Chapter 8

Ensuring clarity and reducing procurement risks in IMSS through strong tender documents and model contracts

This chapter assesses the strengths and weaknesses of the template tendering documents and contracts used by the Mexican Institute of Social Security (IMSS). Potential improvements to the template contracts are proposed to increase certainty and reduce risks in IMSS' procurement activities.

Introduction

Tendering documents, together with the legal framework applicable to any public procurement procedures provide the umbrella framework under which public entities contract with the private sector. These documents preferably include the template versions of the contracts to be executed following tendering procedures (which are called "model contracts"). Tendering documents which set forth comprehensive rules on the three most relevant phases of the tendering process (invitation to tender; evaluation; award) privilege competition between bidders and are likely to ensure a level playing field as well as transparency and integrity in contracting procedures (OECD, 2009).

Similarly, the consistent and systematic use of strong templates of contractual documents provides clarity, security and consistency to both the buying organisation and the marketplace, and reduces risks in the contractual process.

The purpose of this chapter is to assess the template tendering documents and contracts currently used by the Mexican Institute of Social Security (*Instituto Mexicano del Seguro Social* – IMSS) for the acquisition of goods and services, and to provide some proposals for action in order to enhance IMSS contracting procedures.

Model tendering documents and contracts

IMSS model tender documents are clear and in adherence with the applicable legislation

The legality of tender documents, i.e. their compliance with the applicable legislation, constitutes the first step towards a transparent awarding procedure. Considering the volume and diversity of public contracts to be awarded and the known vulnerability of procurement systems to corruption and fraud, the rule of law in the context of public procurement is of the outmost importance.¹

IMSS has provided the OECD review team with nine template versions of tender documents for the acquisition of goods, and another version for the acquisition of services. All templates pertain to contracts formed under open tendering. Considering the nature and type of contracts at hand, these tender documents and the contracts to be awarded under them must comply with the terms of the Law of Acquisitions, Leasing and Services of the Public Sector (Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público – LAASSP), the LAASSP Regulation (Reglamento de la Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público) and IMSS guidelines on acquisitions, leasing and services (Políticas, Bases y Lineamentos en Materia de Adquisiciones, Arrendamientos e Servicios) (altogether hereinafter referred to as the "Applicable Legislation").

All tender documents assessed have the same general contents. While there are not many clauses in these documents, some of their terms are further developed in annexes. These annexes provide, for example, details on how to present a joint bid, the form and terms of performance bonds, and the clear description of the quality and characteristics of the goods, rentals and services being acquired. This use of annexes completing and complementing the solicitation documents has the virtue of offering a more comprehensive tender framework, which strongly details the most relevant features of the awarding procedure, and therefore of increasing its transparency.

Furthermore, the actual terms of the IMSS solicitation documents provide the prospective bidders with a reasonable and sufficient set of the tender rules applying to the relevant aspects

of the tender procedure. As opposed to the use of several different and diffuse solicitation documents for awarding the same kind of contract, IMSS's use of template documents containing similar provisions (in some cases identical provisions) strengthens its procurement process. This practice, on the one hand, shows that IMSS is currently contracting pursuant to uniform and coherent tender procedures. This is likely to lead to a specialisation of its employees, to an increasing know-how on public procurement procedures, and to an enlightened application of contractual terms and legal rules. On the other hand, it allows prospective bidders to better prepare themselves to participate in IMSS tenders by referring to their previous experiences and participation in different tenders launched by IMSS.

A thorough review of IMSS solicitation documents shows that they are generally in line with the relevant terms of the Applicable Legislation, with no particular flaws identified. Most importantly, they contain all the elements required by law (LAASSP, article 29) to be included in tender invitations. In addition, these template documents identify other key elements of the law, such as the review and remedy mechanism, as well as the obligation of the winning bidder to present a performance bond and to demonstrate compliance with tax obligations in high-value contracts. This enhances transparency and integrity in IMSS procurement procedures.

However, all template tendering documents provided appear to relate to standard goods and services and are based on the binary system, using solely mandatory requirements and selecting the winning bid on the lowest price. IMSS could consider developing template tendering documents for complex or sensitive requirements, using other evaluation and selection methods, such as the points and percentages approach. In fact, the LAASSP stipulates that this method of evaluation should prevail over the binary one.

IMSS model contracts are also clear and in adherence with the applicable legislation

As required by the Applicable Legislation (LAASSP, article 29), all solicitation documents assessed include the template version of the contract to be executed (hereinafter referred to as the "Model Contracts"). This encourages a transparent procurement system by guaranteeing:

- that the contract to be executed pursuant to the tender is in line with both the Applicable Legislation and the terms of the tender invitation (if not, the bidders may immediately challenge its terms); and
- that all bidders will be executing the agreement under the same general terms.

The OECD reviewed IMSS Model Contracts against the relevant terms of the Applicable Legislation, and considered the following items:

- Obligations and liability of the parties
- Basis and method of payment
- Inspection, acceptance and warranty
- Dispute resolution mechanisms
- Pre-established deductions and penalties
- Adequate provision for a clear description of the goods or services to be provided by the contractor
- Intellectual property

- Subcontracting
- Replacement of contractor personnel
- Transfer of ownership
- Termination clauses
- Performance guarantee

The review showed that the Model Contracts are in line with the relevant terms of the Applicable Legislation, and did not show contravention or deviation, except in relation to intellectual property.

As required in the Applicable Legislation, the Model Contracts set forth a provision according to which the bidder shall bear exclusive responsibility in case of breach of intellectual property rights (LAASSP, article 45). However, IMSS Model Contracts do not include the necessary provision required by the law which says that IMSS is entitled to the intellectual property rights deriving from contracted consultancy services, advisory, studies and investigations, except when there is an impediment. By inserting such rule in the Model Contracts, IMSS intellectual property rights entitlements under the resulting contracts would be made apparent, enabling it to make free use of the same information in similar future circumstances without the risk of litigation.

The model contracts appear to be generally complied with at time of award

A set of contracts awarded in 2010 and 2011 under national and international tendering procedures is easily accessible from the IMSS website. Even though the actual solicitation documents are not made public, a comparison between these contracts and the Model Contracts provides an indication on the extent to which the models are adhered to at time of contract award. The assessment identified a sustainable and remarkable level of coherence between the two sets of documents, with no substantial or material deviations found which could affect the transparency or legality of the awarded contracts.

Furthermore, a common structure between the Model Contracts and these contracts is clearly traceable, with not only the most relevant clauses replicated, but also the contracts' annexes. It is also noteworthy to point out that the executed versions of these contracts sufficiently complete some provisions that could not be fully described in the template documents, such as annexes with the exact description of goods, rentals or services being acquired, and with detailed delivery timelines). However, due to the draft nature of the Model Contracts and solicitation, some of these documents were left incomplete. Notably, the description of the goods, rentals or services set out in the annexes of the contracts assessed is fairly exhaustive and technically clear.

From the assessment of these reviewed executed contracts, it is evident that their most relevant terms are in line with the several IMSS Model Contracts provided for analysis. This ensures coherence, clarity and legal security in the procurement process and reduce the risks of dispute and litigation. Nonetheless, application of these templates does not appear to be consistent; solicitation documents are reported to diverge from one unit to the other, as discussed in Chapter 9.

Potential improvements to the Model Contracts

The current Model Contracts could be modified to provide higher results to IMSS and better manage risks and lack of clarity

In a subsequent assessment, the strengths, weaknesses and risks of the Model Contracts used in IMSS were evaluated in a comparison with relevant benchmarking legislations and good practices. The assessment showed that the current provisions of the Model Contracts may not fully prevent or mitigate some contractual risks, nor do they provide full legal clarity to IMSS and its suppliers. They also do not maximise the results reached by IMSS under some contracts. In particular, the following items were identified:

A. Intellectual Property

Even when correcting the missing provision identified before, i.e. associated with contracted consultancy services, advisory, studies and investigations, it may be appropriate for IMSS to secure similar intellectual property rights for some goods and services it acquired. An example is the right to modify or maintain, either in-house or through a third party, a piece of equipment developed specifically for the organisation. Doing so would prevent IMSS from being "locked-in" with a single supplier for such services and potentially allow it to obtain better value through competition.

B. Basis and Method of Payment

All Model Contracts assessed contain draft provisions for instances where i) the contract has a fixed price regime and ii) the contract is subject to a price adjustment regime. In the latter case, the Model Contracts expressly determine that the contract should establish the formula or adjustment mechanism as well as the factor attributed to each one of the relevant components. However, only provisions for advance payments and final payment upon delivery are included, no other methods of payment (such as milestone or progress payments) are considered. Such mechanisms are valuable for the proper risk management of some types of requirements. Therefore, IMSS could consider including such provisions in the relevant Model Contracts.

C. Subcontracting Rules

In accordance with the Applicable Legislation, the Model Contracts specify that the rights and obligations deriving from the contract (except for the collection rights) cannot be assigned to another entity, such action being cause for termination of the contract (LAASSP, article 46). However, they do not encompass any provision concerning subcontracting.

Loose subcontracting rules may jeopardise the integrity of a contract if the winning bidder subcontracts a significant portion of the contract in order to reduce its costs, or as part of a collusion agreement.² However, as the European Union's Directive 2004/18/EC states, the possibility to subcontract a share of a public contract (not the entire contract) is one of the most important prerogatives of a procurement system aimed at encouraging the involvement of small and medium-sized enterprises in the public contracts procurement market. Allowing subcontracting does not only promote the development of that important sector of the economy, but also increases the level of competition in public procurement.

As a result, subcontracting is generally accepted. However, limits aimed at guaranteeing the compliance with public procurement's main principles are enshrined through subcontracting rules. This is done differently by OECD countries, some have general subcontracting rules applying to all contracts (Portugal, Box 8.1) while others apply restrictions and rules only to specific contracts (like Canada).³

Box 8.1. Subcontracting provisions of public contracts in Portugal

The Portuguese experience, as set in its Public Contracts Code of 2008 (which aimed at incorporating the European Union (EU) directives on the subject), provides a fair example of the EU standpoint.

The Portuguese Public Contracts Code sets forth sufficient rules allowing subcontracting to operate in a transparent way, without endangering the good compliance of the public contract at hand and without putting competition in jeopardy.

As a general rule, reflected in article 316 of the Portuguese Public Contracts Code, subcontracting in public contracts is possible as long as it is not clearly forbidden by the relevant contract's clauses or by the contract's specific nature.

Nevertheless, according to article 317, no. 2, of the Portuguese Public Contracts Code, "subcontracting is always forbidden:

- when the contract has been awarded pursuant to an invitation procedure, in the cases where only one entity could be invited;
- when (...) the entity to be subcontracted is not allowed to participate in public procurement procedures;
- whenever there is strong evidence that (...) the subcontracting arises from acts, agreements, practices or information susceptible of defrauding competition rules."

If not forbidden, or if specifically allowed in the contract's wording, the public party's authorisation for the private party to subcontract, pursuant to article 318, no. 3, is dependent on:

- the prior presentation of the habilitation documents pertaining to the subcontracted entity, which presentation was mandatory for the private contractor during the contract formation phase; and
- the fulfilment by the prospective subcontracted entity of technical or financial minimum capacity requisites, whenever the contract expressly subordinates the subcontracting to the evaluation of both capacities or, at least, one of them, or to the fulfilment, by the prospective subcontracting entity, of the minimum requisites on technical capacity in connection to the instalments to subcontract whenever the private contractor resorts to the prospective subcontracting entity capacity for the purpose of complying with the qualification requirements in the contract formation phase."

In addition, no. 4 of article 318 of the Portuguese Public Contracts Code sets forth that "the contract may prohibit the subcontracting of certain contractual instalments or of instalments which accumulated value supersedes a percentage of the contractual price". Such a limit will vary in accordance with the nature of the contract and the interests in presence.

Finally, it is also noteworthy to point out that article 321 stipulates that, "In subcontracting situations, the main private contractor stays fully responsible before the public contractor for the due and punctual compliance of all contractual obligations".

Source: Portuguese Public Contracts Code (2008), http://ec.europa.eu/youreurope/business/profiting-from-eu-market/benefiting-from-public-contracts/portugal/index en.htm, accessed September 2011.

IMSS could consider developing and introducing clear subcontracting rules in its Model Contracts. These rules should set forth instruments that scrutinise subcontracting in public contracts and provide sufficient checks and balances, and thereby increase transparency and integrity in the procurement process, making it a "pro-competition" tool.

D. Transfer of Ownership

Even though the Model Contracts contain several rules that are connected in one way or another with the transfer of ownership of the acquired goods (such as acceptance of goods, liability until delivery, substitution of defective goods, etc.), there are no direct, clear and undisputed clauses stating that, from a given date or fact, the goods become IMSS' property. Given the fact that transfer of ownership of the acquired goods is not clearly dealt with in the Applicable Legislation and the Model Contracts, the documents analysed show a contractual risk for both parties, which may lead to poor regulation in this area in the concluded contracts.

It is likely that other Mexican general law contains provisions that clarify how to determine the date and terms of the transfer of ownership. Nevertheless, the inclusion of a clear clause in the Model Contracts would bring further transparency and certainty to IMSS procurement procedures, which reduces the chances of unnecessary dispute or litigation. This would be especially important if IMSS uses flexible methods of payment under which some amounts are paid to the contractor before actual and complete delivery of the goods (such as progress or milestone payments).

E. Inspection, Acceptance and Warranty

Except as it relates to transfer of ownership, the Model Contracts include clear rules covering the right to return/replace products which do not meet the contractual requirements. However, for contracts requiring testing of the acquired goods after installation, additional clarity could be introduced as to the nature of the particular specifications and tests to be done, and the respective responsibilities and liabilities of each party (especially in relation to contractor's obligations should any test fail).

F. Dispute Resolution Mechanism

While the Applicable Legislation considers the possibility of arbitration for long-term services contracts, 4 none of the Model Contracts mentioned the possibility of doing so, nor the terms and conditions to be used if such an approach is chosen. In view of the higher confidence that this dispute resolution mechanism may provide to some suppliers, IMSS could consider including arbitration provisions in the service model contracts, potentially through the creation of a model contract for long-term services.⁵ It is also worthwhile noting that the Applicable Legislation prohibits arbitration for disputes related to contract termination by the public entity (LAASSP, article 80), which can be considered a weakness of the IMSS system (especially in international contracts).

Similarly, the Model Contracts do not mention any other types of dispute resolution mechanisms. This includes conciliation, even though the law provides the right of both IMSS and its suppliers to request its use at any time (LAASSP, article 77). Notwithstanding the fact that IMSS is the second Mexican institution having most often used this mechanism in 2009,6 it could promote it further by clearly indicating in all Model Contracts the parties' right to request it. Doing so would heighten awareness of that mechanism which has proven extremely efficient for the organisation,7 increase the frequency of its use, and enhance the suppliers' confidence in the procurement process.

G. Termination Clauses

As required by the LAASSP, the Model Contracts include provisions for contract termination on the grounds of contractor's default of the contractual provisions, of public interest, or of a *force majeure* event. However, they do not provide for any specific clauses covering the possibility of termination by mutual agreement of IMSS and the contractor. Increased clarity and balance could be introduced in the tender documents and contracts through the inclusion of the specific terms associated with such termination, notably in relation to payments due, compensation and liability.

H. Replacement of Contractor Personnel

Depending on the nature and complexity of the requirement to be met, the experience and qualification of the individual providing part of the work may be of utmost importance. In such instances, this need for high-level expertise will be evaluated as part of the proposal and the individual should be identified by name in the contract to ensure he/she is the one providing the service. However, no such provisions are found in IMSS Model Contracts. This leaves the possibility for the contractor to subsequently replace that

Box 8.2. Personnel replacement provisions in some public contracts in Canada

The Canadian experience provides an example of how contractor personnel replacement can be managed in public procurement. While such replacement is not limited in most instances, the standard provisions of Canada's central procurement department put the following conditions on goods or services contracts of higher complexity:

"If specific individuals are identified in the Contract to perform the Work, the Contractor must provide the services of those individuals unless the Contractor is unable to do so for reasons beyond its control.

If the Contractor is unable to provide the services of any specific individual identified in the Contract, it must provide a replacement with similar qualifications and experience. The replacement must meet the criteria used in the selection of the Contractor and be acceptable to Canada. The Contractor must, as soon as possible, give notice to the Contracting Authority of the reason for replacing the individual and provide:

- the name, qualifications and experience of the proposed replacement; and
- proof that the proposed replacement has the required security clearance granted by Canada, if applicable.

The Contractor must not, in any event, allow performance of the Work by unauthorised replacement persons. The Contracting Authority may order that a replacement stop performing the Work. In such a case, the Contractor must immediately comply with the order and secure a further replacement in accordance with subsection 2. The fact that the Contracting Authority does not order that a replacement stop performing the Work does not relieve the Contractor from its responsibility to meet the requirements of the Contract."

Through this approach, Canada protects the integrity of the procurement process and reduces the risks of inadequate performance while leaving adequate flexibility to the contractor to manage the conduct of its work.

Source: Public Works and Government Services Canada (2012), "Standard Acquisition Clauses and Conditions (SACC) Manual", https://buyandsell.gc.ca/policy-and-guidelines/standard-acquisition-clauses-and-conditions-manual, General Conditions ID 2030 and 2035, accessed 15 March 2012.

individual by another, perhaps of lower qualification and expertise. This jeopardises the integrity of tendering process as well as increasing the risk of inadequate performance.

In line with the Canadian practice described in Box 8.2, IMSS may consider including in the relevant Model Contracts clear provisions on the rights and obligations associated with the replacement of contractor personnel which are set out in its proposal and referred to by name in the contract.

Proposals for action

The IMSS tender documents and template contracts assessed show a fairly advanced procurement system. It is safe to consider that these documents, if correctly enforced, generally provide a reasonable level of impartiality, competition and integrity.

However, they could be improved to further promote competition, transparency and equality of opportunities for prospective bidders, as well as clarity in the resulting contracts, while increasing IMSS rights as well as reducing various procurement risks. As such, and in order to increase the benefits of its procurement function, IMSS could consider the following proposals:

- 1. Developing template tendering documents and model contracts for non-standard or complex requirements. These documents could include provisions associated with the use, when appropriate, of:
 - a. evaluation and selection approaches other than mandatory requirement and lowest price, such as the points and percentage approach;
 - b. arbitration for long-term services contracts, such as allowed in the Applicable Legislation; and
 - c. replacement of contractor personnel evaluated as part of its proposal and identified in the resulting contract.
- 2. Including the following provisions in all pertinent model contracts:
 - a. IMSS entitlement to specific intellectual property rights, in addition to those deriving from contracted consultancy services, advisory, studies and investigations;
 - b. subcontracting rights and obligations;
 - c. clear description of any testing to be done on acquired goods after their installation, including the respective responsibilities and liability of each party for that testing and correction of identified deficiencies;
 - d. clear statement of both parties' right to request conciliation at any time; and
 - e. termination for mutual consent, including related terms such as payments due, considerations and liability.

Notes

- 1. According to the 2005 World Bank indicators, bribery in OECD countries' government procurement is estimated to be adding 10% to 20% to total contract costs. Furthermore, the World Economic Forum Global Competiveness Report for 2010-2011 refers to corruption as the second most problematic factor for doing business in Mexico (right after inefficient government bureaucracy).
- 2. Subcontracting part of the work to the losing bidders has been identified as a method used in collusion to make it worthwhile for them to come up with uncompetitive bids (OECD, 2005).
- 3. As stated in article 8.85 of the *PWGSC Supply Manual (PWGSC, 2011)* a manual of policies and procedures of Canada's central procurement agency standard provisions applying to some types of contracts (such as high-complexity goods or services contracts) require contractors to obtain consent from the contracting officer before subcontracting can take place. The contracting officer will only consent if satisfied with the subcontractor and the proposed subcontract. It further specifies that any deviations are entirely at the risk of the contractor, and that the award of a subcontract does not relieve the contractor of any contractual obligations, nor does it impose any liability upon Canada in relation to the subcontractor.
- 4. For example, article 80 of LAASSP.
- 5. Only one Model Contract provided by IMSS relates to services and is not specific in duration (apparently it is used for short, medium and long-term contracts). The creation of a long-term service model contract would allow for appropriate arbitration provisions to be added (therefore ensuring that they are not used by error for shorter-term contracts). It would also allow provisions that are potentially appropriate for these kinds of contracts (such as subcontracting and personnel replacement rules).
- 6. The Ministry of Public Administration reports that IMSS took part in 78 mediations in 2009, second to the Ministry of Public Administration (with 129 in that year) (SFP, 2010).
- 7. According to the Ministry of Public Administration, 79% of the conciliations undertaken by IMSS over the period 2006-10 resulted in agreement between the parties (SFP, 2010; SFP, 2011).

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