

Unclassified

DAF/COMP/WP2/M(2015)1/ANN6/FINAL

Organisation de Coopération et de Développement Économiques  
Organisation for Economic Co-operation and Development

28-Jul-2016

English - Or. English

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

## **Working Party No. 2 on Competition and Regulation**

### **SUMMARY OF DISCUSSION OF THE HEARING ON AUCTIONS AND TENDERS: FURTHER ISSUES**

**19 June 2015**

*This document prepared by the OECD Secretariat is a detailed summary of the discussion held during the Item V of the 59th meeting of Working Party No. 2 held on 19 June 2015.*

*More documents related to this discussion can be found at [www.oecd.org/daf/competition/tenders-and-auctions.htm](http://www.oecd.org/daf/competition/tenders-and-auctions.htm)*

Please contact Ms. Cristiana Vitale if you have any questions regarding this document [E-mail: [cristiana.vitale@oecd.org](mailto:cristiana.vitale@oecd.org)].

**JT03399546**

Complete document available on OLIS in its original format

*This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.*

DAF/COMP/WP2/M(2015)1/ANN6/FINAL  
Unclassified

English - Or. English

## HEARING ON AUCTIONS AND TENDERS: FURTHER ISSUES

### *Summary of Discussion*

This document summarises the presentations and discussions at the Hearing on Public Procurement held in Paris on 19 June 2015 under Working Party No. 2 on Competition and Regulation of the OECD Competition Committee, **chaired by Mr Alberto Heimler**, Chairman of the Working Party.

It was the second on the wider topic of competition issues in the use of auctions and tenders, following the Hearing of 15 December 2014. Its purpose was to focus on two particular issues in public procurement systems: i) the identification and treatment of Abnormally Low Tenders (ALTs), and ii) the partitioning of contracts into lots.

The issue of bid-rigging in public procurement has been dealt with extensively in previous OECD Roundtables and policy documents,<sup>1</sup> and was not the primary focus on this occasion.

As a basis for the Hearing, an Issues Note by Secretariat staff<sup>2</sup> reported the findings of a survey of OECD countries' practice on these two issues and combined this with a review of literature to draw potential lessons.

Procurement practices vary widely, not only between jurisdictions but also within them as a result of the large number of public bodies undertaking procurement of different kinds and the significant discretion given to them.

The speakers were:

- Ms Ana Rodrigues (OECD), author of the Issues Note;
- Mr János Bertók (Head of Public Sector Integrity Division, OECD);
- Mr Robert Anderson (Counsellor and Team Leader for Government Procurement, WTO);
- Mr Graeme Clark (Senior Adviser, Procurement Policy Department, EBRD);
- Dr Gian Luigi Albano (Head of Research, Consip S.p.A., a body responsible for advising on public procurement in Italy).

---

<sup>1</sup> See OECD Council Recommendation on Fighting Bid Rigging in Public Procurement (2012) and OECD Guidelines on Fighting Bid Rigging in Public Procurement (2009).

<sup>2</sup> [DAF/COMP/WP2\(2015\)1](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp2(2015)1&doclanguage=en), available at: [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp2\(2015\)1&doclanguage=en](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=daf/comp/wp2(2015)1&doclanguage=en).

## 1. Abnormally Low Tenders (ALTs)

Abnormally Low Tenders (ALTs) are financial tenders which are considered to be so low that they could potentially indicate problems with the tenderer's ability to fulfil the contract. **Ms Rodrigues** reported that the concept of ALTs (under a variety of different names) existed in the procurement law of 24 out of the 27 jurisdictions that responded to the survey.

There was agreement among the speakers that the causes and consequences of ALTs can be very different. They may indicate that the tenderer has underestimated the costs (or overestimated the value) associated with carrying out the contract, which can lead to default, cost overruns or low quality implementation if it is awarded to the tenderer. An ALT may also be a form of strategic 'lowballing', whereby a tenderer submits an artificially low bid in order to secure a contract in the expectation of being able to renegotiate its terms ex post via hold-up or outright corruption. In both of these cases the award of a contract to a tenderer submitting an ALT can cause problems with the final cost, quality and timeliness of the contract performance, leading to social welfare losses.

In the other cases, however, an ALT may result from pro-competitive factors. The tenderer may possess efficiencies, resulting for example from complementarities between the tasks of the contract and its other activities, which are being passed on to the public in the form of a low procurement price. A competitive bid, for example by a new entrant, in an area of procurement in which collusion has kept prices high in the past may also appear abnormally low.

Because of these very different implications for contract performance, the question of how to identify and respond to ALTs in the procurement process is a very important one. Although there was debate concerning the most appropriate way of identifying ALTs, the participants were unanimous that a bid classified as an ALT by one or other method should not automatically be excluded from the tender process without further investigation, since this could result in genuinely competitive tenders being rejected. This principle is also reflected in the procurement systems of most of the countries that responded to the survey, in which the tenderer is given an opportunity to justify its low bid to the tendering authority.

**Ms Rodrigues** reported that over half of the jurisdictions surveyed said they used a pre-specified benchmark to identify ALTs in procurement situations. Two broad approaches exist to identifying ALTs by means of such benchmarks. One approach is relative, and identifies an ALT as an outlier in relation to the other bids for the same contract. The other is absolute, and identifies an ALT as a bid that is low by comparison with the prior cost estimates on the part of the public body holding the tender. Hybrid benchmarks also exist.

Relative methods for identifying ALTs are based on thresholds for the deviation of a bid from some statistic (such as the mean or median) from the distribution of bids. **Mr Clark** reported that his division had devised a formula for identifying ALTs that was successful in predicting problematic tenders when applied to data from past procurement exercises.

In some cases relative methods are used not just in identifying ALTs but in determining the winning bid. This is the case with average bid mechanisms, which are derived from the engineering literature. **Ms Rodrigues** cited Canada as an example where such methods are widely used by contracting authorities, particularly when procuring professional services (in which only bids within a certain range of the median are considered) and in defence and major projects (in which a 'lowball penalty' is applied to below-average bids). Her Issues Note points out that average bidding has been questioned in the academic literature but also that there are few empirical studies with which to assess its effectiveness.

In absolute methods of identifying ALTs, the benchmark is the contracting authority's cost estimate or budget for the contract rather than the other bids. **Dr Albano** considered that the use of cost estimates was questionable since the point of a competitive mechanism is to establish a market price for the procurement

based on bidders' superior information about their own costs. Mr Clark said that his group recommended the use of absolute methods only when the number of tenders was fewer than five, which was too low to support a statistical formula based on relative bids.

There was agreement among the speakers that the procurement process should try to eliminate the problems of possible cost underestimation or strategic low bidding through well-prepared tendering information and contract design. Ms Rodrigues referred to this as solving the problem 'at source'.

In order to mitigate cost uncertainty and assist non-incumbents, procuring entities should be obliged to publish all relevant information and provide bidders with sufficient time to prepare their tenders. A more debatable issue is whether the procuring entity's own cost estimates should be made public. On the one hand, if the costing is informative this may assist bidders in formulating their own costings, but on the other it can lead to prices converging around that level, and support collusion. This point was raised by a delegate from India, where internal cost estimates are typically not revealed to bidders. Mr Anderson responded that in his view cost estimates should not be publicised, but that a number of jurisdictions did reveal them.

The discussion touched on various measures to reduce the incentives for strategic underbidding by reducing the scope for bidders to claim subsequent cost increases. Proper tender and contract design should bind bidders to specifications that are adequate and put an onus on bidders to demonstrate their capability and preparations to undertake the project. Mr Clark gave the example of contractors bidding low prices to win road construction projects while knowing that they will be able to put in subsequent claims for much higher costs of land acquisition than stated.

Procedures for renegotiation in the event of unforeseeable circumstances should exist but should be clearly laid down in advance. **Mr Bertók** said that in general much less attention was paid to contract management such as modifications than to the use of technological innovations such as e-procurement. It was agreed that scope for renegotiation was particularly necessary in the case of unique projects which are subject to considerable uncertainty. Dr Albano suggested that some projects are in fact so complex and uncertain that negotiation with reputable bidders might be preferable to competitive tenders, as the academic literature suggests. He felt that there was sometimes too much emphasis on competitive award mechanisms and fixed-price contracts, possibly because governments wanted to be able to give taxpayers the appearance of certainty over costs. He pointed out that in practice many such contracts end up being renegotiated, and gave examples of one-off infrastructural projects that had gone badly awry.

Performance security and financial guarantees, such as letters of credit and surety bonds, can also deter bidders from underbidding in the hope of either renegotiating the price or defaulting on the project, by making them incur the risk of having to carry out the project on the terms originally tendered or suffer a penalty. Ms Rodrigues noted several jurisdictions where these are used. However, Mr Clark reported that clients of MDBs did not feel that enhancing performance security (which is currently the only recourse for them when presented with an ALT) was effective since exercising it involves terminating the contract, which they would only do as a last resort. He emphasised instead the importance of best practice in tender and contract design (e.g. the Well-Prepared Project initiative).

A further potential means of deterring underbidding is the threat of sanctions such as debarment defaulting or underperforming firms from participating in future public tenders. Dr Albano pointed out that, because of the fragmentation of public procurement into many entities, no individual authority had the incentive to put in place an effective post-performance system because the benefits of measures such as debarment would go to other procuring entities to whom the firm might submit bid for contracts. Debarment should therefore be administered by a central institution with oversight over the entire procurement sector. He said this was a further example of the public good dimension to procurement.

## 2. Division of contracts into lots

The Issues Note reported that the division of contracts into lots is promoted in many jurisdictions and in some cases (e.g. Germany) is mandatory. Dividing public procurement contracts into lots is used for a variety of aims, including promoting competition in the tender, promoting competition in the market, and promoting SMEs. Nevertheless the design of lots is generally left at the discretion of the procuring entity, and limited guidance exists.

Speakers agreed that there were no recipes for the appropriate division of a contract into lots given the specific nature of each procurement and the wide variety of aims, sometimes conflicting, that are pursued. However, a number of issues were highlighted.

There is a tension between competition and efficiency in the division of lots. While smaller lots are used to increase participation and to encourage the entry of smaller firms (sometimes with caps or reserved lots for entrants), efficiency losses can arise if there are economies of scale and scope between the lots which cannot be realised if they are awarded to different providers. (Disaggregation of complementary lots can also pose the problem of 'exposure risk' for bidders; package bidding is one solution to this problem although, as noted in Dr Albano's accompanying paper, it is complex for procurement practitioners to administer.) Ms Rodrigues noted that a number of responses to the survey mentioned complaints by bidders that lots were aggregated unnecessarily, creating a barrier to entry, and suggested that lots should only ever be aggregated when this is justified by the existence of complementarities between them.

Another area of discussion concerned the relationship between the number of lots and the possibility of collusion. The Issues Note remarked that having more bidders than lots was important for increasing competition and reducing the risk of collusive outcomes. However, Dr Albano was of the view that lots were sometimes split too much, in a way that facilitated coordinated market-sharing by bidding cartels. He felt that it was very difficult to balance the pro-competitive aims of increasing participation (and promoting SME entry) on the one hand and curbing collusion on the other. He suggested that one way of countering collusion when dividing a contract was to structure the lots in a way that differed from the distribution of bidders' market shares. Because cartels typically divide up the market in proportion to the relative bargaining power of the members, this would make it harder for colluding bidders to arrive at a stable market-sharing scheme. He also advocated simultaneous rather than sequential awards as a means of making it harder for cartels to enforce a division of lots among themselves.

Dr Albano also suggested that the fragmentation of the procurement landscape made it easier for cartels to operate market-sharing and rotation schemes. He said that in Italy alone there are 32,000 contracting entities. Mr Bertók emphasised the importance of demand aggregation via central purchasing bodies, and observed that there was an increasing trend towards such aggregation in the OECD.

### **3. The WTO Agreement on Government Procurement as an enabler of competition**

**Mr Anderson** briefed the Hearing on the WTO Agreement on Government Procurement (GPA) and highlighted its role as a competition enabler. He began by pointing out that procurement typically accounts for 15% of GDP and supports essential functions of government that are vital for development and social policy purposes, such as transport, health and education. It is also an increasingly important as a component of international trade. However, it is widely recognised as a locus for both inter-supplier collusion and corruption – issues which Mr Anderson believed were more closely interrelated than is often recognised.

In addition to the recognised tools of effective competition law enforcement and education of suppliers and procurement officials, Mr Anderson suggested that trade liberalisation, competition advocacy and better procurement design were important in expanding the pool of competing suppliers. The GPA, he explained, is a plurilateral agreement currently covering 43 WTO member countries and promotes mutual access to procurement markets, improved value for money in each member's procurement, and good governance (including transparency, fairness and absence of corruption).

A revised GPA entered force in 2014 following renegotiation between 2002 and 2012. The revisions concern updating the Agreement to take account of electronic procurement tools, and additional flexibility such as shorter notice periods when electronic tools are used or when procuring goods and services that are available on the commercial marketplace. The GPA's significance for good governance is more explicitly recognised through new provisions that require participating governments to carry out their procurements in ways that avoid conflicts of interest and prevent corrupt practices.

Mr Anderson said that the importance of the procurement sector had grown worldwide in the light of the aftermath of the global economic crisis, emerging economies' infrastructure needs, and greater emphasis on procurement and good governance as an underpinning of development.

He ended his presentation by suggesting that in practice, corruption (typically seen as a principal-agent problem) and collusion (a competition problem) were often intertwined, e.g. in perverse procurement designs or improper sharing of information by public officials that favoured colluding bidders. While transparency can curb corruption, it can also facilitate collusion. In his view it was therefore important to tailor transparency measures to the balance of concerns within each country, while also looking to strengthen competition through competition advocacy and trade liberalisation.