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LOCAL PUBLIC PROCUREMENT: HOW TO DEAL WITH A CREATIVE BIDDER?

A CASE STUDY FROM THE NETHERLANDS

M. Peter van der Hoek

ABSTRACT. This paper presents an analysis of the procurement of transportation services for the disabled by the town of Ridderkerk. The method used consisted of a study of the town's files and interviews with 11 persons involved. The tender specifications were peculiar in that they required bidders to submit a schedule with prices per ride for seven classes ranging from 100,000 to over 600,000, whereas the real number of rides amounted to 270,000. One of the bidders quoted high prices for the first classes and very low prices for the last classes. On the basis of all seven classes, he quoted the lowest costs and won the contract. However, on the basis of the real number of rides he was the second most expensive bidder.

INTRODUCTION

This paper presents an analysis of a particular public procurement case pertaining to the town of Ridderkerk, a Dutch town neighboring Rotterdam. The town's budget for a population of nearly 50,000 amounted to €116 million (\$173 million) in 2008. Dutch municipalities are mandated to extend facilities for their disabled citizens to enable their independent participation in society as related to their living situation, transport and wheelchairs. Thus, disabled persons can apply for certain facilities. As the mandate is open-ended, each application meeting the criteria must be approved. A lack of financial means cannot be a reason to reject any application. However, the city council had some latitude with regard to the following:

- the situations and the form in which facilities can be awarded; and
- the amount of financial compensations.

Public procurement is subject to a number of rules established on different legislative levels. First, the *European Union* issued a series of procurement directives prohibiting discriminatory purchasing practices

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(Martin, Hartley & Cox, 1999). The European Court of Justice (EJC) developed a set of basic standards for the award of public contracts, which were derived directly from the rules and principles of the Rome Treaty. “The principles of equal treatment and nondiscrimination on grounds of nationality imply an obligation of transparency which, according to the ECJ case-law, consists in ensuring, for the benefit of any potential tenderer, a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of the procedures to be reviewed” (European Commission, 2006, p. C 179/3).

Initially, governments could easily evade the rules, but later on procurement directives were issued that were considerably more effective. In addition, the new directives also covered services. However, the directives contained a threshold before Value Added Tax (VAT) below which the rules did not apply. In the case of Ridderkerk analyzed in this paper, the threshold amounted to nearly €250,000 (\$370,000).

Second, *national law* was relevant for public procurement. European directives obliged the member states to achieve a certain result, but left them free to choose how to do so. Thus, a directive is a two-tier legislative instrument comprising:

- the directive proper, issued by the European Union, and
- national implementing measures, issued by the member states.

If a directive comes into force, it does not in principle imply direct effect in national law. Rather, member states must transpose a directive into national law, which means adopting national measures to enable them to achieve the results stipulated by the directive.

Third, *local governments* may issue by-laws. The council of Ridderkerk, for example, issued a local act that laid down a number of principles for the town’s procurement policy, the most important being compliance with national and international regulations and cooperation with other local governments where possible.

The contract that Ridderkerk had concluded with a taxi company to deliver transportation services for the disabled expired on September 1, 2003. Therefore, the new contract had to be concluded by this date. This paper analyzes the procurement process. The main conclusion is that Ridderkerk had incurred avoidable costs amounting to €643,500 (\$957,000) over a 3-year period. After a brief overview of the literature

and methodology, this paper will describe Ridderkerk's preparation of the tender, analyze the bidding process, and explain the consequences.

LITERATURE REVIEW AND METHODOLOGY

The English language literature on local government procurement is very scarce. To my knowledge, the *Journal of Public Procurement* is the only scholarly journal covering the subject.² Other journals may also feature articles on local government procurement, but this is fairly rare. An example is Duncombe and Searcy (2007, p. 68) who observed that "... very little is known about what local governments do in practice, and how procurement practices affect government spending." They report the results of a survey on procurement practices used by New York State school districts, and conclude that the use of competitive bidding, purchasing calendars, central warehouses, and bidders' lists was associated with significant cost savings.

There is some literature on competitive procurement in specific countries. Vincent-Jones (1999) addressed the regulatory transition from compulsory competitive tendering to the Best Value framework in the UK. While considering the compulsory competitive tendering a regulatory failure, he foresaw a brighter future for the Best Value framework. Martin, Hartley and Cox (1999) examined the impact of European Union procurement directives on local authority tendering and contract award behavior and presented the findings from a case study of a British local authority (Leeds City Council). They concluded that, in the case of Leeds, there was a tendency to award contracts to domestic firms, which is consistent with an analysis of local authority contract award data for 1993 revealing that over 98% of all awards were made to domestic firms.

Lundberg (2005) surveyed all Swedish municipalities about their procurement of cleaning services. Depending on the volume of the procurement, the contracting entity could be selective and limit the number of bidders. To find an argument to support this, an implementation cost was added to the expected payment to the winner. The empirical results did not support the assumption that an implementation cost actually affects the choice of procurement procedure. Alexandersson and Hultén (2006) analyzed the tender for train services to northern Sweden. They concluded that the winner's bid seemed to have been predatory by intention. It was based on unrealistic assumptions, price dumping and/or cross-subsidization, while there was a

risk that the company would ask for more compensation if the calculation prerequisites were not met. Indeed, the company was able to make the state increase the amount of taxpayers' money spent on its services. In another article (Alexandersson & Hultén, 2007) the authors observed that a lack of transparency pulled public procurement of railway services even further away from being normal markets, ultimately increasing the firms' perceived gains from strategic bidding. Strategic bids disturbed the functioning of the market by making it more unpredictable, which ultimately could deter more rational companies from entering and keeping competition healthy and sustainable.

Mardas and Triantafyllou (2001, p. 110) stressed that "public procurement law is an economic law par excellence and should not be content with legalistic grammatical, historical, teleological, or topological interpretation. Its interpretation should not contradict the economic analysis, if it is not to be governed by the latter." They presented an arithmetic approach that could help limit the extent of a contractor's capacity through qualitative criteria. Additional indicators related to public procurement as well as to industrial and trade performance on the product level could also help one see the extent of protection derived from public procurement policy within European Union member states. The two series of indicators would introduce a primary source of information about the extent of "buy national" policies at the product level, which could guide the European Union's competition policy.

Recently, doubts have been expressed in the Netherlands about the desirability of compulsory competitive tendering in that its scope may be too large. Obermann and Kostal (2003) signaled some fundamental problems of competitive tendering. They concluded that an obligation binding local authorities to put general economic interest services up for competitive tender, as intended by the European Commission, would have considerable medium- and long-term effects on both the process of municipal service provision and the economic position of municipal (public) enterprises. They argued that from an economic point of view, procurement through competitive tendering did not appear to be effective or tenable for all general economic interest services in (all) different areas. Therefore, they concluded that compulsory competitive tendering for service concessions should not be introduced in all areas of public services.

My literature search did not yield any publication about local government procurement of transportation services for the disabled.

Although the literature did pay attention to predatory bidding, I did not find any publication dealing with bidders' using the tender conditions in a creative way such that they seemed to quote the lowest costs, but in reality were more expensive than other bidders. This paper analyses just such a case. The method used was studying the files of the town of Ridderkerk and interviewing 11 persons involved. Seven of those interviewed worked for the town (five civil servants, an alderman and a councilor), one served as a consultant for a private consultancy named D&O, one was the director of the previous transport company, one was the director of the newly contracted transport company and one was the chair of the local advisory board of the disabled.

PREPARING THE TENDER

Local authorities could collaborate and pursue joint tendering procedures. Indeed, one of the principles of Ridderkerk's procurement policy was to seek cooperation with other local governments in the region. Therefore, Ridderkerk collaborated with the town of Barendrecht to tender transportation services for the disabled. The obvious advantage of collaboration is that cooperating local governments will purchase larger volumes, which increases the likelihood of securing relatively low prices.

The towns sought advisory services from D&O to guide them through the bidding process because they had insufficient in-house technical expertise. Representatives of both towns met with a representative of D&O on March 28, 2003. They made engagements and reached conclusions that are laid down in the consultant's proposal of April 11, 2003, which also named the advantages of joint tendering:

- a clear regional system;
- economies of scale that may result in lower transportation costs; and
- shared costs of guidance through the bidding process.

Ensuring that the two towns' activities are geared to one another is considered a requirement for a smooth working of the tendering process. Hence, the proposal to extend the existing contracts with the current transportation companies until April 1, 2004, which should provide both towns sufficient time to prepare the tender and to respect the terms in force.

D&O quoted for drafting the tender documents and administering the whole tender procedure from publication to judging the bids. They claimed to have a quality control system that would guarantee their product's quality including the following:

- keeping in touch with the customer and third parties;
- registering all correspondence and contracts;
- keeping a timetable and budgetary control; and
- managing coordination and audit of internal activities.

The quotation amounted to a total of €7,950 (\$11,900) before VAT.

The procurement department of Ridderkerk criticized the quotation heavily. It considered the number of planned consultative meetings very low relative to previous procurements and the price too high. Moreover, the department wondered whether D&O had responded to Ridderkerk's quote request and why Ridderkerk had not solicited any other quotations. Although these comments did not lead to an adjustment of the offer's content, they did lead to a €1,375 (\$2,045) reduction of the price to €6,575 (\$9,780). Additional costs (more activities and travel costs) raised the total eventually to €7,570 (\$11,260). D&O communicated that the planned starting date of September 1, 2003 was no longer feasible and indicated that Ridderkerk would have to negotiate with the current transport company an extension of the contract until April 1, 2004. When the alderman commissioned the contract to D&O he also requested the addition of some details regarding a specific issue.

The specifications of the tender were finished on October 9, 2003 and comprised five parts:

1. A general description including requirements bids and bidders must meet and the deadline.
2. Selection criteria for bidders.
3. Specifications.
4. A description of the award criterion price consisting of a schedule with seven classes. The first six classes comprised 100,000 rides each, whereas the seventh class was open-ended (>600,000). Bidders needed to quote a price per ride for each class.
5. A description of the award criterion quality.

I have observed that the minutes of the meeting representatives of both towns had with a representative of D&O on March 28, 2003 are lacking in the town's files. As a result, it is impossible to determine whether the quotation was consistent with Ridderkerk's quote request. What can be concluded, however, is that the procurement department's comments³ had little effect. Moreover, it can be concluded that one of the advantages the collaboration with Barendrecht should have had – sharing the costs of guidance through the bidding process – had been realized. However, the documents do not permit determination of whether the other two advantages that had been named had been realized, so this remains unclear.

THE BIDDING PROCESS

When the deadline expired on November 27, 2003, five bids had been received. One of them appears to contain an unusual price structure. Table 1 displays the price structures of the five bids and Table 2 the total annual costs depending on the number of rides.⁴ Table 1 shows how unusual bidder A's price structure was. The price per ride in the first class was high relative to the other bidders, while the price in the second class was the second highest of the five bidders. However, A's price in the other classes was lower than in any other bid. In particular the price per ride in the highest two classes (500,001-60,000 and >600,000) was very low.

D&O's method awarded a score to each specific price per ride. It awarded the highest score to the lowest price, whereas it awarded another score to each other price on the basis of the formula (P_l/P_x) times the maximum score, where P_l was the lowest price and P_x any other price. For example, bidder C offered the lowest price of €2.74 in the first class ($\leq 100,000$ rides). Thus, it received the maximum score of 150. As bidder A's price in the first class amounted to €5.22 (\$7.76), A received a score of $(2.72/5.22)*100 = 78.7$ in the first class. A's price in the third class (200,001-200,000) was the lowest, so A received the maximum score (150). In the highest three classes (300,001-400,000, 400,001-500,000 and >600,000) A also offered the lowest price (€1.39 or \$2.07) and received again the maximum score (50). Bidder B offered a price of €3.58 (\$5.32) in the highest class (>600,000) and received a score of $(1.39/3.58)*50 = 19.4$.

TABLE 1
Price Schedules of Five Bidders

Number of rides per year	Maximum score	Bidder A		Bidder B		Bidder C		Bidder D		Bidder E	
		Price	Score	Price	Score	Price	Score	Price	Score	Price	Score
≤100,000	150	5.22	78.7	4.43	92.8	2.74	150.0	3.24	126.9	3.55	115.8
100,001-200,000	150	4.03	109.4	4.25	103.8	2.94	150.0	3.21	137.4	3.52	125.3
200,001-300,000	150	2.11	150.0	4.06	78.0	2.87	110.3	3.18	99.5	3.48	90.9
300,001-400,000	100	1.67	100.0	3.87	43.2	2.83	59.0	3.14	53.2	3.45	48.4
400,001-500,000	50	1.51	50.0	3.77	20.0	2.75	27.5	3.10	24.4	3.42	22.1
500,001-600,000	50	1.39	50.0	3.68	18.9	2.59	26.8	3.04	22.9	3.39	20.5
>600,000	50	1.39	50.0	3.58	19.4	2.49	27.9	2.98	23.3	3.36	20.7
Total			588.1		376.1		551.5		487.6		115.8

Table 2. Annual Costs

Number of rides per year	Annual costs at x rides				
	Bidder A	Bidder B	Bidder C	Bidder D	Bidder E
100,000	522,000	443,000	274,000	324,000	355,000
200,000	925,000	868,000	568,000	645,000	707,000
300,000	1,136,000	1,274,000	855,000	963,000	1,055,000
400,000	1,303,000	1,661,000	1,138,000	1,277,000	1,400,000
500,000	1,454,000	2,038,000	1,413,000	1,587,000	1,742,000
600,000	1,593,000	2,406,000	1,672,000	1,891,000	2,081,000
270,000	1,072,700	1,152,200	768,900	867,600	950,600

Table 2 shows that bidder A offered the lowest total cost on the basis of 600,000 rides per year. However, the number of rides at the time of the tender amounted to 270,000 per year. The town of Ridderkerk expected this number to rise, but I did not find any quantification of this expectation in the town's files. It seems extremely unlikely that the number of rides would more than double to over 600,000 per year. Even if the number of rides would grow by 10% the new total would not exceed 300,000 rides per year. I did not find any justification for this schedule. Thus, it is unclear why bids had to be based on more than 600,000 rides per year.⁵

Obviously, bidder A was the only one understanding the chances D&O's tender specifications offered. By including a high price in the first two classes of his bid, A reduced his score on the price criterion. However, by offering very low prices in the other classes he made this up. As a result, bidder A received the highest total score on the price criterion. A would undoubtedly have considered that the very low prices in the higher classes were irrelevant as the number of rides would not exceed 300,000 per year. In Table 2 I have also included the total costs if the annual number of rides would total the same number as at the time of the tender (270,000). In this case A was not the bidder with the lowest costs, but rather the second most expensive bidder.

Ridderkerk conferred with D&O about the schedule and proposed another scoring method. However, the tender specifications had been published and could not be legally changed during the bidding process. Thus, bidder A appeared to be the lowest bidder given the published

specifications. Although it was not possible to change the specifications, Ridderkerk could have stopped the tendering procedure and started the whole procedure over again on the basis of new specifications. However, this is not what the town decided to do. It did not choose to stop, but rather continued the procedure.

On March 2, 2004, the town of Ridderkerk took the preliminary decision to contract the transportation services for the disabled out to bidder A, which is Taxi Bakker. Subsequently, one of the other bidders asked questions about this decision, including a question about possible unusual price quotations. Ridderkerk responded by saying that the question was irrelevant and the bidder did not formally object to the preliminary decision. As there were no other reactions, the decision to contract out to Taxi Bakker became final on March 24, 2004.

CONSEQUENCES

Ridderkerk's contract with Reyertax, the current transport company, would originally expire on August 31, 2003, but had been extended until April 1, 2004, the date by which the bidding process should have been finished and the newly contracted transport company should have taken over. However, the delay in finalizing the contract with Taxi Bakker forced Ridderkerk to move the starting date to October 1, 2004. Therefore, the contract with Reyertax was again extended, until October 1, 2004 and at a 5% reduced cost level. As a result, the towns of Barendrecht and Ridderkerk had different starting dates and, thus, also different ending dates: April 1, 2007 for Barendrecht and October 1, 2007 for Ridderkerk.

Ridderkerk's delay affected the costs of Barendrecht because it would enter the classes with lower prices per ride at later dates. Therefore, Barendrecht submitted a claim to Ridderkerk as compensation for the higher costs resulting from Ridderkerk's delayed starting date.⁶ Barendrecht demanded an advance of €76,744 (\$114,500) for the period June-September 2004, but agreed after mutual consultations to a reduced amount of €36.254 (\$54,100). Further consultations led to the agreement that Barendrecht would have a second look at its claim and Ridderkerk would make its own calculation.

In February 2005, Ridderkerk communicated that there was no cost disadvantage for Barendrecht if Taxi Bakker invoiced the two towns correctly. Therefore, Ridderkerk requested Barendrecht to withdraw its claim. Although Barendrecht did not respond, Ridderkerk's third

program monitor 2006 - adopted on November 2, 2006 - showed that it paid €24,700 (\$36,900) to Barendrecht in March 2006. Ridderkerk's files are not complete and do not contain documents that clarify which agreements the two towns had reached and how this problem eventually was solved. Given that Ridderkerk never promised any compensation it is not clear why it honored Barendrecht's claim anyway.

It seems obvious that Ridderkerk had made avoidable costs. I define avoidable costs as the total costs minus the costs that would not have been incurred if the contract had been awarded to the lowest bidder, but was also timely so that the services could have started on time and no extensions of the contract with the current transport company had been necessary. There are two reasons underlying the avoidable costs:⁷

1. The contract was not awarded to the lowest bidder. The total costs for the two towns would have been €303,800 (\$453,300) per year lower at 270,000 rides per year. Given Ridderkerk's share amounting to €167,100 (\$249,300), the avoidable costs for Ridderkerk due to not selecting the lowest bidder total €501,300 (\$747,900) over the 3-year-period: October 1, 2004-October 1, 2007.
2. Ridderkerk had to extend the contract with Reyertax (the previous transport company) due to the fact that Taxi Bakker was unable to start on time. The costs of extending the contract with Reyertax exceeded the costs of the lowest bidder by €117,500 (\$175,300). In addition, the late start of Taxi Bakker had led to Barendrecht's claim of €24,700 (\$36,900) on Ridderkerk. Thus, the total avoidable costs due to the late start of Taxi Bakker amounted to €142,200 (\$212,200).

It is now clear that the overall total avoidable costs for Ridderkerk amounted to €643,500 (\$960,200) over the whole period, which was over 36% of the amount Ridderkerk was tendering. The council of Ridderkerk accepted this without drawing any political conclusion regarding the alderman responsible for the tender. Therefore, there seemed to be no pressure on the town's mayor and aldermen to draw lessons from this failure.

SUMMARY AND CONCLUSIONS

Dutch municipalities are mandated to extend facilities for their disabled citizens to enable them to participate independently in society. Therefore, they need to tender transportation services for the disabled.

This paper presents an analysis of the procurement of these services by the town of Ridderkerk. A problem that I frequently encountered is that the town's files are far from complete, not only because documents are simply lacking, but also because minutes of meetings were sometimes not made in the first place. As a result, it is not always possible to ascertain what was agreed and arranged. For example, due to missing documents, the files do not afford determination whether D&O's quotation was consistent with Ridderkerk's quote request.

Ridderkerk collaborated with the town of Barendrecht to tender transportation services for the disabled. Because they had insufficient in-house technical expertise, their procurers sought advisory services from a private consultancy (D&O) to guide them through the bidding process. The procurement department criticized D&O's quotation heavily, which led to a reduction of the price by €1,375 (\$2,051) to €6,575 (\$9,810), but not to an adjustment of the offer's content. The tender specifications D&O drafted were peculiar in that they required bidders to submit a schedule with prices per ride for seven classes ranging from $\leq 100,000$ to $>600,000$, whereas the real number of rides amounted to 270,000 at the time of the tender. Even if the number of rides would have grown by 10%, the new total would not have exceeded 300,000 rides.

One of the five bidders (Taxi Bakker) understood the chances this schedule offered. By quoting high prices in the first classes and very low prices in the last classes he obtained a high score on the award criterion price. In practice, only the high prices in the first three classes would be relevant as the number of rides per year did not exceed 300,000. On the basis of all seven classes (up to $>600,000$ rides per year) Taxi Bakker was the lowest bidder. Therefore, the contract was awarded to Taxi Bakker. However, on the basis of the real number of rides (270,000 per year) he was the second most expensive bidder.

Ridderkerk could have discontinued the tender before preliminarily awarding the contract to Taxi Bakker. Next, the town could have started a new bidding procedure on the basis of another schedule with four classes ranging from $\leq 100,000$ up to $>300,000$ rides per year. It goes without saying that starting a new tender would have required another extension of the current contract, which would have caused additional costs. However, these costs would have been considerably lower than the avoidable costs Ridderkerk incurred. The town's crucial mistake was that it did not terminate the tender before it had already preliminarily awarded the contract to Taxi Bakker. The advice the town sought from a law office about discontinuing the procedure after the contract's

preliminary award was redundant as the town should have known this would be illegal.

Obviously, Ridderkerk incurred avoidable costs. These costs totaled €643,500 (\$960,200) over the whole period or over 36% of the amount Ridderkerk was tendering. Strikingly, the council of Ridderkerk accepted this outcome without drawing any political conclusion regarding the alderman responsible for the tender.

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NOTES

1. European Court of Justice Cases C-324/98, Telaustria, [2000] ECR I-10745, paragraph 62, C-231/03, Coname, judgment of 21.7.2005, paragraphs 16 to 19 and C-458/03, Parking Brixen, judgment of 13.10.2005, paragraph 49.
2. *Government Procurement* also covers the subject, but this is a (non-scholarly) magazine that aims at providing practical content for procurement professionals.
3. The main comments pertain to the price (too high) and the number of consultation moments (too low).
4. The total pertained to the costs for the towns of Barendrecht and Ridderkerk together. Ridderkerk's share in the total amounted to 55%.
5. The fact that D&O changed its method later on suggests that they learned from this experience and considered the method used in the Ridderkerk case inappropriate with the benefit of hindsight.
6. File 1.844.32 WVG folder compensation request by the town of Barendrecht.
7. The calculation below does not include a relatively low amount of €850 (\$1,265) Ridderkerk paid for unnecessary legal advice about the bidding procedure.

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