities and suppliers in public works contracts. The Capital Works Management Framework consists of a series of best practice guidance, standard contracts and generic template documents. In Section 8 of the Instruction to Tenderers documents, it states that:¹⁶

If, in the Employers opinion, the tendered contract sum is abnormally low... the Employer may require the candidate to provide details of the constituent elements of the tendered Contract sum or the tendered amounts... If, having considered the information provided, the Employer is of the view that either the contract sum or the tendered amounts is abnormally low or abnormally high, the Employer may reject the tender.

No precise method for defining an ALT is given in Irish procurement law or non-statutory guidance.

*Lithuania*¹⁷

In 2009, Lithuania adopted an order on guidelines for reasoning of abnormally low tenders for goods, services or works. The *Guidelines Order*, together with the *Definition Order*, specify the provisions regarding an ambiguous notion of abnormally low tenders established in the law. They also clarify situations in which the contracting authority has an obligation to request and the supplier has an obligation to provide the reasoning of an abnormally low tender.

¹⁴ Confirmation email from GPS Official to RaISe

¹⁵ Confirmation email from SPD Official to RaISe

¹⁶ Section 8.3, Instructions to Tenders I, <http://constructionprocurement.gov.ie/invitations-to-tender-works/>

¹⁷ For more information, see <http://lexuniversal.com/en/news/9883>

According to the Definition Order, an abnormally low tender means that the price provided for in the tender might be insufficient for the proper performance of a public procurement agreement: (a) if the price is at least by 15 or more percent lower than the arithmetic average of prices of other tenders; or (b) if the price is at least by 30 or more percent lower than expenses originally scheduled for the public procurement at issue.

The Netherlands

Email correspondence from PIANOo, the government body responsible for public procurement in the Netherlands, confirmed that:¹⁸

There is no guidance or factsheet for contracting authorities on how to decide whether an offer is abnormally low. The current procurement regulations provide the necessary information concerning this subject. The provisions in the procurement regulation are consistent with the European procurement directives and jurisprudence of the European Court of Justice.

Luxembourg

Luxembourg law defines ALTs in public procurement as follows:¹⁹

Whatever method for establishing prices is imposed by the bid documents or by the contract, all the prices set out in the offer should be normal prices. Prices are considered as being abnormally low in circumstances in which, after allowing for all expenditures, the price offered leaves no margin for a normal level of profit.

2.2.3 Competing Definitions

Without a concrete definition in EU law of what constitutes an abnormally low tender, a number of competing definitions have emerged.

A report entitled *Prevention, Detection and Elimination of Abnormally Low Tenders* notes that:²⁰

There are number of existing systems in use in EU and other countries that are intended to detect ALTs. These are essentially arithmetic systems that measure the deviation of a particular tender price from an average of all tender prices submitted. The deviation that identifies a tender as being

¹⁸ Email correspondence PIANOo with RaiSe.

¹⁹ DG III Working Group on Abnormally Low Tenders Report, *Prevention, Detection and Elimination of Abnormally Low Tenders in the European Construction Industry*, Section 4.2, <http://www.ceetb.eu/docs/Reports/DG3ALT-final.pdf> - Normal profit occurs when total revenue is equal to total costs. In other words, normal profit occurs when firms break even.

²⁰ Ibid

abnormally low varies between 10% and 15% but views were expressed by contributors to the survey that such systems are of limited efficacy.

In addition, the report provides the following working definition of ALTs:²¹

A tender is assumed to be abnormally low if: in the light of the client's preliminary estimate and of all the tenders submitted, it seems to be abnormally low by not providing a margin for a normal level of profit; and, in relation to which the tenderer cannot explain his price on the basis of the economy of the construction method, or the technical solution chosen, or the exceptionally favourable conditions available to the tenderer, or the originality of the work proposed.

The Procurement Lawyer's Association report notes that European case law has provided guidance when defining ALTs. Below is an extract from the report:²²

Various formulae appear in the decisions of the ECJ and CFI/General Court... [which define the following:]

*Whether the bid is "**genuine**" (Lombardini, above, and C-143/94 Fratelli Costanzo SpA [198ECR 1839).*

*Whether it is "**genuine and viable**" or "**sound and viable**" (SECAP, above).*

*Whether it is "**reliable and serious**" (T-4/01 Renco SpA [2003] ECR II-171 and T-148/04 TQ Travel Solutions Belgium SA [2005] ECR II-2627).*

*Whether it is "**serious**" (T-121/08 PC-Ware Information Technologies BV). [emphasis added]*

2.2.4 Proposals for a new EU Directive on Public Procurement: Clarity on ALTs

Proposals for new EU directives in the area of public procurement replacing 2004/17/EC and 2004/18/EC were issued in December 2011. They attempt to add clarity to competing definitions of what constitutes an ALT.

Article 69 and 79 of the proposals state that:²³

Abnormally low tenders

1. Contracting authorities shall require economic operators to explain the price or costs charged, where all of the following conditions are fulfilled:

²¹ Ibid

²² Procurement Lawyers' Association, (n12) p. 4

²³ Article 69, Proposal for new EU Directive, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52011PC0896:EN:NOT>

(a) the price or cost charged is more than 50 % lower than the average price or costs of the remaining tenders

(b) the price or cost charged is more than 20 % lower than the price or costs of the second lowest tender;

(c) at least five tenders have been submitted.

According to the EU Commission website, the proposals were to be adopted at the end of 2012 for implementation by Member States by June 2014. However, at the time of writing this paper, the proposals have not yet been adopted.²⁴

2.3 Conclusions and issues for consideration

Overall, as highlighted throughout this section, it appears that by virtue of its existence, the definition and guidance provided by CPD compares favourably with other jurisdictions, particularly those within the UK.

The proposals for the forthcoming EU procurement directive may add some clarity to the definition of ALTs at a European level. However, without a definitive directive, the potential impact on UK legislation is unclear. Nonetheless, should the proposals be implemented as they stand, they will include a concrete definition of ALTs.

²⁴ See note 23