

Division into lots and SME participation in public procurement

*Does Article 46 of the new Directive 2014/24/EU achieve its
aim of promoting SME participation in public procurement?*

Candidate number: 76

Number of words: 13 606



JUS399 Master thesis

UNIVERSITETET I BERGEN

01.06.2016

Contents

- 1 Introduction 3**
 - 1.1 Background 3**
 - 1.2 Purpose and research questions 4**
 - 1.3 Demarcation 5**
 - 1.4 Method and material 5**
 - 1.5 Disposition 7**

- 2 Small and medium-sized enterprises 8**
 - 2.1 Introduction and definition..... 8**
 - 2.2 Facilitating SMEs in public procurement 9**
 - 2.2.1 SMEs participation as an objective 9
 - 2.2.2 The benefits of SME participation 10
 - 2.2.2.1 SMEs importance at EU level 10
 - 2.2.2.2 SMEs importance in Norway 12
 - 2.2.3 The disadvantages of SMEs 12
 - 2.2.4 Conclusion 13
 - 2.3 The barriers to SME participation in public procurement 14**

- 3 Dividing contracts into lots to facilitate SMEs 15**
 - 3.1 Introduction..... 15**
 - 3.2 Lot division as a SME vehicle 16**
 - 3.3 Risks generated by dividing contracts into lots 17**
 - 3.3.1 Interference with competition 17
 - 3.3.2 Bid rigging 17
 - 3.3.3 Lot division may not be feasible 19
 - 3.3.4 Increased costs and complication of the procurement procedure 19
 - 3.4 Conclusion 19**

- 4 The effects of Article 46 on SME participation 20**
 - 4.1 Introduction..... 20**
 - 4.2 Presentation of Article 46..... 21**
 - 4.2.1 The legislative process 21
 - 4.2.2 The final outcome of Article 46..... 22
 - 4.3 Does Article 46 achieve its goal of promoting SMEs? 23**

| | | |
|------------|---------------------------------------------------------------------------|-----------|
| 4.3.1 | General remarks | 23 |
| 4.3.2 | The obligation to provide a justification | 24 |
| 4.3.2.1 | The requiremnt of ‘indication of the main reasons’ | 25 |
| 4.3.2.2 | The principle of good administration | 29 |
| 4.3.2.3 | The fundamental market freedoms..... | 30 |
| 4.3.2.4 | The principle of competition..... | 31 |
| 4.3.2.5 | Conclusion on the effects of the remedies | 32 |
| 4.4 | Reflections | 33 |
| 5 | The Norwegian proposal on lot division..... | 34 |
| 5.1 | Introduction..... | 34 |
| 5.2 | Current public procurement legislation | 34 |
| 5.3 | Presentation and general remarks on the lot division proposal..... | 35 |
| 5.4 | The requirement of ‘kort begrunnelse’ | 36 |
| 5.5 | Brief comparison to other Member States | 38 |
| 5.6 | Reflections | 39 |
| 6 | Concluding remarks..... | 40 |
| 7 | Bibliography | 42 |

1 Introduction

1.1 Background

Each year, contracting authorities spend about 19 per cent of the EU gross domestic product on purchasing supplies, services and works, which corresponds to approximately EUR 2.4 trillion.¹ Thus, winning public contracts is an important source of revenue for all businesses in Europe, including small and medium-sized enterprises (SMEs).

Despite their small size, the benefits of SMEs have been highlighted on several occasions. They are regarded as the backbone of the European economy, and have potential for job creation, growth and innovation.² Also, SME participation in public procurement is considered important as it causes increases competition leading to better value for money for contracting authorities.³

However, SMEs struggle to establish themselves in the public procurement market and are underrepresented in procurements above EU thresholds, because their size is not compatible to large-scale contracts.⁴

This issue was taken into account in the Commission's proposal on new public procurement regulations⁵ as part of the motivation to modernise the public procurement directives was to make public contracts more accessible for SMEs.⁶ Among the measures taken to achieve that aim was to *invite contracting authorities to divide contracts into lots*.⁷ This proposal resulted

¹ Cernat and Kutlina-Dimitrova, *International Public Procurement: From Scant Facts to Hard Data*, Chief Economist Note, Issue 1, April 2015, p. 2

² Commission Staff Working Document – *European Code of Best Practice Facilitating Access by SMEs to Public Procurement Contracts*, SEC(2008) 2193, p. 4. Henceforth *Code of Best Practice*; European Commission, *Green Paper on the Modernisation of EU Public Procurement Policy: Towards a More Efficient European Procurement Market*, COM(2011) 15 final, p. 27 Henceforth *Green Paper*

³ *Code of Best Practice*, p. 2

⁴ Loader, "The Challenge of Competitive Procurement: Value for Money Versus Small Business Support", *Public Money & Management*, 2007, 27:5, pp. 307-314, at p. 310

⁵ European Commission, *Proposal for a directive of the European Parliament and of the Council on public procurement*, COM(2011) 896 final

⁶ COM(2011) 896 final, p. 10

⁷ COM(2011) 896 final, p. 11

in Article 46 of the new Public Sector Directive 2014/24/EU,⁸ which for the first time make regulation of lot division part of the public procurement regime.

The concept of dividing contracts into lots is considered an adequate tool to help SMEs overcome the obstacles of large public contracts. However, both economic and legal literatures have stressed that lot division might risks interfering with competition and facilitate bid rigging. It is further submitted that lot division may not always be feasible and that lot division requires more resources from contracting authorities. Whether these risks will create problems in practice depends largely on the design of Article 46.

Moreover, despite being relatively new and only recently implemented by the Member States, the design of Article 46 has already been the subject of criticism. The objection against the lot division-rule is that the *soft approach*⁹ risks that Article 46 will not achieve its aim of promoting SMEs in public procurement. Some have even predicted that Article 46 will remain a political flag devoid of content.¹⁰

Member States are free to facilitate SME participation further through lot division in their national legislation. How Article 46 has been implemented by the Member States will therefore largely determine whether the provision will contribute to the success of SMEs in public procurement, or whether the provision will remain a political flag, as predicted by legal theory.

1.2 Purpose and research questions

The purpose of this thesis is to analyse Article 46 of the Directive 2014/24 and how the provision affects the participation of SMEs in public procurement from a legal standpoint. More precisely, this thesis discusses why there is a need to promote SME participation in public procurement, the implications of lot division and whether Article 46 is suitable to promote SME's in public procurement. Consequently, my research questions are the following:

⁸ Henceforth Directive 2014/24

⁹ Sánchez Graells, *Public Procurement and the EU Competition Rules*, 2. Edition, 2015, p. 347; Herrera Anchustegui, "Division into Lots and Demand Aggregation – Extremes Looking for the Correct Balance?". In *Reform or Deformation of the EU Public Procurement Rules in 2014*, Grith Skovgaard Ølykke & Albert Sanches-Graells (eds.), 2016 – in press, p. 7.

¹⁰ Herrera Anchustegui (2016 – in press), pp. 7 and 15

- What is the rationale justifying SME participation?
- Why is dividing contracts into lots considered a SME friendly tool and what are the risks?
- What is the legal regime applicable to division of contracts into lots and its interpretation?
- How the provision on division of contracts into lots, and in particular the *justification required* to award a single contract, affects SME participation in public procurement.

1.3 Demarcation

The thesis excludes the analysis of the Utilities Directive 2014/25/EU Article 65, as this directive applies a more light touch regime on public procurement, compared to Directive 2014/24.¹¹ The Concessions Directive 2014/23/EU is also omitted, since concession contracts are characterised by being assigned as an exclusive right and consequently this directive does not contain any provision on lot division.

The thesis is therefore limited to analysing the provision on division of contracts into lots in the new Public Sector Directive 2014/24/EU, namely Article 46. This thesis will not investigate other measures taken the directive to promote SME participation.¹²

For practical reasons, the material used in this thesis is limited to sources that are available through the 20th of May 2016.

1.4 Method and material

Dividing contracts into lots is regulated in Article 46 and the supplementary recitals in the new Public Sector Directive 2014/24. Because Article 46 is new there are currently no decisions from the European Court of Justice¹³ on how the provision shall be understood. Consequently, the analysis of the provision will mainly be based on the written legislation in

¹¹ Poulsen, Jakobsen and Kalsmose-Hjelmborg, *EU Public Procurement Law*, 2. Edition, 2012, p. 140

¹² Other inventions are the European Single Procurement Document in Article 59, limitation of requirements for participation in Article 58 and direct payment to subcontractors in Articles 71.1 and 71.7

¹³ Henceforth ECJ

Directive 2014/24. However, judgements from the ECJ will be used as inspiration to predict what the future possibly holds for Article 46.

Essential to determine the effects of Article 46 on SME participation is how the provision is implemented by the Member States in their national legislation. EU directives are binding upon the Member States; however, national authorities have discretionary power to choose the form and method for the implementation as long as they meet the results set out in the directive.¹⁴

The 22nd of January this year, the Norwegian Government proposed a new law on public procurement, which is currently being considered in the Parliament.¹⁵ Norway is party to the EEA Agreement and is therefore obliged to comply with EU directives in areas covered by the EEA Agreement and implement EEA relevant directives in national legislation.¹⁶ Parliamentary Decision is expected in mid-June and new regulation on public procurement will be adopted after the law is passed by the Parliament. The Ministry estimate that regulation enters into force in autumn 2016.¹⁷ The regulation will contain the more detailed rules on public procurement including a provision regulating lot division.¹⁸ Thus, the analysis is based on the current proposal for new Regulation on Public Procurement § 14-1.¹⁹

For the analysis of § 14.1 (2), the EU directive is relevance, because the provision is set out through the EEA Agreement.²⁰ However, considering that § 14-1 is not yet implemented, the thesis will not go into depth when analysing this provision. The main purpose of the analysis is to gain perspective on the impact of Article 46. On this basis, the thesis will also undertake

¹⁴ TFEU Article 288 para 3

¹⁵ Prop. 51 L (2015-2016) - Lov om offentlige anskaffelser (anskaffelsesloven); Regjeringen, Nytt anskaffelsesregelverk er underveis
<https://www.regjeringen.no/no/tema/naringsliv/konkurransopolitikk/offentlige-anskaffelser-listeside/nytt-anskaffelsesregelverk-er-underveis/id2482572/>.

¹⁶ EEA Agreement Article 7

¹⁷ Regjeringen, Nytt anskaffelsesregelverk er underveis
<https://www.regjeringen.no/no/tema/naringsliv/konkurransopolitikk/offentlige-anskaffelser-listeside/nytt-anskaffelsesregelverk-er-underveis/id2482572/>.

¹⁸ Prop. 51 L (2015-2016), p. 71

¹⁹ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser, p. 68. Available at
<https://www.regjeringen.no/contentassets/a20179ad1beb4de9b4d7f5ccec80c094/horingsnotat-2-forskrift-offentlige-anskaffelser.pdf>

²⁰ EEA Agreement Article 65

a brief comparison of the implementation of the provision in Denmark, United Kingdom and France.

As this thesis investigates various aspects related to the division of the contracts into lots, the method and material may vary based on the topic of the discussion. The common denominator is the emphasis on legal and economic theory in addition to guiding statements, such as from OECD, Communications, Working Documents and Notices from the European Commission and Green Papers. However, it is important to bear in mind that these sources are not legally binding upon the Member States as they are considered to be soft law.²¹

1.5 Disposition

The thesis has initially presented the theme and which legal sources and methods that will be used. As mentioned, the theme of the thesis is to establish the rationale behind facilitating SMEs in public procurement and whether the provision governing lot division achieves its aim of promoting SMEs.

The second chapter investigates the rationale behind facilitating SMEs and the barriers facing SMEs in public procurement from an economic perspective.

The third chapter examines the concept of lot division as a SME friendly tool. This chapter also investigates the potential risks deriving from lot division.

Chapter four is the core of the thesis. This chapter starts with a presentation of Article 46, before evaluating whether the provision will achieve its aim of fostering SME participation. The focus of the chapter is on the justification requirement in Article 46.1.

Chapter five analyses the Norwegian proposal on lot division. The chapter also compares this proposal to the implementation of Article 46 in other Member States.

The sixth and final chapter accounts for the concluding remarks and reconnects to the introductory research questions.

²¹ Senden, *Soft Law in European Community Law*, 2004, pp. 123-219

2 Small and medium-sized enterprises

2.1 Introduction and definition

The aim of dividing contracts into lots is to adapt public procurement to the needs of SMEs.²² Furthermore, fostering SME participation has been highlighted by the Council as one of the five main points of the public procurement reform leading up to the current directive.²³ *Thus, the question arises as to why SME promotion is considered important in public procurement, and further why they are striving to establish themselves on the public procurement market.*

Before tackling these questions, the term ‘SME’ must be addressed. According to Directive 2014/24, SMEs shall be understood as defined in the Commission Recommendation.²⁴ This instrument defines SMEs based on size and turnover:

- *SMEs* are enterprises, which employ fewer than 250 persons and have an annual turnover of maximum EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.
- *Small enterprises* are defined as an enterprise, which employs less than 50 persons and whose annual turnover and/or annual balance sheet total do not exceed EUR 10 million.
- *Microenterprises* are defined as an enterprise, which employs less than 10 persons and whose annual turnover and/or annual balance sheet do not exceed EUR 2 million.²⁵

According to this definition, SMEs have limited capacity in in terms of both finances and manpower, which affects the contractual obligations they are able to undertake and hinders their ability to win large and important procurement documents. Given these limitation it is interesting that SMEs have received such positive reviews. Thus, section 2.2 discusses why SMEs are an important asset in public procurement and furthermore, section 2.3 investigate the barriers facing SMEs in public procurement.

²² Directive 2014/24, recital 78

²³ The Council, Press Release – *Council adopts directives for the reform of public procurement*, 6337/14, 2014, p. 2

²⁴ Directive 2014/24, Article 83.3; *Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises*, 2003/361/EC, O.J L 124. Hereafter referred to as the *Commission Recommendation*

²⁵ *Commission Recommendation*, Annex 1, Article 2

2.2 Facilitating SMEs in public procurement

2.2.1 SMEs participation as an objective

Before analysing the benefits of SMEs, it is appropriate to place SMEs among the EU public procurement objectives.

EU public procurement has been institutionalized to achieve what are referred to as *vertical* and *horizontal* objectives. The *vertical objective* refers to the specific function of public procurement, which is the procurement of supplies, services or works by a contracting authority to carry out its tasks.²⁶ For example, a health authority buys surgical supplies to provide health services.²⁷

Horizontal policies refer to the policies promoting societal objectives that are not necessary to achieve the functional objective.²⁸ They are often referred to as *secondary policies*, however, this term is unfortunate since it assumes that it assumes the prior existence of decisions concerning the levels of purchasing, that these policies are of secondary or limited importance or irrational.²⁹ Consequently, the term horizontal is used in the following.

SME promotion is classified as a horizontal objective.³⁰ However, as shall be seen in the discussion below, *fostering SME participation as a separate policy may also benefit other horizontal policies in public procurement* – which are established as equally important in EU public procurement as the mere function of acquiring supplies, services or works. Also, SME promotion contributes to achieve other goals in public procurement.

²⁶ Arrowsmith and Kunzlik “Public procurement and horizontal policies in EC law: general principles”. In: *Social and Environmental Policies in EC Procurement Law – New Directives and New Directions*, Sue Arrowsmith and Peter Kunzlik (eds.), 2009, p. 13

²⁷ Arrowsmith and Kunzlik (2009), p. 13

²⁸ Arrowsmith and Kunzlik (2009), pp. 12-13

²⁹ Arrowsmith and Kunzlik (2009), pp. 13-15

³⁰ Hatzis, “The legality of SME development policies under EC law”. In: *Social and Environmental Policies in EC Procurement Law – New Directives and New Directions*, Sue Arrowsmith and Peter Kunzlik (eds.), 2009, p. 345; Trybus, “The Promotion of Small and Medium-Sized Enterprises in Public Procurement: A Strategic Objective of the New Public Sector Directive?” In *Modernising Public Procurement: The New Directive*, François Lichère, Robert Caranta and Steen Treumer (eds.), 2014, p. 256; Sánchez Graells (2015), pp. 102-103

2.2.2 The benefits of SME participation

2.2.2.1 SMEs importance at EU level

SMEs are often recognised as the backbone of the European economy.³¹ Also, the *Code of Best Practice* sums up the rationale behind facilitating SMEs in the public procurement market as follows:

“An increased involvement of SMEs into public purchasing will result in higher competition for public contracts, leading to better value for money for contracting authorities. In addition to this, more competitive and transparent public procurement practices will allow SMEs to unlock their growth and innovation potential with a positive impact on the European economy”.³²

According to this statement, SMEs are of strategic importance in both EU public procurement and the EU economy.

Firstly, the vast majority of businesses in Europe are SMEs, representing 99.8 per cent of all enterprises in the non-financial business sector.³³ SMEs produce more than half of the EU gross domestic product by adding 58 per cent of the gross value in the sector.³⁴ Thus, *achieving a higher level of SME participation in public procurement has a positive impact on the EU economy.*³⁵

*Secondly, SMEs provide economic stability even during the time of economic crisis.*³⁶ For example, although the gross value added by SMEs declined after the financial crisis in 2008,

³¹ *Code of Best Practice*, p. 4

³² *Code of Best Practice*, p. 2

³³ CARSA, PwC Luxembourg, Innova SpA, The University of Manchester, Manchester Institute of Innovation Research et. al., *Annual Report on European SMEs 2014/2015 - SMEs start hiring again*, Report prepared for the Commission, 2015, p. 3. Henceforth *SMEs start hiring again*

³⁴ *SMEs start hiring again*, p. 3; PwC, ICF and Ecorys, *SMEs access to public procurement markets SMEs access to public procurement markets and aggregation of demand in the EU*, Study prepared for the European Commission, 2014, pp. 5 and 25. Henceforth *SMEs access to public procurement*

³⁵ *Green Paper*, p. 27.

³⁶ Burgi, “Small and medium-sized enterprises and procurement law – European legal framework and German experiences”, *Public Procurement Law Review*, 2007, 16, pp. 284-294, on p. 259

SMEs recovered after 2009.³⁷ It also appears that SMEs did not suffer equally to larger enterprises after the financial crisis: according to a survey in United Kingdom, 28 per cent of SMEs reported that their turnover exceeded their pre-crisis turnover, while 34 per cent reported that their turnover had remained the same.³⁸

Thirdly, SME promotion contributes to protect and expand the labour market in Europe. SMEs already employ 67 per cent of the EU population, representing approximately 90 million jobs.³⁹ Furthermore, SMEs create considerably more employment than large companies.⁴⁰ In fact, SMEs accounted for 71.4 per cent of the increase in the non-financial business sector's employment in 2014.⁴¹ This makes SMEs a vital asset for Europe's many unemployed seeking work.

*Fourthly, SME participation has positive effects on competition, which is considered one of the primary goals of public procurement.*⁴² A higher SME participation increases the competition for public contracts by broadening the potential provider base over time.⁴³ Increased competition leads to better value for money and efficiency of public spending, which is highlighted in Directive 2014/24.⁴⁴

*Lastly, by increasing the number of competitors in the relevant market, SMEs have a tendency to create innovation.*⁴⁵ SMEs tend to have a simpler organisation and less bureaucratic structure, which makes them more flexible and allow for them to adapt and respond to the needs in the market.⁴⁶ Innovation drives economic growth while it improves the efficiency

³⁷ Wymenga, Spanikova, Barker, Konings, and Canton, *EU SMEs in 2012: at the crossroads - Annual report on small and medium-sized enterprises in the EU, 2011/12*, Report for the European Commission, 2012, pp. 9-10

³⁸ BIS, *BIS Small Business Survey 2010, 2011*, p. 1

³⁹ *SMEs start hiring again*, p. 7

⁴⁰ Trybus (2014), p. 257 for further references

⁴¹ *SMEs start hiring again*, p. 3

⁴² Burgi (2007), p. 285; Trybus (2014), p. 259; Sánchez Graells (2015), p. 101

⁴³ Hatzis (2009), p. 346; COM(2011) 896 final, p. 11

⁴⁴ Directive 2014/24, recital 2; Trybus (2014), p. 259; Sánchez Graells (2015), p. 105

⁴⁵ Burgi (2007), p. 285; Georghiou, Edler, Uyerra and Yeow, "Policy instruments for public procurement of innovation: Choice, design and assessment", *Technological Forecasting and Social Change - An International Journal*, 86, 2014, pp. 1–12, at p. 4

⁴⁶ Hatzis (2009), p. 346 for further references

and quality of public services in addition to achieving value for money.⁴⁷ Innovation is therefore among the horizontal objectives in public procurement.⁴⁸

2.2.2.2 SMEs importance in Norway

The advantages of SMEs in Norwegian economy and public procurement are analogue to the benefits they impose at EU level. However, there are some aspects of SMEs impact in the Norwegian economy that calls for a brief review.

The public sector represents a large market in Norway. In 2014, public authorities purchased supplies, services and works for NOK 462 billion, which equals approximately EUR 49,8 billion.⁴⁹ Thus, getting assignments from the public constitutes an important source of revenue for enterprises.

According to the Commission's *SBA Sheet*,⁵⁰ SMEs make up 99,8 per cent of all Norwegian enterprises and account for about 68 per cent of all employment in the Norwegian business economy, which is only 1 percentage point higher than the EU average.⁵¹ However, the value added generated by SMEs in Norway is significantly higher than the EU average.⁵² This implies that SMEs play a more important part in Norwegian economy, compared to their contributions at EU level.

2.2.3 The disadvantages of SMEs

Despite the abovementioned advantages of SMEs, they also have some disadvantages, which may indicate that SMEs should not be promoted in public procurement.

⁴⁷ Directive 2014/24, recital 47

⁴⁸ Sánchez Graells (2015), pp. 102-103

⁴⁹ See procurement statistics at <http://www.ssb.no/offentlig-sektor/statistikker/offinnkj>; Based on exchange rates per 28.05.2016

⁵⁰ Commission, *2014 SBA Fact Sheet Norway*. Henceforth *SBA Fact Sheet*. Available at <http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review/>

⁵¹ *SBA Fact Sheet*, p. 2

⁵² The average value added by SMEs in EU is 58 per cent while the value added by SMEs in Norway is 71 per cent, see *SBA Fact Sheet*, p. 2

The first objection is that *SMEs are not necessarily the most efficient firms because they have less opportunity to generate economies of scale⁵³ and finance innovation due to their size compared to larger enterprises.*⁵⁴ However, this does not imply that all SMEs are not efficient or innovative. It is submitted by OECD that new technologies reduce the importance of economies of scale in every aspect.⁵⁵ Furthermore, innovation is not dependent on economies of scale and financing, as flexibility also facilitates innovation.⁵⁶

The second objection is that *too much SME participation in public procurement involves the use of further expenditures due to the need to evaluate tenders.* Public authorities arguably have an interest in avoiding excessive use of resources during the procurement procedure due to their limitations on budgets and administrative resources. An excessive use of resources to evaluate tenders contradicts the aim of ensuring the most efficient use of public funds and value for money, which is highlighted as part of the motivation for the public procurement reform.⁵⁷

2.2.4 Conclusion

Promoting SMEs has positive effects on the European economy due to their value creation, economic stability and contribution to the labour market. Meanwhile, SME participation benefits public procurement by increasing the competition, which leads to more efficient spending and value for money. Also, SMEs innovative tendencies are equally important to the European economy and public procurement.⁵⁸

As mentioned, the objection that not all SMEs are efficient does not imply that SMEs should not be promoted in public procurement. Thus, the remaining objection is the expenditures imposed on public authorities due to the need to evaluate more tenders. However, this concern relates to an *excess* amount of SMEs in public procurement. The key is to strike a balance between SME participation and the appropriate selection in the procurement procedure, as a

⁵³ “[...] the average cost per unit of output decreases with the increase in the scale of the outputs procured”, see Whish & Bailey, *Competition Law*, Seventh edition, 2012, p. 10.

⁵⁴ Pagano and Schivardi, "Firm Size Distribution and Growth", *Scandinavian Journal of Economics*, 2003, 105:2, pp. 255-274, at page 267

⁵⁵ OECD, *Small and Medium-sized Enterprises: Local Strength, Global Reach*, Policy Brief, 2000, p. 1. Available at <http://www.oecd.org/cfe/leed/1918307.pdf>

⁵⁶ See above in 2.2.2

⁵⁷ Directive 2014/24, recital 2

⁵⁸ Directive 2014/24, recital 47

balanced SME participation will increase the competition over time, which will lead to better value for money.⁵⁹

In summary, easier access to the public procurement market helps SMEs reach their potentials of growth, job creation and innovation while achieving greater competition for public contracts.⁶⁰ SME participation in public procurement should therefore be encouraged.

2.3 The barriers to SME participation in public procurement

Despite SMEs overall potential, they are underrepresented in public procurement, at least in procurements above EU- thresholds.⁶¹ This underrepresentation arguably deprives the European economy and the public procurement market from the benefits deriving from SME participation. Thus, this section examines *why there is a need to promote SMEs in public procurement through dividing contracts into lots*.

A study prepared for the Commission concerning SMEs access to public procurement does not reveal a significant difference between the number of SMEs winning domestic or direct cross border public contracts. Between 2009 and 2011, SMEs won 56 per cent of domestic contracts and 54 per cent of cross border contracts.⁶²

However, the average contract value won by SMEs is considerably lower than those won by larger enterprises. The combined value of the contracts won by SMEs represent only a 29 per cent share of the above-threshold market in the EU, and only 22 per cent in the EFTA States.⁶³ These aggregated contract values are disproportionate to SMEs overall significance in the economy: the 29 per cent share is considerable lower than SMEs share of gross value added produced in the business economy (58 per cent).⁶⁴

Why is it that SMEs are struggling to participate in public procurement?

⁵⁹ Sánchez Graells (2015), p. 105

⁶⁰ COM(2011) 896 final, pp. 10-11

⁶¹ *SMEs access to public procurement*, p. 5

⁶² Above EU thresholds, see *SMEs access to public procurement*, p. 67

⁶³ *SMEs access to public procurement*, p. 29

⁶⁴ *SMEs access to public procurement*, p. 35

Evidence suggest that there are a number of factors influencing the lack of SME participation⁶⁵, but the *size* of the contract⁶⁶ is probably the most prominent of them all as also recognised by the Commission.⁶⁷ *In fact, the larger a contract, the less likely it will be awarded to SMEs.* This effect is felt whenever contracts are larger than EUR 60 000.⁶⁸ The same effect is not observed among lower-value contracts.⁶⁹ The disadvantages that large contracts impose on SMEs are that the costs of tendering are too high or that the scale of the contract is beyond their capability.⁷⁰

As the value of public contracts has a major influence on the extent to which SMEs can access public contracts above EU thresholds, *dividing contracts into lots is one of the most important tools to facilitate SME participation.*⁷¹ Breaking contracts down into lots enables public contracts to be better suited to fit the capacity and the potential specialisation of SMEs.⁷²

3 Dividing contracts into lots to facilitate SMEs

3.1 Introduction

As a result of the realisation that large contracts is a major obstacle for SMEs, and among four new instruments to facilitate SMEs in public procurement⁷³, Directive 2014/24 now contains a provision regulating division of contracts into lots.⁷⁴ Dividing contracts into lots has

⁶⁵ Other obstacles are ensuring access to relevant information, the quality and understanding of the information provided, the qualification levels and financial requirements, administrative burden, the emphasis on price, time limits to draw up tenders and ensuring payments on time, see *Code of Best Practice*, pp. 2-3

⁶⁶ Hatzis (2009), p. 365; Loader, “Are public sector procurement models and practises hindering small suppliers? Evidence from English local authorities”, *Public Money & Management*, 2011, 31:4, pp. 287-294 on p. 292; *SMEs access to public procurement*, p. 49

⁶⁷ *Code of Best Practice*, p. 2

⁶⁸ *SMEs access to public procurement*, p. 6

⁶⁹ *SMEs access to public procurement*, p. 6

⁷⁰ Loader (2007), 27:5, p. 310

⁷¹ *SMEs access to public procurement*, p. 53

⁷² Shoenmaekers, “The role of SMEs in promoting sustainable procurement”, In *Sustainable Public Procurement Under EU Law: New Perspectives on the State as Stakeholder*, Beate Sjøfjell and Anja Wiesbrock (eds.), 2016, p. 169

⁷³ Other innovations are the European Single Document in Article 59, limitations of requirements for participation in Article 58 and direct payments to subcontractors in Articles 71.3 and 71.7

⁷⁴ Directive 2014/24 Article 46

received a lot of support as an SME friendly tool; however, the concept has simultaneously given rise to concerns due to potential risks imposed by dividing contracts into lots. This chapter investigates why lot division has been granted positive reviews as an SME friendly tool in section 3.2 before analysing the potential risks in section 3.3.

3.2 Lot division as a SME vehicle

Lot division implies that the contracting authority breaks a public contract into different lots in which economic operators may submit tenders for. The contracting authority then evaluates the submitted tenders for each lot, and award the winning tenderer of a lot with a contract corresponding to the content of the specific lot. For example, a contract for the purchase of computers is worth EUR 1 million. Instead of putting a single contract out to tender, the contract is divided into five lots each worth EUR 200 000. After the winning tenderer for each lot is chosen, the contracting authority signs contracts with five economic operators on the delivery of the amount of computers corresponding to each lot.

Dividing contracts into lots causes the individual contract to correspond better with SMEs restricted financial, personnel and technical capacity. As stated by Morand,

“[t]echnically, the very first way of enabling direct SME participation in public procurement is to divide proposed acquisitions of supplies and services into reasonably small lots to permit offers on quantities less than the total requirement. This allotment (or unbundling) favors wide small business participation”.⁷⁵

Also, it is not unusual that SMEs are more efficient to provide just a part of a bigger contract, since they are often tailored to offer specifically limited supplies, services or works.⁷⁶ Thus, dividing contracts into lots allows contracts to be better suited to their specialisation and restricted skills.⁷⁷

⁷⁵ Morand, “SMEs and public procurement policy”, *Review of Economic Design*, 2003, 8:3, pp. 301-318 on p. 302

⁷⁶ Grimm, Pacini, Spagnolo and Zanza, “Division into lots and competition in procurement”. In: *Handbook of procurement*, Nicola Dimitri, Gustavo Piga and Giancarlo Spagnolo (eds.), 2006, p. 180

⁷⁷ Shoenmaekers (2016), p. 169

In addition to create smaller contracts that correspond better with the capacities and specialisation of SMEs, lot division also generates more contracts, which contributes to increase SME participation. As argued by Herrera Anchustegui, lot division leads to more contracts being put out to tender while lowering their value, giving “[...] more chances [for SMEs] to win some lots and obtain a *slice of the procurement pie*”.⁷⁸ In other words, dividing contracts into lots multiplies the amount of contracts SMEs are able to tender for.⁷⁹

As seen in this discussion, lot division is an adequate tool to help SMEs overcome the obstacles of large contracts and thus promote their participation in public procurement. However, there are a few risks linked to lot division, which are reviewed immediately below.

3.3 Risks generated by dividing contracts into lots

3.3.1 Interference with competition

As stressed by Hatzis, lot division is only lawful under the public procurement regime if both SMEs and large enterprises are allowed to tender for the contract as a whole or parts of it, and if the award of the contract goes to the overall best offer, because otherwise, lot division would impose “[...] an artificial interference with competition which cannot be justified”.⁸⁰ However, as shall be seen in the analysis of Article 46.2, the provision allows for multiple bids and will thus not interfere with the competition

3.3.2 Bid rigging

Dividing contracts into lots facilitates SME participation, which in turn generates increased competition. However, lot division also have the potential of hindering competition.⁸¹

Sánchez Graells stresses that lot division risks facilitating bid rigging, which is an infringement of the competition rules in TFEU Article 101 and EEA Agreement Article 53.⁸² Directive 2014/24 states that the award of public contracts has to comply with the principles

⁷⁸ Herrera Anchustegui (2016 – in press), p. 2, his emphasis

⁷⁹ Shoenmaekers (2016), p. 169

⁸⁰ Hatzis (2009), p. 367; See similar views in Sánchez Graells (2015), pp. 350-351.

⁸¹ Grimm et al. (2006), p. 179

⁸² Sánchez Graells (2015), p. 350

of the TFEU although contracting authorities are not undertakings and the competition rules do not apply to them.⁸³ However, competition law applies to the tenderers.⁸⁴ Thus, public procurement law and competition law regulate two different sides of the procurement and it is therefore natural that these regulations complement each other.⁸⁵

According to the OECD, bid rigging, also referred to as collusive tendering,

“[...] occurs when businesses, that would otherwise be expected to compete, secretly conspire to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process”.⁸⁶

Bid rigging is harmful to public procurement as it drains resources from public authorities and ultimately the taxpayers by undermining the benefits of competition and weakens the confidence in the competitive process.⁸⁷

Since bid-rigging agreements are conducted in secret, they are difficult to discover.⁸⁸

However, economic theory suggests preventing the risk of bid rigging by applying two criteria when contracts are divided into lots. Firstly, to prevent distribution of lots among tenderers, weaken the collusion and increase the chances of detection, the number of lots should be smaller than the expected number of tenderers.⁸⁹ Secondly, the number of lots must exceed the number of contracts to reserve additional lots for new entrants.⁹⁰ Consequently, lot division regulation should not require contracts to be divided into specific numbers of lots, but allow for flexibility.⁹¹ In line with these recommendations, Article 46.1 gives the

⁸³ Directive 2014/24, recital 1; Case C-205/03 P *FENIN v Commission* [2006] ECR I-6295, para 26 and Case C-113/07 P *Selex Sistemi SpA v Commission* [2009] ECR I-2207, para 102, referred to in Ølykke, “How does the Court of Justice of the European Union Pursue Competition Concerns in a Public Procurement Context?”, *Public Procurement Law Review*, 2011, 6, pp. 179-192, at pp. 180-181.

⁸⁴ Ølykke (2011), p. 179

⁸⁵ As indicated by Directive 2014/24, recital 1

⁸⁶ OECD, *Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement*, 2012, p. 5

⁸⁷ OECD, *Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement*, 2012, p. 5

⁸⁸ OECD, *Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement*, 2012, p. 15

⁸⁹ Grimm et al. (2006), pp. 168-169; Sánchez Graells (2015), p. 350

⁹⁰ Grimm et al. (2006), p. 169; Sánchez Graells (2015), p. 350

⁹¹ Sánchez Graells (2015), p. 350

contracting authority discretion to decide the number of lots, which reduces the risk of facilitating bid rigging.⁹²

3.3.3 Lot division may not be feasible

It is also submitted that lot division might not always be feasible, in that dividing the contract might render the procurement of supplies, services or works concerned technically or economically difficult to implement, or decrease the efficiency of the procurement process or raise the procurement costs disproportionately.⁹³ Lot division regulation must therefore allow for flexibility so that public procurement is not impeded and to avoid ineffective and costly procurement procedures.⁹⁴ However, this has also been taken into account in the design of Article 46.1, which allow for the award of a single contract in these situations.⁹⁵

3.3.4 Increased costs and complication of the procurement procedure

A more practical concern is that dividing contracts into lots complicates and increases the costs of the procurement process. Lot division might cause legal complications regarding the division of work and increase coordination costs.⁹⁶ Dividing contracts into lots involves dealing with multiple parties and contracts, which is more costly, both financially and administratively than dealing with only one party and one contract.⁹⁷ In addition, public authorities usually have limited budgets and administrative resources, which causes lot division to not always be desirable from the contracting authority's point of view.

3.4 Conclusion

As seen by the discussion above, the risks concerning interference with competition, bid rigging and that lot division might not be feasible for the procurement concerned, has been taken into account in the design of Article 46 as the analysis in section 4.2.2 shows.

⁹² See also Sánchez Graells (2015), p. 350

⁹³ Sánchez Graells (2015), p. 349

⁹⁴ Sánchez Graells (2015), p. 349

⁹⁵ Directive 2014/24, recital 78

⁹⁶ Hatzis (2009), p. 366

⁹⁷ Hatzis (2009), pp. 366-367; Pedro Telles points out that lot division also increases the transaction costs for economic operators since more resources are required to bid on multiple lots than to bid once on a large contract, see blogpost at <http://www.telles.eu/blog/2015/4/30/public-contracts-regulations-2105-regulation-46>

Also, the concern of increased costs and complication of the procurement procedure will be remedied although this does not follow from the design of Article 46. Despite that lot division increases the administrative costs for contracting authorities, the benefits deriving from an increased SME participation in public procurement and increased competition for the specific public contract and for future public contracts, improves value for money, will outweigh this objection.⁹⁸ More precisely, even though lot division is more costly than awarding a single contract in a *short-term perspective*, the increased supplier base will generate cost-savings in a *long-term perspective*.⁹⁹

Concluding, Article 46 is a SME-friendly tool since it does not require using additional secondary policy mechanisms to promote SME participation and neither has significant market distorting effects by decreasing competition.¹⁰⁰

4 The effects of Article 46 on SME participation

4.1 Introduction

As seen from the discussion above, lot division is an adequate tool to promote SMEs in public procurement and letting them overcome the obstacles of large contracts by generating contracts more compatible to their size. However, despite being relatively new, and only recently implemented by the Member States, Article 46 has already been the subject of criticism due to its *soft approach*¹⁰¹ which risks that the provision will not achieve its aim of *promoting SMEs in public procurement, but merely remain a political flag devoid of content*.¹⁰²

Thus, this section analyses the legal regime applicable to dividing contracts into lots in section 4.2 before evaluating the effects of the provision on SME participation, and in particular the justification required to award a single contract, in section 4.3.

⁹⁸ Hatzis (2009), p. 367; Sánchez Graells (2015), p. 348

⁹⁹ Herrera Anchustegui (2016 – in press), pp. 6 and 14

¹⁰⁰ Morand (2003), p. 302; Herrera Anchustegui (2016 – in press), p. 2

¹⁰¹ Sánchez Graells (2015), p. 347; Herrera Anchustegui (2016 – in press), p. 7

¹⁰² Herrera Anchustegui (2016 – in press), pp. 7 and 15

4.2 Presentation of Article 46

4.2.1 The legislative process

The previous public procurement directives¹⁰³ did not contain any provisions on dividing contracts into lots. Although they allowed for contracts to be divided into separate lots, their intentions was not to *regulate* lot division, but rather to ensure that lot division did not circumvent the thresholds and avoid the directives from applying to the tender process.¹⁰⁴ The only other reference to lot division was made in Directive 2004/18/EC Annex VII A, which stated that if contracts were divided, an indication of the possibility of tendering for one, several or all the lots needed to be included in the contract notice.¹⁰⁵ Article 46 is thus an innovation that came along with the adoption of Directive 2014/24.

The wording of the disposition dealing with lot division was disputed during the legislative process, and in particular the phrasing of the requirement to provide a justification when contracting authorities decides not to divide the contract. This section takes a brief look at the historical development of the provision.¹⁰⁶

The idea behind the Commission's proposal¹⁰⁷ was to invite contracting authorities to divide contracts into lots to make public contracts more accessible for SMEs by demanding a specific explanation when lot division was not chosen.¹⁰⁸

According to the original proposal Article 44.1 – contracting authorities “[...] shall provide in the contract notice or in the invitation to confirm interest a *specific explanation of its reasons*”.¹⁰⁹ The associated recital 30 further elaborated that contracting authorities “[...] should be encouraged to divide contracts into lots, and be obliged to state the reasons for not

¹⁰³ Directive 2004/18/EC and Directive 2004/27/EC

¹⁰⁴ Directive 2004/18/EC, Article 9.5 and recital 9; Directive 2004/17/EC, Article 17.6 and recital 17; Trybus (2014), p. 262

¹⁰⁵ Sánchez Graells (2015), p. 347

¹⁰⁶ For a more detailed discussion, see Herrera Anchustegui (2016 – in press) pp. 2-6

¹⁰⁷ COM(2011) 896 final

¹⁰⁸ COM(2011) 896 final, p. 11

¹⁰⁹ COM(2011) 896 final, p. 76, my emphasis

doing so”.¹¹⁰ In summary, the Commission’s proposal put forward a “divide or explain” approach.¹¹¹

The Parliament supported the need to promote SMEs access to public procurement; however, their view was that “[...] a near total obligation for contracting authorities to divide contracts into lots is the wrong approach”.¹¹² In keeping with this notion, the Parliament suggested suppressing the “divide or explain” approach in Article 44.1.¹¹³

However, an interim solution was ultimately reached. The final wording of Article 46.1 is therefore a compromise between a strict explanation duty and a proposal to suppress this duty as a whole. The following sections analyses the final wording of Article 46, with an emphasis on the reception of the “divide or explain” justification and its effects on SME participation.

4.2.2 The final outcome of Article 46

First and foremost, Article 46.4 allows Member States to decide when and under which circumstances public procurement contracts shall be divided pursuant to national legislation.

When lot division is not made mandatory, Article 46.1 states that contracting authorities “[...] may decide to award a contract the form of separate lots and may determine the size and subject matter of such lots”. Lot division could be done on quantitative basis, in that the individual contract size correspond with the capacity of SMEs, or on qualitative basis, in accordance with the different trades and specialisations involved to adapt the content of the individual contracts more closely to the specialised sectors of SMEs or in accordance with different subsequent project phases.¹¹⁴

If the contract is not divided, contracting authorities must provide an “[...] indication of the main reason for their decision [...]”.¹¹⁵ Any administrative or judicial supervision of the

¹¹⁰ COM(2011) 896 final, p. 21

¹¹¹ Herrera Anchustegui (2016 – in press), p. 3

¹¹² Parliament, *Report on the proposal for a directive of the European Parliament and of the Council on public procurement, A7-0034/2013, 2013*, p. 29

¹¹³ Parliament, *Report on the proposal for a directive of the European Parliament and of the Council on public procurement, A7-0034/2013, 2013*, p. 95 Amendment 163 and p. 300 Amendment 68

¹¹⁴ Directive 2014/24, recital 78

¹¹⁵ Directive 2014/24, Article 46.1

reasons is banned, meaning that contracting authorities retain autonomy to apply any reasons they deem relevant.¹¹⁶

According to Article 46.2, contracting authorities must specify in the contract notice or the invitation, whether it is allowed to tender for one, several or all lots. Contracting authorities may however, limit the number of lots that may be awarded to the same tenderer.

Member States may also provide that, where more than one lot may be awarded to the same tenderer, contracting authorities may award contracts combining several or all lots where this provided for in the contract notice or invitation, in addition to which lots or groups of lots that may be combined.¹¹⁷

As seen by this analysis, Article 46 has taken into account the risks generated by dividing contracts into lots.¹¹⁸ The provision facilitates competition between larger companies and SMEs by not favouring SMEs and allowing bundling of lots, as well as providing flexibility in that lot division is not obligatory when it renders the execution of the procurement difficult. Also, Article 46 increases the likelihood of preventing and detecting bid rigging by allowing the contracting authority to decide the number of lots to be created.¹¹⁹

4.3 Does Article 46 achieve its goal of promoting SMEs?

4.3.1 General remarks

As a whole, Article 46 is welcome because it regulates of lot division, which promotes SME participation. Further, Article 46 ensures that lot division is part of the framework for the procurement regulation in all Member States, and thus creates a greater degree of homogeneity regarding facilitating SMEs throughout Europe. However, there are a few issues regarding the design of Article 46, which give rise to doubt of whether the provision will be an effective remedy to promote SME participation in public procurement.

¹¹⁶ Directive 2014/24, recital 78; See different view in Sánchez Graells (2015), p. 347

¹¹⁷ See Article 46.3

¹¹⁸ See discussion in section 3.3

¹¹⁹ Sánchez Graells (2015), p. 350

Firstly, I submit that SME participation would be facilitated further if Directive 2014/24 provided certain circumstances in which lot division was obligatory. The current national discretion has led to, as shall be seen in the comparative analysis of the implementation below, that none of the selected Member States chose to make lot division mandatory pursuant to Article 46.4. As indicated by Article 46.4, there are circumstances in which it is possible to require mandatory lot division, and these would be circumstances, that would not depend upon the conditions in the various Member States. However, although it is possible to identify common terms at EU level, it is appropriate to leave this discretion to Member States, as mandatory lot division is a matter of national policy as well. In addition, this discretion up to Member States does not contradict the purpose of Article 46, which is to increase SME participation.

Secondly, I submit alongside with the concerns raised in legal theory¹²⁰ that the soft justification required when awarding a single contract according to Article 46.1 fails to provide sufficient incentives to divide contracts. This statement is elaborated in section 4.3.2.

Thirdly, I submit that the possibility to bundle lots pursuant to Article 46.3 counteract the effort to divide the contract in the first place.¹²¹ When lots are reassembled back into larger contracts, SMEs will once again experience the difficulties of large contracts. However, as submitted by Sánchez Graells, it is important to allow flexible rules “[...] that allow for a trade-off between fostering competition between smaller bidders and allowing larger bidders to exploit economies of scale, as well as for independent decisions to be made by tenderers – since multiple or package bidding will encourage bidders to submit more competitive packages than they would for independent lots or all the lots”.¹²² Although bundling of lots puts SMEs at disadvantage, it is necessary to avoid artificial disruption of competition and to comply with the public procurement principle of non-discrimination.¹²³

4.3.2 The obligation to provide a justification

¹²⁰ Herrera Anchustegui (2016 – in press), p. 7

¹²¹ Trybus (2014), p. 353; Sánchez Graells, 2015, p. 352

¹²² Sánchez Graells (2015), p. 350

¹²³ Hatzis (2009), p. 367

4.3.2.1 The requirement of ‘indication of the main reasons’

In view of the remarks above, an increased SME participation will depend on whether the justification requirement is likely to provide strong enough motivation to divide public contracts. However, the final outcome of the justification requirement in Article 46.1 has been described in legal literature as *soft-approach*¹²⁴, which might not be able to facilitate lot division and SME participation. Thus, this section outlines the objections in legal literature and evaluate whether the justification required will incentivise contracting authorities to divide contracts.

Although lot division is desirable to facilitate SME participation, it is recalled that dividing contracts into lots generates increased use of resources for contracting authorities, and due to their usually limited budgets and administrative resources, lot division may not be desirable from the contracting authority’s perspective.¹²⁵ However, despite being more costly in a short-term perspective, lot division increases the supplier base, which will generate cost-savings in a *long-term perspective*.¹²⁶ Contracting authorities must therefore be given incentives to be encouraged to divide contracts into lots. The function of the justification requirement in Article 46.1 is to provide such incentives.

The rationale for requiring a justification when deciding to award a single contract is for contracting authorities to be “[...] encouraged to divide large contracts into lots” and to establish “[...] a duty to consider the appropriateness of dividing contracts into lots [...]”.¹²⁷ Trybus elaborates further by stating that “[t]he obligation to provide reasons for awarding a single contract forces officers to pause to consider the possibility to divide the contract into lots”.¹²⁸ Moreover, I submit that when contracting authorities fail to provide relevant and sufficient reasons as to why they do not consider lot division appropriate, they will have no choice but to divide the contract.

First of all, it is clear when reading Article 46.1 that lot division is the general rule, and that the award of a single contract is the exception. By identifying lot division as the main rule,

¹²⁴ Sánchez Graells (2015), p. 347; Herrera Anchustegui (2016 – in press), p.7

¹²⁵ See discussion in section 3.3.4

¹²⁶ Herrera Anchustegui (2016 – in press), p. 7

¹²⁷ Directive 2014/24, recital 78

¹²⁸ Trybus (2014), pp. 265-266

incentives to divide the contract are generated because it creates a general expectation that contracts will be divided and derogations must be justified.

As mentioned, the wording in Article 46.1 was chosen as a compromise and differs from the original and more prescriptive proposal in Article 44.1, which required contracting authorities to give a ‘specific explanation of its reasons’.¹²⁹ It may nevertheless be argued that regardless of the formulation, the reasons for not dividing the contract must appear in the contract documents, resulting in that contracting authorities are forced to consider whether the contract should be divided. From this point of view, the choice of wording will not impact contracting authorities incentives to divide the contract.

However, the change implies that the two wordings impose different requirement to the justification and *what varies is the level of thoroughness of the assessment*. In line with this notion, the final outcome of Article 46.1 is described in legal literature as a softer “divide or explain” approach¹³⁰, since the wording does not require a thorough justification from contracting authorities.

Herrera Anchustegui argues that the final outcome of the provision in Article 46.1 is “[...] rather timid and ambiguous [...]” as the wording of ‘providing an indication’ imposes a lower threshold of motivation of the decision [...]”.¹³¹ Further, he argues that Article 46 “[...] may risk becoming a political flag devoid of content”.¹³² In my opinion, the criticism is legitimate, as ‘indication’ does not imply the same level of completeness as ‘specific explanation’; the more thorough and detailed explanation required the more contracting authorities are forced to conduct a proper assessment on whether the contract should be divided. A requirement to provide an ‘indication’ gives little motivation to make a carefully considered assessment, since it does not require a full review of the assessment to appear in contract notice. In addition, the clarification that only the ‘main reasons’ is needed lowers the motivation to undertake a thorough assessment further, compared to the Commission's proposal, which did not limit the justification requirement to include only the main reasons.

¹²⁹ See the discussion in section 4.2.1

¹³⁰ Sánchez Graells (2015), p. 347; Herrera Anchustegui (2016 – in press), pp. 2 and 7

¹³¹ Herrera Anchustegui (2016 – in press), p. 7

¹³² Herrera Anchustegui (2016 – in press), p. 7

Furthermore, recital 78 points out that when considering lot division, contracting authorities are “[...] free to decide autonomously on the basis of any reason it deem relevant [...]”.¹³³ Thus, contracting authorities have considerable freedom with regards to which reasons they consider to be sufficient, and thus retain authority for when lot division is appropriate. This public buyer is closest to evaluate the appropriateness of lot division, especially since lot division might not be feasible for the specific work, service or supply they want to procure.¹³⁴ A certain degree of flexibility is therefore sensible.¹³⁵ However, when the demands on the justification are low and no administrative and judicial review of the reasons provided shall take place, this freedom of choice might risk rendering Article 46.1 devoid of content, as worded by Herrera Anchustegui.

Fortunately, the Directive provides examples that guide the application of Article 46.1 by listing some reasons in which it is justified not to divide the contract into lots. These would be instances in which lot division risks

“[...] restricting competition, or risk rendering the execution of the contract excessively technically difficult or expensive, or that the need to coordinate the different contractors for the lots could seriously risk undermining the proper execution of the contract”.¹³⁶

Although these examples are not exhaustive, they provide, in my opinion, a threshold for acceptable reasons not to divide contracts into lots. By showing situations where lot division may not be appropriate, the seemingly limitless freedom of contracting authorities is counteracted to a certain extent because the reasons they use must comply with this threshold.

In addition to specifying a certain threshold, I submit, based on the contribution of Sánchez Graells, that these examples also guides how the assessment should be carried out, by indirectly providing the legal standard; *lot division is the main rule, unless it proves to be inadequate or disproportionate due to the work, supplies and services concerned*.¹³⁷ Although contracting authorities are free to base their decision on the reasons they deem relevant, these

¹³³ Directive 2014/24, recital 78

¹³⁴ Sánchez Graells (2015), p. 349.

¹³⁵ Sánchez Graells (2015), p. 349.

¹³⁶ Directive 2014/24, recital 78

¹³⁷ Sánchez Graells (2015), p. 349.

reasons must be sufficient to prove that lot division is inadequate or disproportionate for the contract concerned in. Thus, the main reasons of why lot division is inadequate or disproportionate must appear in the contract documents, and this will create confidence in that the contracting authorities based their decision on acceptable reasons.

However, the justification requirement in Article 46.1 is still problematic as a mere ‘indication of the main reasons’ makes it difficult to assess whether the contracting authority has seriously considered lot division. This concern might risk that contracting authorities circumvent the duty to consider lot division. Both Herrera Anchustegui and Trybus argue that *the soft requirement might tempt to use the “cut and paste” method.*¹³⁸ This method implies that the contracting authority only lists standard reasons to award a single contract without seriously considering lot division.¹³⁹

In my opinion, this risk of “cut and paste” answers gives cause for serious concern that Article 46.1 is not capable of facilitating lot division as intended. Since no thorough justification needs to appear in the contract documents it is easy for contracting authorities to circumvent the process of weighing the arguments for and against dividing the contract, and this risk of circumventing the assessment render the whole point of providing an ‘indication’ meaningless. Since a proper assessment is crucial to create adequate incentives to divide the contract, the objection in legal theory is legitimate.

Concluding, this analysis shows that the design of Article 46.1 has some important deficiencies, in particular the risk of the ‘copy paste’ method, which might negatively impact the ability of the provision to create incentives for contracting authorities to divide contracts into lots and impact SME successful participation in EU public procurement. The next sections therefore consider whether the issues of the soft wording can be remedied through the principle of good administration in section 4.3.2.2, the fundamental market freedoms in section in 4.3.2.3 and finally the competition principle in section 4.3.2.4 before concluding on the effects of these remedies in section 4.3.2.5.

¹³⁸ Trybus (2014), p. 266; Herrera Anchustegui (2016 – in press), p. 7

¹³⁹ Trybus (2014), p. 266

4.3.2.2 *The principle of good administration*

The Charter of Fundamental Rights of European Union¹⁴⁰ Article 41 sets out *the principle of good administration* and states that the right to good administration includes “the obligation of the administration to give reasons for its decisions”.¹⁴¹ ECJ has expressly stated, however, that the Charter is not addressed to Member States, but solely the institutions, bodies, offices and agencies of the EU.¹⁴² *This means that contracting authorities are not bound by the principle of good administration.*

However, the right of good administration might constitute an integral part of *the right to defence*, which is a principle of EU law.¹⁴³ Herrera Anchustegui argues in line with Advocate General Wahl¹⁴⁴ that the issue would in that case be to decide whether

“[...] *providing a mere indication* of the reasons not to divide is sufficient to *fulfil the thresholds required by the rights of good administration and defence under EU law* or, it if on the contrary, contracting authorities are obliged to give a clear explanation why the contract was not divided, the standard required from the Commission when deciding competition law cases, for example”.¹⁴⁵

In this context it is recalled that even though Directive 2014/24 precludes the possibility for legal and administrative supervision, this only applies to the *reasons* the contracting authority deems relevant, and not whether the contracting authority has provided a *sufficient justification*.¹⁴⁶

Further, Herrera Anchustegui argues that

¹⁴⁰ Henceforth *the Charter*; The Charter has the same legal status as TEU and TFEU meaning that the Charter serves aid to the interpretation of EU Directives, see TEU art. 6.1, see Lenaerts, “Exploring the Limits of the EU Charter of Fundamental Rights”, *European Constitutional Law Review*, 2012, 8:3, pp. 375-403 on pp. 375-376

¹⁴¹ *The Charter*, Article 41.2 (c)

¹⁴² See inter alia C-482/10, *Teresa Cicala v Regione Siciliana* [2011] ECR I-14139 para 28; Joined cases C-141/12 and C-372/12, *Ys and others* [2014] EU:C:2014:2081 para 67; C-166/13, *Mukarubega* [2014] EU:C:2014:2336 para 44; Herrera Anchustegui (2016 – in press), p. 7

¹⁴³ C-166/13, *Mukarubega* para 45 which referred to Article 41.2 (a), see Herrera Anchustegui (2016 – in press), p. 7

¹⁴⁴ C-268/14 P, Opinion of Advocate General Wahl in *Italmobiliare SpA v European Commission*, EU:C:2015:697, para 51

¹⁴⁵ Herrera Anchustegui (2016 – in press), p. 7, his emphasis

¹⁴⁶ Directive 2014/24, recital 78; See different view in Sánchez Graells (2015), p. 347

“[a] mere indication of the reasons not to divide the contract would probably be considered by the CJEU as limiting excessively the right of good administration and defence as the claimant would lack sufficient information as to the reasons determining why the contract was not divided”.¹⁴⁷

In my opinion, this argument is legitimate as lack of information restricts the right to defence in two respects.

Firstly, for the right to defence to be effective, the complainant must have *sufficient information to evaluate whether or not to take legal action*. Lack of information makes it difficult for the complainant to assess whether the award of a single contract was in accordance with Article 46.1.

Secondly, the burden of proof that follows national procedural law usually lies on the complainant.¹⁴⁸ *When most of the information regarding the decision not dividing the contract is kept in the hands of the contracting authority, or solely in their knowledge, it is difficult for the complainant to attain the proof requirements*. When the complainant knows that he cannot prove his case, he will refrain from making a complaint at all.

Thus, lack of information leads to a high threshold for complaints, which would restrict the right to defence and ultimately result in that the justification is solely in the contracting authorities' discretion. For the right of defence to be effective, the ECJ could argue that the 'indication' must be sufficiently substantive so that economic operators have the possibility to *review whether the award of a single contract was in accordance with Article 46.1*.

4.3.2.3 The fundamental market freedoms

The award of public contracts needs to comply with the free movement of goods and freedom to provide services, which comprises free movement of goods, freedom of establishment and

¹⁴⁷ Herrera Anchustegui (2016 – in press), p. 7

¹⁴⁸ Bovis, *EU Public Procurement Law*, 2. Edition, 2012, p. 231

freedom to provide services.¹⁴⁹ In this relation, Herrera Anchustegui argues that if the mere ‘indication’ constitutes a breach on the right to defence, the ECJ could

“[...] argue that the lack of substantive indications may implicitly reduce the incentives of economic operators to tender and, therefore may impact their exercise of the fundamental market freedoms”.¹⁵⁰

As a mere ‘indication of the main reasons’ does not provide sufficient incentives for contracting authorities to divide contracts into lots, there will not be many contracts that SMEs will be able to tender for, which in turn reduces their incentives to tender. Following this argumentation, the ECJ could require that contracting authorities provide a substantive explanation of the reasons as to why the contract was not divided into lots”.¹⁵¹

4.3.2.4 The principle of competition

Competition is considered as one of the most overreaching and desirable goals in public procurement as competition helps ensure value for money.¹⁵² The importance of the competition principle resulted in Article 18.1, which codifies that the principle of competition should be a normative and legal guideline for the interpretation of the rules on procurement in the directive.¹⁵³ Thus, Article 18.1 is relevant for the interpretation of the justification requirement in Article 46.1. Also, any anti-competitive procurement practises constitute a breach of Directive 2014/24.¹⁵⁴

Article 18.1 proclaims that, “[t]he design of the procurement procedure shall not be made with the intention [...] of artificially narrowing competition”. Further, it explains that competition shall be considered artificially narrowed where “the design of the procurement is

¹⁴⁹ Directive 2014/24, recital 1

¹⁵⁰ Herrera Anchustegui (2016 – in press), p. 7-8 for further references.

¹⁵¹ Herrera Anchustegui (2016 – in press), p. 7-8 for further references.

¹⁵² Sánchez Graells (2015), pp. 102 and 105;

¹⁵³ Sánchez Graells, “A Deformed Principle of Competition? – The Subjective Drafting of Article 18(1) of Directive 2014/24”. In: Grith Skovgaard Ølykke & Albert Sánchez-Graells (eds.), *Reformation or Deformation of the EU Public Procurement Rules in 2014*, 2016 – in press, p. 7.

¹⁵⁴ Sánchez Graells (2015), p. 215

made with *the intention of unduly favouring or disadvantaging certain economic operators*".¹⁵⁵

When lot division is not chosen, SMEs are put to a disadvantage while the competition decreases, since there are fewer potential economic operators able to tender for the contract. However, this does not in itself constitute a breach of Article 18.1 as provision requires that the disadvantage of certain economic operators must be *unduly*.

This means that when lot division, in line with the legal standard established in section 4.3.2.1, proves to be inadequate or disproportionate to the nature of the contract, the award of a single contract does not *unduly* favour larger companies or disadvantage SMEs, since there are legitimate reasons as to why the contract was not divided.

On the contrary, if a contracting authority merely copy-paste standard reasons to avoid lot division, I submit that this might constitute a violation of Article 18.1; when lot division is refused in this hypothetical scenario, the design of the contract *unduly disadvantages and favours certain economic operators*.

Following this argumentation, the ECJ could argue that contracting authorities must provide a substantial justification in order to comply with the competition principle.

4.3.2.5 Conclusion on the effects of the remedies

The implications of the right to good administration and defence, the fundamental market freedoms and the competition principle do not directly remedy the soft wording of Article 46.1. However, they are additional mechanisms, which could motivate contracting authorities to undertake a proper assessment on whether lot division is appropriate and to provide a substantial 'indication' to avoid the risk of being challenged by the ECJ.

Nevertheless, relying on these remedies to motivate contracting authorities to provide a substantial justification is not a practical solution. As the aim of Article 46.1 is to provide incentives to divide the contract, the motivation should derive from the provision itself.

¹⁵⁵ My emphasis. The discussion on the subjective element of 'intention' is outside the scope of this thesis. For a discussion on the topic, see Sanchez Graells (2016 – in press)

4.4 Reflections

Although the lot division-rule has received a lot of support as a SME-friendly tool and is seen as the most adequate tool to promote SME participation, the design of Article 46 has some important deficiencies, which will risk the provision becoming devoid of content.

Since Directive 2014/24 does not identify circumstances in which lot division shall be mandatory, SME participation depends on the incentives to divide contracts arising from the justification requirement, unless Member States choose to implement mandatory lot division in their national legislation. Although SME participation is also affected negatively by the possibility to bundle lots, this is a necessary method to comply with the principle of non-discrimination.

I submit that the *justification requirement is too weak to create sufficient incentives to divide the contract*, especially considering the additional financial and administrative costs imposed on the contracting authority caused by lot division.

Although Directive 2014/24 provides the legal standard for the assessment on whether the contract should be divided, this provides little help, as the assessment does not have to appear in the procurement documents. Thus, requiring a mere ‘indication of the main reasons’ gives little motivation to divide contracts and risks the use of “copy-paste”-method.

The implications of the right to good administration and defence, the fundamental market rights and the competition principle provides the opportunity for judicial review of ‘indication of the main reasons’, which might help create incentives to undertake a proper assessment and provide a substantial justification when awarding a single contract. This presupposes that ECJ will follow similar argumentations in the future to come. However, to rely on judicial review to create a more substantial requirement than a mere ‘indication of the main reasons’ is an impractical solution, since the incentives to divide contracts should derive from Article 46.1 as the aim of the provision is to encourage contracting authorities to divide contracts into lots to facilitate SME participation.¹⁵⁶

¹⁵⁶ Directive 2014/24, recital 78

5 The Norwegian proposal on lot division

5.1 Introduction

The national policy on lot division varied between Member States before the adoption of Directive 2014/24.¹⁵⁷ The inclusion of Article 46 ensures that lot division is part of the framework for the procurement regulation in all Member States, and thus creates a greater degree of homogeneity in EU. Although EU/EEA Directives are legally binding, Member States are free to choose the form and method as long as the results set out in the Directives is achieved.¹⁵⁸

Directive 2014/24 specifies that Member States are free to go further in their efforts to ease of access for SME participation by lot division; either by extending the requirement to give reasons or by making lot division mandatory under certain conditions.¹⁵⁹ Thus, the effect of lot division as a SME-vehicle in practice depends largely on the national regulation.

The implementation of Article 46 may vary between Member States. The aim of this part is to evaluate the Norwegian proposal, and in particular the justification requirement, before comparing it to the implementation in Denmark, United Kingdom and France.

5.2 Current public procurement legislation

Both the current Public Procurement Act¹⁶⁰ and Regulation¹⁶¹ on public procurement contain provisions, like the previous public procurement directives, allowed contracts to be divided into lots. The only references to lot division state that contracting authorities are not allowed to divide a contract to avoid the Public Procurement Act and Regulation from applying.¹⁶² Otherwise, as in the case of the former public procurement directives, division of contracts is not regulated.

¹⁵⁷ *SMEs access to public procurement markets*, p. 6

¹⁵⁸ TFEU Article 288 and EEA Agreement Article 3 and 7.

¹⁵⁹ Directive 2014/24, recital 78

¹⁶⁰ Anskaffelsesloven

¹⁶¹ Forskrift om offentlige anskaffelser

¹⁶² Anskaffelsesloven § 5 femte ledd bokstav c and Forskrift om offentlige anskaffelser § 3-1 tredje ledd

A proposal on new law on public procurement is currently being considered in the Parliament.¹⁶³ After Parliamentary Decision is made this proposal repeal the current Public Procurement Act although some changes may be made during the Parliamentary hearing. Division of contracts into lots will be regulated in the forthcoming Regulation and the current proposal suggests implementing the lot division rule in § 14-1.¹⁶⁴

5.3 Presentation and general remarks on the lot division proposal

The Norwegian proposal for new regulation on public procurement does not make lot division mandatory as allowed for by Article 46.4. This decision is justified in the preparatory works by the potential negative consequences of lot division concerning the legal responsibility and risk distribution when the responsibility is placed on multiple economic operators.¹⁶⁵ In my opinion, specifying in the contract that the party to it is responsible might solve this objection. Although the placement of responsibility might be difficult to establish or predict for some procurements since the different contributions are interrelated, mandatory lot division does not have to encompass such contracts, but rather where it is easier to distinguish between the various contributions.

Furthermore, another objection against mandatory lot division in the preparatory work is that lot division requires more personnel and resources for technical and financial coordination and monitoring when implementing the contract, and that lot division would make it more difficult to apply to the functional requirements.¹⁶⁶ In my opinion, difficulties with functional requirements do not necessarily apply to all purchases. For example, the purchase of paper could be made through several economic operators without interfering with functional requirements of the purchase. Regarding the increased use of administrative and financial resources when buying through lots, the benefit of long-term value for money outweighs the

¹⁶³ Regjeringen, Nytt anskaffelsesregelverk er underveis <https://www.regjeringen.no/no/tema/naringsliv/konkurransopolitikk/offentlige-anskaffelser-listeside/nytt-anskaffelsesregelverk-er-underveis/id2482572/>; Prop. 51 L (2015-2016) - Lov om offentlige anskaffelser (anskaffelsesloven)

¹⁶⁴ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser

¹⁶⁵ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser, p. 17

¹⁶⁶ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser, p. 17

short-term savings by awarding a single contract.¹⁶⁷ However, although SMEs would be facilitated further, mandatory lot division is a matter of national policy and discretion.¹⁶⁸ As previously mentioned in section 4.3.1, the decision not to implement mandatory lot division does not contradict the purpose of increase SME participation.

According to the proposal, contracting authorities must therefore undertake an assessment of whether lot division is appropriate for the specific contract pursuant to Article 46.1 of Directive 2014/24. The proposed Public Procurement Regulation § 14-1 (2) demands a “kort begrunnelse” – a short explanation, from contracting authorities when they decide not to divide the contract.¹⁶⁹ Judicial review of the grounds, either KOFA or the courts, is not possible.¹⁷⁰ An analysis of the justification requirement takes place in section 5.4.

Norway also suggests implementing the option of combing several or all lots pursuant to Article 46.3 in the proposed § 14-1 (5).¹⁷¹ As argued in section 4.3.1, this reassembling of contracts might counteract the efforts to divide contracts in the first place. However, it is necessary to avoid artificial disruption of competition and to comply with the public procurement principle of non-discrimination.¹⁷²

Overall, the proposed lot division implementation into the Norwegian legislation seems in my opinion to be supportive of short time savings for the contracting authorities and efficiency rather than to support SME participation. This approach is disappointing, considering the important part SMEs play in Norwegian economy.¹⁷³

5.4 The requirement of ‘kort begrunnelse’

The preparatory work does not reveal whether the choice of wording was disputed or whether “kort begrunnelse” demands less than an ‘indication of the main reasons’. The lack of explanation suggests that the lawmakers consider § 14-1 (2) to be in accordance with

¹⁶⁷ Herrera Anchustegui (2016 – in press), p. 14

¹⁶⁸ Directive 2014/24, Article 46.4

¹⁶⁹ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser, p. 68, my translation

¹⁷⁰ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser, p. 17

¹⁷¹ My translation

¹⁷² Hatzis (2009), p. 367

¹⁷³ See section 2.2.2.2

‘indication’ in Article 46.1. The aim of this discussion is to evaluate the incentives to divide contracts into lots created by the Norwegian justification requirement of ‘kort begrunnelse’.

The wording of ‘begrunnelse’ – ‘explanation’ suggest that it is not enough to simply point at the reasons why the contract was not divided, and thus creates a greater insight into the contracting authority’s assessment compared to a mere ‘indication’. However in my opinion, since the literal wording explicitly requires the explanation to be “short”, it may be argued that the Norwegian regulation *sets a lower minimum requirement than provided by Article 46.1, and thus create lower incentives to divide the contract*. In addition to this low demand on completeness, by not specifying that the main reasons must be included, the Norwegian implementation may lead to even less substantial justifications than that of Article 46.1. If this interpretation is assumed, the proposed § 14-1 (2) violates Norway’s obligation to implement Directive 2014/24 Article 46.1 pursuant to EEA Agreement Articles 3 and 7.

At the same time, the consultation document makes it clear that contracting authorities are obliged to consider lot division, and that contracting authorities must provide an *explanation* when they choose not to divide the contract.¹⁷⁴ The latter implies a stricter justification requirement than ‘kort begrunnelse’. However, EU directives must be implemented in a manner so it appears clear to the citizens what rights and obligations are entailed to anticipate their legal position.¹⁷⁵ This means that it is not permissible to let the detailed content of a provision to be stated in preparatory work, which is common in Norwegian law.¹⁷⁶ Thus, since a stricter justification requirement never made it to the proposed § 14-1 (2), the wording leaves no doubt that contracting authorities are only obliged to provide a ‘kort begrunnelse’.

However, where the implementation fails to achieve the aim of a provision deriving from an EEA Directive, the Norwegian principle of presumption applies to ensure the effect of the EEA rule through an EEA-friendly interpretation of the Norwegian provision.¹⁷⁷ The core of this principle is that the Norwegian courts, so far, advice, interpret national law in line with Norway's international obligations. According to the Supreme Court decision in *Finanger I*

¹⁷⁴ Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser, p. 17

¹⁷⁵ Sejerstad, Arnesen, Rognstad og Kolstad, *EØS-rett*, 3. Utgave, 2011, p. 51

¹⁷⁶ Sejerstad et al. (2011), p. 51

¹⁷⁷ Sejerstad et al. (2011), p. 265; Franklin, ”Om innholdet i og rekkevidden av det EØS-rettslige prinsippet om direktivkonform fortolkning”, *Jussens Venner*, 2012, nr. 5, pp. 269-317 on p. 269.

does not apply when the EEA rule and Norwegian law is in *clear conflict*.¹⁷⁸ If that is the case, the result is that the Norwegian rule is given precedence over the directly conflicting EEA law provision.¹⁷⁹ Although § 14-1 (2) provides a lower minimum requirement than Article 46.1, it does not appear that an EEA-friendly interpretation pursuant to the principle of presumption will lead to a result that clearly contradicts the wording in § 14-1.

If this is the case, the presumption principle implies that § 14-1 (2) shall be given a content which is in accordance with Article 46.1 meaning that the requirement of ‘kort begrunnelse’ shall be understood as setting the same minimum requirement as providing an ‘indication of the main reasons’. Given that they set the same requirement to justification, the same objections against merely providing an ‘indication of the main reasons’ in Article 46.1 can therefore be invoked against providing a ‘kort begrunnelse’ in § 14-1 (2).

5.5 Brief comparison to other Member States

Similar to the previous EU-directives, the repealed Danish procurement law did not regulate lot division.¹⁸⁰ The Danish implementation does not make lot division mandatory, however, bundling of lots pursuant to Article 46.3 is implemented.¹⁸¹ When deciding not to divide the contract, contracting authorities are required to ‘oplyse om baggrunden herfor’ – which translates to a requirement of ‘disclose the reasons’.¹⁸²

The UK government has not followed the option in Article 46.4 to render it obligatory to award specific contracts in the form of separate lots. The implementation allows for bundling of several or all lots.¹⁸³ Contracting authorities are required to provide an ‘indication of the main reasons’ for their decision not to subdivide into lots¹⁸⁴, which is a ‘copy-paste’ of the justification requirement in Article 46.1.

¹⁷⁸ Rt.2001.1811 (Finanger), referred to in Franklin (2012), p. 269.

¹⁷⁹ Franklin (2012), p. 269

¹⁸⁰ Folketinget, L 164 - Forslag til Udbudslov, p. 92. Available at http://www.udbudsportalen.dk/ImageVaultFiles/id_43367/cf_202/Forslag_til_udbudslov_med_kommenterar.PDF

¹⁸¹ Udbudsloven, Afsnit II, Kapitel 6, § 49 stk. 3 nr. 2

¹⁸² Udbudsloven, Afsnit II, Kapitel 6, § 49 stk. 2, My translation

¹⁸³ The Public Contracts Regulations 2015 no. 102, Part 2, Chapter 2, Section 5, Sub-Section 5, Article 46 (6)

¹⁸⁴ The Public Contracts Regulations 2015 no. 102, Part 2, Chapter 2, Section 5, Sub-Section 5, Article 46 (2)

France already included a general obligation to divide into lots unless this would lead to restriction on competition or make the contract difficult, expensive or impossible, which is a formula resembling Article 46.¹⁸⁵ According to the new legislation, contracting authorities shall, in principle, award a contract in the form of separate lots. Contracting authorities must provide the ‘motive son choix’ – the motivation for their choice not to subdivide the contract into lots.¹⁸⁶ Also, bundling of lots is allowed.¹⁸⁷

As seen by this discussion, the implementation in Denmark and France provides a stricter justification requirement than the implementation in United Kingdom and the Norwegian proposal.

The implementation of Article 46 in the Member States and the Norwegian proposal on lot division can be summarised in a table as shown below.

| Member State | Mandatory lot division | Bundling of lots | Justification requirement |
|----------------|------------------------|------------------|----------------------------------|
| Norway | No | Yes | ‘kort begrunnelse’ |
| Denmark | No | Yes | ‘oplyse om baggrunden herfor’ |
| United Kingdom | No | Yes | ‘indication of the main reasons’ |
| France | No | Yes | ‘motive son choix’ |

5.6 Reflections

Considering that SMEs play an even more significant role in the Norwegian economy compared to the EU average in terms of value added, it could have been expected that the Norwegian proposal on lot division went further in facilitating SMEs, either by making lot division mandatory under certain circumstances or by setting a stricter minimum requirement when lot division is not chosen, as allowed by Directive 2014/24.¹⁸⁸

¹⁸⁵ Décret n° 2006-975 du 1er août 2006 portant Code des Marchés Publics, Chapitre IV, Article 10, referred to in Hererra Anchustegui (2016 – in press), p. 3

¹⁸⁶ Ordonnance n° 2015-899 du 23 juillet 2015 relative aux marchés publics, Titre II, Chapitre Ier, Section 3, Article 32 II

¹⁸⁷ Ordonnance n° 2015-899 du 23 juillet 2015 relative aux marchés publics, Titre II, Chapitre Ier, Section 3, Article 32 I (implicitly).

¹⁸⁸ Directive, recital 78

However, the Norwegian proposal neither made lot division mandatory nor required a stricter justification requirement, which does not promote lot division further than the absolute minimum requirements in Article 46.

If the proposed § 14-1 (2) is implemented in the Public Procurement Regulation as it is at today, the justification requirement would not create strong incentives to divide contracts into lots. However, it is possible that Norwegian Administrative law will provide additional motivation for contracting authorities to undertake a proper assessment and provide more substantial justifications than required from the wording of § 14-1 (2) when they decide not to divide the contract. Whether this is the case will be shown in the future to come, either by the contracting authorities use of 'kort begrunnelse' in practice or by a decision in KOFA if the wording is challenged.

6 Concluding remarks

As established in this thesis, promoting SME participation benefits the European economy and public procurement due to their contributions to the gross domestic product and economic stability during economic crisis, by increasing competition for public contracts, their importance to the European labour market and innovative tendencies. Although increased SME participation may require using more resources due to the need of evaluating tenders, the focus of Directive 2014/24 focus is to achieve savings in a long-term perspective. The key is to strike a balanced SME participation.

The most adequate tool to let SMEs overcome the barrier of large contracts in public procurement is to divide contracts into lots, however, lot division may also generate some unwanted effects. Fortunately, the design of Article 46 has taken into account the potential risks of lot division that have been raised in both legal and economic theory. It paves the way for competition between large and small companies without favouring SMEs, provides flexibility making it possible to detect and prevent bid-rigging and takes into account that lot division may not always be feasible for the procurement of supplies, services or works concerned.

Directive 2014/24 expects that the new regulation on lot division will contribute to improve the level of success among SMEs.¹⁸⁹ *Although we cannot be certain of the ultimate effect, it is appropriate to make a few final remarks on Article 46 as an SME vehicle.*

The provision seeks to provide incentives for contracting authorities to divide contracts by establishing lot division the general rule, making it mandatory to provide an 'indication of the main reasons' when lot division is not chosen. The soft wording might however, risk that contracting authorities will not be incentivised to divide contracts into lots. The preamble alleviates the soft requirement to some extent by providing the threshold for acceptable reasons and the legal standard. These measures may help to raise the motivation to divide contracts and may limit contracting authorities' freedom. However, the thresholds and the legal standard do not reduce the risk of the "cut and paste" method.

The potential remedies deriving from the right to good administration and defence, the fundamental market freedoms and the competition principle may contribute to motivate contracting authorities to provide a substantial 'indication' to avoid the risk of being challenged by the ECJ. However, it is not certain that ECJ would follow the same argumentation lines in the future to come. Also, the incentives to divide contract should come from the Article 46 itself, as the main aim of the provision is to encourage lot division.

The impact of the new regime on division of contracts into lots does not solely depend on the transposition of Article 46 in the Member States, but *also depends on how the potentially differing national regimes will be used by contracting authorities in practice.*¹⁹⁰ Although some Member States chooses to require a stricter justification requirement, the low requirement of 'indication of the main reasons' in Article 46.1 paves the way for low justification requirements in Member States, as seen by the Norwegian and British implementation in section 5.5.

Another aspect that is not discussed in this thesis that might contradict the efforts of Article 46 is the demand aggregation techniques provided for in Directive 2014/24. Both economic and legal literature argues that these techniques negatively impact lot division and SME participation. According to Flynn & Davis, promoting demand aggregation and SMEs at the

¹⁸⁹ Directive 2014/24, recital 124

¹⁹⁰ Trybus (2014), p. 266

same time, is an uneasy mix of policies and competing agendas, which in practice tend to counteract each other.¹⁹¹ Considering the facilitation of demand aggregation in Directive 2014/24, SMEs should be facilitated further through lot division by requiring a stricter justification requirement.

De lege ferenda, I submit that the design of Article 46 should have kept the initial proposal of requiring a *specific explanation of its reason* when deciding not to divide the contract in order to facilitate lot division and contribute to the success of SMEs in public procurement.

At least the number of single contracts and the communicated reasons for not dividing the contract will be visible to the public. This makes it possible for both the Commission and national authorities to evaluate whether the lot division is seriously considered or whether the use of ‘cut and paste’ standard reasons suggests that there is an almost automated avoidance of the approach¹⁹². Also, this information allows Commission and national legislators to review whether Article 46.1 or the national implementation suffices to promote SME participation.

The most striking conclusion is therefore that Article 46.1, might not be as efficient in promoting SMEs as intended, but is at least a step in the right direction towards promoting SME participation in public procurement.

7 Bibliography

Bibliography

EU Treaties

TEU – Treaty on the European Union O.J C 326 (2012)

TEUF – Treaty on the Functioning of the European Union O.J C 326 (2012)

¹⁹¹ Flynn & Davies, “The Rhetoric and Reality of SME Friendly Procurement”, *March Public Money & Management*, 2015, 35:2, pp. 111 -112 at p. 12; Herrera Anchustegui (2016 – in press), p. 14,

¹⁹² Trybus (2014), p. 266

Charter

The Charter of Fundamental Rights of European Union, 2012, O.J C 326 (2012)

Directives

Directive 2004/17 - Directive 2004/17/EC of 31 March 2004 coordinating the procurement procedures of entities in the water, energy, transport and postal services sectors, OJ L 134, 30.4.2004 (“The Utilities Directive”)

Directive 2004/18 – Directive 2004/18/EC of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, OJ L 134, 30.4.2004 (“The Classical Directive”)

Directive 2014/23 – Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts [2014] O.J. L 94/1 (“The Concession Directive”)

Directive 2014/24 – Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC [2014] O.J. L 94/65 (“The Public Sector Directive”)

Directive 2014/25 – Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC [2014] O.J. L 94/243 (“The New Utilities Directive”)

The Council

Press Release – *Council adopts directives for the reform of public procurement*, 6337/14, 2014. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/140975.pdf

The Parliament

European Parliament, *Report on the proposal for a directive of the European Parliament and of the Council on public procurement*, A7-0034/2013, 2013

The European Commission

Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, 2003/361/EC, O.J L 124

Commission Staff Working Document – *European Code of Best Practice Facilitating Access by SMEs to Public Procurement Contracts*, SEC(2008) 2193

European Commission, *Green Paper on the Modernisation of EU Public Procurement Policy: Towards a More Efficient European Procurement Market*, COM(2011) 15 final

European Commission, Proposal for a directive of the European Parliament and of the Council on public procurement, COM(2011) 896 final

Wymenga, Paul, Spanikova, Viera, Barker, Anthony, Konings, Joep and Canton, Erik *EU SMEs in 2012: at the crossroads - Annual report on small and medium-sized enterprises in the EU, 2011/12*, Report for the European Commission, 2012

PwC, ICF and Ecorys, *SMEs access to public procurement markets SMEs access to public procurement markets and aggregation of demand in the EU*, Study prepared for the European Commission, 2014

Commission, *2014 SBA Fact Sheet Norway*. Available at <http://ec.europa.eu/growth/smes/business-friendly-environment/performance-review/>

CARSA, PwC Luxembourg, Innova SpA, The University of Manchester, Manchester Institute of Innovation Research London Economics, DIW Berlin, DIW Econ, *Annual Report on European SMEs 2014/2015 - SMEs start hiring again*, Report prepared for the Commission, 2015

Cernat, Lucian and Kutlina-Dimitrova, Zornitsa, *International Public Procurement: From Scant Facts to Hard Data*, Chief Economist Note, Issue 1, April 2015. Available at http://trade.ec.europa.eu/doclib/docs/2015/april/tradoc_153347.pdf

EEA

EEA Agreement - Agreement on the European Economic Area OJ No L 1, 3.1.1994

The Organisation for Economic Co-operation and Development

OECD, *Small and Medium-sized Enterprises: Local Strength, Global Reach*, Policy Brief, 2000, p. 1. Available at <http://www.oecd.org/cfe/leed/1918307.pdf>

OECD, *Recommendation of the OECD Council on Fighting Bid Rigging in Public Procurement*, 2012

National legal sources

Norway

Legislation

Lov om offentlige anskaffelser 16. august 1999 nr. 69 (anskaffelsesloven)

Forskrift om offentlige anskaffelser 7. april 2006 nr. 402

Preparatory works

Prop. 51 L (2015-2016) - Lov om offentlige anskaffelser (anskaffelsesloven)

Det Kongelige Nærings- og fiskeridepartementet, Høringsnotat 2 – Ny forskrift om offentlige anskaffelser. Available at

<https://www.regjeringen.no/contentassets/a20179ad1beb4de9b4d7f5ccec80c094/horingsnotat-2-forskrift-offentlige-anskaffelser.pdf>

Denmark

Legislation

Udbudsloven LOV nr. 1564 af 15/12/2015

Preparatory works

Folketinget, L 164 - Forslag til Udbudslov, p. 92. Available at

http://www.udbudsportalen.dk/ImageVaultFiles/id_43367/cf_202/Forslag_til_udbudslov_med_kommentarer.PDF

United Kingdom

Legislation

The Public Contracts Regulations 2015 no. 102

France

Legislation

Décret n° 2006-975 du 1er août 2006 portant Code des Marchés Publics

Ordonnance n° 2015-899 du 23 juillet 2015 relative aux marchés publics

Books

Bovis, Christopher, *EU Public Procurement Law*, 2. Edition, 2012

Poulsen, Sune Troels, Jakobsen, Petter Stig and Kalsmose-Hjelmborg, Simon, *EU Public Procurement Law*, 2. Edition, 2012

Sánchez Graells, Albert, *Public Procurement and the EU competition rules*, 2. Edition, 2015

Sejerstad, Fredrik, Arnesen, Finn, Rognstad, Ole-Andreas og Kolstad, Olav, *EØS-rett*, 3. Utgave, 2011

Senden, Linda, *Soft Law in European Community Law*, 2004

Whish, Richard & Baily, David, *Competition Law*, Seventh edition, 2012

Edited books

Arrowsmith, Sue and Kunzlik, Peter, “Public procurement and horizontal policies in EC law: general principles”. In: *Social and Environmental Policies in EC Procurement Law – New Directives and New Directions*, Sue Arrowsmith and Peter Kunzlik (eds.), 2009

Grimm, Veronika, Pacini, Riccardo, Spagnolo, Giancarlo and Zanza, Matteo, “Division into lots and competition in procurement”. In: *Handbook of procurement*, Nicola Dimitri, Gustavo Piga and Giancarlo Spagnolo (eds.), 2006

Hatzis, Nicholas, “The legality of SME development policies under EC law”. In: *Social and Environmental Policies in EC Procurement Law – New Directives and New Directions*, Sue Arrowsmith and Peter Kunzlik (eds.), 2009

Herrera Anchustegui, Ignacio, “Division into Lots and Demand Aggregation – Extremes Looking for the Correct Balance?”. In *Reform or Deformation of the EU Public Procurement Rules in 2014*, Grith Skovgaard Ølykke & Albert Sanches-Graells (eds.), 2016 – in press. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2665040

Sánchez Graells, Albert, “A Deformed Principle of Competition? – The Subjective Drafting of Article 18(1) of Directive 2014/24”. In: Grith Skovgaard Ølykke & Albert Sánchez-Graells (eds.), *Reformation or Deformation of the EU Public Procurement Rules in 2014*, 2016 – in press. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2642971

Shoenmaekers, Sarah, “The role of SMEs in promoting sustainable procurement”, In *Sustainable Public Procurement Under EU Law: New Perspectives on the State as Stakeholder*, Beate Sjøfjell and Anja Wiesbrock (eds.), 2016,

Trybus, Martin, “The Promotion of Small and Medium-Sized Enterprises in Public Procurement: A Strategic Objective of the New Public Sector Directive?” In *Modernising*

Public Procurement: The New Directive, François Lichère, Robert Caranta & Steen Treumer (eds), 2014

Articles

Burgi, Martin, “Small and medium-sized enterprises and procurement law – European legal framework and German experiences”, *Public Procurement Law Review*, 2007, 16, pp. 284-294

Flynn & Davies, “The Rhetoric and Reality of SME Friendly Procurement”, *March Public Money & Management*, 2015, 35:2, pp. 111 -112 at p. 12; Herrera Anchustegui (2016 – in press), p. 14

Franklin, Christian, ”Om innholdet i og rekkevidden av det EØS-rettslige prinsippet om direktivkonform fortolkning”, *Jussens Venner*, 2012, nr. 5, pp. 269-317

Georghiou, Luke, Edler, Jakob, Uyarra Elvira and Yeow, Jillian, ”Policy instruments for public procurement of innovation: Choice, design and assessment”, *Technological Forecasting and Social Change - An International Journal*, 2014, 86, pp. 1–12

Lenaerts, Koen, “Exploring the Limits of the EU Charter of Fundamental Rights”, *European Constitutional Law Review*, 2012, 8:3, pp. 375-403

Loader, Kim, “The Challenge of Competitive Procurement: Value for Money Versus Small Business Support”, *Public Money & Management*, 2007, 27:5, pp. 307-314

Loader, Kim “Are public sector procurement models and practises hindering small suppliers? Evidence from English local authorities”, *Public Money & Management*, 2011, 31:4, pp. 287-294

Morand, Pierre-Henri, “SMEs and public procurement policy”, *Review of Economic Design*, 2003, 8:3, p. 301-318

Pagano, Patrizio and Schivardi, Fabiano, "Firm Size Distribution and Growth", *Scandinavian Journal of Economics*, 2003, 105:2, pp. 255-274

Ølykke, Grith Skovgaard “How does the Court of Justice of the European Union Pursue Competition Concerns in a Public Procurement Context?”, *Public Procurement Law Review*, 2011, 6, pp. 179-192

Survey

BIS, BIS Small Business Survey 2010, 2011. Available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32228/11-p74-bis-small-business-survey-2010.pdf

Websites

Regjeringen, "Nytt anskaffelsesregelverk er underveis". Available at <https://www.regjeringen.no/no/tema/naringsliv/konkurransopolitikk/offentlige-anskaffelser-listeside/nytt-anskaffelsesregelverk-er-underveis/id2482572/>. Last assessed 26.05.2016

Statistisk sentralbyrå, "Offentlige innkjøp, 2014". Available at <http://www.ssb.no/offentlig-sektor/statistikker/offinnkj>. Last assessed 26.05.2016

Telles, Pedro, "Public Contracts Regulations 2105 - Regulation 46". Available at <http://www.telles.eu/blog/2015/4/30/public-contracts-regulations-2105-regulation-46> . Last assessed 26.05.2016

Table of Cases

The European Court of Justice

General Court

Case C-205/03 P *FENIN v Commission* [2006] ECR I-6295

Case C-113/07 P *Selex Sistemi SpA v Commission* [2009] ECR I-2207

C-482/10, *Teresa Cicala v Regione Siciliana* [2011] ECR I-14139

Joined cases C-141/12 and C-372/12, *Ys and others* [2014] EU:C:2014:2081

C-166/13, *Mukarubega* [2014] EU:C:2014:2336 para 44

Opinion of GA

C-268/14 P, Opinion of Advocate General Wahl in *Italmobiliare SpA v European Commission*, EU:C:2015:697,

Norwegian Supreme Court

Rt.2001.1811 (Finanger)