

Elements of abnormally low tenders: A comparative analysis of EU procurement directive and case law

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Abstract

Nowadays remains a challenge for the Contracting Authorities to organize procurement in a way that contracts are awarded to competitive tenders, without adverse effects on the contract implementation. Due to the descending pressure on prices, clients are receiving with increasing frequency bids that are substantially lower than estimated or than the other bids. The EU Directives on public procurement refer to this phenomenon through the term of “*Abnormally Low Tenders*” (ALT). Although the concept is regulated, there is no working definition of what constitutes an ALT in reality. Therefore dealing with ALT becomes more complex if we consider that both the Contracting Authorities and the bidders aim for low tenders. The questions that emerge in such situations is below what price should a tender be considered abnormal and what is the process to determine such tenders. In this context the issue of ALT has two main parts: the detection of ALT and the decision on whether to reject or not. However, the focal point of the problem, on which this article focuses, remains the identification of ALT, examine the potential of setting standards for the identification of ALT and formulate suggestions on how to improve the outcome of tendering processes.

Keywords: abnormally low tenderers, procurement, contracting authority, rejection.

Introduction

There are various reasons for the appearance of abnormally low tenders (ALT) in public procurement procedures.

Misunderstanding or misinterpretation: The submission of an abnormally low tender may be the result of the economic operator’s misunderstanding or misinterpretation of the requirements of the contracting authority.

Underestimation of risks: The submission of an abnormally low tender can be the result of an underestimation of the risks attached to the execution of the contract. This phenomenon is referred to in economic literature as “the winner’s curse”.

Non-compliance with social, labour and environmental laws: The submission of an abnormally low tender can be the result of non-compliance with binding legal requirements concerning social, labour or environmental law.

Subsidy: The submission of an abnormally low tender may be the consequence of the receipt of a subsidy by the economic operator. Subsidized companies are allowed to participate in public procurement procedures but, as explained below, their tenders should be rejected if they are abnormally low because of illegal state aid.

Deliberate strategy of an economic operator: The submission of an abnormally low tender may represent the deliberate action or strategy of an economic operator in order to provide continued employment for staff or to drive competitors out of the market.

The EU directive on procurement contains explicit provisions on “abnormally low offers”.¹ Although the directive itself doesn't define the concept, it refers to an offer that, because of its favorable terms, raises a suspicion that the provider will not be able to perform according to the terms offered. In such a case the provider may either not deliver properly or may seek extra payment (either for the agreed work or through excessive remuneration from later variations).

The Directive does not generally prevent rejection of low bids but provides that when a bid appears abnormally low the purchaser must seek a written explanation before rejecting it for that reason. In this respect Article 69(1) of the Directive states:

“Contracting authorities shall require economic operators to explain the price or costs proposed in the tender where tenders appear to be abnormally low in relation to the works, supplies or services”

In addition the same Article contains some other indications linked to the explanations that can justify a potential ALT and relate them in particular to:

- *economics of the manufacturing process, services provided or methods of construction;*
- *technical solutions chosen or any exceptionally favourable conditions available to the tenderer for the supply of the products or services or for the execution of the works;*
- *originality of the works, supplies or services proposed by the tenderer;*
- *compliance with obligations deriving from mandatory EU law or from national law that is compatible with EU law in the fields of social, labour or environmental law or international labour law;*
- *possibility for the tenderer to obtain state aid.*

The Directive uses the words “in particular” before listing the possible explanations and therefore the list is not exhaustive. It is nevertheless not purely indicative either. According to the case law of the ECJ, contracting authorities are not allowed to limit the scope of factors or elements to which explanations may relate.

Indications deriving from the case-laws of the Court of Justice of European Union

In the absence of a definition of what constitutes an ALT, various cases have been brought to Court of Justice of European Union (ECJ). By reviewing them, four points about the process of detecting ALT can be made:

- Contracting Authorities are not obliged to investigate for ALT; they only have the right to do so.
- Contracting Authorities are not allowed to reject tenders without first asking the bidder(s) for explanation in written, on precise points of the bid(s), to be provided within due time.
- Mathematical standards can only be used as indicators to identify tenders for which explanation may be asked. For transparency reasons bidders should know beforehand what system is applied.
- ALT should be related to objective concepts as the economic sustainability of bids. The latter should not be related to a margin for profit. Conversely, the justification for the empowerment of contract agencies to reject an ALT is that they should not award a contract that will result in a situation where complying with the contract conditions and project requirements, is unfeasible.

¹ Article 69 of the Directive 2014/24/EU, of 26.2.2014, OJ 2014 L 94/65.

In the Case *Fratelli Costanzo*² ECJ ruled that it violates the directive provision to reject a bid as abnormally low simply on the basis of a mathematical formula, without seeking explanations. Also in joined cases *Impresa Lombardini*³ the ECJ elaborated on the implied procedural safeguards required by this process of seeking explanations. The Italian legislation and practice in that case required each tenderer to submit, along with its tender, explanations of the most significant elements of its prices. These elements were designated in the contract documents for each contract and were required to cover elements accounting for at least 75% of the total estimated price. If a tender was considered to appear abnormally low the contracting entity could consult the explanations submitted along with the tender to see if there was a satisfactory explanation of the low price. If there was not, it was permitted to reject the tender without seeking further explanations. The ECJ was required to consider whether the directive is complied with when explanations for the low price are required to be submitted at the same time as the tender without the possibility for the tenderer to supply further explanations at a later point. The ECJ concluded that the directive is not complied with in such a case, since the provision requires an *inter partes* procedure. According to the ECJ this requires that the entity should request explanations of those parts of the tender that give rise to suspicion in the particular case and to assess the response to that request. This, stated the ECJ, entails that the tenderer be given the opportunity to provide explanations:

- after knowing that the tender is abnormally low;
- after knowing the threshold applied to determine that the particular tender is abnormally low;⁴
- after knowing which parts of the tender the entity considers problematic.

The ECJ considered that it is not possible for the tenderer to provide "useful and complete" explanations when the tenderer is not aware of the precise aspects of the tender that are considered problematic. The ECJ also stated that the procedure must involve *proper exchange of views* at an appropriate time.⁵ The ECJ also stated that the fact that explanations were sought only for 75% of the price element would also infringe the directive since tenderers must be able to provide explanations of all constituent elements.

The ECJ stated, however, that a requirement to provide explanations in advance was not in itself in violation of the directive. Explanations can be sought in advance, provided that tenderers whose tenders are still considered abnormally low after the explanations have been considered are given the opportunity to submit further explanations in accordance with the requirements set out above. The rules are not wholly clear, however, on the extent of the discretion to accept or reject low bids once an explanation has been sought. Clearly it is implied by the provision on explanations that such bids may at least sometimes be rejected after seeking an explanation.

² Case C-103/88, *Fratelli Costanzo SpA v Comune di Milano*.

³ Joined cases C-285/99 and C-286/99, *Impresa Lombardini SpA v ANAS*.

⁴ In relation to this part isn't clear from the judgments of the ECJ and the academic researches whether information on this must be given when the tender is considered abnormally low based on a discretionary judgment rather than the application of a formula.

⁵ In the view of ECJ ruling to the *Impresa Lombardini Case* this should be done before coming to the decision to award the contract (see paragraph 43 of the ruling).

Treating an Abnormally Low Tender from the Contracting Authority prospective

Coping with ALT becomes more complex if we consider that both the contracting authorities and the bidders aim for low tenders. Contractors aim to win the contract to ensure they have work for their skilled staff and to protect their cash flow, and thus may even decide to tender at a loss. For contracting agencies that strive for resource efficiency, receiving low bids is usually welcomed. However, if a tender proves economically unviable the client will be confronted with cost escalation and a performance that has adverse effect on the project. The contract scope is reduced where possible to cut expenditures and contractors intend to charge the client for extra work outside the contract scope. Costs for quality control during contract execution, operational and maintenance costs are typically higher. The friction created between contractual parties often leads to long disputes between client and contractor. From the Contracting Authority prospective an ALT may involve certain risks related to:

- Non-performance;
- Missing out on a better overall tender package;
- Greater overall costs; including additional management costs and post tender variations;
- The costs of retendering;
- Legal costs of a procurement challenge.

In the light of the above factors the process of determining if the tender is to be considered an ALT, is an area which causes some difficulties to the CA. Before the CA decides to reject what it considers to be an “*abnormally low tender*”, it first needs to define what it considers to be an ALT for all offers. The CA should first clarify with the tenderer why its offer is so low and whether there are any particular circumstances which would reasonably explain the low offer, for example, innovative technical solutions or particular circumstances allowing it to obtain supplies at favorable conditions. Based upon the analysis of the justification provided by the tenderer, the CA should decide if the tender should be rejected or accepted.

What can the Contracting Authority do? Certainly, the prudent contracting authority, where it has concerns that any bid is abnormally low, should fully investigate whether that bid is sustainable. But that is a matter of commercial common sense as much as it is one of good procurement law practice. An abnormally low tender which may be rejected is one that is priced at such a level that the authority considers itself, in all the circumstances, unable to rely upon the contract being properly performed. That conclusion might follow even if the contract was not actually loss-making, if it did not generate a normal level of profit, but it would not necessarily follow if losses would be sustained. In theory, the issue of whether a particular tendered price is abnormally low might be viewed from two perspectives: comparison with some absolute standard; or comparison with the other bids received. The most obvious absolute standard would be the normal market price, but save in the case of fairly straightforward contracts there may often not be an established market price against which comparisons may readily be made. Another possible standard might be the authority's own pre-estimate of what it expects to have to pay for the service in question, but the authority may be ill-equipped to make an accurate estimate, especially in a fluid and changing market,

or in the case of a complex or unusual contract.

In order to avoid an ALT situation the contracting authority has the possibility to address some initial remarks at the procurement planning stage. An abnormally low tender may highlight a fault in the specification or may implicate a possibly incorrect determination of the estimated total value of the contract. It could be the case that the tenderer has misunderstood the specifications or that the specifications have been badly drafted (and therefore are open to exploitation once the contract has been signed). In any circumstances the contracting authority shall request in writing details of the constituent elements of the tender, which it considers relevant and shall verify those elements by consulting the tenderer, taking account of the evidence supplied. If, however, the investigations carried out show that the price is genuine, the tender in question cannot be considered as abnormally low and it cannot be rejected. If the contracting authority decides to reject a tender on the grounds that it is abnormally low, it is obliged to inform the economic operator of the reasons for the rejection of its tender as rapidly as possible, and in any event within 15 days of receipt of the economic operator's written request for that information.⁶ The reasons for the rejection of tenders found to be abnormally low should also be included in the individual report on the procurement procedure prepared by the contracting authority.⁷

It appears that the procedural route to be followed for undertaking the investigation is somehow clear, but on the contrary the procurement rules in case of the Directive do not determine the method of calculating an anomaly threshold, leaving this issue to the discretion of EU Member. According to the case law of the ECJ, arithmetical methods can be applied in order to identify abnormally low tenders, but they may not result in the "automatic" exclusion of such tenders.⁸ The ECJ has made it clear that a contracting authority having received a bid that it suspects to be abnormally low must request an explanation of the bid from the relevant economic operator.

When may a tender be rejected as abnormally low? Having called for and received an explanation of the pricing, what conclusion has to be reached based on that explanation before the right to reject the bid arises? Where there is no pre-defined method of identifying tenders that appear abnormally low and may call for an explanation, the answer to this question will also serve to define what an authority should be looking out for when tenders are received. Fundamental though this question is, there appears to be no authority that addresses it directly. Various formulae appear in the decisions of the ECJ. They include whether the bid is "genuine"⁹ and whether it is "reliable and serious".¹⁰ These formulae are not entirely helpful.

There is a mixture of systems applied to determine if the tender is abnormally low by distinguishing two main evaluating standards: absolute and relative. Absolute standards use as an indicator the deviation of the (lowest) tender from the cost estimation of the client. Relative standards use as an indicator the deviation from the offers of the other bids. A minimum number of received bids is often required for the

⁶ Article 55 (2) b of the Directive 2014/24/EU.

⁷ Article 84 of the Directive 2014/24/EU.

⁸ *Lombardini Case*.

⁹ As emerged during the ruling in *Lombardini case*.

¹⁰ As emerged during the ruling in *Renco Case*.

applicability of relative standards, to strengthen the trustworthiness of the calculated mean. Based on the same line of reasoning, when the number of received bids is sufficient the highest and the lowest bid can be omitted from the calculation of the mean. On the contrary, below a certain number of bids the mean cannot constitute a trustful indicator.

Absolute as well as relative standards have both advantages and disadvantages. The competitive advantage of relative standards is that they reflect market conditions. The disadvantage is that they leave space for distort and require a minimum number of bids for the mean to be trusted. Absolute standards are always applicable, but a reliable cost estimate is required. Legally establishing the cost estimate as a standard requires the contracting authority to be able to substantiate the estimate and argue on it. Improving the accuracy of the estimate of the contracting authority is important and requires an extensive cost reference database.

How to deal with ALT in the context of procurement for EU external actions?

Also PRAG¹¹ in line with the EU directive provides an ill-description of what should be considered ALT and how the Contracting Authority should deal with such tenderers. In both sections dealing with award criteria for service, works or goods contract, it stipulates the 'right' rather than 'obligation' of the Contracting Authority to deal with and clarify the cases of an ALT. As such the Contracting Authority can reject tenders that appear to be abnormally low in relation to the goods, works or service concerned. However rejection on that ground alone is not automatic. The concerned tenderer must be asked, in writing, to provide details of the constituent elements of its tender, notably those relating to compliance with employment protection legislation and working conditions in the location of the contract, such as the economics of the products, the manufacturing process, the technical solutions chosen or any exceptionally favorable condition available to the tenderer, the originality of the tender. In view of the evidence provided by the tenderer, the contracting authority decides on whether to reject the tender or not. Both that decision and its justification must be recorded by the Contracting Authority, whose decision should be based merely on the ECJ rulings dealing with ALT.

Conclusions

Identifying ALTs is considered a step towards economically sustainable procurement. Developing a framework to detect ALTs is a very complex process, but has the potential to prove beneficial for all parties involved. Bidders will be motivated to submit tenders that do not involve unreasonably high risks. Contracting authorities will have an incentive to enhance their expertise in procurement. Most importantly, both parties will be encouraged to work together as professional counterparts, for the benefit of the society, by delivering successful and resource-efficient projects.

It is essential to describe the standards in qualitative terms and the process for the detection of ALTs in the tendering guidelines, in order to preserve uniformity and

¹¹ Practical Guide to Procurement and Grants for European Union External Actions.

transparency for all participants in a tender. Therefore is advisable to establish a standardized process for the detection of ALTs in the tendering guidelines, to achieve uniformity in decision making and enhance transparency of the process. To the end a mathematical standards for the detection of ALTs need to be set in the tender documents, to be context specific and fine tune those standards with the market conditions.

Contracting Authority should improve the accuracy of the estimate and requires an extensive cost reference database, establishing thus a reliable tool to compare and identify ALT in any future bidding procedure.

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