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Competition in Public Procurement Markets

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More documents related to this discussion can be found at:

<http://www.oecd.org/governance/procurement/toolbox/> and <http://www.oecd.org/daf/competition/tenders-and-auctions.htm>

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1. Introduction

1. Competition is a fundamental force that delivers economic efficiency and innovation, leading to a higher level of consumer welfare. In the area of public procurement, competition ensures that governments achieve value for money:

“[...] public procurement procedures shall promote competition for public contracts to ensure best value for money”¹ (p. 3)

“[...] in public procurement, competition promotes efficiency, helping to ensure that goods and services offered to public entities more closely match their preferences, producing benefits such as lower prices, improved quality, increased innovation, higher productivity and, more generally, “value for money” to the benefit of end consumers, users of public services and taxpayers”² (p. 1)

2. However, in public procurement markets competition may not emerge naturally, and may need to be promoted and ensured by proper rules and by proper enforcement. While explicitly recognising the value of competition as a tool to pursue public procurement goals, the EU Directives on public procurement repeatedly warn against the (mis)use of procedures and techniques that might hamper competition in the relevant markets. Similarly, in the United States, the Competition in Contracting Act (CICA) of 1984 requires that contracts be entered into after “full and open competition through the use of competitive procedures” unless certain circumstances exist that would permit agencies to use non-competitive procedures.³

3. While a competitive public procurement market is widely accepted as an objective, it is less clear *how* to recognise when there is effective competition in these markets. Defining competition as the mere absence of “bid rigging” would be at best a minimal condition. Effective competition is often thought to be measured simply by the number of participants in a given bidding procedure. However, while more participants would in many circumstances increase the level of competition, the number of participants is at best only a proxy for the intensity of competition.

4. First, participants can have quite different characteristics in terms of the value they are able to offer, and their willingness to offer the best value that they can. The value for money achieved in the bidding procedure, besides depending on the absolute number of participating firms, is very much related to the characteristics of participating firms and hence the intensity of competition.

¹ United Nations Conference on Trade and Development (UNCTAD), *Competition Policy and Public Procurement*, 2012, Geneva. The document is accessible through http://unctad.org/meetings/en/SessionalDocuments/ciclpd14_en.pdf.

² OECD, *Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement*, 2012, Paris. The document is accessible through <http://www.oecd.org/daf/competition/RecommendationOnFightingBidRigging2012.pdf>.

³ Competition for awarding federal contracts was introduced as early as 1809 when Congress passed the first law requiring competition in federal procurement contracting. This law established what came to be known as “formal advertising” as the preferred method for federal procurements by specifying that “all purchases and contracts for supplies or services ... shall be made by open purchases, or by previously advertising for proposals.” 2 Stat. 536 (1809), accessible through <http://uscode.house.gov/statviewer.htm?volume=2&page=536>.

5. Second, not only do firms differ in terms of size and experience in public procurement markets, but in any procurement procedure, they may also differ with regard to whether they bid as an “incumbent” rather than a “potential entrant”. Minimising advantages to incumbents where possible, for example by ensuring non-incumbents have access to the same information as the incumbent, can increase competition and force incumbents to put forward their best offer. However, in spite of a widespread view that competition should guarantee that players are all equal in each and every bidding procedure, efficiency does *not* require designing competitive procedures so as to eliminate any potential competitive advantage enjoyed by current contractor(s).

6. Third, the number of participating firms does not necessarily coincide with the number of submitted bids. This may happen simply because smaller firms decide to participate as a consortium. As joint bidding may have both pro-competitive and anti-competitive effects, it is not necessarily the case that a procurement procedure with three solo bidders will trigger a higher level of competition than one with one solo bidder and a one two-firm consortium.

7. Fourth, competition is most effective in delivering value when a buyer can observe the value offered by different suppliers and choose between those suppliers. Where the value of a product cannot be observed at the point of purchase, as for example with ‘experience’ or ‘credence’ goods, effective competition requires that the buyer is able, through contracts or incentives, to ensure that the *delivered* value for money (at the execution stage) is in line with that which was *promised* (at the contract award stage). If this is not possible then bidders can simply compete to promise the best value, rather than to deliver it. This is why buyers that are not confident of their ability to hold bidders to their promises may decide to treat abnormally low tenders (ALTs) with caution.

8. Fifth, procurement is a repeated activity within a market. Competition for a contract *today* can have an impact on the scope for competition in that market *tomorrow*, especially in markets where a Public Administration acts as a monopsonist. In such circumstances, designing procurement procedures that result in a single awardee may have an adverse effect on the intensity of competition, as losing bidders may be forced to exit the market, or may become weaker bidders (through loss of experience or learning). A centralised procurement agency aggregating most of the public demand for a specific good/service may therefore be particularly concerned about this risk. Given these concerns, buyers may in some cases see value in splitting procurements into lots and adopting “award limits” (that is, setting a ceiling on the number of lots that each firm can be awarded) in order to help preserve competition *over time* and hence deliver better value in the long-run.

9. In the remainder of this paper, we therefore focus on ways to protect the intensity of competition, not just the number of participants, when addressing the risks of abnormally low tenders (Section 2), when dividing contracts into lots (Section 3), and in drawing up rules governing joint bidding (Section 4). In each case, the paper seeks to provide practical guidance on ways to address buyers’ concerns and enhance efficiency without restricting competition.

2. Abnormally Low Tenders

2.1. Why ALTs may raise concerns

10. There are broadly two risks from ALTs that may concern a buyer.⁴ Firstly, that the bidder has underestimated the costs of the project, and that when it realises this, it will pull out of the contract and renegotiate, or otherwise impose additional costs on the buyer that were not included in its bid. This, for example, is the underlying issue for procurers who are concerned that a low price indicates that the quality of the product is poor in some respect that is not adequately captured by the quality criteria against which they assess the bid ('you get what you pay for'). Secondly that the bidder has intentionally bid at a price below its cost in order to win the contract, foreclose rivals, with the intention of increasing its price to an uncompetitive level to recoup its losses at a later date ('the price is too good to be true').

11. Surprisingly, while discussions abound on the fact that an ALT bid may lead to a problematic supply, a shared definition of an ALT is missing. Taken literally, the term suggests a deviation from the norm, that is, it seems to be possible to recognise an ALT by comparing it to a "normal" tender. However, international regulations (see Box 1) differ on what constitutes a normal price. In some cases, the norm is defined as some allegedly "sustainable" price benchmark based on the procuring entity's estimate of the likely costs. The buyer is likely to make its own estimate of these costs when most production costs will arise during the execution of the procurement contracts (e.g. civil works, infrastructures, services with a high manpower component). In other cases, the norm is defined as some average of the other bids received. For example, often a tender is deemed to be an ALT when it is lower than x% of an adjusted average of all submitted bids.

⁴ A third concern in the European Union is that the ALT is made possible through state aid, which distorts competition. See Article 69 of Directive 2014/24/EU on public procurement.

Box 1. International Regulations on Abnormally Low Tenders

1. United Nations

UNCITRAL' Model Law on Public Procurement (2011) states the following with regard to ALTs:

“The procuring entity may reject a submission if the procuring entity has determined that the price, in combination with other constituent elements of the submission, is abnormally low in relation to the subject matter of the procurement and raises concerns with the procuring entity as to the ability of the supplier or contractor that presented that submission to perform the procurement contract, provided that the procuring entity has taken the following actions:

- The procuring entity has requested in writing from the supplier or contractor details of the submission that gives rise to concerns as to the ability of the supplier or contractor to perform the procurement contract; and
- The procuring entity has taken account of any information provided by the supplier or contractor following this request and the information included in the submission, but continues, on the basis of all such information, to hold concerns.”

2. World Trade Organization

On the subject of ALTs, the WTO/GPA states the following:

“Only tenders that conform to the essential requirements of the tender notice or documentation and are from a supplier which complies with the conditions for participation can be considered for award. Entities have the obligation to award contracts to the tenderer who has been determined to be fully capable of undertaking the contract and whose tender is either the lowest tender or the tender which is determined to be the most advantageous in terms of the specific evaluation criteria set forth in the notices or tender documentation. An entity that has received a tender abnormally lower than other tenders may enquire with the tenderer to ensure that it can comply with the conditions of participation and be capable of fulfilling the terms of the contract.” (Article XIII: 4)

3. European Union

In the European Union, article 69 of the Directive 2014/24/EU puts an explicit obligation on contracting authorities in member states to explain the price or costs contained in a tender in situations where tenders “appear to be abnormally low in relation to the works, goods or services”. Interestingly, the Directive provides no guidance as to the basis upon which a tender may “appear” abnormally low, although it does provide some guidance as to which elements of a tender price may be subjected to further scrutiny.

4. Multilateral Development Banks

Multilateral Development Banks' (MDBs) procurement policies/rules do not contain any specific reference to ALTs either. However, Instructions to Tenderers 31.2 - Tender Adjustments of the Standard Tender Documents for works state:

“If in the opinion of the Employer the Tender which results in the lowest Evaluated tender Price, is seriously unbalanced or front loaded or substantially below the Employer's estimates, the Employer may require the tenderer to produce price analyses for any or all items of the Bill of Quantities to demonstrate the internal consistency of those prices with the methods and schedule proposed”.

5. United States

Unlike the set of international regulations above, the US Federal Acquisition Regulation establishes further how price analysis is to be done in order to assess whether or not a bid is to be considered sustainable. Federal agencies may seek different kinds of information ranging from certified costs to comparison with historical acquisition prices for similar items and government estimates, market analyses, and expert technical advice. In a 2013 bid protest decision, the Government Accountability Office made it clear that, in awarding fixed-price contracts, while agencies need to evaluate the price reasonableness of a proposal (whether a price is too high) they need not carry out a price realism analysis (whether a price is too low).

2.2. Risks to consider when addressing ALTs

12. In seeking to address the concerns they have over ALTs, procurers need to take care to avoid taking actions that may reduce competition and reduce the value that their procurement achieves.

13. Automatically excluding bids that are deemed to be ALTs risks reducing the effectiveness of the procurement, and hence the value achieved, in four ways. Firstly, excluding low-price bidders may remove the best value option that is available to the buyer. Secondly, excluding low-price bidders reduces the competitive pressure on incumbent bidders to offer their best price. Thirdly, using convoluted criteria to define and exclude ALTs based on their distance to rival bids can discourage new entry since differentiating on price increases the risk of being excluded. Finally, it also increases the incentive for bidders to collude by creating a mechanism to remove low-price competitors that would otherwise disrupt the collusion.

14. As a result, a series of judgments by the European Court of Justice (ECJ) (see Box 2) highlight that, in the European Union, when challenging a suspected ALT, contracting authorities cannot automatically exclude the bid and must instead seek explanations from tenderers in order to gather evidence on the tender's sustainability. However, requiring costly due diligence or assumption checking on only those bids that are defined, according to some criteria as ALTs, would also discourage firms from making the most competitive bid they can. Moreover, these cases make it clear that identifying ALTs using mathematical methods that depend on relative distances between bids risks providing tenderers with a stronger incentive to manipulate their offers.

Box 2. Abnormally Low Tenders: Some ECJ Law cases

In the SAG case (C-599/10), the ECJ was asked whether a contracting authority may or must seek clarification from a tenderer in connection with the abnormally low price. The Court highlighted that under Article 55 of Directive 2004/18, if, for a given contract, tenders appear to be abnormally low in relation to the goods, works or services, the contracting authority must, before it may reject those tenders, ‘request in writing details of the constituent elements of the tender which it considers relevant’.

The ECJ also stated in the Agriconsulting Europe case (T-570/13) that the contracting authority is obliged, when examining tenders that are abnormally low, to request the tenderer to furnish the necessary explanations to prove that those tenders are genuine.

On the other hand, the Court pointed out in the Data Medical Service case (C-568/13) that the possibility of rejecting an ALT is not limited solely to the case in which the low price proposed in that tender is explained by the grant of state aid which is unlawful or incompatible with the internal market. That possibility is more general in character.

Finally, in the joined cases of Lombardini and Mantovani (C 285/99 and C 286/99) the ECJ noted that the method for determining whether or not a tender is abnormally low may have an effect on tenderers’ bidding strategy. Indeed, a method for calculating the anomaly threshold based on the average of the tenders for a given contract risks being falsified by tenders not corresponding to a genuine wish to contract but merely seeking to influence the result of that calculation.

2.3. Solutions to concerns over ALTs

15. A procurer’s concern that they will be left bearing the risk if firms underestimate their costs is a problem of inadequate contracting tools in the face of uncertainty. Their concern that firms may strategically bid low with the intension of renegotiating when rivals have exited is known as predatory pricing. The solution to these concerns has five elements, each of which should be well publicised to potential bidders. The proportionality of these solutions is discussed below.

16. First, the contract needs to ensure that the bidder internalises the risk that costs turn out higher than expected. For example, make the contract award conditional on the bidder covering the cost of a Surety (or “performance”) bond.⁵

⁵ These are a guarantee that the firm will fulfil the obligation specified in the bond. Surety bonds are secured by the surety company’s assets. The bidder’s assets are never pledged. Many performance bonds give the surety three choices: completing the contract itself through a completion contractor (taking up the contract); selecting a new contractor to contract directly with the owner (that is, the procuring entity); or allowing the owner to complete the work with the surety paying the costs. The penal sum of the performance bond usually is the amount of the prime construction contract, and often is increased when change orders are issued. The penal sum in the bond usually is the upward limit of liability on a performance bond. However, if the surety chooses to complete the work itself through a completing contractor to take up the contract then the penal sum in the bond may not be the limit of its liability. The surety may take the same risk as a contractor in performing the contract. For an in-depth analysis of the difference between a letter of credit and a surety bond in terms of incentives to bidders see A.R. Engel, J.-J. Ganuza, E. Hauk and A.

17. Second, potential bidders should be provided with all relevant information about the project so as to make realistic cost estimates, particularly those aspects that are not immediately available to non-incumbents. For example, these might include geological surveys and other project-specific information gathered over time, demand features, and patterns of past purchases in high-value centralised procurements where purchases are carried out by different public bodies.

18. Third, set out sanctions for any bidder that pulls out or fails to deliver the terms of its contract except where the information originally provided has proved inaccurate (incorrect or incomplete). These might include fines, temporary debarment of suppliers, or permanent debarment of individuals, and legal actions for damages claims by the contracting authority against the contractor. These would be more credible and hence stronger sanctions where they are non-discretionary. Where the sanctions include fines or damages the procurer might consider, particularly in high value projects, offering whistleblower rewards based on recovered damages for those whistle-blowers that report (with evidence), cases where a firm knowingly bids at a price that it intends to renegotiate at a later date.

19. Fourth, apply proportionate checks on the assumptions used by any winning bidder, not only those of an ALT bidder. In Italy, for instance, the Code for Public Contracts foresees that any tender evaluated according to the most economically advantageous tender criterion is deemed to be an ALT if it is awarded *both* 80% (or more) of the maximum technical score *and* 80% (or more) of the maximum financial score, the rationale being that “suspicious” bids tend to be those with a (relatively) high-quality content at (relatively) low financial conditions. Then, at least in principle, any tender receiving 79% of the maximum technical score and 95% of the maximum financial score is not deemed to be an ALT. In such cases, due diligence should be applied despite the bid not being an ALT.

20. Finally, the procurer should refer to the competition authority those cases in which it suspects that a firm has knowingly bid at a price it intended to renegotiate at a later date.

21. Such solutions are however unlikely to be necessary where alternative suppliers exist and the buyer can quickly ask them to step in if a firm pulls out of its contract. For example, this might be the case if the procurement is for standardised goods or services, rather than large-scale public works or key public services where continuity of service is important. Notably the existence of these alternatives means that the bidder is unlikely to have engaged in predatory pricing. In such circumstances, the procuring entity might consider:

- Formally asking the closest-ranked firm to replace the contractor. When contracts are awarded by means of the lowest-price tender criterion - for instance, in the case of fuel, electricity or natural gas - replacing the contractor with closest-ranked supplier would not have any impact on quality, although it remains a debatable question which financial conditions should prevail. When, instead, firms offer differentiated products, and the procurement contract is awarded according to the most economically advantageous tender criterion, replacing the contractor with closest-ranked competitor would also have an impact on the kind of product the procuring entity would receive.

Wambach, “Managing Risky Bids,” in N. Dimitri, G. Piga and G. Spagnolo (eds.), *Handbook of Procurement*, Cambridge University Press, 2006.

- Adopt a multi-award procurement solution, such as a multi-award framework agreement (with fixed contractual conditions), so that a replacing contractor would be immediately able to step in. This solution, although formally different, mimics the one described in the point above.

2.4. Recommendations

22. This leads to the following recommendations on managing the risks of very low tenders:

- Assessing all bids, and not automatically excluding a bid on the basis of a bidder's low price can reduce the risk of damaging the effectiveness of the procurement, and hence the value achieved.
- Checking the cost assumptions of the winning bid, whether it is a low bid or not, to make sure it is sustainable, can reduce the risk of discouraging more competitive bids. Any checks that are carried out need to be proportionate to the procurement in question to avoid creating unnecessary inefficiency in the process.
- Providing all potential bidders with clear tender documentation including all the relevant information that is available on the product or service that is being procured, and allotting a period of time that is proportionate to the size and complexity of the procurement can help bidders to make better cost estimates. This is particularly important in technically complex projects where it may take time to develop more accurate cost estimates.
- Requiring that the winning bidder take pre-emptive steps to internalise the risk that its costs turn out higher than expected can reduce the risk of bidders underestimating their costs. For example, this could include taking out insurance in the form of a performance bond that pays out to the procurer in the event that the contractor cannot ensure that the project is delivered on the originally agreed terms.
- Setting out in the tender documentation sanctions for any bidder that pulls out or fails to deliver the terms of its contract, unless the information that was originally provided by the procurer proved to be inaccurate (incorrect or incomplete). For example, these could include penalties, temporary debarment of firms, permanent debarment of individuals, or initiating legal actions for damages claims by the contracting authority against the contractor. The tender documentation can also specify that renegotiation will only be considered where the information that was originally provided by the procurer proved to be inaccurate (incorrect or incomplete).
- Creating whistle-blower rewards in high value projects may help to identify and discourage cases where a firm knowingly bids at a price that it intends to renegotiate at a later date. These rewards might be given to those that report (with evidence) cases in which damages are subsequently recovered.
- Referral to the Competition Authority when it is suspected that a firm knowingly bid at a price it intended to renegotiate at a later date.

3. Splitting contracts into lots

23. Whether, and if so, how, to split a procurement contract into different lots, is one of the most important decisions in designing a competitive procurement process. By affecting the number and the type of firms that are able to compete, ‘lots design’ can have a dramatic impact on the intensity of competition in the market, and hence for current and potential future contracts.

3.1. Advantages of splitting contracts into lots

3.1.1. Facilitating entry

24. Awarding multiple lots can improve participation of small and medium-sized enterprises (SMEs) and specialist firms. For instance, when division into multiple lots involves unbundling a procurement contract that includes heterogeneous products or services, SMEs may foster competition as they may display higher levels of specialisation/efficiency than bigger competitors. For example, this might be the case in the markets for IT equipment, chemical reagents for laboratories, and medical equipment. Furthermore, when the contract is split into multiple geographical lots, smaller firms might be able to compete in terms of logistics on certain lots but not others.

3.1.2. Reducing buyer lock-in

25. Multiple lots may also reduce the risk of market power resulting from *buyer lock-in*, which is a potential by-product of the repeated nature of public procurement activities. Buyer lock-in is potentially harmful as it can reduce participation and the degree of competition over time. Buyer lock-in may be generated by two main factors:

- **Learning by doing**, whereby incumbent firms may be able to improve the value of their bid as a result of their experience as contractors to the buyer (e.g. ICT services). In other words, having been the contractor *yesterday* increases the knowledge of the buyers’ needs, and thus positively affects the ability to better tailor a bid in today’s competitive tenders. In monopsony cases, it can also deny rivals the opportunity to learn and hence lead to their exit from the market. In either case, this increases the likelihood of the incumbent being selected as the contractor.
- **Idiosyncratic investments**, whereby specific investments are needed to carry out the procurement project. These investments turn into sunk costs as they cannot be exploited for purposes other than the one for which they were made, thus raising entry barriers for new competitors. (e.g. defence/space procurement).

3.1.3. Reducing the risk of collusion

26. Fostering the participation of SMEs through multiple lots also adversely affects the ability of any active cartel to successfully implement a collusive strategy, as SMEs may behave as a disruptive “competitive fringe.” Moreover, the higher number of potential competitors, all other things being equal, the more difficult it is for an “all-inclusive” cartel to emerge.

3.2. Risks to consider when splitting procurement contracts into lots

27. There are at least three potential drawbacks from splitting a procurement contract into lots.

- **May not deliver multiple awardees.** While promoting participation, splitting a procurement contract into lots does not guarantee that the same bidder will not win all lots. Therefore, it does not remove the risks of buyer lock-in and hence market power.
- **Inefficiency.** When bidding is allowed only on a lot-by-lot basis, bigger firms, despite having the opportunity to exploit synergies among lots, are not able to exploit those synergies that are available in their bid for each individual lot. This may lead them to bid a higher price for each individual lot (compared to the price they would offer if they were bidding for the total volume). For example, their price might be higher to ensure they cover their fixed costs in the event that they win a smaller number of lots. Division into lots can therefore be inefficient if there would in any case have been healthy competition for current and future undivided contracts.
- **Facilitating collusion.** Multiple lots may also help a cartel solve the problem of how to allocate collusive profits among cartel members.⁶ Indeed, where contracts are divided into lots, and the number of lots exceeds the number of bidders, the cartel can allocate a certain number of lots to each member without resorting to any side-payment scheme that may raise the likelihood of detection by antitrust authorities. A multi-lot procurement contract may thus facilitate the implementation of the most recurrent techniques for implementing bid-rigging:⁷
- **Cover bidding** (also known as "complementary" or "courtesy" bidding). Cover bidding occurs when some competitors agree to submit bids for certain lots that are either too high to be accepted, or contain special terms that will not be acceptable to the procuring entity. Such bids are not intended to secure the procuring entity's acceptance, but are merely designed to give the appearance of genuine competitive bidding. Cover bidding schemes are the most frequently occurring forms of bid rigging and defraud purchasers by creating the appearance of competition to conceal secretly inflated prices (see Box 3 for two recent cases in the European Union).
- **Bid suppression.** In bid suppression schemes, one or more competitors who otherwise would be expected to bid, or who have previously bid, agree to refrain from bidding for a certain lot, or to withdraw a previously submitted bid so that the designated winning competitor's bid will be accepted.

⁶ See, for instance, A. Heimler, "Cartels in Public Procurement," *Journal of Competition Law and Economics*, 2012, 8 (4), pp. 849-862.

⁷ For a comprehensive set of guidelines on preventing and fighting bid-rigging see OECD, *Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement*, 2012, Paris. The document is accessible through <http://www.oecd.org/daf/competition/RecommendationOnFightingBidRigging2012.pdf>.

Box 3. Cover bidding in bid-rigging cases

In 2010, the Spanish Competition Commission (CNC) fined four companies in the medical waste management sector for allocating tenders called by the public health systems of various regional governments from at least 1994 to 2007. It was shown that the companies allocated those government customers by coordinating their bids through the creation of temporary joint ventures, cover bidding and suppression of bids.

In 2009 the United Kingdom Competition Authority (OFT) fined 103 companies a total £129.2 million for bid-rigging in public and private tenders for the construction of hospitals, schools and universities in 2000- 2006. The bid rigging included cover bidding and, in some cases, false invoices to disguise compensatory payments between bidders. These conducts were investigated pursuant to a complaint filed by an auditor of the national health system.

In 2008 the European Commission sanctioned nine Belgian international moving companies. The cartel operated for 19 years and rigged tenders using a cover bidding system. The companies distributed the profits through compensation payments they called “commissions”, which were included in the end price and distributed amongst the unsuccessful bidders using false invoices.

3.3. Solutions to the potential drawbacks of lot splitting

28. There are a number of options for further steps that a procurer can take in order to address the three potential drawbacks from splitting a procurement contract into lots. These can help to diminish the risk of reducing competition and the value that the procurement achieves.

3.3.1. Risk of creating inefficiency

29. Firstly, the inefficiency drawback can be tackled by adopting a tendering format that allows for *package bidding*, whereby competing firms can bid (at different terms) for individual lots as well as for bundles of lots. The European Union, for example, has addressed this issue in article 46(3) and recital 79 of the 2014/24/EU Directive on public procurement. The use of package bidding in public procurement is however, not very common.

3.3.2. Risk of not delivering multiple awardees

30. Secondly, to guarantee multiple awardees, procurers may introduce *participation or award limits*.⁸ The participation limit defines the maximum number of lots for which any bidder can compete, whereas the award limit sets the highest number of lots that each bidder can be awarded (see Box 4). Both participation and award limits seem to serve the same function, although they may generate different strategic considerations.

⁸ See for example the EU art. 46(2) and recital 79 of the 2014/24/EU Directive on public procurement.

Box 4. Award limits

In 2017, the UK's communications regulator, Ofcom, will auction 190 MHz of spectrum in the 2.3 GHz and 3.4 GHz bands – an increase of just under a third of the total mobile spectrum currently available. The 40 MHz of spectrum to be sold in the 2.3 GHz band is already supported by mobile devices. The 150 MHz of spectrum to be sold in the 3.4 GHz band is not currently used by most mobile devices, but is likely to be usable by future devices in coming years. Ofcom will apply a cap, of 255 MHz, on “immediately useable” spectrum that any one operator can buy. As a consequence of this proposed cap, BT/EE would not be able to bid for spectrum in the 2.3 GHz band.

31. There are however, a number of problems with the use of participation limits.
- They can create inefficiency. When facing a participation limit, each firm is likely to bid for those lots that it values most. Thus, if bidders have the same preferences over lots, the lower the number of admissible bids, the higher the chances that at least one lot receives no bids at all. This can generate potentially sizeable costs for a public organisation in terms of foregone outsourcing opportunities.
 - By preventing firms from bidding for all lots, the participation limit may help a cartel implement a market-sharing scheme involving bid-suppression, since the bidding pattern under a bid-suppression strategy would not look very different from the bidding pattern that is required to comply with the restriction. The collusion would therefore be less likely to be recognised as such by antitrust authorities.
 - Participation limits might mean that in effect, only a predetermined class of firms bid for certain lots.⁹ For instance, by splitting one single contract into two very heterogeneous lots - one of high value and the other of low value - and by adopting a participation limit on one lot only the procuring entity might in effect create a set-aside in favour of small participants. The latter would be likely to bid the low-value lot, whereas bigger firms would be “confined” to the high-value one. Such protection for smaller firms can reduce competition and lead to the buyer having to accept a poorer value bid. However, it is also worth noting that set-asides can also have pro-competitive effects if they help sponsor new entry.
32. In contrast to participation limits, if an award limit is adopted as a way to guarantee multiple awardees, then firms can submit bids for all lots. “Weak” bidders have a stronger incentive to bid on all lots knowing that they may benefit from “strong” bidders becoming constrained at the award stage. Thus, an award limit might raise the number of submitted bids from weak bidders, although it would also mean that the procuring entity would give up the possibility of selecting the best value for money bid in each lot.

⁹ Set-asides are lots/contracts for which only a predetermined class of firms are allowed to bid. One noticeable example is the set-aside policy implemented in the United States through the Small Business Act. See https://www.sba.gov/sites/default/files/policy_regulations/Small%20Business%20Act_0.pdf

3.3.3. Risk of facilitating collusion

33. Thirdly, the risks of lot division facilitating collusion can be mitigated by splitting the contract into fewer lots than there are expected bidders. Indeed, for a given number of firms and for a given overall value of the procurement contracts, the higher the number of lots the higher the risk of collusion. This is because the cartel can allocate lots in a way that more precisely reflect each participant's agreed share of cartel profits.

34. Furthermore, at least in high-value procurements (e.g. framework agreements managed by centralised agencies) one should also consider to what extent the value of different lots is similar (*homogenous* lots) rather than different from each other (*heterogeneous* lots). The reason is that each cartel conspirator's share of collusive profits typically depends on that conspirator's bargaining power within the cartel. Thus, when this bargaining power is asymmetrically distributed among cartel members, that is, when cartel members would otherwise enjoy very different levels of market power, heterogeneous lots may facilitate the task of sharing collusive profits.

3.3.4. Recommendations

35. This leads to the following recommendations on lot design:

- Splitting procurement contracts into lots and providing all relevant information that is available on the products or services within each lot may increase the participation of efficient smaller or specialist firms, reduce the risk of collusion, and reduce buyer lock-in.
- Allowing package-bidding can ensure that efficient larger firms can still exploit potential economies of scale or scope that may exist across lots.
- If splitting contracts into lots does not increase participation then it may simply make it easier to implement bid-rigging strategies. Hence, buyers should be confident that there is a demand for smaller lots from potential bidders who would not otherwise participate in the bidding.
- When splitting lots, procurers can make it more difficult for colluding bidders to agree on a division of lots by making sure that the number of lots is less than the number of expected bidders, and the size of the lots differs from the market share of the bidders.
- Participation and award limits may each result in multi-award outcomes, but this can come at the risk of obtaining poorer value. Buyers should therefore be rigorous in assessing the likelihood that a multi-award outcome will increase value. Where they decide to use such tools, the award limit seems to have fewer potential drawbacks than the participation limit.
- Lots design which is stable and predictable over time can help cartels to resort to a variety of collusive schemes. Consequently, procuring entities, particularly those managing high-value procurement contracts, should aim at making their strategies concerning lot design unpredictable to the extent possible, and ensuring bidders are aware of this unpredictability.

4. Joint Bidding

4.1. Why Joint bidding may raise concerns

36. Joint bidding is the practice of two or more firms submitting a single bid. Bidding consortia among potential competitors, under a temporary rather than a long-term agreement, are rather common in public and private procurement. In the 1970s, the US Ministry of the Interior prohibited joint bidding for the concessions for offshore oil exploration, the presumption being that joint bidding aimed at reducing the number of bids, was thereby softening competition. Indeed the anticompetitive concerns over “horizontal” joint bidding consortia - that is, joint bidding among similar firms that are normally competing with each other - are clear: they can reduce the number of submitted bids and make market-sharing agreements easier to implement (see Box 5 for a case of anticompetitive joint bidding in Italy).

Box 5. Anticompetitive joint bidding in a centralised framework agreement for restaurant vouchers

In 2002, the Italian Competition Authority (AGCM) uncovered a cartel formed by 8 out of 10 companies, which had been invited by the Italian centralised procurement company - Consip S.p.A. - to submit a tender for a nation-wide framework agreement, split in 5 geographical lots, for restaurant vouchers. Vouchers are often used by Italian public administrations as a substitute for canteen services. The colluding companies joined a temporary consortium were able to exploit two arguably pro-collusive features of the tender design, namely i) the “kinked” scoring rule used assigned financial scores as a (convoluted) function of the distance of each bid from the average of all submitted bids; and ii) most of the technical score was awarded as an increasing function of the network of the restaurants that accepted the meal vouchers issued by each company. Since the consortium was able to count of larger networks than fringe competitors, it was able to compute in advance the resulting advantage in terms of technical score in each lot. Then the consortium’s financial offers were conceived to as to keep the resulting average as high as possible, then suffering a disadvantage in terms of financial score towards fringe competitors but not to a point to jeopardise the technical score advantage.

37. However, while “horizontal” bidding consortia may reduce competition and hence should be subject to scrutiny, consortia between firms specialised in different components of, say, a bundled procurement contract, are usually admitted and welcome in procurement since they can improve the value of a bid.

4.2. Pro-competitive effects of joint bidding

38. The procompetitive effects of joint bidding can sometimes be underestimated:
- *Fostering participation.* Specialist and small and medium enterprises (SMEs) often find it difficult to meet economic selection criteria for large contracts in order to compete as solo bidders. Joint consortia among SMEs can therefore raise the number of bidders.

- *Reducing uncertainty.* Bidders joining a joint venture are able to share private information on uncertain aspects of the procurement contract, and therefore may submit a better informed joint offer than any of them could do individually. This aspect is paramount in complex civil works, but is also relevant in centralised procurement when participating bidders do not know all the characteristics of the different public authorities that are bundling their needs into a single contract.
- *Synergies.* Firms might specialise in different aspects of production and so whilst able to participate individually they may offer a better quality joint bid.

4.3. Approaches to assessing joint bidding consortia

39. Although most public procurement regulations and guidelines at the international level allow firms to form “horizontal” bidding consortia, they take different stance concerning whether there exist intrinsic features of “horizontal” bidding agreements that should be considered anti-competitive *per se*.

40. For instance, in the 2012 Note by the UNCTAD Secretariat titled “Competition Policy and Public Procurement” one reads: “[...] joint bidding *shall not*¹⁰ be allowed for enterprises that are in a position to participate individually in a public tender, since this would significantly reduce the level of competition.” The statement *presumes* that joint bidding among firms that would be able to participate as solo bidders will have anti-competitive consequences due to a reduction in the number of submitted bids without regard to the potential for the joint bids to offer better value than the individual bids would have (in which case competition might have intensified). This approach is broadly consistent with the conclusions of the OECD discussion in 2008, which suggested that procurement officials consider limiting joint bids: “A bidding consortium should not be permitted if each firm in the consortium has the economic, financial and technical capabilities to supply on its own the procured products.”¹¹

41. In contrast, in the US, joint bidding between firms that would be able to participate as solo bidders is not presumed to be anti-competitive. Instead, the competitive effect is considered to be ambiguous and hence, when subject to challenge, to require a case-by-case ex-post assessment. The US Federal Acquisition Regulation (FAR) foresees the “contractor team arrangement,” comprising two major cases. In the first, two or more companies form a partnership or joint venture to act as a potential prime contractor (horizontal teaming arrangement). In the second, a potential prime contractor agrees with one or more other companies to have them act as its subcontractors under a specified government contract or acquisition program (vertical teaming arrangement).¹² FAR 9.602(a) explicitly recognises that teams may be desirable from the government’s standpoint, as it “[m]ay¹³ enable companies to complement each other’s unique capabilities,” and “offer the Government the best combination of performance, cost, and delivery.”¹⁴

¹⁰ Italics added

¹¹ Public Procurement—The Role of Competition Authorities in Promoting Competition, DAF/COMP(2007) 34, OECD, 8 January 2008, page 9.

¹² FAR 9.601.

¹³ Italics added.

¹⁴ Specific constraints on joint ventures are foreseen only when they bid for set-aside contracts. See Title 13 of the Code of Federal Regulations - Part 121 (§121.103) Small Business Size Regulations. This constraint is

42. The EU Directive 2014/24 foresees more broadly that “[g]roups of economic operators, including temporary associations, may participate in procurement procedures. They shall not be required by contracting authorities to have a specific legal form in order to submit a tender or a request to participate.”¹⁵

4.3.1. Recommendations

43. Joint bidding in procurement is best assessed on a case-by-case basis instead of being prohibited up front on the basis of the nature of the procurement contracts and the features of the supply market. However, a prohibition of horizontal joint bidding by companies that could also participate alone may well be much easier to administer and would not promote litigation. Alternatively, a presumption might be adopted that joint bidding will not be permitted, except where this presumption can be rebutted by the firms, proving to the procurer’s satisfaction that their separate bids would have been weaker.

44. Whichever approach is adopted it needs to be effective in identifying those instances where joint bidding reduces competition rather than generating efficiencies. As an example, this is more likely in those cases where the bidders have similar expertise, and at least one of them has market power.

known as the “three-to-two” rule whereby the same joint venture cannot be awarded more than three set-aside contracts in two years. As set-aside contracts are normally reserved to small businesses, joint ventures between similar firms give rise to bigger economic operators that might enjoy a disproportionate advantage with respect to solo bidders. Consequently, the “three-to-two” serves the purpose of limiting the additional advantage that joint ventures might enjoy when competing for set-aside contracts.

¹⁵ Art. 19(2) of the Directive 2014/24/EU. See also recital 15.