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# CHINA: PUBLIC PROCUREMENT – OPPORTUNITIES AND CHALLENGES



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China does not only have a huge private market that offers business opportunities. In various sectors public spending accounts for the biggest share of investment, offering interesting business opportunities. Stepping into the Chinese procurement market therefore seems tempting. However, access to this market is restricted by various PRC laws, regulations and policies. While China joined the WTO in 2011, it has not yet concluded its accession to the WTO Government Procurement Agreement. Before stepping into the PRC market, companies therefore must carefully assess whether their business set up allows for a successful competition in China.

## I. Legal Framework

The public procurement sector in the PRC is governed by the PRC Government Procurement Law (“Procurement Law”) and related measures and regulations which apply to government procurement of goods, construction and services. For government procurement projects subject to bidding, the PRC Law on Bid Invitation and Bidding (“Bidding Law”) and related measures and regulations apply. In addition, other national policies and provincial/local rules address matters of government procurement. National policies aim at achieving different (national) goals of economic and social development such as the promotion of small and medium-sized enterprises or energy saving products. Local governments have further implemented administrative measures for government procurement that apply to their own procurement activities, such as catalogues for centralised procurement or value thresholds for centralised procurement. .

### 1. ENVIRONMENTAL PROTECTION LAW

The Procurement Law applies to purchasing activities within the PRC conducted with fiscal funds by government departments, institutions and public organisations when the concerned goods/services or projects fall within the Centralised Procurement Catalogue (“**Catalogue**”) or where the value of the goods/services and projects services exceeds the prescribed procurement thresholds. Procurement activities of State-owned enterprises (“**SOEs**”) do not fall under the Procurement Law but must adhere to the Bidding Law.

Since 2007 a new version of the Catalogue has been issued every two years, with the Catalogue covering a wide range of products and services, the purchase of which is classified as “centralised procurement” being subject to the Procurement Law. In addition to such centralised procurement, decentralised procurements of the following categories are subject to the Procurement Law as well:

- goods/services that are outside the Catalogue whereby an individual item or a bulk item is worth more than RMB one million or
- construction projects valued over RMB 1.2 million

The Procurement Law does however not apply to emergency purchases that are caused by serious natural disasters and other events of force majeure and purchases involving national security and secrets.

## **2. BIDDING LAW: GOVERNMENT PROCUREMENT FOR CONSTRUCTION PROJECTS**

Where government purchasing activities concern construction projects which are subject to bid invitation and bidding, the Bidding Law applies. The Bidding Law lists construction projects that are subject to bid invitation and projects entirely or partly invested with State-owned funds or financed by the State.

The term “construction projects” entails alterations and extensions, decoration, demolition and renovation works. Further, it applies to goods related to the actual construction works, thus comprising all indispensable components that constitute a construction project, as well as the required equipment, materials and its design. Hence, where a construction project is procured by way of bidding, such bidding must entail goods and services relating to the construction works, too. The Bidding Projects Provisions promulgated by the National Development and Reform Commission (“**NDRC**”) define “projects entirely or partly invested with State-owned funds or financed by the State” as projects that (i) use more than RMB 2 million of budgetary funds whereby such funds account for more than 10 % of the total investment amount; and (ii) use the funds of State-owned enterprises and institutions whereby such funds amount for the controlling or dominant position. A bidding process must be carried out for such a project, if its survey, design, construction and supervision as well as procurement of key equipment and materials related to it meet any of the estimated price standards under a single contract:

- construction contract  $\geq$  RMB four million
- contract for important equipment/materials  $\geq$  RMB two million
- contract for survey, design, supervision or other services  $\geq$  RMB one million

As a result, project contracts conducted by government departments/institutions or public organisations falling under the above thresholds are governed by the Procurement Law as well as the Bidding Law. Under certain circumstances, the application of the Bidding Law is excluded if, e.g. a particular design or use of patents or knowhow is required or where the procuring entity has its own capacities to carry out construction projects.

## II. Procurement Process

The actual procurement process comprises several phases, depending on the actual bidding method chosen and the parties involved. The general roadmap is as follows:

**Procurement Method:** If a procurement project is subject to government procurement, the procurement entity shall select the method under which the procurement is carried out. Under the Procurement Law, the available methods include public invitation for bidding, invited bidding, competitive negotiation, single-source procurement, individual procurement, inquiry about quotations and other methods confirmed by the competent authorities. The usual method for government procurement is public invitation for bidding. Under the current Catalogue, government procurement of goods/services purchased in a single construction project or individual purchases of  $\geq$  RMB 2 million are subject to public invitation for bidding.

**Procurement Agents:** If items under the Catalogue shall be procured, the procuring entity must entrust an “institution for centralised procurement”, which is an institution set up by the government. Items not included in the Catalogue can be procured by the procuring entities directly or through one of the aforesaid institutions or through qualified private procurement agents. Procurement agents act as intermediaries between the procuring entities and the bidders. Foreign companies (if qualified at all to participate) or their Chinese subsidiaries participating in a procurement process will hence not only have to deal with the procuring entities, but – as case may be – also with the procurement agents (also called “bid inviting agents”) or an “institution for centralised procurement”.

**Tender Documents:** The minimum content for tender documents according to law comprises:

- name, address and contact details of the procuring entity, procurement agency, name/budget of the project, procurement requirements, publication period, supplier qualifications, etc.
- date, place, and manner for obtaining bid documents, bid document price, deadline for bid submission, date/place of bid opening, contact details of the person in charge of the procurement project, etc.

The bid invitation announcements for construction projects must in addition include:

- profile, scale and funding sources of the project
- location and time schedule of the project
- location and time for obtaining bid invitation documents or prequalification documents
- bid invitation/prequalification document fees

- bidders qualifications

**Deadlines:** Under both the Procurement Law and the Bidding Law, a bid invitation must be published at least 20 days prior to the bid submission deadline.

**Publication of Procurement:** Tender documents for procurement projects can e.g. be accessed through the following channels:

**Publications requirements under Procurement Law:** Central Government Procurement Centre website <http://www.zycg.gov.cn/> (in addition, local governments have their own government procurement platforms).

**Publication requirements under Bidding Law:** NDRC has designated the following newspapers, information networks and other media for bidding announcements:

- China Procurement and Bidding Net <http://www.chinabidding.com.cn>
- China Daily <http://cn.chinadaily.com.cn/>
- China Economic Herald <http://www.ceh.com.cn/>
- China Construction News <http://www.chinajsbcn.com/>

International tender notices must be published in the English version of China Daily and can be accessed under <http://www.chinadaily.com.cn/>

Construction projects under the supervision of the PRC Ministry of Housing and Urban-Rural Development are published by the China Association of Construction Enterprise Management under the website <http://www.cacem.com.cn/>

Publications regarding bidding for procurement of machinery and electric products are published on the website <http://www.chinabidding.com/>

**General Qualification Requirements for Suppliers and Contractors:** Entities that aim to participate in procurement activities in the PRC have to meet certain statutory minimum qualification requirements (in addition to the qualification requirements set by the bid inviting party). Statutory general qualification requirements for suppliers and contractors include:

- civil liability capacity
- good business reputation

- sound financial and accounting systems
- equipment and professional expertise for contract performance
- no violation of tax/social insurance contribution obligations
- no serious legal violations in the course of its business for the last three years prior to procurement process participation
- fulfilment of other requirements (which shall neither be unreasonable nor result in discriminatory suppliers treatment)

**Special Qualification Requirements:** In addition to the general qualification requirements, special qualification requirements apply, e.g. for PRC construction projects where bidders must provide PRC qualification certificates as well as other track record information proving their legal and actual qualification. This means that for these projects foreign entities in practice will usually not qualify but they must have locally qualified Chinese subsidiaries (and even then foreign-invested construction companies do not qualify for most of the Chinese domestic construction projects due to legal restrictions governing foreign-invested construction enterprises in China).

Chinese construction laws grade all construction companies based on their capitalisation, track record, staff count/qualification, investment forms and alike.

International bidders (where legally qualified to bid, e.g. for procurement of goods or for services not requiring a local establishment in China) are required to demonstrate equivalent qualifications in terms of experience, track record and minimum annual turnover in the past years.

In case bidding is carried out by a consortium, the bidders may only qualify according to the lowest grade among the consortium members.

Non-fulfilment of special qualification requirements renders a procurement contract invalid, granting the procuring entity the right to termination.

**Bid Documents:** Bidders must consider the requirements of the tender documents in terms of scope, information and deadlines and ensure to respond to all conditions described therein, otherwise the bid can be rejected. According to law, bid documents shall include:

- business license of the bidder
- financial reports (including tax/social insurance contribution proof)

- proof that the bidder has the equipment and technical expertise necessary for performing relevant contracts
- confirmation by the bidder not to have committed serious legal violations during its course of business within three years prior to submitting the bid
- other documents/information legally required by the tender documents

Sealed bid documents must be submitted within the deadline and in the form required by the tender documents. Bid documents submitted after the deadline or not properly sealed shall be considered invalid and rejected.

**Modification and Withdrawal of Tenders:** In the procurement of goods/services, bidders have the right to supplement, amend or withdraw submitted bid documents any time before the tender deadline and they shall inform the procuring entity (or its agent) in writing in case of such action before the tender deadline. If duly issued and sealed, supplement/amendment is regarded as an integral part of the bid documents.

**Evaluation and Comparison of Tenders and Bids:** Tenders and bids are evaluated by bid evaluation committees. Bid evaluation committees will first evaluate if the tender and the bids are valid. Bid evaluation committees will declare a tender or bid invalid or require the bidding process to be annulled without any evaluation of its actual content if certain – mainly formal legal – requirements are not met (e.g. if a bid does not comply with the requirements outlined in the tender documents).

After such first initial formal determination of the general validity of the tender and the bid, different methods will apply in regard to the evaluation of the actual content thereof. Evaluation methods comprise the following three categories:

- “Minimum Bid Evaluation Method” mainly applies to standard customised goods and general service projects. The winning bid is primarily determined by the price offered. Where all bidders fulfil the substantial requirements of the tender documents, the bidder offering the lowest price wins.
- “Comprehensive Bid Evaluation” mainly applies to goods, services or projects which contain complicated technologies or do not have unified standards of specification, performance, process, etc.. Here, the evaluation is carried out based on certain criteria according to quantitative indicators. The bidder achieving the highest score of such indicators wins.
- “Performance-to-Price Method” is a sub-form of the Comprehensive Bid Evaluation where not the offered price is the decisive factor but the result of a comprehensive analysis of all other relevant factors (including technology, financial standing, credit, performance,

service, response to tender documents, etc.). The evaluation score is then divided by the offered bid price and the bidder with the highest quotient wins.

During an ongoing bid evaluation, the evaluation standards, methods and conditions for valid bid participation may not be altered. After a bid evaluation committee concluded its evaluation, the successful bidder(s) will receive the bid award and the evaluation result notice will be published through government media.

**Domestic Goods/Services/Suppliers Preferred:** According to the Procurement Law, governments “shall procure domestic goods, construction and services”. In other words, imported products produced abroad that enter into the PRC through customs shall be second choice only. For domestic products with import elements, it is commonly held that they are considered “domestic” if at least 50 % of their added value is created in the PRC. Only under the following circumstances may goods and services be procured from abroad instead of being sourced domestically:

- goods/services are unavailable in China
- goods/services are available in China but cannot be procured at reasonable commercial terms (habitually this is deemed to be the case if the local price is  $\geq 20\%$  higher)
- goods/services are procured for use outside the PRC
- PRC legislation otherwise allows the procurement of foreign goods/services

The Bidding Law does not require procurement of domestic goods/services.

Any procurement of imported goods/services by government is subject to approval by the competent authorities, e.g. requiring that the imported goods/services must be “advantageous to domestic independent innovation or learning of core technologies”, and that “priority must be given to suppliers that transfer technology and provide training services and other compensation”.

### III. Procurement Contracts

After the procurement process is completed, the procuring entity and the bid winner(s) shall enter into a procurement contract within 30 days from the bid winning notice. Contracts among only PRC parties must be governed by PRC laws and also any government procurement contract must be governed by PRC laws (even if one of the other contract parties

would be a foreign party). Contracts between non-PRC government parties and foreign parties for the delivery of goods/services can generally be governed by PRC or foreign laws (though in practice the tender documents will usually already require that PRC law shall apply to the procurement contract),enterprises or other polluters who store or otherwise dispose solid waste in violation of mandatory environmental protection standards. The discharge of “taxable pollutants” into legitimate waste treatment facilities is not considered as “directly discharging of taxable pollutants” and thus not subject to EPT (neither is any other legitimate storage/disposal subject to EPT).

Pursuant to the Procurement Law any procurement contract must be in writing and if the bidder is a consortium, all parties to such consortium must execute the procurement contract and bear joint and several liability.

Pursuant to the Bidding Law, it is prohibited for the bid winner to transfer the procurement contract as a whole or to divide it into parts and transfer these parts to third parties. Sub-contracting is only admissible for minor contract portions and only if the right to subcontract is agreed upon in the procurement contract. Subcontractors may not further subcontract their contract scope and in any event the bid winner remains responsible for all subcontracted parts, and subcontractors must assume joint and several liability with the bid winner.

## IV. Review Procedures

Bid participants may claim for review of each step of the procurement process (e.g. in regard to the initial procurement documents, the procurement proceeding or its result). Both Procurement Law and the Bidding Law provide for a similar three-step review mechanism:

- Query to procuring entity/procurement agent or objection to bid inviting party
- Complaint to supervising department/department of administrative review
- Judicial review

Where a query/objection, complaint or judicial review is successful, certain consequences are triggered depending on the stage of the procurement process. Such consequences may e.g. lead to a revision of the initial procurement documents, re-initiation of the procurement process or compensation of damages caused.

## VI. Anti-Corruption Measures

Chinese legislators undertake a broad range of measures to contain corruption in public procurement activities. These measures e.g. prohibit malicious collusion of different players in bidding activities (i.e. engaging in bidding rings). Such activities may lead to imprisonment of the persons directly in charge for up to three years. Further, under the Procurement Law and the Bidding Law, the Anti-Unfair Competition Law and the Criminal Law, bribery of procuring entities undertaken by bidders is punishable and may lead to the confiscation of illegal gains, fines, a listing for violation in the official list of suppliers with records of misconduct (“blacklisting”, i.e. certain information of the concerned business and its management will be made available to the public), disqualification from government procurement activities for up to three years and in serious cases a revocation of the bidder’s business license.



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