FOREIGN INVESTORS COUNCIL IN LATVIA

Position paper No. 5

31 May 2013

Position Paper on Suggestions to Amend Regulations on Public Procurement

1. Executive Summary

Public procurement is an essential component of every European Union member-state's economy. The European Commission has calculated that European Union member-states, including Latvia, spend approximately 19% of GDP on public procurement.

Considering the share of the economy accounted for by public procurement, further positive growth of the state economy hinges on public procurement in accordance with public procurement principles specified by the European Union (i.e. transparency, non-discrimination, equal treatment, mutual respect, and proportionality), as well as the goals specified in Section 2 of the Public Procurement Law (hereinafter referred to as PPL) and Section 2 of the Law on the Procurement of Public Service Providers (hereinafter referred to as LPPSP):

1. ensuring transparency of the procurement procedure;
2. ensuring free competition among suppliers, as well as an equal and fair treatment to them;
3. ensuring efficient allocation of the assets of the state, municipal governments, and public service providers.

Considerable changes are required in regulations of public procurement for public service providers, in order to more comprehensively observe the core principles of public procurement and the goals specified in the LPPSP, which would consequently improve the business environment in Latvia and contribute to reducing the proportion of the shadow economy.

Therefore, with this statement of opinion, the Foreign Investors Council in Latvia (hereinafter referred to as the FICIL) would like to make its suggestions and underscore the following aspects of improving the public procurement system in Latvia:

1. Application of procurement execution procedure as specified in the applicable legislation to so-called "below-threshold" procurement of public service;
2. Updates to the LPPSP with an *expressis verbis* reference to application of the PPL outside fields of application specified in the LPPSP;
3. Effective implementation of legal protection mechanisms for contestation of decisions made within the framework of "below-threshold" procurement fulfilled by public service providers;
4. Improvement of legal regulations of the LPPSP according to amendments introduced in the PPL, in order to promote the achievement of public procurement aims;
5. The contracting authority's right to exclude from participation in procurement any bidder who formally meets tender requirements but about whom the contracting authority has

justified doubts of their ability to fulfil obligations in good faith;
6. Reducing the scope of applying the *in-house* exception;
7. Reinforcement of the role of guidelines issued by the Procurement Supervision Bureau;
8. Timely access to information about planned procurement.

2. Recommendations and substantiation

Having evaluated the current legal regulations and the practice of their implementation in Latvia, FICIL has arrived at the following suggestions regarding the necessary changes in public procurement regulation:

1. SUGGESTIONS FOR AMENDMENTS TO THE LAW ON THE PROCUREMENT OF PUBLIC SERVICE PROVIDERS

1.1. Application of procurement execution procedure as specified in the applicable legislation to so-called "below-threshold" procurement executed by public service providers

In accordance with the currently applicable wording of the LPPSP, the aforementioned law and the procurement procedures specified therein apply only to procurement conducted by public service providers where the contract price is equal to or higher than the threshold specified by the Cabinet. This means that the public procurement procedures specified by the LPPSP must be applied if the contract price for construction works exceeds LVL 3 540 500, or the contract price for delivery or service contracts exceeds LVL 283 240.

Although the LPPSP specifies that a public service provider is entitled to apply this law to so-called "below-threshold" procurements, this is actually not the case in practice. Based on information gathered by members of the FICIL, the total amount under contracts concluded by public service providers in 2011 exceeded 600 million lats (specifically, LVL 609 495 803), with 53% (LVL 326 607 037) granted without application of public procurement procedure because the amounts under those procurement agreements did not reach the thresholds specified in the applicable legislation. It should also be noted that, compared to 2008, the amount of agreements concluded within the framework of public procurement procedure in 2011 decreased by 25%.

One possible explanation for such a downward trend is the action of public service providers, dividing a tender into smaller procurements to avoid enforcement of the procurement procedure specified in the LPPSP. This is confirmed indirectly by statistical data, which shows that the average value of an agreement concluded by public service providers in 2011 above the EU procurement thresholds was LVL 2 111 036, which is 64.1% lower as compared to 2010 (LVL 5 887 296).

Considering the aforementioned, and the comparatively high threshold values applicable to public service providers, it would be essential to ensure observance of fair and equal treatment principles and free competition among suppliers in procurements conducted by public service providers where the agreement price does not reach the agreement price threshold specified by the Cabinet. In this regard, it should be noted other European Union member-states have legislated on a procedure for organisation of such "below-threshold" procurements. In Latvia, the procedure specified for common public procurement is specified in PPL Section 8^1. With regard to the activity of public service providers, it should be added that, despite the conclusions drawn from the practice of the European Union Court – where the principles stemming for the Treaty on the

Functioning of the European Union (e.g. equal treatment, openness, mutual recognition etc.) also apply to procurements where the expected agreement price is lower than the specified "thresholds" – in Latvia, in most cases, the public service providers do not observe these principles in "below-threshold" procurements, and interested suppliers are in fact not provided effective protection from violations of their rights.

We should note that in 2011, the Procurement Supervision Bureau published its "Procurement guidelines for public service providers", applicable to procurements in the fields specified in the LPPSP and have agreement prices lower than the threshold values specified by the Cabinet but higher than LVL 3000 for procurement and service agreements or LVL 10 000 for construction works. However, because the application of these guidelines is only binding for agreements implementing projects financed by EU structural funds, Cohesion Fund and other entities, which note this specifically; in practice, the PSB guidelines are applied, either in full or in part, in rare cases only.

In this regard, FICIL **suggests amending (supplementing) the LPPSP, specifying the minimum contract price for public service providers' "below-threshold" procurements, the general procedure for announcing (publishing) such "below-threshold" public service provider procurements (including the amount of information to be published), the minimum time period for announcement and decision-making, applicable regulations and principles regarding the documentation of such "below-threshold" procurements, etc. as well as the duty of LPPSPs to develop internal procedures on managing "below-threshold" procurement.** An alternative solution includes a special reference in the LPPSP to legal regulations, which apply when a public service provider conducts "below-threshold" procurements.

We also draw attention to the fact that the European Commission is currently working on drafting European Union procurement directives which, based on current estimates, might be adopted in late 2014 or the first half of 2014. However, because implementation of these directives in Latvia might take place no sooner than a couple years following their adoption, the amendments to the LPPSP offered by the FICIL should be made independently from action on the draft EU directives.

1.2. Updates to the LPPSP with an *expressis verbis* reference to application of the PPL outside fields of application specified in the LPPSP

One of the issues identified by FICIL members that is frequently encountered in practice is that, as the basis for not applying procurement procedure, public service providers often note that they, being special legal subjects, are bound solely by the LPPSP, as a result of which with regard to activity in fields which are not regulated by this specific law, in the operation of public service providers, the PPL is not applied in practice. This is also evident from violations established in reports by the State Control, regarding situations where public service providers have concluded agreements on procurement of goods or services without applying the public procurement procedures specified in the applicable legislation.

In this regard, it should be noted that the current Public Procurement Law Section 3 Paragraph One Clause 9 specifies that the Public Procurement Law is not applied [only] if the contracting authority concludes a procurement agreement to conduct activities in specific fields as specified in the Law on the Procurement of Public Service Providers. Therefore, outside the fields of activity specified in the LPPSP, a service provider/contracting authority must apply the Public Procurement Law and the procurement procedures specified therein.

In order to avoid any ambiguity in this regard, **we suggest supplementing Section 8 of the Law on the Procurement of Public Service Providers with the provision that: „*if a contract refers to activity in fields which are not regulated in Sections 3, 4, 5, 6 and 7 of the law, the Public Procurement Law shall apply*".**

1.3. Effective implementation of legal protection mechanisms to contestation of decisions made within the framework of "below-threshold" procurement fulfilled by public service providers

FICIL notes that ensuring a quick and efficient mechanism for legal protection is one of the hallmarks of a democratic state. Likewise, the broadest possible access to judicial authority would promote the public trust for subjects of public governance, as the legality of the decisions they make would be subject to evaluation and review.

In accordance with the current legal regulations and the court practice of the Supreme Court Department of Administrative Cases, a legal entity currently has practically no legal recourse for contesting or appealing decisions of public service providers which have been made in concluding agreements below the thresholds for public service providers as specified by the Cabinet (i.e. LVL 3 540 500 for construction works agreements or LVL 283 240 for delivery and service provision agreements). It should be added that such decisions made by a public service provider likewise cannot be contested out of court because the Procurement Supervision Bureau does not consider such applications (complaints). Therefore, a situation exists where neither institutional, nor judicial control applies to decisions made for considerable amounts by public service providers (namely, in accordance with statistical data for 2011, the average price of an agreement concluded by public service providers was LVL 2 111 036), which contradicts the purpose of public procurement regulation – to ensure free competition and effective allocation of public service providers' assets.

Considering the aforementioned, the FICIL Workgroup for Public Procurement Matters **suggests amending (updating) the LPPSP, specifying that a bidder who submits an offer for a so-called "below-threshold" procurement and believes that their rights have been infringed or might be infringed, is entitled to contest decisions with the Administrative District Court, in accordance with the procedure specified in the Administrative Procedure Law. The decision of the Administrative District Court may be contested through cassation with the Administrative Cases Department of the Supreme Court Senate.**

Likewise, we suggest including a regulation in the LPPSP specifying that **with regard to "below-threshold" procurements conducted by a public service provider, the applicant may request enforcement of temporary regulations by the court in contested cases** and in accordance with the procedure specified in the Administrative Procedure Law.

1.4. Improvement of legal regulations of the LPPSP according to amendments introduced in the PPL, with the aim of improving public procurement

The LPPSP was adopted by the Saeima on 25 August 2010, and since then no amendments have been made. The PPL has been amended considerably since 2010 based on initiatives by state government authorities and the non-governmental sector (including FICIL), in order to ensure effective use of public funding, transparency of procurement procedures, free competition among suppliers, as well as an equal and fair treatment of them.

The following amendments to the PPL are noted as being the most imperative for improving the law:

1) specifying the obligation of the contracting authority to obtain necessary information within the framework of a public procurement directly from institutions and public databases;
2) defining the contracting authority's right to verify the qualifications of subcontractors involved by the bidder and application of the bidder exclusion criteria specified in the applicable legislation to subcontractors involved by a bidder;
3) restrictions on the maximum amount of bid bonds;
4) organising a meeting of interested suppliers following a request by at least two interested suppliers;
5) in exceptional cases, the right to conclude a procurement agreement for a term of more than five years, provided that the relevant consent from the Cabinet has been obtained and such provisions are essential for ensuring execution of the agreement;
6) rights and provisions applicable to amending a concluded procurement agreement and general agreement;
7) rights and provisions applicable to the contracting authority's replacement of personnel involved in executing a procurement agreement (on the experience and qualifications of which the procurement was based), subcontractors, etc.

In order to achieve the goals of the public procurement, FICIL suggests amending the LPPSP reflecting the aforementioned principles and legal regulations in the LPPSP as well.

2. SUGGESTIONS FOR AMENDMENTS TO THE PUBLIC PROCUREMENT LAW

2.1. The contracting authority's right to exclude from participation in procurement bidders who formally meet tender requirements but about whom the contracting authority has justified doubts regarding their ability to fulfil obligations in good faith

The current normative regulations do not envisage the contracting authority's ability to exclude "unfair" merchants from participation in procurement who had received the right to conclude a procurement agreement earlier by deceiving the contracting authority about their ability to execute the agreement in due quality and on time, resulting in non-performance of the procurement agreement and forcing the contracting authority to terminate it unilaterally.

Such circumstances do not facilitate fair competition and complicate quick and efficient execution of procurement procedures.

Furthermore, 2004/18/EC Article 45 (2.d) grants a member-state the right to specify in its legislation that a bidder may be barred from participating in procurement procedure if the bidder "*has been guilty of grave professional misconduct proven by any means which the contracting authorities can demonstrate"*. In such cases, no valid decision by a competent institution or court judgement establishing this fact is required – it is assumed that such violations of a bidder's professional activity are established and substantiated by the contracting authority themselves. This, of course, is conditional on such a contracting authority's decision being subject to the control of a competent institution (e.g. the Procurement Supervision Bureau) or court.

In this instance, we suggest **supplementing Public Procurement Law Section 39 Paragraph One**, specifying that **the contracting authority is entitled to exclude** a bidder from participation in the procurement due to a significant violation of professional ethics, for example, one may consider a case when:

(a) the bidder [or other merchant on whose professional or commercial capacity the bidder was relying], in executing a procurement agreement concluded with the contracting authority earlier, had not executed, culpably, the earlier procurement contract, and the relevant contracting authority had withdrawn from the agreement unilaterally due to violations of the procurement agreement by the bidder and in accordance with the provisions of the contract, and:
   (i) [within a certain period] following the contracting authority's notice of unilateral withdrawal from the contract and in accordance with the procedure specified in the contract, the bidder has not filed a claim against the contracting authority on execution of the procurement contract, or
   (ii) the court has, in accordance with a judgement which has come into force and become incontestable, has acknowledged the contracting authority's action as justified.

This restriction on participation in public procurement would be specified for a certain period of time (e.g. 3 years). Moreover, contracting authorities would be obliged to notify the relevant state government institution (e.g. the PSB) of such cases of unilateral contract termination, thereby ensuring availability of such information.

Currently, similar legal regulations have already been incorporated in the Defence and Security Procurement Law.

However, at the same time, the recent judgement of the European Union Court on 13 December 2012, in a case involving the Polish Post (C-465/11), where the EUC acknowledge that, on the one hand, the term "violation of professional ethics" specified in Directive 2004/18/EC Article 45 (2.d) should be interpreted as any kind of misconduct that affects a bidder's professional trustworthiness and not just violations of an ethical nature (§27), but, on the other hand, "gross professional misconduct" generally includes a bidder's malicious intent or gross negligence, as a result of not all incorrect, imprecise or erroneous actions by the bidder (in the relevant case – non-fulfilment of the contract) denotes gross professional misconduct, but may be evidence of the bidder's possible limited professional competence on certain matters (not to be treated as gross professional negligence!).

2.2. Reducing the scope of applying the *in-house* exception

The currently applicable Public Procurement Law Section 3 Paragraph One Clause 7 specifies that the law is not applied if a contracting authority concludes a contract on construction works, deliveries or provision of services performed by an institution which meets all of the following criteria:

(a) it is under complete control of one or several contracting authorities (such control manifesting as the right to affect considerable goals and decisions of the activity of the controlled institution);
(b) at least 80 per cent of its annual financial turnover consists of fulfilment of specific tasks in the interest of controlling contracting authorities or other contracting authorities which are controlled by the contracting authorities controlling the institution;
(c) its capital shares or stocks are fully owned by the subcontractors that control it.

Although the specified regulations formally correspond to European Council directive 2004/18/EK and European Union Court practice, practical implementation of this exception has a considerable negative impact on free competition among suppliers, which in certain markets is

completely eliminated. Likewise, the current PPL regulation does not restrict the contracting authority's right to rely on *in-house* procurement even in cases where other market participants are capable of providing the necessary services in adequate volume and quality and at a considerably lower price. This regulation, among other concerns, allows undutiful and inefficient allocation of public funds, distorting the free market and free competition among suppliers.

It should also be noted that the current regulation is rather general and does not provide legal regulations for situations where the actual state of affairs change during execution of a procurement agreement.

In this regard, **we suggest amending Section 3 Paragraph One Clause 7 of the PPL,** specifying that;

(a) the aforementioned *in-house* exception applies only if the articles of association of the relevant capital company (or the shareholder/stockholder agreement) specifies that all strategic and determinative shareholder board decisions are made unilaterally;
(b) the aforementioned *in-house* exception applies only in cases where the contracting authority is the direct recipient of the relevant construction works, supplies or services;
(c) if, following conclusion of an agreement in accordance with the exception specified in Public Procurement Law Section 3 Part One Clause 7, the actual state of affairs changes or it is established that any of the exception application criteria no longer applies, the contracting authority is obliged to announce a new procurement procedure immediately [within no more than one month].

2.3. Reinforcement of the role of guidelines issued by the Procurement Supervision Bureau

In order to ensure accurate and uniform interpretation and application of public procurement norms, thereby reducing the number of unsubstantiated claims and promoting free and fair competition among bidders, FICIL believes it necessary to facilitate reinforcement of the role of the guidelines issued by the Procurement Supervision Bureau.

In this regard, amendments (updates) to the Public Procurement we suggest specifying that:

(a) the Procurement Supervision Bureau is provided with expert that cooperate with involved state government institutions, state and municipal government owned companies and non-governmental organisations in order to develop and approve binding guidelines for the implementation of procurements in certain fields;
(b) where it is deemed adequate, possible, and justified, considering the circumstances, when organising procurement procedures, a contracting authority is obliged to consider the guidelines developed by the Procurement Supervision Bureau, with enforcement of the principles and practice specified therein during the consideration of complaints regarding possible violations of procurement procedure.

2.4. Timely access to information about planned procurement

FICIL suggests the relevant amendments to the PPL, stipulating that:
1) A prior informative notice (PIN) is published regarding **all procurement procedures of elevated complexity** (such as procurements within the framework of which complex technical solutions or considerable volumes, requiring the drafting of a technical offer that takes additional

research, as well as procurements where certain sections of the technical offer require innovative work), excluding cases when negotiation procedure is applied without publishing a prior notice about an agreement, regardless of whether:
a) the contracting authority uses reduced time frames for submission of bids;
b) the total agreement prices for public procurements within the next 12 months reach the thresholds specified in Paragraphs 2.5 and 2.6 of Cabinet Regulation No. 519, "Regulations on Threshold Prices for Public Procurement Agreements" (Agreement Price Provisions);
2) the PIN provides information regarding each procurement procedures, specifying planned volumes and the planned agreement price.

Using the relevant guidelines, the PSB should promote practice where contracting authorities have public procurement sections on their websites, which are clear and easy to find. In such a instance, a contracting authority should not only publish its PIN, but wherever possible, also the plans for its public procurements.

FICIL suggests also making the relevant amendments to Cabinet regulation No. 171 of 6 March 2007, "Procedure for Institutions Publishing Information on the Internet", Paragraph 11.13 stipulates that "the 'Public Procurement' section shall include information (in accordance with the template provided in Annex No. 1 to these regulations) on the public construction works, supply and service agreements concluded by the institution in writing." **FICIL suggests specifying in the Cabinet regulation that an institution's "Public Procurement" website section should also include information on expected procurements (PINs and public procurement plans, if available).**

Furthermore, FICIL suggests that the PSB, when communicating with suppliers, should notify them about the option for interested suppliers to request the contracting authority so as to provide them with any technical specifications, which it intends to apply to agreements for which a PIN has been published, as specified in PPL Section 18 Paragraph One.