

## **MARKET COMPETITION THROUGH PAST PERFORMANCE CRITERIA: AN AMSTERDAM CASE**

W.B. Ten Haaf

*W.B. Ten Haaf, LL.M., is a corporate lawyer of the city of Amsterdam, The Netherlands. He advises the organizational branch “Waternet”, which specializes in local watergovernment. The author specializes in litigation in public procurement and construction law.*

### **1. ABSTRACT**

Due to the economic crisis and recession, building co-operations are experiencing a decreasing demand in their fields of operations. Public procurement, both local and otherwise, seems to have become a breeding ground for constructors’ and suppliers’ competition strategies. This has as its effect an increase in judicial conflicts and trials. Commonly second-best scoring contractors and suppliers in specific past performance related procurements, litigate the performances of the best scoring contestant, and therefore not just try to disqualify their direct competitors, but intentionally try to prevent them from building up a sufficient past performance for future procurement.

Amsterdam/Waternet has learned to avoid litigation and improve competition conditions by performing thorough market reconnaissance, in combination with different ways of temporarily decreasing the common past performance criteria.

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### **3. The economic crisis, construction fraud and current competition in the Netherlands**

In 2002 the Netherlands was captivated by the Dutch parliament's investigation into wide-spread construction fraud. The investigating parliamentary commission concluded that building co-operations illegally and on a large scale agreed on prices in public procurement, and therefore willingly excluded competition. It was estimated that an average of 8,8 percent of all government spending in procurement hence had been lost. The legal countermeasures of the Dutch government brought an end to most of this fraud, which left a Dutch constructors market with a new financial balance.

Secondly, of course, the worldwide economical crisis has left its mark on the construction market in the Netherlands. According to the so-called Zürich Euroconstruct Country Report of 2009 the Dutch construction market faces, after a relapse of 6 percent in 2009, another drastic decrease of 9 percent in 2010. This is significantly worse than the comparable markets in its neighbouring countries (2).

Hence the construction and suppliers' markets in the Netherlands nowadays are characterized by a certain hard-grained competition.

### **4. Competition stands out in local public procurement, a case concerning VCA-certification.**

Litigation in procurement had been almost non-existent for the specific governmental water authority of Amsterdam called Waternet, since contractors and suppliers preferred and favoured a steady business relation, and feared to compromise their chances in future procurement. However, a court action in 2004 pointed out that things were about to change.

In the Netherlands, the VCA certification required for procurement is a commonly used tool. It guaranteees specifications and conditions concerning general safety, health and environment during the proceedings of a constructors' project. Amsterdam/ Waternet has been using this generally acknowledged certificate as a standard condition in construction procurement. The VCA-certificate is commonly awarded to building companies for a period of ten years. This of course means that periodically a new application has to be filed at the semi governmental organization responsible for the allocation of the certificates.

In 2003, during tendering for the construction of an embankment the best scoring bidder (hereafter known as “party A”) was a small and relatively new player on the local field of water construction projects. The second-best scoring bidder (hereafter known as “party B”), was a vast concern with a considerable built up past performance record in comparable constructions. Party B apparently decided to shrewdly invest in three litigation procedures, concerning the validity of the smaller enterprise’s tender. The key-issue was the validity of the VCA-certificate of the best scoring bidder.

At the moment party A’s bid was made, party A had been VCA-certified for a period of ten years by the organization responsible for certification. The validity of this specific certificate ended a few months after the moment the bid was made. It would become invalid during the course of the future activities. At the moment of the bid, party A had already applied to renew its VCA-certificate for another period of ten years. Furthermore, the organization responsible for certification had already reviewed the application for the renewal of the certificate, and considered the application valid. It had even indicated that a renewal of the VCA-certificate would be awarded pro data, directly following the period of the former awarded certificate. There could therefore be no discussion at all on the matter of whether party A would materially be able to meet the standards on general safety, health and the environment during the embankment construction project.

Party B, however, insisted on the fact that right at the exact moment of the bid, it was uncertain whether or not party A would be sufficiently certified throughout the duration of the project.

It took constructor B three litigations, including the accompanying legal costs, to get the second-best scoring bidder a verdict that finally turned over the contracting authority’s original decision to grant the tender to party A.

Amsterdam/Waternet lost over a million euros on this case.

By then, it became clear to Amsterdam/Waternet that the local market was increasingly willing to use public procurement as a stage for competition, and for disqualification of competing parties and suppliers. To this end, legal flaws in the public procurement process, as well as flaws in the bids of the direct contestants, were actively sought and utilised.

## **5. Market competition through past performance criteria, an Amsterdam case**

With the steady increase of litigation in public procurement, Amsterdam/ Waternet noticed also an increasing interest from constructors and suppliers in the filed projects of other contestants, intended to measure up to the determined past performance criteria in specific procurement procedures.

In 2009 Amsterdam/ Waternet was confronted with an exemplary case concerning proceedings in yet another embankment construction. Under the specifications and conditions of the specific tender for the proceedings on this embankment project all bidders had to produce a reference list regarding their technical and organizational skills.

This reference list had to consist of at least three projects showing that the constructor in question successfully executed similar projects in a five-year period. Accordingly, the minimum requirements for this assignment stated that these reference projects had to have been delivered on time, specifically within the determined construction periods. The contract price of the reference projects concerned had to have been sixty percent of the amount of the bid on the newly offered embankment construction project. Of course, the reference projects had to be carried out in the field of the enlargement of embankments. The construction would be granted to the constructor submitting the lowest bid. According to the written report of the procurement procedure held, the constructor which finished first, (hereafter known as “party C”) with a bid of EUR 801 K, and a combination of contractors (hereafter known as “party D”) , operating on a regular basis, ended up second with a bid of EUR 823 K.

In the procurement procedure rules, a fifteen day period was provided for immediate litigation. During this period the combination of contractors D requested information on the specific bid of contractor C, as well as all documents attached to this bid, and a lawsuit was filed against the intended decision to grant the construction to constructor C.

Again it was noted that a constructor willingly tried to disqualify another competing constructor, by a thorough scouting for legal flaws in the bid of the contestant. However, this time it became clear that apparently another, new strategy was applied. The combination of constructors D’s motif also meant to safeguard its own share of the market.

The combination of contractors (D) had obtained an excellent past performance on embankment constructions and similar technical constructions and services in the water management fields of operations. In the geographical Amsterdam area the combination had won procurements in similar projects over the years, creating

abundant technical knowledge and specified expertise. Generally speaking, it controlled the specific part of the market at hand. Competing companies on any kind of regular basis were exceptional. Therefore, it had been easy for this combination to fulfil the set past performance criteria in the public procurement, because it had built up an extensive list of accomplished well-nigh equal projects, in both magnitude and price.

The winning bidder C on the other hand had had quite some trouble to compose a list of three similar reference projects. Although cooperation C already had been working for Amsterdam/ Waternet for quite some time on a variety of different projects, it was relatively new in the market of the enhancement of embankments. Therefore it could only produce one comprehensive direct reference project. The two other reference projects existed in content of all separate segments required. It was principally undisputed that the technical and organizational skills of contractor C were sufficient to successfully fulfil the assignment. The experience of Amsterdam/ Waternet itself in previous projects with this contractor would affirm this. Now, the second best bidder D started its immediate litigation, and directly attacked the validity of the filed reference projects of the best scoring contestant C.

It was well known by construction co-operations in the Amsterdam area that Amsterdam/ Waternet commonly prescribed a reference list of three reference projects to ensure the technical and organizational skills of bidders. Other public authorities also avail themselves of similar standards of past performance criteria. Therefore the intent of the litigation not only regarded the acquisition of the specific construction, but also targeted the attempt of a newcomer on the market to obtain a new reference project, meaning to build up a sufficient past performance for future procurement. The combination of contractors D hereby tried willingly to preserve their accomplished share of the market.

Against the intended ruling of Amsterdam/Waternet the combination D stated that all three reference projects actually had to be factual enlargements of embankments. The acknowledged fact that two out of three reference projects of the winning bidder consisted of all actual proceeding elements required could be, according to the combination D, of no importance, regarding the set out condition that the reference projects had to be carried out in the field of the enlargement of embankments. Amsterdam/Waternet argued that it was obvious that the reference projects were meant to deliver proof of the technical and organizational skills of all bidders, which were

in this specific case undebated. Moreover, by demanding reference projects *in the field of* the enhancement of embankments, the specific past performance criteria allowed other reference projects than strict embankment enhancement.

The court of Amsterdam however ruled a strict legally verdict, stating that a condition on past performance in the conditions and specifications of the assignment demanding reference projects *in the field of* the enhancement of embankments actually *had to be* enhancements of embankments.

New-comer C had to be excluded from the procurement at hand, and the order was subsequently granted by the court to the well experienced combination of constructors D.

By this verdict Amsterdam/ Waternet was compelled to re-orientate on its specifications and conditions on past performance criteria, if it wanted to secure any substantial competition in future public procurements. Meanwhile, the strategy of the combination of contractors D had, on a certain limit, been a success. Contractor C went bankrupt in 2010.

## **6. Solutions**

Amsterdam/Waternet has a considerable interest in a competing market of embankment enhancement, as it grants yearly tenths of million of euros on constructions in this specific field of operations. By now the organization has learned to avoid litigation and improve competition conditions by thorough market reconnaissance, in combination with different ways of temporarily decreasing the commonly used past performance criteria. More specific, Amsterdam/ Waternet means to avoid that standard past performance criteria preclude promising skilled contractors with a still scant past performance.

A vital condition is market reconnaissance. In general, market explorations examine market characteristics more closely. These include characteristics such as market volume, segments, distribution chains, market developments, branch culture, and market size estimation. The possibility of a division between the main contractors and subcontractors, as well as research including market price levels, are both awarded special attention. In the local field of operations of Amsterdam/ Waternet this means primarily that the built up experience with contractors over the years is being used to understand the specific market on these diverging, above mentioned aspects. Furthermore all newly filed bids in procurement are being used to identify the existing past performance of the active

contestants in this specific market, and to identify new-comers on the market.

With the obtained information it is up to the authors of the specifications and conditions in the succeeding procurements to alter the past performance criteria. In case of an apparent less competing market the most far-reaching option is to definitely lower in general all conditions regarding past performance. The disadvantages of this option however are obvious. By lowering the standard of the overall used criteria, the procurement authority gives in to the technical and organizational skills required, and risks to be obliged to grant contracts to insufficiently skilled building constructors.

Amsterdam/ Waternet therefore has opted for a more nuanced approach. The implemented market reconnaissance may reveal a dominance of one or more contractors on a specific part of the apparent market. A market reconnaissance may also show the introduction of one or more skilled new-comers, still being in the process of building up a sufficient past performance.

Depending on the market developments at hand Amsterdam/Waternet applies different ways of temporarily decreasing the commonly used past performance criteria. Although it cannot be ruled out that this provisional decreasing of the past performance criteria allows an exceptional, non sufficient contractor to slip through in a particular procurement procedure, in general a variation of criteria due to a flexible approach of the procurement authority, may alter the market itself, temporarily allowing new-comers within previously set boundaries.

In addition to this flexible approach Amsterdam/Waternet has opted for a list of pre-recognized constructors on all minor tenders. The list is open to contractors at all times, and there is no limitation in the amount of participating contractors. To accede this list of pre-recognized constructors one needs to measure up against the specifically set past performance criteria only once. In the following procurements among the pre-recognized constructors, the past performance of the contestants is therefore no longer an issue, and litigation on this particular footing can be avoided in advance.

Amsterdam/Waternet has learned at first hand that markets are not only being designed by constructors and suppliers. Procurement authorities themselves are able to improve competition conditions if necessary, applying a flexible and measured approach of their past performance conditions.

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W.B. ten Haaf

Contact and information: [bas.ten.haaf@waternet.nl](mailto:bas.ten.haaf@waternet.nl),  
Amsterdam, March 29<sup>th</sup>, 2010