# MANDATORY PROCUREMENT RULES: ONE YEAR ON

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**The Mandatory Rules for Procurement by Departments are one year old.**

**They are not yet being fully applied by all affected agencies and they continue to raise challenges.**

**Affected agencies should move quickly to update practices and processes relevant to their specific risks and needs.**

**Suppliers to government agencies will also benefit from knowing how the new rules will affect their business.**

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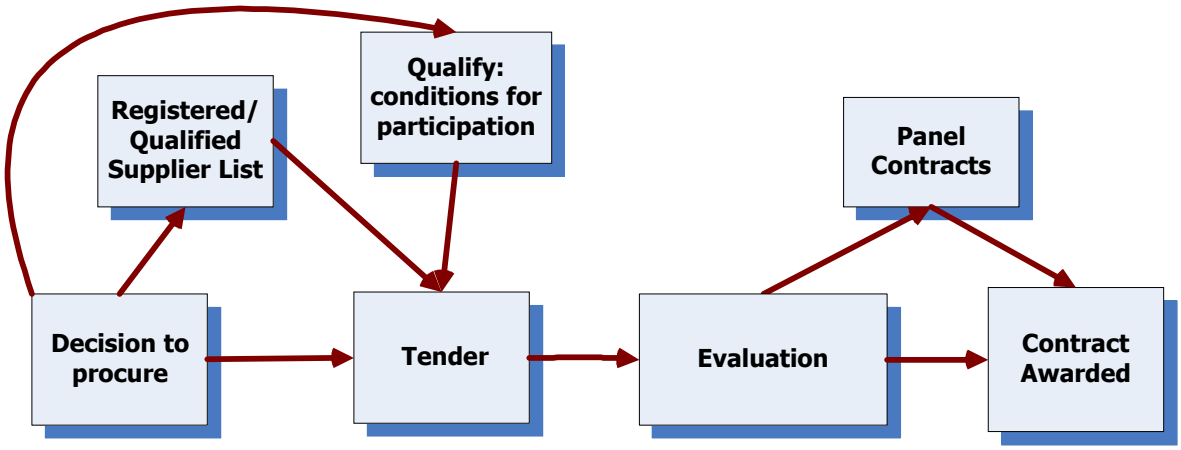


## 1 Introduction

The **Mandatory Rules for Procurement by Departments**[1] (the Rules) represent a major change. While they adopt some existing practices, the Rules also introduce changes, crystallise processes and add further requirements. There is much in the detail as well, and issues around how existing law fits with the Rules. They greatly increase exposure for non-compliance.

The Rules apply to:

- All Departments and Ministries, and the Defence Force and Police; and
- Most[2] of their purchases of goods and services with a whole-of-life value over $100K+GST ($10M+GST for construction services[3]).

Other public sector agencies are encouraged to apply the Rules as well.[4] There is a prospect that this will be more likely as a result of Audit New Zealand's requirements which are currently under review.[5]

## 2 Do existing guidelines apply?

Yes, whether the purchases are above or below those thresholds.[6] But where there is a difference, the new rules trump the old.[7]

The Rules expressly refer at para 4 to continued application of:

- The 2002 MED Guidelines, *Government Procurement in New Zealand: Policy Guide for Purchasers*.[8] These Guidelines are currently under review by MED with a view to meshing them with the Rules;[9]

[1] http://www.med.govt.nz/templates/MultipageDocumentTOC____19669.aspx
[2] Exceptions, such as grants, and getting continued services in appropriate cases due to inter-changeability requirements, are covered in the Rules' appendices.
[3] For construction services below $10M, there are still some compliance issues: eg para 7(b) (ii) of the Rules.
[4] Rules para 10.
[5] See Government Procurement Advisory Notes (March 2007): http://www.med.govt.nz/templates/MultipageDocumentTOC____25534.aspx.
[6] Audit New Zealand and MED have emphasised that internal rules and good practice requirements are still required for purchases below the threshold in the Rules: see Government Procurement Advisory Notes (March 2007): http://www.med.govt.nz/templates/MultipageDocumentTOC____25534.aspx.
[7] Rules para 5.
[8] http://www.med.govt.nz/templates/MultipageDocumentTOC____8903.aspx.

- The Auditor-General's *Procurement: A Statement of Good Practice*[10]. This Statement is also under review with an update due out towards the end of this year.

Depending on the circumstances, agencies need to have regard to other material such as:

- Their own procurement guidelines (which by now should have been updated to reflect the Rules);

- SSC and OAG Guidance in regard to larger IT projects[11].

## 3 **Legal and Other Compliance Considerations**

The Rules implement, and go further than, the Trans-Pacific Free Trade Agreement (known as the P4 Rules)[12]. They are endorsed by Cabinet.

On the judicial review continuum[13], few procurement processes were reviewable, as the Privy Council had confirmed.[14] Because these new rules apply across-the-board, are endorsed by Cabinet, implement New Zealand's international commitments, and reinforce principles of equality and fairness, there is now a greater prospect that procurement will attract the attention of disgruntled parties and the Courts. There is also the added uncertainty arising out of the recent *Diagnostic Medlab* decision and what might happen on the appeal from that judgment.

MED has concluded[15] that, Cabinet having invited Ministers to instruct Chief Executives to ensure compliance by their Departments with the Rules, then once instructed, the Chief Executive has a legal obligation under section 34(b) of the Public Finance Act 1989.

However, even if there is uncertainty as to the legal implications of the Rules it would be prudent for Departments to comply with them anyway. Other agencies can review them (in particular, MED, OAG and the Ombudsman[16]). There are also "*Front page of the Dominion*" implications.

For example, Audit New Zealand is developing an approach for ensuring appropriate auditing and compliance in relation to the Rules.

In all those circumstances, Departments, at least, should comply with the Rules. Additionally, Government has signalled a move toward an across-the-board procurement policy (including as to sustainability). MED is currently upsizing its procurement team and it plans to conduct rolling reviews of agencies.

## 4 **Interpreting the Rules**

It would also be prudent for agencies to avoid interpreting the Rules restrictively.

The Rules go overboard to minimise restricted application of the Rules. But there are some points where a tight interpretation could be argued.

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[9] See Government Procurement Advisory Notes (March 2007): http://www.med.govt.nz/templates/MultipageDocumentTOC____25534.aspx.
[10] http://www.oag.govt.nz/2001/procurement/.
[11] http://www.ssc.govt.nz/display/document.asp?NavID=114&DocID=5287 (*SSC: Guidelines for Managing and Monitoring Major IT Projects*) and http://www.oag.govt.nz/2000/it-oversight/ (*OAG: Governance and Oversight of Large Information Technology Projects*).
[12] See our article, *Government Purchasing Processes set for the Biggest Change in Years*, at http://www.wigleylaw.com/Articles/LatestArticles/government-procurement-s-biggest-shake-up-in-years/
[13] Or "*rainbow*", as Professor Taggart describes it, as there is no simple linear continuum.
[14] *Mercury Energy* and *Pratt v Transit New Zealand*. See our article, *Tenders, RFPs and Competitive Purchasing: Traps for Unwary Buyers & Sellers*, at http://www.wigleylaw.com/Articles/ArticleArchive/TendersRFSCompetitivePurchasing/
[15] See Frequently Asked Questions on Procurement Rules at http://www.med.govt.nz/templates/ContentTopicSummary____22481.aspx.
[16] See our article, *Public Sector Purchasing and the Ombudsman: A new decision* at www.wigleylaw.com/Articles.

We consider a narrow approach is risky. Agencies should adopt the spirit of the Rules.

Audit New Zealand, for example, has indicated that its audit in relation to the Rules will "*… be looking for a proper consideration of underlying policies and how to put them into practice, rather than just a narrow compliance approach.*"[17]

## 5 Terminology

The Rules use different words for commonly-understood existing processes. This paragraph may help reduce confusion. In particular:

- **Open tendering** (by which any supplier can put in a proposal or tender to supply the goods or services). This includes all types of competitive bidding including a Request for Tender (RFT), Request for Proposal (RFP) and a Request for Quote (RFQ), or competitive estimate. The process chosen will depend upon circumstances such as the size of the acquisition, the variations and solutions that could suit the agencies' needs, and so on.

- Rather than going straight to open tendering, the agency, as now, can use a multi-step process. This is equivalent to an Expression of Interest (EOI) (by which all suppliers can put in an EOI and the agency then down-selects to a smaller list). That is followed by a closed tender process such as an RFP. That EOI process is described, in the Rules, as **qualification by way of conditions for participation**. The EOI process is sometimes called ROI – Registration of Interest.

- A Request for Information (RFI) is, strictly speaking, just that: a request for further information from suppliers. However sometimes that name is given to the EOI process. Whatever words are used, clarity as to the desired outcome is essential in the documents, whatever they are called.

- Agencies can set up what the Rules call **Registered or Qualified Supplier Lists**. Provided a supplier meets specified criteria, the agency must add it to the list. But the Agency must still go out to the open market when it goes through a tender process, and not limit itself to that Supplier List.

- The **Registered/Qualified Supplier List** is entirely different from the **qualification process by way of conditions for participation**.

- It is also different from the structure under the Rules which is called **Panel Contracts**. A panel of suppliers can be chosen and they sign a Panel Contract, following an open tender process (which can be preceded by way of qualification via conditions for participation). The agency then buys its goods and services from one or more of the suppliers on the panel. This also is similar to current processes (for example, agencies may appoint a panel of law firms to provide advice in overlapping and specialist areas).

## 6 Open Tendering Principles

A key principle is that open tendering[18] is normally required. The Rules don't apply to the circumstances in Appendix 1 (such as the acquisition of health and education services). Additionally open tendering is not required in the circumstances in Appendix 2 (a typical example is where additional goods and services are bought to integrate with existing goods and services (e.g.: computer equipment).

Open tendering proceeds in two ways:

[17] See Government Procurement Advisory Notes (March 2007): http://www.med.govt.nz/templates/MultipageDocumentTOC____25534.aspx.
[18] Rules para 23.

- The single-step path: any supplier can respond to the tender.[19]

- The multi-step route: all suppliers can participate in an open qualification process (notified on GETS[20]) in line with the existing Expression of Interest (EOI) process[21]. This would select a limited number of suppliers to go forward to a closed tender.

## 7 Suppliers get equal and fair treatment

All suppliers must get equal opportunity and equitable treatment on the basis of their financial, technical and commercial capacity.[22] The rules are dotted with words and concepts such as equality, fairness, etc. While these concepts are a hallmark of decision-making, they are stated with a high level of clarity, which calls for careful compliance. It's bold indeed to require procedures that "*guarantee* the fairness and impartiality of the procurement process."[23]

## 8 What must be included in the tender documentation?

There must be enough information to allow suppliers to submit responsive tenders, and that includes the essential requirements and evaluation criteria.[24]

Suppliers must be given at least ten working days to respond (but there is an implicit encouragement to make that period longer)[25].

Departments also must be careful in their use of technical specifications to:

- avoid creating unnecessary obstacles to international trade or domestic supply[26]; and

- unduly limit which products are capable of meeting the requirements.

Despite Auditor-General reports such as in relation to Light Armoured Vehicles, this remains an issue in some quarters.

## 9 Communications with Suppliers

Departments must not seek or accept advice to be used in the preparation or adoption of any technical specification from a party that may have an interest in that procurement, "*if to do so would prejudice fair competition*".[27]

We think it is particularly important that this should not be used to preclude pre-tendering discussions with suppliers. Suppliers frequently complain (often with justification) that if they had been consulted first, the request for goods and services would improve and better benefit the agency's needs.

The solution of course is to consult (where appropriate and necessary (for example where the same information can't be obtained from a third party)), in a way which would not "*prejudice fair competition*". Getting information from a variety of sources and potential suppliers (and/or sharing that information with others) may go some way toward solving this problem. Careful handling of the information would help.

[19] Rules para 23.
[20] Rules para 24.
[21] Rules para 23.
[22] Rules para 16.
[23] Rules para 43.
[24] Rules para 28.
[25] Rules para 27.
[26] Rules para 19.
[27] Rules para 22.

It must be remembered that project risk (that is, the risk of a particular project failing) is generally much higher (and has a much greater impact on the agency) than process/probity risk. It is generally impossible to 100% meet all risks of a project and its procurement. There is an inherent risk in focusing on process, excessively away from project risk. That should be taken into account when decisions are made. Additionally, the main and ultimate goal is to get great goods and services for the Department. This is not to say that process issues should be minimised. Proper compliance should achieve that main goal, and other goals such as fairness and encouraging competition.

Our observations above apply also to requests for further information from suppliers during the tender process. Departments must endeavour to reply promptly to any reasonable request "*… provided that such information does not give that supplier an advantage over its competitors in the procedure for the award of the contract. The explanation or information provided to a supplier may be provided to all suppliers that are invited to tender*".[28]

Overlapping this is an obligation not to disclose a supplier's confidential information where appropriate.[29]

Particularly where the tender documents are not sufficiently self-explanatory or go down a sub-optimal path (frequently, suppliers advise this is a common problem leading to project risk failure for agencies), agencies should strive hard to free up communications.

Given the requirements of the Rules and other probity requirements, this can be quite a challenge. However there is much to be gained by getting this right. This is a major risk area in many procurement processes, particularly for complex projects. Communication inadequacies (before and during the procurement process) can lead to project failure. In itself it can also lead to unfairness, with the incumbent supplier having much more information than the other potential suppliers.

## 10 Conflict of Interest

Departments must have in place policies to eliminate any potential conflict of interest on the part of those engaged in or having influence over a procurement.[30]

The Auditor-General has just released new guidance on conflicts of interest: *Managing Conflicts of Interest: Guidance for Public Entities*[31].

As the OAG guidelines indicate, whether or not there is a conflict of interest in any particular case is not always a simple issue. The recent *Diagnostic Medlab* decision further demonstrates the challenges in this area.

There is an important potential area where it is arguable a person should not be conflicted.[32] The Privy Council case, *Pratt v. Transit New Zealand*[33] established that it is acceptable (even desirable) for someone with adverse prior knowledge about a tenderer to be on an evaluation panel, provided the evaluation panel and the agency act in good faith. Each situation will need to be addressed on its own merits. It is to be hoped that the net effect of the Rules, the OAG Guidelines, and the Privy Council decision, is that having experienced professionals, possibly with prior adverse knowledge of a tenderer, on an evaluation panel is not precluded. The baby should not be thrown out with the bath water.[34]

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[28] Rules para 30.
[29] Rules para 15.
[30] Rules para 14.
[31] http://www.oag.govt.nz/2007/conflicts-public-entities/
[32] Whether this remains so following the introduction of the Rules should be revisited, or clarified in some way, such as in the forthcoming changes to the MED and OAG guidelines. See in particular Rules para 14.
[33] For more detail see our article, *Tenders, RFPs and Competitive Purchasing: Traps for Unwary Buyers & Sellers* at www.wigleylaw.com/Articles
[34] Unfortunately this is not a point that is made clear in the OAG *Managing Conflicts of Interest: Guidance for Public Entities*, with the most relevant case study example given (Case Study 9 on page 41) coming to a conclusion that there is conflict of

## 11 Modifications

Where the agency modifies the essential requirements and evaluation criteria, it must give notice of this, and allow tenderers to resubmit[35]. As a result of the *Diagnostic medlab* case, and other developments, we think the need to go to the market again when there is material change will be increasingly important.

## 12 Syndicated and Aggregated Procurement (and purchasing through third parties)

The Rules show how they work with syndicated and aggregated procurement[36] and purchasing through third parties such as brokers.[37]

## 13 GETS

The GETS role is confirmed and expanded, with a view to making public many of the stages of the procurement process.[38]

## 14 Award of Contract

Any tender that doesn't comply with essential requirements and conditions of participation in the tender documents **must** be rejected.[39] This is a real danger area for purchasing agencies (which could lose the ability to have what might otherwise be their best choice) and for vendors. Experience shows that requests for tenders are often framed in a way that makes non-compliance by vendors close to inevitable. Vendors to date have often taken the risk on this, and purchasers have had some latitude. Overlay this with the Ombudsman's views on the need to go back to vendors to seek further clarity in some instances[40] and we have quite a risk-laden area that needs careful handling to minimise risk yet achieve best outcomes.

The contract must be awarded to the supplier that offers best value for money in terms of the essential requirements and evaluation criteria set out in the tender documents.[41] The Department can only override this if it is not in the public interest to award a contract[42]. The Department must not cancel the procurement or modify an award of contract to circumvent the Rules[43].

Because the procurement decision **must** directly co-relate with the essential requirements and evaluation criteria, the tender documents should be carefully drawn. Currently, often they are not. It's common experience to find that tender documents don't fit well with what the purchaser actually needs, or could get from suppliers to best achieve its needs.

Value for money dictates the outcome, not the place of origin or degree of foreign ownership of the supplier. Local presence or local supply can still be relevant.[44] For example, having a local supplier

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interest, although the facts are different from those in *Transit v. Pratt*. The conclusion on the facts of the case study is correct in our view. In some way it would be useful if this point, about evaluation panels and prior adverse knowledge, is highlighted in some way.

[35] Rules para 31

[36] Rules, footnote 8 and Frequently Asked Questions on Procurement http://www.med.govt.nz/templates/ContentTopicSummary___22481.aspx

[37] Rules para 13.

[38] Rules paras 47 and 50.

[39] Rules para 44.

[40] See our article, *Public Sector Purchasing and the Ombudsman: A new decision* at www.wigleylaw.com/Articles,

[41] Rules paras 17 and 45.

[42] Rules para 45.

[43] Rules para 46.

[44] As is set out in more detail in the 2002 MED Procurement Guidelines.

or a local office may be a significant factor in the evaluation of a proposal. MED explain how these Rules fit with initiatives such as *Buy Kiwi*.[45]

## 15 Documenting the Process

Agencies must document how they implement the processes (such as the evaluation) so they can be reviewed (e.g.: by the Auditor-General[46]).

## 16 Registered/Qualified Supplier Lists

Agencies can establish these supplier lists yet still need to go out to market each time there is a new qualifying tender.[47] No Department has done this yet.

## 17 Panel Contracts

Panel Contracts are an option[48]: this allows agencies to appoint, after an open tender process, a panel of suppliers for particular goods and services.

There are no specific rules on how choices are made among those on the panel. However it is likely that a principled and fair approach will be needed. That reflects para 4 of the Rules which requires compliance with the OAG and MED procurement guidelines.[49]

## 18 Procurement Plan

There's a requirement for an annual procurement plan, the first of which was to be produced by each Department and Ministry by 14 July 2006; and updated at least every six months.[50] This also goes online on GETS.

Only a handful of Departments have met this requirement so far.

## 19 What should be happening?

As the Rules have been in place for a year, all Departments should have upgraded their procurement processes and manuals, and produced their annual procurement plans with six monthly updates.

While most of the rules clarify existing processes and requirements, in reality the changes are considerable and there is much in the detail. If they haven't done so already, all affected agencies should look closely at:

- Clarifying and updating processes and manuals, tailored to meet unique needs.
- Setting up processes so that they best meet the practical needs of the purchasing agency; the aim is to get the best goods and services, by fair means.
- Recognising that a full variety of options, such as Requests for Proposals, Requests for Quotes (particularly for smaller and straightforward purchases) remain open.
- Important will be to find ways to handle the obligations in the new rules as cost-effectively as possible. Many vendors and purchasers have experienced a disproportionately high cost of

[45] Frequently Asked Questions on Procurement http://www.med.govt.nz/templates/ContentTopicSummary____22481.aspx
[46] Rules paras 50 and 53. See also See Government Procurement Advisory Notes (March 2007): http://www.med.govt.nz/templates/MultipageDocumentTOC____25534.aspx.
[47] Rules paras 47, 39 and 41.
[48] Rules para 42.
[49] See also the MED comments in the Frequently Asked Questions on Procurement http://www.med.govt.nz/templates/ContentTopicSummary____22481.aspx.
[50] Rules paras 51 and 52.

government procurement process. This is particularly acute for purchases at the lower end of the scale. The $100K threshold is low and agencies should address ways of minimising what can be very high cost (handled poorly, that cost can easily exceed the benefits of competitive purchasing).

- Consider the range of available options. Increased use of the *"Conditions for Participation Qualification"* method may be useful, for example.

- Address the detail in the new rules, as it applies to the agency's needs, such as: (a) who can participate on the evaluation panel; (b) how vendors are to be consulted before the tender is issued (such consultation is often best practice in any event; the rules require this to be carefully handled), and (c) crafting tender documents to avoid being locked into unsatisfactory outcomes.