



ING. ANTONIS MEGREMIS  
ROYAL HASKONING DHV  
ADVISOR / INFRASTRUCTURE

# ABNORMALLY LOW TENDERS (ALT)

## ABNORMAAL LAGE INSCHRIJVINGEN: KUN JE DIT

## OBJECTIEF VASTSTELLEN EN WAT KUN JE ER TEGEN DOEN?

### 1. The problem of Abnormally Low Tenders

Contracting authorities in the field of infrastructure strive to deliver value to society, while they need to cope with budget restrictions. The challenge is to organize procurement processes in a way that contracts are awarded to competitive tenders, without adverse effects on the contract realization. Due to the downward 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 “Abnormally Low Tenders” (ALTs). Although the concept is regulated, there is no working definition of what constitutes an ALT in reality.

Coping with ALTs becomes more complex if we consider that both the contracting authorities (or project owner or client) 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 may be welcome at one level. 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 contractor that is bound to make a loss struggles to save costs and reduces expenditure on quality, innovation, training and safety. These effects are passed on through the supply chain to subcontractors that

are squeezed, suppliers and employees. 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. The questions that emerge are:

- below what price should a tender be considered abnormal
- what is the process to determine such tenders.

### 2. The process to detect Abnormally Low Tenders

In the absence of a definition of what constitutes an ALT, various cases have been brought to European Courts. By reviewing them, four points about the process of detecting ALTs can be made:

- Contracting agencies are not obliged to investigate for ALTs; they only have the right to do so.
- Contracting agencies 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.
- ALTs 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-

### Samenvatting

Abnormaal lage inschrijvingen (ALT's) worden als ongunstig beschouwd voor de economisch duurzame uitvoering van (infrastructuur) projecten. Ook al is dit fenomeen in de EU-richtlijnen inzake overheidsopdrachten geregeld, er bestaat geen algemeen aanvaardbare definitie van ALT's of een juridisch kader (criteria) om dergelijke inschrijvingen in de praktijk te identificeren. De identificatie van ALT's is bovendien ingewikkelder geworden met de invoering en het grootschalige gebruik van geïntegreerde contracten, zoals Design en Construct (DC). De opdrachtgever beschikt tijdens de aanbesteding van geïntegreerde contracten immers niet over een gedetailleerd ontwerp, en ontbeert daardoor de nodige informatie voor het opstellen van een trefzekere kostenraming

waarmee de inschrijvingen kunnen worden vergeleken. De vraag die naar voren komt is: op welk punt moet een inschrijving abnormaal worden beschouwd en wat is het proces om dergelijke inschrijving te identificeren?

Zowel uit dit afstudeeronderzoek als in praktijk bij aanbestedingen van geïntegreerde contracten blijkt, dat door toepassing van objectieve criteria (zogenaamde standaarden) abnormaal lage inschrijvingen (ALT's) geïdentificeerd kunnen worden. Aanbevolen wordt om dergelijke standaarden expliciet op te nemen in de aanbestedingsrichtlijnen van de opdrachtgever en in voorkomende gevallen nader te specificeren in de betreffende aanbestedingsleidraad.

ing 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.

### 3. EU standards to detect Abnormally Low Tenders

#### 3.1 National law of the 28 EU members

In the EU, 8 out of 28 members use mathematical standards to identify ALTs under National law. We can distinguish absolute and relative evaluating systems. Relative standards examine the deviation of a tender for the mean of the tenders, while absolute standards examine the deviation from the clients's cost estimation. Other countries make use of both approaches together, depending on the number of valid bids received. When relative standards are used, there is a prerequisite for a minimum number of bids for the standards to be applicable. This prerequisite is related to the trustworthiness of the mean. In some cases the highest and the lowest bids are excluded from the calculation of the mean if the number of bids is sufficient. The thresholds used vary significantly, as it can be seen in table 1.

The competitive advantage of relative standards is that they reflect market conditions. The disadvantage is that they leave space for manipulation and require a minimum number of bids for the mean to be trusted.

Type of Standards	Mean of the thresholds	Bandwidth of the thresholds
Relative	21.25 %	[15 – 30] %
Absolute	24 %	[10 – 40] %

Table 1 - Average and the bandwidth of the thresholds used in relative or absolute systems.

Absolute standards are always applicable, but a reliable cost estimate is required. Legally establishing the cost estimate as a standard requires the contracting agency to be able to substantiate the estimate and argue on it.

#### 3.2 EU Public Procurement Directive

In 2014 a new EU public procurement directive (2014/24/EU) entered into force. The initial version of EU Commission proposal for a new directive (2011) involved in Article 69 standards to detect ALTs:

“Contracting authorities shall require economic operators to explain the price or costs charged, where all of the following conditions are fulfilled:

- (a) the price or cost charged is more than 50 % lower than the average price or costs of the remaining tenders;
- (b) the price or cost charged is more than 20 % lower than the price or costs of the 2nd lowest tender;
- (c) at least five tenders have been submitted.”

Those standards appear to be arbitrary, aiming to form a base for negotiation, as they allow for a higher deviation of the lowest tender than any standards encountered in the EU. In other words, the proposed (2011) standards “encapsulate” the ones already applied and do not come in conflict with any of those. At the end the standards were not included in the new EU Directive of 2014.

### 4. Implications of DC & DBFM contracts and the EMVI mechanism

The legislation on ALTs is established regardless of the project type, the award mechanism or the contract form. However, those parameters have a major impact on the detection of ALTs. Integrated contracts, such as Design & Construct (DC) and Design-Build-Finance-Maintain (DBFM), are becoming dominant for complex projects in the Netherlands. Because the design is part of the scope to be tendered, the project owner lacks a detailed design during tendering. As a result, the scope for which the project owner and contractors calculate cost may differ, leading to cost estimates that deviate.

Using integrated contracts also has a detrimental effect on the accuracy of the build-up method that is predominantly used by project owners to estimate costs. Due to the lack of a detailed design, the cost estimation is made on a higher level of the work breakdown structure and the uncertainty is higher. Therefore, the complexity of evaluating bids and detecting abnormalities is enhanced.

The scope in the tender documents is altered due to complications arising when executing the works. Probabilistic cost methods are used to estimate cost, which integrate risks on the estimate. Failing to take into account or underestimating certain risks is a common path leading to ALTs. Consequently, the risk analysis is a critical parameter for the investigation for ALTs. Another aspect of integrated contracts is that contracting agencies describe their requirements in functional specifications. This creates ground for misinterpretations and bidders may “misread” the specifications and bid below cost. In addition, functional specifications may lead to very different design solutions. Thus, the range of price and quality offered in the bids is expected to be higher, and their comparability lower.

The 2012 Dutch procurement act stipulates awarding integrated contracts based on the Economically Most Advantageous Tender (Economisch Meest Voordelige Inschrijving). EMVI alleviates pressure on the price criterion but it has negative implications for the detection of ALT. Combining quality criteria with price is complex, thus similar scores are often attributed to all bidders for quality. Consequently, it becomes unclear whether the price is consistent with the quality that is offered.

According to Article 53.1 of the EU Directive 2004/18/EC, in terms of the Economically Most Advantageous Tender, various criteria are weighted and scored, for example, quality, price, technical merit aesthetic, functional characteristics, environmental characteristics, running costs, cost-effectiveness, after-sales service, technical assistance, delivery date or completion period.

### 5. Focus on uniform cost estimation and EMVI to facilitate detection of ALTs

The detection of ALTs proves to be a complex problem that requires more than setting mathematical standards. The procedural steps that

need to be taken by contracting agencies to deal with ALTs are equally important. Improving the accuracy of the estimate of the contracting authority is important and requires an extensive cost reference database. Moreover, the cost estimation by the contracting authority and the bidder(s) need to be aligned. Differences in the cost estimates of the project owner and the bidders go beyond the mismatches in the scope:

- Owners calculate both contract and non-contract costs while bidders calculate only the former.
- Owners do not consider market conditions and base their cost estimation on business economics.
- Owners and bidders use estimating methods where the constituent elements of cost may differ.

A valuable step should be to work towards adopting a common definition of what is involved in the cost elements. This would strengthen the owners understanding of how bid prices were built up. On a project basis this can be achieved by asking for price specifications in the bids. Breaking down the scope in parts about which price specifications are requested is a complicated task and it might limit the design freedom of bidders. Lastly, the process of quantifying the qualitative aspects of the EMVI should be improved in a unified way. This would allow examining if the quality that is offered is abnormal in relation to the price.

**6. Establish a framework to detect Abnormally Low Tenders**

The EU legal framework gives valuable freedom for contracting authorities to decide how to act on ALTs. There is no general duty for them to investigate for ALTs, but only a right. If an unsatisfactory explanation is provided by the bidder, the contracting authority has a right to decide if he wishes to reject the tender. The only duty for the client is to investigate a tender before rejection, thus standards can only be used to identify tenders for which explanation should be asked.

Standards can be set:

- under national law,
- in the clients tendering guidelines,
- and/or in the tender documents.

Establishing mathematical standards under national law is not recommended because the standards would apply for different markets, project types and contract forms. On the other end, acting solely on the level of the tender documents does not guarantee the consistency of the process. Contracting authorities should describe the process to be followed in their tendering guidelines, to achieve uniformity in decision making, enhance the transparency of the process and preserve competition.

A non-exhaustive list of factors to be examined for the detection of tenders should be described in the tender documents. The main factors are the deviation from the cost estimation, the deviation from the mean of the bids and the risk analysis. The exact factors and thresholds will be specified in the tender documents based on the project context. To avoid false statements by bidders it must be stated that if the explanation on a bid is accepted, it will be legally binding for the contract execution.

Quantitative standards set in the tender documents must be context specific, but the characteristics of the framework can be determined:

Absolute and relative standards should be used together, depending on the number of bids. The cost estimate should be the indicator when few tenders are received, provided that the cost estimate is reliable. Above a certain number of valid bids the mean of all bids should be used. If sufficient bids are received the highest and lowest should be omitted in calculating the mean, to avoid outliers’ effects.

Up to certain deviations, from the mean of the bids or from the cost estimate, there is ambiguity on whether bids should be examined. Beyond that level it is without doubt that tenders should be investigated. Based on this line of reasoning it is recommended to set gradual standards. Up to a certain deviation investigating should be optional, above that point it should be mandatory (Table 2). In the former case, clients should consider the risk profile in deciding whether to investigate the bid. Table 2 reflects the result of the consultation of more than twenty legal and cost experts throughout two rounds of interviews. This constitutes an indicative framework for the detection of ALT in DC and DBFM infrastructure projects. Its purpose is to indicate the features of a potential framework to be set in the tender guidelines. In order to develop an efficient framework, standards need to be fine tuned with the project type and market conditions.

<i>Deviation of tenders</i>	<i>Action</i>	<i>Number of valid bids</i>	<i>Suggested Indicator</i>
15 - 35 %	Right to investigate	< 5	Cost estimation
		5-7	Mean of all bids
> 35 %	Duty to investigate	> 7	Mean of the bids excluding highest & lowest

*Table 2 - Recommended decision criteria to start an investigation.*

**7. Evaluation**

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 infrastructure projects.

**References**

<sup>1</sup> The article is based on a study at TU Delft (2013), carried out with the support of Royal HaskoningDHV. The research involved a systematic consultation of twenty cost and legal experts, from the public and private sector and was closely supervised by a committee consisting of: Prof. mr. dr. M.A.B. Chao-Duivis (Managing Director Institute for Construction Law), Ir. L.P.I.M. Hombergen (Senior adviser Rijkswaterstaat), Ir. L. Heijnders (Adviser Rijkswaterstaat) and Ir. J. R. Deketh (Leading Professional Royal HaskoningDHV). An extensive version of this article has been previously published as: A. Megremis, “Abnormally low tenders: objectifying detection”, [2014], Tijdschrift Aanbestedingsrecht. ■