

## 6 Conditions on lots

### Practical desirability versus legal acceptability

*Jan Telgen, Niels Uenk, Wouter Lohmann and Elisabetta Manunza<sup>1</sup>*

#### 1 Introduction

Conditional tendering is shorthand for a technique in which a tender is divided into separate lots, while the award procedure contains conditions that restrict the number of possible tender outcomes (assignments of lots to bidders). A simple example is a tender in two lots with the additional condition that both lots cannot be awarded to the same supplier. Conditional tendering is a well-known technique that is applied frequently and is highly regarded in major private companies, especially in large tenders. The reasons for applying conditions may vary from the desire to use dual sourcing to the limitation of the total number of contracted suppliers and from concentrating supplier and contract management efforts to preventing a dominant position in the supply market.

Contrary to the private sector, conditional tendering is not used (frequently) in the public sector. We consider the legal acceptability of the technique. One of the concerns in this matter is that the use of conditions may imply that the best bid on a specific lot is not awarded the contract. This situation occurs for example when one supplier submits the best bid on multiple lots, while a condition determines suppliers can only win one lot.

The current European Directives do not contain regulations on lots in general or on conditional tendering. The new directives (2014/24/EU), however, do cover lots in Article 46 and allow for one condition: contracting authorities may limit the number of lots that may be awarded to one tenderer. This and other provisions in the new EU directives provide the basis for our analysis of the legal acceptability of conditional tendering.

#### 2 Conditional tendering

Conditional tendering<sup>2</sup> is a technique that may be used when a tender is divided into separate lots. The main feature of this technique is the use of conditions that affect the awarding of the lots to bidders. Many different conditions may be applied, such as 'no one bidder can win all lots', 'the total number of lots won by any supplier may not exceed X' or 'the total number of suppliers that win a lot is not more than Y'. Conditions may be used by a buyer who does not want

Table 6.1 Three bids on three lots

Bidder	Lot 1	Lot 2	Lot 3
A	€1	€3	€5
B	€3	€2	€6
C	€5	€5	€3

its suppliers to become too powerful or who wants to limit the number of suppliers the buyer has to manage.

The conditions may vary greatly as exemplified by the examples given above. Their common characteristic is that they somehow tie the various lots together: the awarding of the lots to a bidder cannot be done for each lot separately. The assignment of lots to bidders is a matter of mutual dependency: the lots have to be considered in combination.

Consider an example where three bidders compete for three lots, under the condition that we do not want to have more than two suppliers. Table 6.1 shows the offers in costs quoted by the bidders. We want to evaluate the offers on lowest cost.

Obviously, without the condition, we would award lot 1 to bidder A, lot 2 to bidder B and lot 3 to bidder C. With the condition however, the best solution is to award lots 1 and 2 to bidder A and lot 3 to bidder C. So even though bidder B is best on lot 2, he does not get that lot awarded.

The numerical example given above uses lowest cost, but similar examples can be given for awarding to the Most Economically Advantageous Tender (MEAT).

This result does not pose any mathematical or economical problems. Here we analyze the legal acceptability of conditional tendering.

### 3 Practical applications

The practical applications of conditional tendering are numerous. We give some real-life examples.

A large European FMCG-company needs carton packaging in all their factories in a large number of countries. The company wants to tender for the carton packaging and decides to use separate lots per type of packaging and for each country. Assuming 50 different types of packaging are used in 20 different countries, the result is 1000 lots. As the company does not want to deal with 1000 suppliers each supplying just one type of packaging to one factory, it will introduce conditions. One obvious condition is to limit the total number of suppliers. Another one is to limit the number of suppliers per country or per type of packaging, thereby limiting the transportation movements per factory or providing economies of scale in producing the packaging.

A second example involves a large manufacturing company that produces and sells in Europe and North America. For its trans-Atlantic transportation, the

company hires shipping companies for 50 different routes back and forth. The manufacturing company tenders with each route as a separate lot and adds conditions on the total number of suppliers it wants to deal with. Additionally, the bidders are allowed to add conditions to their offers as well. For example, a bidder may offer a discount on its fares when it wins both the outbound and the inbound lot. Alternatively, a bidder may be willing to supply on any two routes, but not on three or more as its vessel capacity is insufficient. The bidder may put in a bid for all routes, but adds the condition it can't take on more than two routes.

Finding the best solution in conditional tendering is not an easy task. Only in very small scale examples it is possible to do this 'by hand'. Mathematically finding the best solution requires the application of linear programming (LP) or integer programming (IP); techniques that are widely available. For relatively simple problems an add-in in MS Excel or freely available software may suffice, but for more complicated cases specialized software is required. Several companies provide extensive software packages that can optimize tenders with many lots and conditions. For example, Trade Extensions<sup>3</sup> and Sciqwest-Combinenet<sup>4</sup> have conducted such tenders for large private companies like Unilever, Procter and Gamble, BP and Mars. The involvement of this type of company illustrates the (economical) benefits of conditional tendering. Applications in public sector however are rare.

#### **4 Considerations**

Applications of conditional tendering in the public sector have caused some debate on LinkedIn fora. In the debate objections against using conditional tendering were raised based on the legal provisions in the EU directives and European case law. The objections can be grouped under two main arguments.

The first argument concerns the legal requirement that all detailed rules of the award procedure should be related to the subject matter of the contract. Opponents of conditional tendering argue the conditions in conditional tendering generally do not refer to the subject matter of the tender itself. The conditions refer to additional arguments like limiting the number of suppliers, guaranteeing a minimum number of suppliers or avoiding dependence on one supplier etc. All of these conditions refer more to the market situation and the position the contracting authority wants to take in that market, than to the subject matter of the contract itself. The argument continues by stating that the conditions cannot be applied in a tender since they are not related to the subject matter of the contract. As a consequence it is argued conditional tendering is not allowed under the directives.

The second argument is that, using conditional tendering, any specific lot may be awarded to a tenderer who did not submit the best bid for that lot. Simple examples of such a situation are tenders in which no supplier may win more than a specified number of lots or where two specific lots may not be won by the same supplier or when there is a maximum number of suppliers over the total

number of lots. If awarding each lot individually to the best tenderer would mean violating such a condition, at least one lot has to be awarded to a tenderer who did not submit the best bid. This seems to be at odds with the objective of the award procedure and the principles of equal treatment and transparency as clarified in the case law of the EU Court of Justice. Note that this argument is valid for both awarding on lowest price and awarding to the Most Economically Advantageous Tender.

## 5 Analysis

The previous section concludes that applying conditions on awarding lots – however useful it may be – might conflict with the EU directives on public procurement. In this section we analyze the issue in more detail against the new (2014) EU procurement directive 2014/24/EU (henceforth: the directive).<sup>5</sup>

### 5.1 Lots and conditions in new directive

According to Article 46 of the directive contracting authorities are allowed to award a contract in the form of separate lots. Actually, throughout the recitals and the directive itself it becomes apparent that division of contracts into lots is strongly encouraged. Recital (78) states: ‘Public procurement should be adapted to the needs of SMEs (small and medium size enterprises). [...] To that end and to enhance competition, contracting authorities should in particular be encouraged to divide large contracts into lots.’

Furthermore, Article 46 actually requires contracting authorities to motivate in the procurement documents their decision not to subdivide into lots. This indicates dividing a contract into lots is the default option.

Paragraph two of Article 46 contains provisions regarding what contracting authorities shall and may do, when awarding a contract in the form of separate lots. The first part of paragraph 2 states: ‘Contracting authorities shall indicate, in the contract notice or in the invitation to confirm interest, whether tenders may be submitted for one, for several or for all of the lots.’

This means, if a contracting authority wishes to limit the number of lots to be awarded to an individual tenderer, one option is to limit the number of lots for which tenderers may submit a tender. This same goal can be reached by conditional tendering: allowing each tenderer to submit a tender for multiple or all lots, and deciding which tenderer is awarded which lot(s) in the award phase of the procedure. This latter approach is preferred from an economic point of view. If a contracting authority limits the amount of lots it awards to individual tenderers, these tenderers are still allowed to tender for more lots. Tenderers may in fact tender for all lots, leaving the contracting authority with more options from which it selects the combination that fulfills its conditions and is economically most advantageous. If a contracting authority only allows tendering for a limited number of lots, by definition there will be less tenders per lot for the contracting authority to choose from – and therefore less potential to achieve the actual

economic optimum. Limiting the number of lots to tender for is a rather crude way to achieve a similar result as with conditional tendering. However it is clear that from an economic point of view for contracting authorities limiting the number of lots to tender for is suboptimal.

Bearing this economic advantage for conditional tendering in this specific example in mind, we continue the analysis of paragraph 2 of Article 46. The second part of this paragraph reads:

Contracting authorities may, even where tenders may be submitted for several or all lots, limit the number of lots that may be awarded to one tenderer, provided that the maximum number of lots per tenderer is stated in the contract notice or in the invitation to confirm interest.

The directive furthermore states that the contracting authority shall indicate the objective and non-discriminatory criteria or rules they intend to apply to determine which lots will be awarded. This is a clear example of applying a condition regarding the awarding of lots that is explicitly allowed by the directive.

Reviewing the corresponding recitals for this article confirms this. Recital (79) states:

contracting authorities should, for instance in order to preserve competition or to ensure reliability of supply, be allowed to limit the number of lots for which a tenderer may tender. they should also be allowed to limit the number of lots that may be awarded to any one tenderer.

To complete the analysis of Article 46, which is of such importance for the subject of lots, the third paragraph states that Member states may provide that contracting authorities may award contracts combining several or all lots where more than one lot may be awarded to the same tenderer. Again, to comply with the principles of transparency and equal treatment – contracting authorities must specify the possibility of doing so in the contract notice or invitation to confirm interest, and indicate the (groups of) lots that may be combined.

### *5.2 Are conditions in general allowed?*

In the previous section we conclude that at least one condition on the awarding of lots is explicitly allowed in the directive: limiting the amount of lots to be awarded to individual tenderers. The question now is whether this means other conditions on awarding lots are allowed as well. What if, for example, rather than limiting the number of lots that any one supplier may be awarded, the contracting authority wishes to deal with a maximum number of suppliers? Or what if the contracting authority for strategic reasons requires different suppliers for specific lots? These are distinct goals that constitute a certain (economic) value to the contracting authority and these goals can be achieved using conditions on awarding lots as well. However, the conditions to achieve these goals are

different. For example instead of limiting the number of lots awarded to individual tenderers, a contracting authority may in contrary limit the number of different suppliers all lots are awarded to.

Unfortunately, neither the directive nor the recitals provide a conclusive answer to this question. Applying conditions to awarding lots is not explicitly recognized or discussed as such. However, we can review the arguments against the use of conditions in the light of the explicitly allowed condition of limiting the amount of awarded lots to tenderers.

The main argument against the use of conditions is that they do not relate to the subject matter of the contract. In the next section we discuss whether this is indeed problematic for applying conditions by reviewing relevant articles and recitals of the directive covering this relation to the subject matter of the contract.

### *5.2.1 Relation with the subject matter of the contract*

The new directive provides detailed provisions on the circumstances under which an award criterion is considered to be related to the subject matter of the contract. Article 67.3 of the directive states:

award criteria shall be considered to be linked to the subject matter of the public contract where they relate to the works, supplies or services to be provided under that contract in any respect and at any stage of their life cycle [...]

To understand what the European Commission has in mind when it mentions 'in any respect and at any stage of their life cycle', we turn to the recitals. Recital (97) states that

the use of the award criteria relating to the works, supplies or services to be provided under the public contract in any respect and at any stage of their life cycle from extraction of raw materials for the product to the stage of disposal of the product, including factors involved in the specific process of production, provision or trading and its conditions of those works, supplies or services or a specific process during a later stage of their life cycle, even where such factors do not form part of their material substance.

It is clear that this definition of the required relation with the subject matter of the contract extends beyond award criteria in at least one aspect; Article 70 stipulates contract performance conditions should be linked to the subject matter of the contract within the meaning of Article 67(3). Other articles that mention the link to the subject matter requirement – like Article 42 on Technical specifications – however do not refer to the Article 67 definition of this concept.

### *5.2.2 Conditions related to subject matter of contract?*

Considering this broad view on the relation of award criterion, we argue that conditions on the awarding of lots are in fact related to the subject matter of the contract by giving three arguments.

A first indication for the relation between conditions and the subject matter of contracts is that conditions reflect a certain (economic) value to the contracting authority in the light of the execution of the contract. This value reflects for example in reduced supply risk by requiring different suppliers for different lots, or in contrary in reduced contract management efforts and transaction costs by limiting the number of different suppliers. These factors are not part of the 'material substance' of the contract but they are directly related to the execution of the contract and (economic) consequences for the contracting authority – at least in any respect at any stage of the life cycle such as Article 67.3 requires.

A second argument for the existence of a relation between conditions on awarding lots and the subject matter of the contract is the fact that these conditions will typically be different for every tender. Conditions on awarding contracts are tailored to minimize risks or maximize opportunities related to the specific subject matter of the contract. No (sensible) contracting authority would apply generic conditions to different contracts.

Finally, and perhaps the most compelling argument to consider conditions on awarding lots as related to the subject matter, is the explicit allowed example of limiting the number of lots awarded per tenderer. Clearly the European Commission recognizes the relation between at least this condition and the subject matter of the contract.

Concluding this section: we identify one example of conditional tendering, which is mentioned and allowed explicitly in the directive. We analyze this example in light of potential objections against the use of conditions, and based on this analysis we argue other conditions are allowed as well.

### *5.3 How to apply conditions?*

If conditions on the awarding of lots are allowed under the new directive, the final question is how to apply conditions in a tender from a technical point of view. The directive only deals with one specific condition – limiting the number of lots that may be awarded to any one tenderer – explicitly. Paragraph 2 of Article 46 indicates that contracting authorities can simply mention this condition clearly in the contract notice or invitation to confirm interest, together with the objective and non-discriminatory criteria or rules the contracting authority will apply to determine which lots will be awarded to which tenderers.

The directive does not discuss conditions in general, or other examples such as a maximum total number of suppliers for all lots. If our analysis is correct, and other conditions – provided that they comply with this directive and the principles of equal treatment and transparency in general – are allowed, there is one means that may be very well suited.

Article 70 of the directive allows contracting authorities to apply special conditions to the performance of the contract. This article states:

contracting authorities may lay down special conditions relating to the performance of a contract, provided they are linked to the subject matter of the contract within the meaning of Article 67(3) and indicated in the call for competition or in the procurement documents. Those conditions may include economic, innovation-related, environmental, social or employment-related considerations.

The intention and motivation for using conditions in awarding lots seems to fit the description and the goal of conditions described in this Article 70 very well. Examples of conditions we provide have an economic motivation in general, and in the previous section we argue the presence of a relation with the subject matter of the contract.

## **6 Conclusion**

Conditional tendering is a well-known technique that is frequently used and highly regarded in major private companies, especially in large tenders. The reasons for the conditions may vary from the desire to use dual sourcing to the limitation of the total number of contracted suppliers and from concentrating supplier and contract management efforts to preventing a dominant position in the market.

In this chapter, we analyze the use of conditions on awarding lots in tenders against the new EU directive 2014/24/EU on public procurement. We consider the relevant provisions on dividing contracts into lots, determining the lots, awarding these lots in tenders, and more specifically the provisions on the relation of criteria (and conditions) to the subject matter of the contract. We conclude at least one specific condition is allowed, as this is specifically stated in the directive. Based on an analysis of this condition and the relevant provisions, we conclude conditions on awarding lots can very well be considered to have a relation to the subject matter of the contract. When applying conditions on the awarding of lots, obviously this should be done transparently, objectively and should not discriminate against any one of potential tenderers. The contracting authority should state the use of conditions in the tender documentation or contract notice, and should include the objective and non-discriminatory criteria or rules they apply to determine the award of lots within the bounds of the condition. As such, conditions can be considered as special conditions relating to the performance of a contract as described in Article 70 of the directive.

In addition to this legal analysis we take a more economic approach to the question at hand. The technique of conditional tendering – widely used in private sector procurement – is an economically sensible technique. Moreover, using this technique actually supports achieving some of the goals of the directives; achieving the best value-for-money for the contracting authority, preserve competition, adapting public procurement to the needs of SMEs, and supporting economic progress.



### Notes

- 1 All authors are associated with the Public Procurement Research Centre: a cooperation between the University of Utrecht and the University of Twente, the Netherlands. Address for correspondence: [j.telgen@utwente.nl](mailto:j.telgen@utwente.nl).
- 2 See also Dimitri, Piga and Spagnolo, *Handbook of Procurement*, Cambridge University Press (2006), Ch. 7 and 8.
- 3 [www.tradeextensions.com](http://www.tradeextensions.com).
- 4 [www.sciquest.com](http://www.sciquest.com).
- 5 <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0024&from=EN>.