

EIC Position

on the MDB Working Group's consultation on “Abnormally Low Tenders”

Introductory Remarks

European International Contractors (EIC) has as its members construction industry trade associations from fifteen European countries and represents the interests of the European construction industry in all questions related to its international construction activities. The main objective of EIC is to improve the political, legal, economic and financial framework conditions for the international business of European contractors. In 2013, the international turnover of companies associated with EIC's Member Federations amounted to almost 168 billion €. This result was confirmed by the latest survey on the “Top 225 International Contractors”, published in the magazine Engineering News-Record, which showed that the market share of European contractors (including Turkey) on the international construction market amounted to more than 50%.

In the last decades the supply-demand equilibrium has changed significantly in the context of public procurement for international construction projects. The supply part has expanded and diversified, while the demand part could not follow this expansion. Whilst the lowest offer meant an adequate and sufficient profit margin two decades ago, today it means in most of the cases gaining experience and staying alive in the best case scenario, while it means a loss in the worst case scenario. In order to avoid bankruptcy, companies desperately need to win new projects in an international market where the competition is on the extreme end and this situation forces companies to offer very low bid prices.

One of the key drivers for Abnormally Low Tenders (ALT) internationally is the competition strategy of major international players in the market, in particular from Asia. A leading company of the sector may put forward a very aggressive price bid in order to drive out its competitors, only to present expensive bids once there is no significant competitor left in the market. From this perspective, ALT are a form of unfair competition and should be rejected on MDB financed works contracts, as they have adverse effects on all parties.

EIC appreciates that the Multilateral Development Banks have established a joint Working Group, led by EBRD, to review the ALT issue in the context of works contracts and to identify potential ways in which this issue can be addressed under MDB/IFI financed projects. We agree with the analysis of the MDBs and many of its clients that that acceptance of an ALT frequently results in numerous problems and issues for Contracting Authorities (CAs) during the subsequent contract implementation phase and that contractors should be discouraged from submitting tender prices, which put the delivery of a given contract at risk. In this spirit, EIC has reviewed the MDB's respective Working Group Paper dated October 2014 and would like to submit the following observations.

EIC Position on Abnormally Low Tenders

Based on the findings and analysis of the above-mentioned paper, the MDB Working Group (MDB-WG) has drafted various recommendations as well as a Sample ALTs Clarification Procedure on which EIC would like to submit the following comment:

MDB-WG Recommendation No. 1

The WG proposes that Contracting Authorities (CAs) should have the right, and authority, to reject tenders that are considered to be abnormally low. However, the WG does not consider that CAs should have the right to automatic rejection based on any pre-determined assessment as to what may or may not constitute a minimum acceptable price. Therefore, in all instances where tenders are considered by the CA to be abnormally low, tenderers must, through the clarification process currently provided for in the Bank's STD, be provided with an opportunity to provide an explanation for the low price. A tender may only be rejected in the event that a tenderer fails to provide a satisfactory, and plausible, explanation for the low price.

EIC comment:

EIC supports the MDB-WG's recommendation to introduce new provisions into the MDB Harmonised Standard Tender Document for Works (STD) which would permit the rejection of an ALT provided that, following a detailed clarification process, a tenderer is unable to justify its low price. As a general remark, however, EIC would like to raise at the beginning a **strategic question**, namely whether such clarification process should be vested with the CA – which might have only limited resources available and/or a conflict of interest – or whether it **should be initiated, conducted and financed by the MDBs** as part of their responsibility to execute **fiduciary oversight** and to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency. Whilst we acknowledge that such additional responsibility might lead to an increase in lending cost, the corresponding **positive knock-on effects on transparency, integrity, fair competition and corporate responsibility** would by far outweigh the marginally higher financing cost. In any case, EIC would like to stress the importance of **entrusting the clarification procedure to a qualified and independent third party**, such as a first-class, reputable consulting company.

Turning to the identification of ALTs, EIC agrees with the MDBs' finding that there appears to be **no universally accepted definition of an ALT and the majority of laws and regulations which cover the topic do not contain a clear definition**. At the same time, we believe that **Article 20 of the UNCITRAL Model Law on Procurement** provides a **practical starting-point**, as it requires the CA prior to initiating a thorough investigation to establish that the low price offer "*raises concerns... as to the ability of the supplier or contractor that presented that submission to perform the procurement contract*". EIC would like to suggest adding the words "**... for the tender price offered**" at the end of the sentence in this context.

Whilst we acknowledge that an amended UNCITRAL provision would still remain open to interpretation, some general characteristics to identify ALT, including numerical standards, can be determined. EIC would support the approach outlined in the Annex on the Sample Clarification Procedure (at page 44): "*If the lowest tender price transpires to be substantially, say **more than 15%, below the second price ranked tender and/or in excess of 25% below the average tender prices**, this should generally constitute evidence of submission of an ALT and highlight the potential risk of the lowest price tenderer having grossly underestimated (intentionally or unintentionally) the actual cost of the works.*"

When calculating the deviation, the **number of tenders received should play a role**. In case that the CA has received less than five tenders, the average tender price should be established by valuing the cost estimate as an actual tender. In case that the CA has received eight bids or more, the highest and the lowest tenders should be omitted from the calculation of the mean of the tenders in order to avoid extremes. Whilst certain reservations, qualifications or adaptations would have to be made for complex or innovative works, e.g. Design-Build, the outlined **rule of thumb would be an acceptable starting point for “standard” infrastructure projects**, i.e. with a straightforward risk profile and limited complexity.

Finally, as regards the **level of discretion for the CA to investigate**, EIC would recommend the UNCITRAL wording according to which **MDBs should stipulate a mandatory requirement for an ALT to be investigated and to be rejected if proven to be an ALT** rather than providing their clients with a “tool” to do so.

Concerning the MDB-WG’s reflection (at page 21) on the question whether a tenderer, in the event that it can legitimately evidence that it made a mistake in its pricing – which resulted in an unintentionally low tender price – should be permitted to withdraw its tender without forfeiting its tender security, EIC holds the opinion that **such tender should be rejected if the error results in an ALT**. If the tender is not rejected and the bidder decides to withdraw, **it must lose its tender guarantee**, as otherwise the very purpose of the tender security would be thwarted. EIC would like to question in this context what examples of “legitimate evidence” the MDB-WG has in mind.

MDB-WG Recommendation No. 2

The WG proposes that the Bank’s STD for Works be updated to include a provision which, at the tendering stage, requires CAs to set the amount of performance security at a level which will genuinely protect the CA against financial loss in the event of default of the successful tenderer under the contract. This proposal will result (in the result) in the redundancy of the provision in ITT 33.1 – Tender Adjustments of the Bank’s STD for Works which currently permits CAs to require contractors to increase the level of performance security in the event that a tender price is substantially below the cost estimate. (Note: The possibility to increase the level of performance security will still remain in the event that a tender price is subsequently determined to be “unbalanced or front loaded”).

EIC comment:

Whilst EIC understands that such recommendation may help to convince certain contractors not to tender, we believe that the **negative consequences of such new provision by far outweigh the positive impact** and that the proper implementation of Recommendation No. 1 in the ITT’s may have a better and more efficient effect on the treatment of ALTs.

MDBs should bear in mind that an increase of the amount of the Performance Security **generates higher costs for the project**, and **ultimately for the Contracting Authority**. In addition, such measure will **increase the risk profile of projects** for contractors. Knowing that most contractors have corporate rules prohibiting the issuance of Performance Securities in amounts higher than 10% of the contract price, the recommended measure may have an **adverse effect and deter competent contractors and/or SME’s from tendering**. Another negative effect is the **increased burden on the contractor’s credit lines** that are necessary to back the Performance Security.

Based on our experience, we would also like to highlight that **Performance Securities can be misused by ill-willing clients** to blackmail the contractor and thus **higher volumes will increase drastically the contractor's risk in the event of abuse of call on the Performance Security** by the Contracting Authority.

Last but not least, higher Performance Security amounts will have a **negative impact on the integration of subcontractors and/or partners** from economies mainly in the focus of the MDB's investments. International contractors usually require respective counter-securities and it will get more difficult for local companies to provide such guarantees the higher the required security amounts are.

MDB-WG Recommendation No. 3

The WG proposes that ITT 33.1 – Tender Adjustments of the Bank's STD for Works be amended to read as follows: "If in the opinion of the Employer the Tender which results in the lowest Evaluated Tender Price, is seriously unbalanced or front loaded or considered to be abnormally low, the Employer may require the tenderer to produce detailed price analyses for any or all items of the Bill of Quantities, and supplementary evidence, to demonstrate the internal consistency of those prices with the methods and schedule proposed. After evaluation of the price analyses, taking into consideration the schedule of estimated Contract payments, in the event that the Employer considers that the Tender is seriously unbalanced or front loaded, the Employer may require that the amount of the performance security be increased at the expense of the tenderer to a level sufficient to protect the Employer against financial loss in the event of default of the successful tenderer under the Contract. In the event that the Employer considers that the detailed price analyses, and/or supplementary evidence provided by the Tenderer, do not satisfactorily account for the abnormally low price, the Employer may reject the Tender."

EIC comment:

EIC generally agrees with the MDB-WG's proposal that the CA/Employer may require the tenderer to produce detailed price analyses for any or all items of the Bill of Quantities, and supplementary evidence, to demonstrate the internal consistency of those prices with the methods and schedule proposed.

With reference to our comment under Recommendation No. 2, EIC would like to sound a note of warning that the option to increase the amount of the Performance Security may appear as an easy remedy but, given its negative knock-on effects for the construction industry in general combined with the unwelcome effect of higher tender prices, at the end of the day such solution would be a disservice to our industry. Hence, **EIC generally advises against a higher level of Performance Security.**

Instead, in the event of **unbalanced/frontloaded tender prices**, the CA may **oblige the tenderer to prove whether its cash-flow is reasonably balanced and adjust unit prices** so that a reasonably balanced and positive cash-flow is achieved. However, such adjustments may not result in a situation where the contractors would be forced to pre-finance the contract.

As mentioned under our comment to Recommendation No.1, the **remedy in case of an ALT under a revised ITT 33.1** should be (i) an **obligatory enquiry** to produce detailed price analyses, and (ii) if the result of such analyses is not satisfactory, a **mandatory rejection of the tender.**

MDB-WG Recommendation No. 4

The WG proposes that the WG be tasked with the preparation of a Procurement Guidance Note which will provide further clarity to CAs with regard to the manner in which tenders which are considered to be abnormally low are to be assessed in the tender evaluation process (in accordance with the procedure highlighted in Annex 1 – Sample ALT Clarification Procedure).

EIC comment:

EIC would like to express its appreciation to the MDB-WG for drafting a **very comprehensive and robust Sample ALT Clarification Procedure**. With one exception stated below, EIC can support the outlined sample procedure.

Having said so, we consider the provision relating to the “**Clarification to be provided by tenderer’s subcontractors**” (at page 48) as too general and too far-reaching, bearing in mind that the CAs already have an opportunity to check subcontractors’ capability in the tender, not only in case of an apparent ALT but for all submitted tenders. It is not unusual that tenderers are required to disclose their subcontractors for particular (important) parts of the works in the contract (**Nominated Subcontractors**) for which a proof of capability shall already be required by all tenderers. Additionally, the CA may limit the subcontractor participation by a percentage level to ensure that the majority of the works will be performed by the (capable) main contractor and it is also usual that subcontractors exceeding a certain level of performance shall be appointed only with the Employers/ Engineers approval.

Hence, EIC believes that a **further requirement to demonstrate subcontractors’ capability – even if in case of an alleged ALT only – may unreasonably limit the contractor’s freedom of disposition**, in particular as the contractor will always have to cover the consequences of his subcontractors’ defaults and may be forced to perform the works on his own. The only case when we consider such clarification of subcontractors’ capability as appropriate is if the parts of the works giving rise to an ALT suspicion cannot be performed by the main contractor, either by reason of capability, local legal constraints and/or otherwise.

EIC conclusion

EIC would like to thank the MDB-WG for including our federation into the consultation on this important subject and we are fully prepared to share our experience with the MDBs in order to lead this commendable exercise to a very good result.

In closing, EIC considers that the MDB-WG should come up with a revised specification or instruction to borrowers for making bid comparisons reports. The Specification should include a requirement for the borrower to provide a reasoned statement in respect of ALT. EIC would sincerely hope that it will be given the opportunity to review those instructions when they have been finally produced.

Berlin, 6th February 2015