ISSUES OF THE LEGAL REGULATION OF ENERGY COMPANIES DURING COMPETITIVE PROCUREMENT

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As per Federal Law No. 223-ФЗ "On the Procurement of Goods, Works, Services by Certain Types of Legal Entities" dated July 18, 2011, energy companies may conduct procurement in accordance with the Procurement Regulation approved by the Customer. This Regulation shall comply with the basic principles of procurement activities, such as equality and fairness. The Procurement Regulation shall not contain any provisions limiting access to the bidding procedures, inter alia, by establishing unreasonable requirements for the bidders.

As per the Code of Administrative Offenses and Federal Law No. 135-ФЗ "On Competition Protection" dated July 26, 2006, any bidder is entitled to seek legal redress for the violation of its interests, if it believes that anti-competitive practices are being used. However, in consideration of such disputes, it is essential to balance the interests, so that, by observing the interests of the bidders, the customers could exercise their right to receive high-quality deliverables, as well as apply one of the statutory principles aimed at the implementation of measures necessary to cut the customer's costs.

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According to V.V. Romanova, the legal regulation of the balance of interests between parties to social relations in the energy sector is one of the main objectives of energy law and order as a necessary component of public law and order. She highlights that the effectiveness of energy law and order largely depends on the effectiveness of the system of the legal regulation of social relations in the key economy branch, elements of the legal regulation system, and their interrelation [1]. At the moment, balancing the interests of energy companies as parties to procurement procedures is problematic.

Article 3 of Federal Law No. 223-ФЗ "On the Procurement of Goods, Works, Services by Certain Types of Legal Entities" dated July 18, 2011 (hereinafter referred to as the "Federal Law on Procurement") distinguishes the following types of competitive procedures:

- Invitation to tender, namely: bidding conducted as an open tender, a closed tender, an e-tender,
- Auction conducted as an open auction, a closed auction, an e-auction,
- Request for proposal conducted as a closed request for proposal or an electronic request for proposal,
- Request for quotation conducted as a closed request for quotation or an electronic request for quotation.

An energy company can also establish another method of procurement in its Procurement Regulation, provided that the requirements of Article 3 of the Federal Law on Procurement are met.

As aptly noted by I.G. Yakovleva, the term *procurement* is currently missing from the Federal Law on Procurement [2].

Federal Law No. 44-ФЗ "On the Contract System for the Procurement of Goods, Works, Services for State and Municipal Needs" dated April 5, 2013 defines the procurement as follows: "the procurement of goods, works, services for state or municipal needs means a set of activities performed by the customer as prescribed hereby in order to satisfy the state or municipal needs. The procurement begins with the selection of the supplier (contractor, provider) and ends with the fulfillment of their respective obligations by the parties to the contract. If, in accordance with this Federal Law, the publication of a procurement notice or the submission of an invitation to participate in supplier (contractor, provider) selection is omitted, the procurement begins with the execution of a contract and ends with the fulfillment of their respective obligations by the parties to the contract".

Energy companies often encounter difficulties when trying to define the scope of procurement correctly without violating Federal Law No. 135-ФЗ "On Competition Protection" dated July 26, 2006, or restricting competition. For example, when a trade mark is referred to in the procurement scope description, the wording *(or equivalent)* shall be used, with some exceptions, including: the procurement of spare parts and consumables for the machines and equipment used by the customer in accordance with the technical documents on these machines and equipment. In this case, there are no problems with the procurement, as long as the power equipment in question is not obsolete or expired. The company may order the necessary quantity of spare parts from the manufacturer specified in the equipment data sheet.

But what if the equipment has expired or has been discontinued, and the company cannot afford to buy new and more advanced equipment? In this case, the Customer has to conduct a competitive bidding procedure for supply of consumables with specific characteristics. Equipment manufacturers are often willing to meet the company halfway and supply materials that are most compatible with the installed equipment, but single sourcing in this case is not permitted by law.

In this context, the anti-trust authorities will view a single-source procurement as restricting access to the market for potential bidders and the violation of the anti-trust laws, and with good reason. But is it fair to consider a detailed description of material characteristics to be a market restriction in this case? It seems reasonable that, to ensure safe operation, the customer practically cites the technical characteristics of the existing material, and these wordings can be construed as an attempt to describe the scope of procurement in a way that the goods could only be delivered by one supplier.

It can lead to court and antitrust litigation. Alleging that their rights to participate in the bidding procedure are infringed upon, participants state that their competitive bids shall be reviewed by the committee as the equipment they offer has more advanced characteristics. Supervising authorities generally side with the bidder notwithstanding the arguments that the materials may not be compatible with the installed equipment and will decrease its lifetime dramatically.

A similar problem occurs when the equipment to be procured has to be the same as that already installed. In this case, it is not procurement of spare parts as such, but purchase of an equivalent will disrupt the integrity of the process system, resulting in significant losses.

The customer shall not include specific equipment in the terms of reference without stating that the bidder is allowed to offer an

equivalent, if delivery of the specified equipment is impossible. From the point of view of supervising authorities, it is a violation to include requirements that would restrict the number of bidders participating in the procurement in the terms of reference. However, the legislator provides for an exemption from this rule in the event that there is no other way to provide a more detailed and clear description of the procurement scope. Conducting procurement of services involving design operations or any kind of research also gives rise to a whole host of questions. Is it rightful to dictate what kind of method the contractor shall apply in conducting such research? On the one hand, the practice proceeds from the assumption that this condition restricts the market and prevents companies using alternative research methods from participating. On the other hand, company experts have the right to decide what research method they deem to be the most effective / advanced / economically sound. The company conducts bidding procedures in order to determine how many companies are able to render a service in a certain way / using a certain method. The research may have already been conducted in alternative ways and failed to provide the expected results, so the customer is looking for contractors using a method appropriate for the region in question.

As correctly pointed out by L.I. Shevchenko, "one of the key areas of focus of law enforcement in the energy sector is to create an effective mechanism for the resolution of disputes arising between business entities as they undertake and discharge contractual obligations" [3].

Another problem of procurement procedures is the inclusion of such a criterion as *goodwill* in the evaluation method. However, the question is how to evaluate it without prejudice to transparency of the procurement and fair competition conditions.

An attempt to define this parameter in the procurement laws was made by Resolution of the Russian Government No. 1085 "On the Approval of the Rules for the Evaluation of Bids, Final Offers of Bidders Participating in the Procurement of Goods, Works, Services for State and Municipal Needs" dated November 28, 2013, stating that the Customer may specify goodwill as one of the evaluation criteria. The Customer is entitled to request:

- Availability of positive feedback on the companies' business,
- Period of service,
- Number and qualifications of the employe0 es engaged in contract performance,
- Availability of sufficient assets to fulfill the obligations incurred.

Each of these criteria can be rather questionable for a fair evaluation of the bidder's integrity.

Another example is the work experience. Procurement documents often state at least three years of work experience as a requirement. As a confirmation of work experience, a list of contracts with a similar scope for the past three years is requested.

Nevertheless, it raises a number of questions when applied in practice. Let us consider a specific procedure with medical services as the scope of procurement.

The procurement documents state that the bidder is required to have work experience of at least three years. Two bids have been submitted. One bidder is a legal entity incorporated over three years ago, having a list of contracts for similar services, but having recent university graduates among its staff. Whereas the other bidder is a newly incorporated legal entity with a small number of contracts or even without any executed contracts, but having highly-qualified personnel with professional experience of more than 15 years. In this situation, the committee will have to choose the first bidder, even though common sense dictates that the second bidder will provide more qualified medical care.

The requirement for the number and qualifications of the employees engaged in contract performance also raises many questions when applied in practice. Bidders receiving a lower score due to the absence of qualified staff are seeking to have this decision declared a restriction of competition. Potential contracting parties state that it is not financially viable to hire personnel before winning the tender. Such situations are common with contractor agreements, when the contractor hires personnel depending on the contract scope.

From the point of view of the bidder, it has to bear unreasonable expenses pursuant to the

labor and tax laws, which, apart from increasing the cost of its services, thus making the bid less attractive, could also lead to a situation when the employees will have to be dismissed if the bid is unsuccessful.

Whereas the Customer justifies its requirements by stating that the quality of the deliverables will depend on the personnel qualifications. In resolving such issues, the practice proceeds from the scope of procurement on a case-by-case basis. When preparing documents for procurement procedures, the company evaluates the need to include this criterion in the evaluation method, as well as the personnel requirements.

It is impossible to assess the sufficiency of assets to fulfill the obligations incurred in actual practice, because no potential contractor will disclose its account balance or accounting records. Disclosure of such information would compromise the company's information security.

Some customers request information on judicial disputes the company is involved in. One might wonder, however, what kind of disputes they are referring to in this case. Can labor disputes or internal corporate disputes challenging the powers of or decisions made by the company's management bodies be seen as damaging the company's goodwill? Is it acceptable to take into account only the disputes related to cases similar to the scope of procurement or only those for which the company is the defendant?

However, a situation may arise when the bidder is the claimant in a claim for more than RUB 5 million, then it will not have enough working funds to provide the services. Can the company be deemed to have negative goodwill in this case? The question is likely a theoretical one, because in this case we can only suspect that the bidder will have insufficient working funds and, if the procurement results are challenged, the Federal Arbitration Court and the court will side with the bidder and find granting of privileges to another bidder unlawful.

Once again, what is the procurement committee to do, if it encounters a bidder with damaged goodwill: reject the bid or lower the score and make sure the evaluation method takes this information into account? Most likely, it would be safer to admit the bidder to participate in the procurement while taking this information into account during the evaluation.

However, there is a problem when it is the only bidder. In accordance with Article 3.2. of the Procurement Law, the Customer cannot cancel the procurement at this point, nor can it work with a company buried in lawsuits.

Before the latest amendments to the Procurement Law, the Customer had the right to cancel the request for proposals, adjust the procurement documents and conduct a new request for proposals. Frequently, the absence of bidders is due to the fact that potential bidders find the procurement price, advance payment conditions, or deadlines unacceptable. Terms and conditions of the procurement documents cannot be adjusted at the final stage, but it used to be possible to cancel the bidding procedure and conduct a new one.

Another problem is dumping. A bidder offers a price so low that, according to the evaluation method rules, this bid has to be declared the successful one. It is clear, however, that the service simply cannot be provided at this cost.

Naturally, the contract could be terminated at a later date, damages can be recovered, and the unscrupulous contractor can be even included in the list of bad faith vendors, but time will be wasted. What if seasonal works are being procured? In this case, they will be no longer relevant.

In situations like this the committee has to choose one of the following: disqualify the bidder or lower its score during the evaluation.

It seems that the most adequate course of action for the prevention of such violations is to state that a bid can be disqualified in the event that the price is lower than the initial maximum price by more than 20% in the procurement documents.

However, in this case, the Customer can expect the disqualified bidder to lodge an appeal. Accordingly, to minimize the risk of a lawsuit, the minimum *threshold* value used to disqualify bidders shall be justified. A thorough market analysis has to be conducted to justify not only the maximum price, but also the price below which the service cannot be provided as such, even after optimizing the material quality, logistic schemes, etc.

However, most customers prefer to lower the scores rather than disqualifying the bidders on the grounds that, as per Article 449 of the Russian Civil Code, a tender can be invalidated in the event that *someone was unreasonably disqualified*. This results in the risk of the contract awarding procedure being declared invalid, thus rendering the awarded contract void. Long-lasting litigation will draw away management and financial resources of the company. Besides, the courts face the problem of voiding a contract that has already been or is currently being performed.

By the time the tender is invalidated, the Customer no longer requires the services, and the services of a bona fide vendor have to be paid for, because all the obligations thereunder have been or are being discharged at the point when the contract is voided.

In summary, it can be said that many problems arise during competitive bidding procedures at the moment due to absent adequate legal regulation balancing the interests of the customer and the contractor. The best way to settle these issues is to include a method of their resolution in local regulations of energy companies.

The legislative control and implementation of administrative sanctions for a wider scope of issues could have an opposite effect: the quality of the services rendered by the contractor will deteriorate, performance schedules will shift due to never-ending litigation, customers will have to award contracts to vendors incapable of providing the service, complete the work, or deliver the goods with an adequate level of quality.

Thus, when handling appeals, the supervisory authorities shall examine the circumstances of the appeal: no only formal compliance with the procedure, but motivation of the lodger of the appeal, consequences and enforceability of the judgment delivered.

The conducted legal analysis supports V.V. Romanova's conclusion that the legal regulation of the balance of public law and private law interests in the energy sector is one of the main objectives of the energy law and order [4]. A.G. Lisitsin-Svetlanov was correct in saying that "a distinctive feature of the energy sector is that most of its segments are effectively facing the impossibility to ensure the same level of competition in the market as in the other economy sectors, necessitating a combination of private law and public law elements of regulation" [5]. These circumstances shall be taken into account in order to improve the legal regulation of procurements involving energy companies. ■

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