INFRASTRUCTURE FOR GROWTH: HOW TO FINANCE, DEVELOP, AND PROTECT IT

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4. CONSTRUCTION OF INFRASTRUCTURE IN EUROPE

ULRICH PAETZOLD

For more than 50 years, the EU has been gradually working on the opening-up of public procurement markets. Hitherto, this was more or less reserved to national or regional players. Previous work resulted not only in some packages of Directives (1971, 1989, 1993, 2004, 2014) but also in increased cross-border participation in public procurement tenders – those for major infrastructure projects in particular.

Throughout the decades, the goal has been to reduce or demolish the existing barriers in order to achieve fair and transparent cross-border competition in a single market. A neglected aspect, however, was that this single market might, one day, need protection against the procurement practices of some of its own members.

The underlying reason for such developments seems to be that many contracting authorities/Member States have been facing severe budgetary problems. This has also concerned the financing of construction and maintenance of infrastructure which is otherwise considered necessary for the sound development of Europe's industry, society, and cities. Any such lack of means is amplified by the EU's Stability and Growth Pact rules and the "additionality" principle (*i.e.*, EU funding must be complemented by national funding, not substitute for it).

Often, this has led to awarding contracts to the lowest bidder. Current directives make awarding a contract to the most economically advantageous tender ("MEAT") mandatory, but in practice, the lowest ones tend to be awarded the contract. This result, astonishing at first sight, is actually possible either by making price the only award criterion of "MEAT" (which the directives allow unless the national legislator restricts/forbids it) or by giving considerably more weight to price than to quality aspects. In this context, the expression "a well-prepared project" should certainly be re-evaluated.

In tender procedures with the participation of third country state-owned enterprises ("SOEs"), some evidence indicates that contracts might have been awarded to abnormally low tenders. Most surprisingly, in none of these cases this aspect has been examined in depth, either by national authorities or the European Commission.

More specific elements will be shown in the following examples.

EXAMPLE 1

Poland, motorway A2, Stryków (Łódz) - Konotopa (Warschau), 91 km total length, total budget €1 billion, EIB loan €500 million, in addition to the EU funds available for the country, 2009-2012.

Two lots of this motorway were awarded to a consortium led by the Chinese construction SOE "COVEC" at a price more than 70% below the estimated budget and more than 30% cheaper than the second lowest offer.

Both the procedure and the contents of the tender raised questions, most of which were addressed in the remedy procedures, which did not ultimately change the award decision. The tender was signed by a person without power. The court considered that this was mentioned too late.

The bank guarantee was drawn up with a Chinese bank not active in the EU. The Commission considered that no such condition for the bank guarantee had been published.

In the tender, 30 positions were priced "0 zł", despite the express indication in terms of calculation that each position had to be priced. The court considered that this was not an unconditional obligation.

COVEC offered US$100 million for the tender phase and more after the award until completion, but the qualification documents showed that the net value of COVEC amounted to only US$97 million. The Commission considered that even if this were the consequence of state aid, it would be irrelevant because the European rules were applicable only for EU Member States.

COVEC claimed it would not need any expensive European bank loans, as it and its owner had enough financial resources. This would also make it possible to purchase material, equipment, and services on a large scale immediately and thus achieve price advantages as well as immunity from cyclical price fluctuations. For logical reasons alone, these arguments do not explain the large price difference. As a result of significantly higher overall contract volumes in the Polish market, European competitors are likely to achieve considerably larger volumes and price advantages.

Other reasons given by COVEC were low general administrative expenses, efficient organisation of work, no need for risk margins, use of its own construction machines, cheaper costs of Chinese personnel, unique organisation methods and a low profit margin.

None of these reasons can convincingly explain the significant price difference.

COVEC also claimed that its price was calculated on the assumption that it might win two lots, so that it would benefit from considerable economies of scale.

Logically, this means that none of the two tenders was viable as such and should have been excluded.

Overall, it is astonishing that none of these elements triggered any serious investigation by national authorities or the Commission.

It is interesting to note that neither of these two contracts was completed. Both were terminated by both sides following a series of problems and differences of opinion, which also led to litigation. In view of the immovable date of the UEFA Soccer Championships 2012, the two contracts were re-awarded in an urgency procedure. The contract prices were 20% higher than the second lowest offer in the initial award procedure.

EXAMPLE 2

Croatia, Pelješac bridge, (2,4 km, EU financing €357 million), 2018-ongoing.

This project was awarded to a consortium of four Chinese SOEs. Their offer was 23% cheaper than that of the next consortium, led by a European contractor. The appeals of two European consortia were rejected.

This case also raised questions, but neither the national authority nor the Commission saw any reason to change the award decision.

Abnormally Low Tender (ALT)

In fact, the Commission considered that the contracting authority did not have sufficient reason to perceive this tender to be abnormally low, because all tenders were significantly above the budget estimation and none of the interested contractors lodged a complaint against the indicated price or asked for clarification of the price, despite several rounds of questions and clarifications.

None of these arguments is convincing.

Usually, such budget estimations are made several years prior to tendering and awarding, but they do not normally reflect the up-to-date market situation. Most regrettably, this argument looks like guidance on

how to ensure that the award to ALT cannot be contested successfully. On top of this, as the estimated budget is just an indication but not a limit or guidance value, there is not much reason to start conflictual discussions with the contracting authority at that stage.

With respect to the principles explained by the EU General Court (case T-700/14, judgement 26/1/2017, para. 54), major differences between the estimated budget and the tender prices can be taken into consideration for checking the reliability of tenders. If a contracting authority does not do this, it prevents itself from having an up-to-date basis for the correct assessment of tenders.

Prices of specific items

The successful tender contained specific items with excessively low prices, some of them as low as between 3.9% and 21.8% of the prices offered in the European consortium's tender, in other words between 96.1% and 78.2% cheaper. The Commission considered that the relatively low number of such cases compared to the total number of items would not provide conclusive evidence for the existence of an ALT.

This is not entirely convincing. The existence of a couple of inexplicable/unexplained examples, such as these extreme ones, should be reason enough for more thorough checks.

In the meantime, there is information that the winning consortium pays normal market prices to sub-contractors and suppliers. Obviously, this is a legal requirement, but one wonders how this can be achieved despite the excessively low prices tendered. In other words, what would have been the correct tender price if such specific items had been tendered for the same price which is being paid now?

State-Owned Enterprises (SOEs)

Another aspect which was not taken into consideration in this procedure is the fact that the winning companies are SOEs. This raises the question of whether these astonishingly low tenders might be the result of state aid or subsidies negatively impacting the competition.

That said, Commissioner Hahn is reported (FT, 6/3/2019) to have criticised the EU's decision to fund 80% of a bridge in Croatia being built by a Chinese company, which he said was "most likely being subsidised back home". It will be interesting to see whether the Commission has really changed its mind.

EXAMPLE 3

Bulgaria, railway "Elin Pelin to Kostenets", part of the "Railway-Sofia-Plovdiv-TENT-Orient-EastMed" TEN-T corridor, 85% financed by EU funds.

The published tender results can be summarised as follows:

The consortium led by the Chinese SOE CCCC had a score which was 41% lower in technical value and 28% cheaper than the second, a European consortium. In other words, the European consortium was 69% better in technical value and 39% more expensive.

In total, the winning consortium achieved 2% higher marks than the European one, thanks to a weighting of max. 60 points for price and max. 40 for technical value.

It will be interesting to see what reasons will be given as a justification for this 28% price difference and whether the award decision will be confirmed.

Possible ways forward

For the future, it will be crucial to ensure that both national contracting authorities and Chinese SOEs working in the EU Internal Market respect both the letter and the spirit of EU law, such as public procurement rules, posting of workers or state aid rules, as well as the fundamental principles of EU Treaties.

This requires the EU to develop clear positions for the defence of its interests, in order to be prepared for negotiations and situations in which other global players in world-wide trade will defend their interests vigorously.

More specifically, it seems necessary to adapt the public procurement rules to these developments, *i.e.*

- by introducing a threshold for mandatory verification (not automatic exclusion), for example if the difference between the preferred bidder and the second offer amounts to 20% or more;
- by introducing an obligation for effective, thorough analysis, transparent for verification by courts, if necessary;
- by introducing an obligation to exclude any bidder which cannot prove not to be an ALT;
- by applying EU state aid rules to any contractor wishing to work in the EU Internal Market;
- by assuming the existence of illegal state aid in any case of SOE participation.

This assumption can be lifted by proving that no illegal state aid is involved. Otherwise, there should be a mandatory exclusion of this bidder/SOE.

Other very important aspects, which will also have to be addressed by the EU, are all those linked to international trade and governed by the rules of WTO, OECD, etc. They have not been covered in this article given that it focuses on the EU Internal Market.

Latest developments

Very recently, the European Commission and the European Council published documents which seem to indicate that cases such as the ones shown above might have led to a change of mind and a more realistic, less naïve approach concerning the participation of third country state-owned enterprises in EU public procurement, in particular for important infrastructure, as well as concerning competition world-wide.

Commission communication "EU-China – A strategic outlook" (12/3/2019)

Action 6: To promote reciprocity and open up procurement opportunities in China, the European Parliament and the Council should adopt the International Procurement Instrument before the end of 2019.

Action 7: To ensure that not only price but also high levels of labour and environmental standards are taken into account, the Commission will publish guidance by mid-2019 on the participation of foreign bidders and goods in the EU procurement market.

The Commission, together with Member States, will conduct an overview of the implementation of the current framework to identify gaps before the end of 2019.

Action 8: To fully address the distortive effects of foreign state ownership and state financing in the internal market, the Commission will identify before the end of 2019 how to fill existing gaps in EU law.

Conclusions of the European Council meeting (22/3/2019)

(p. 2) Fair competition should be ensured within the Single Market and globally, both to protect consumers and to foster economic growth and competitiveness, in line with the long-term strategic interests of the Union. We will continue to update our European competition framework to new technological and global market developments. The Commission intends to identify before the end of the year how to fill gaps in EU law in order to address fully the distortive effects of foreign state ownership and state-aid financing in the Single Market;

(p. 3) The EU must also safeguard its interests in the light of unfair practices of third countries, making full use of trade defence instruments and our public procurement rules, as well as ensuring effective reciprocity for public procurement with third countries. The European Council calls for resuming discussions on the EU's international procurement instrument;

Memorandum of Understanding and projects signed between China and Italy on 23/3/2019

On the other hand, the signing of such an MoU and some 28 projects by Italy, one of the largest EU Member States and founding member of the EU, gives further reason for concern. As examples in Asia, Africa, and the Balkans show, even Chinese investment comes at a price, perhaps not immediately, but eventually. It is most regrettable that in addition to the EU Member States involved in the Chinese "16+1" project, Italy has now joined the new Silk Road project, believing this to be advantageous for citizens and business in Italy. We will see where all of this will lead to.

CLARIFICATION

In order to avoid any misunderstanding, the European construction industry federations FIEC and EIC always point out that they are firmly opposed to any form of protectionism and are in favour of fair competition in mutually open markets. Fair and healthy competition, based on contract conditions which allocate risks in a balanced way, contributes to progress and innovation. On the other hand, unfair and unhealthy competition, based on unbalanced conditions and the lowest price only, endangers the EU economy and society. They also stress that they are in favour of genuinely reciprocal market access opportunities and corresponding incentive measures (*i.e.* trade defence instruments) at EU level if international negotiations do not achieve tangible progress.