

PROCUREMENT POLICY

GUIDELINES ON FACTORS THAT CAN BE CONSIDERED WHEN TRYING TO REDUCE THE RISKS OF OVER-DEPENDENCY ON A SUPPLIER

SUMMARY PAGE

Assess the situation at hand

1. Could over-dependency be a concern? **PP ⇒ 6-9**
- Is there a risk of capacity failures/financial difficulties on the part of the supplier?
 - Does the supplier have the potential to exploit its position?
 - Could the supplier's share of business deter other bidders?

2. Gather accurate intelligence to understand the wider picture: **PP ⇒ 12-15**
- Ensure a thorough understanding of the purchasing side: what is the total public sector requirement and what proportion will this procurement be of it?
 - Ensure full consideration is given to the position of the supplier(s), including: the characteristics of the market, the main players and their market share, any barriers facing new entrants (including those specific to the government market).
 - Keep in mind the impact of cumulative department purchasing.

Within the legal and policy framework, decide the best course of action

1. In applying selection criteria and award criteria, consider: **PP ⇒ 16-21**
- Is the firm already overstretched?
- consider exclusion if financial or technical capabilities are compromised.
 - Does one firm have the capability to meet all the requirements?

2. Use flexibilities in the EC rules to inform the structure of the procurement: **PP ⇒ 22-29**
- Consider the possibilities of unbundling, division into lots, disaggregating, seeking variants, sub-contracting.
 - Re-tender rather than extend (where extension is possible for certain contracts let under the negotiated procedure only).

Framework Agreements

PP ⇒ 30-31

- Where danger of actual or impending over-dependency arises, opt for multiple suppliers; design the categories to encourage SMEs and/or new entrants.

In summary

PP ⇒ 37-39

- Seek to obtain an accurate and comprehensive picture of the market in question at the beginning of the procurement.
- Consider if over-dependency exists/is in danger of developing.
- Use the selection and award stages, and the careful structuring of the contract, as effective tools in addressing over-dependency issues.
- Complete an overall assessment of any action to be taken; the potential disadvantages of one option will need to be considered in deciding which procurement route to follow.
- Remember that over-dependency should be addressed throughout the life of a procurement – including after the contract award.

Procurement Policy
Office of Government Commerce

**GUIDELINES ON FACTORS THAT CAN BE CONSIDERED WHEN TRYING TO
REDUCE THE RISKS OF OVER-DEPENDENCY ON A SUPPLIER**

Introduction

1 In December 2003 OGC published the report, 'Increasing Competition and Improving Long-term Capacity Planning in the Government Marketplace'. This note fulfils one of the report's recommendations, to provide guidelines on the factors to be taken into account when seeking to reduce the risk of adverse consequences arising from over-dependency. It is not the intention of this note to discourage the establishment of long-term relationships or the benefits that such associations can bring. Its purpose is to identify situations in which over-dependency is at risk of occurring, and then to establish the ways of avoiding and addressing any related issues that may arise.

2 The greater part of this note refers to procurements which are covered by the detailed procedural rules in the EC public procurement directives, and the actions contracting authorities can take consistent with those rules. A commentary on possible approaches in cases where the national security exemption applies is in paragraphs 32-36 below. The guidance may also generally be helpful in relation to other public contracts outside the scope of the directives, and those not covered by all the detailed rules. In the case of contracts of a value below the thresholds, it is less likely - but still possible - that concerns of over-dependency will arise.

3 The duty of Best Value (Local Government Act 1999), as applicable to Local Government bodies, can also be considered in the context of this note, as Best Value authorities are encouraged to develop a "mixed economy" of service provision. The National Procurement Strategy for Local Government, which encourages councils to interact with a diverse range of suppliers, should also be instrumental in helping to prevent over-dependency issues occurring.

4 The guidance issued by the former Treasury Central Unit on Purchasing (CUP)¹, which suggested that no supplier should have more than 40 per cent of its business with government, has now been withdrawn.

5 Other relevant guidance in considering supplier capabilities includes the recent OGC publications, "Supplier Capability Assessment" and "Capturing Innovation".

¹ CUP Guidance 60, paragraph 8.4

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Meaning of over-dependency

6 There are different ways in which the government or public sector collectively, or an individual government or public sector purchaser, may be already, or at risk of becoming, over-dependent on a supplier. Examples of over-dependency referred to in the 2003 report include instances where:

- a supplier is so over-stretched by existing demand that the risk of capacity failures or financial difficulties arises as a result.
- a supplier's share of the government business is such that it has the potential to exploit its position, or that its dominance may deter other bidders.

7 Over-dependency can be influenced by several factors. These might include a lack of willing players for a tender, insufficient competition in the wider market, or when the cost of changing supplier is deemed too high. Failure to identify and act on issues of over-dependency can have adverse effects, including risks to successful contract completion, reduced competition and less innovation in the market.

8 The responses required for over-dependency will vary. For example, it may be necessary to consider interim arrangements with a supplier whose capacity to deliver is compromised, in order to facilitate a firmer financial footing for the supplier. However, the risk of potential abuses can be lessened if measures are taken to lower the barriers to entry to the public sector market, or ways are sought to develop other suppliers. A fuller discussion of ways to address these issues is included below.

9 Over-dependency on the part of the purchaser is not an indicator that the supplier is dominant in the market as a whole, which in turn could bring competition rules into play. Even if the supplier is dominant in this market, competition rules will only apply if the supplier seeks unfair competitive advantage or acts in a way that abuses its dominant position.

Legal and Policy Context

10 It should be noted that the strategy adopted by purchasers to guard against over-dependency on a supplier must be legal under the EC public procurement rules, and consistent with the Government's policy on achieving value for money in public procurement. For example, it would be **illegal** under the EC procurement rules to exclude a supplier at the selection (or award) stage simply on grounds of their market dominance, or the purchaser's over-dependency on that supplier. The application of value for money policy would also militate against the exclusion of a supplier on these grounds, as the firm may well be able to offer the best price/quality bid.

11 It is neither easy to take pre-emptive action where over-dependency is at risk of developing, nor feasible to take action which might constrain a supplier.

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Nevertheless, there are tools and techniques which the intelligent client can use, within the boundaries of the law and consistent with value for money policy, to prevent or mitigate the effects of over-dependency. As in all complex public procurements, the earlier the strategic assessment is carried out, the better.

Prior information is essential

12 Accurate intelligence is vital in enabling dependency and capacity issues to be judged. Before embarking on ways of dealing with supplier(s) where dependency is a reality or at risk of becoming so, the public purchaser requires knowledge and understanding of the wider picture. This should cover both the purchasing side (what is the total government/public sector requirement and what proportion will *this* procurement be of it?) and the position of the supplier(s).

13 On the supply side, the public purchaser needs up to date and accurate information including: the characteristics of the market generally; the players within it; their market share; the ease or difficulty for new entrants; and the respective share that each player has in the government part of the market concerned. The purchaser also needs to understand the extent to which the “government sub-market” is distinct from the market as a whole (if, indeed, at all), and if there are barriers to entry which are specific to the government market. OGC’s Supplier Relations Division is one source of information and intelligence on specific key suppliers and supply markets. This should go hand in hand with other actions to stimulate supplier interest, also discussed in the report, ‘Increasing Competition and Improving Long-term Capacity Planning in the Government Marketplace’.

14 A thorough understanding of the interaction between purchaser and supplier(s) is crucial to the assessment of the strategy which will stimulate or maximise competition, whilst also securing best value for money. The information will also help purchasers get the most out of analytical tools such as the Gateway Risk Potential Assessment (RPA) and the Gateway review process. The RPA is particularly useful in both programme and project development, and can enable purchasers to assess predetermined areas of risk before the start of each OGC Gateway Review, and to identify the skills and resources required in the review team.

15 Another issue to be considered is the impact a public purchaser’s current requirement might have as part of the bigger impact of total public sector demand on the market. The cumulative effect of departments’ purchasing may distort the market even if an individual department’s requirement is relatively small.

Addressing over-dependency

16 Where a problem of over-dependency has been identified, there are factors which purchasers can legitimately take into account in planning and executing their procurement, to avoid or to mitigate the potentially adverse consequences. Specific strategies cited in the Kelly report include:

- Insisting on the transferability of intellectual property rights, especially in relation to Information and Computer Technology (ICT) contracts.

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- Stipulating required standards to ensure compatibility (should a single supplier be unable to continue to deliver, for example).
- Agreeing to pay an element of the bidder's costs: for example, the Inland Revenue agreed to meet the unique costs of transition to its major IT contract (ASPIRE).
- Extensive dialogue with the relevant market sector.

In addition, contracting bodies might also consider the following questions:

Is the firm already over-stretched?

17 There is case law² to suggest that firms may be excluded from a tendering process if the amount of contracting activity they are engaged in exceeds a ceiling established in national law. In this case, the amount of work was based on the total value of works in both the public and private sectors carried out by the company concerned. The Court ruled that this might be a useful indicator of the economic and financial standing of a bidder, one of the legitimate criteria for assessing selection.

18 In the UK, there is no such ceiling established in national law. Nevertheless, in individual procurements it would be legally possible at the **selection stage**, to take a view of the impact of a firm's existing government or public sector commitments on its financial and technical capacity to meet the advertised requirement. In this context it would be possible to use the selection process (which may include the use of pre-qualification questionnaires) to request the relevant details of the contracts awarded to a supplier in the preceding three years (five years for works' contracts), provided those contracts are for goods and services similar to the procurement in question.

19 At the **award stage**, and where the evaluation is on the basis of the 'most economically advantageous tender', there may be some specific deliverability issues not considered at the selection stage which relate to a bidder's exposure on other contracts. Care will be needed, as always, to ensure that the award criteria are related to the subject matter of the contract in question. The evaluation should only concern new issues (i.e. not considered at the selection stage), which would have a direct bearing on its ability to deliver to the requirement. Any weighting system (which under the new Public Sector Procurement Directive is normally required) should be communicated to the bidders beforehand, for example in the tender notice. It is worth noting, however, that in complex procurements authorities can request implementation plans (relating to areas such as transition), to ensure that the key areas of successful delivery are addressed. This might list the key personnel to be assigned to the contract, and thus help ensure that skills and experience are not diverted once the award of the contract has been made as a result of pressure from involvement with other tenders or from fulfilling other contracts.

20 Before addressing over-dependency in this way, contracting authorities should weigh up whether a restriction would be compatible with securing value for

² European Court of Justice (ECJ) ruling in Bellini (C27/86)

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money, or with encouraging the suppliers to innovate and meet the requirement in a different way. Market capacity problems can be solved by the market itself if given sufficient advance notice of demand. In the same way, individual suppliers can also meet capacity challenges, for example, by bringing in short term resource to meet a large order. The extent to which a firm can be considered over-stretched will, in any case, vary according to factors such as the business-criticality and length of the contract. It is for these reasons that UK government guidance *no longer includes* the rule of thumb that suppliers should not be invited to commit themselves to more than 40% of their turnover on any one requirement. Purchasers should also be conscious of the risk of adverse political fallout in appearing to 'punish success'.

Does one firm have the capability to meet all the requirements?

21 This question too can legitimately be posed at both the selection and award stages in the ways described above. However, in some cases where over-dependency is an issue, the supplier will be able to satisfy the minimum selection criteria and score well at the award stage, because they have the breadth of resources to call on. In these cases, the way the procurement is structured, as opposed to the way the bidders and bids are evaluated, will become the more important means of avoiding or containing over-dependency. Some examples are provided in the next section. The structuring of the procurement will also address related issues of encouraging SME, Voluntary and Community Sector and Social Enterprise participation, and help to enhance the capture of supplier innovation.

Using the flexibilities in the EC rules

22 There are various procurement options possible under the EC rules, which can be deployed to limit the risks of over-dependency. The contracting authority will also need to evaluate any disadvantages. For example, there may be extra financial cost and risk in disaggregating supply through letting several contracts, especially where these need to interact smoothly to provide the whole requirement. Further information on the pros and cons of aggregating and bundling can be found in OGC's recently published guidance: "Aggregation - is bigger always better?"

Unbundling

23 A very large and complex requirement may be split into discrete contracts, for example, to separate the provision of IT infrastructure from the provision of management of the service; in other words, to let two contracts rather than one. This may make sense from an operational management perspective, as well as to avoid over-dependency. However, care must be taken to ensure that any such action is completed within the framework of value for money, and that the risks of creating smaller contracts are evaluated and balanced with the risks of maintaining a larger agreement. A breach of EC rules will only occur if the division is intentionally and artificially constructed to reduce the value of each contract below the relevant threshold in order to avoid application of the rules.

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Division into lots

24 A very large requirement can be divided into lots, which will increase the probability that more than one supplier wins a share of the total government business. As above, care must be taken to ensure EC rules are not breached by deliberate division to avoid application of the rules.

Disaggregating

25 Although demand may be at a national level, it does not have to follow that the procurement has to be carried out at that level. For example, the National Programme for IT (NPfIT) in the NHS has been carried out on a regional basis. This approach has helped ensure that the available business is spread among a number of suppliers, thereby reducing the risk that the contracting authority becomes over-dependent on one supplier.

Seeking variants

26 Where an award is to be made on the basis of the most economically advantageous tender, contracting authorities may seek variants from bidders. Use of one or more variants to the core proposal, where appropriate, could increase the likelihood of bids resulting in a bigger and more diverse supplier base than would have existed otherwise.

Sub-contracting

27 Although it is not open to the contracting authority to require a certain level of sub-contracting, it is possible to ask the tenderer to indicate in the contract documents the degree of sub-contracting he intends. The contracting authority is also entitled to ensure that the capability and skills required, including those of sub-contractors, are sufficient to deliver the contract.

28 A contracting authority can pursue an 'integrated procurement' or partnering approach, asking the prime contractor to make his supply chain transparent. This procurement strategy would help identify proposals which spread activities and risk along the supply chain. This approach can be used without breaching the legal requirement to assess the bidder only on grounds of financial standing and technical capability/ability. Depending on the nature of the project, it may be that sub-contracting of particular elements to specialist sub-contractors would actually increase the technical reliability of the bid.

Reducing the hold of an incumbent during the contract

29 In those (limited) circumstances where it is open to contracting authorities under the negotiated procedure to expand an existing contract to include additional services, or to secure repeat services, **and** where there is a risk of over-dependency, the contracting authority could instead tender competitively for those additional requirements or extra orders, in order to attract new suppliers.

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Framework Agreements

30 The existing EC Directives are silent on framework agreements. However, the new consolidated public sector directive includes a provision on Framework Agreements. We consider this sets out established practice. As such, we believe there is low risk in following the text of the directive in advance of its transposition into national law. The new provision clarifies that a contracting authority may establish a Framework Agreement with either a single supplier, or a number of suppliers so long as there are at least three suppliers in the Agreement.

31 Where the contracting authority is aware of its actual or impending over-dependency on one supplier, it would be possible (and sensible) to opt for a multiple supplier framework agreement, and to design the categories of provision in a way which will encourage participation by smaller firms or new entrants to the government market.

National security

32 Although there is a very limited number of contracts where the protection of national security is an issue, this section is included for completeness. In such a case, dependency on certain suppliers may give rise to particular concerns. The EC directives do not apply³, but the requirement in *Government Accounting* on government departments and their agencies, and NDPBs, to obtain value for money, **does** apply.

New contracts

33 The exemption from the rules in the directives, including the requirement to advertise in the OJEU, removes procurements from their scope wherever they cover goods, services or works which are secret, or which, 'must be accompanied by special security measures', or where they concern, 'the protection of the essential interests of that State's security'.

34 This provision gives contracting authorities an additional protection against some of the risks of over-dependency, because the constraints on selection and award criteria do not apply, but arguably adds to the risk of becoming over-dependent by virtue of reducing the number of competitors. Contracting authorities would need to weigh up the relative risks of over-dependency in deciding whether or not to invoke this exemption.

Existing contracts

35 In some instances, an issue may arise where an existing contractor is taken over by a firm with links to a country which is deemed undesirable from a national security point of view. The acquisition itself may be subject to investigation by the competition authorities. Their assessment of whether to clear, block or subject the

³ Exemption for contracts classified as secret and contracts requiring special security measures

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acquisition to conditions would take wider economic issues into account beyond the existence of a sensitive government contract(s). It would be open to the contracting authority to submit views to the competition authorities examining the case.

36 It would be open to the contracting authority to terminate the contract early on grounds of change of ownership. The issue of damages for early termination would depend on the contract terms and conditions. There would remain the practical issue of finding a replacement provider to run the contract, with the attendant disruption of the service or supply.

Conclusion

37 With care, the factors of capacity and capability can be legally evaluated in the procurement process to address over-dependency. This must not have a discriminatory effect. The existence and cause of over-dependency should have been established beforehand. This, in turn, relies on good quality information and analysis.

38 Contracting authorities can avoid or mitigate over-dependency by using the flexibilities in the EC rules. The potential disadvantages of any one option will need to be considered in the overall assessment of which procurement route to follow, particularly if these add cost or lose value for money. If action is taken at an early stage, it will be possible to find a procurement strategy to prevent over-dependency arising in the first place, or if it is unavoidable, to contain it.

39 It should be remembered that action to address over-dependency is an ongoing process. Good contract management should identify any new areas of over-dependency risk that may arise from, for example, the contractor expanding his business or filling his order book without recourse to appropriate resources. This will help ensure that over-dependency continues to be addressed even after the award of a contract has taken place.

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