



SIGMA

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CROATIA

PUBLIC PROCUREMENT SYSTEM

ASSESSMENT MAY 2008

1. Comparative Summary

A number of substantial changes in the Croatian procurement system took place during 2007 and at the beginning of 2008. A new Public Procurement Law came into force on 1 January 2008 together with a set of secondary regulations.

Beyond the requirements deriving from the *acquis*, it is very positive to note that the new law introduced a number of procedural improvements as well, which promote good and sound procurement practices. Many of these areas for improvement were addressed as problems in previous Sigma assessment reports.

In the area of concessions/PPPs, serious fragmentation exists in both the legislative and institutional frameworks. There is a need to prepare a coherent and EC-compliant legal framework and to create a co-ordinating Concessions/PPP unit(s) for supporting the implementation of these projects.

It remains to be seen whether the new institutional set-up will function effectively.

2. Public Procurement Legislation

Public procurement in Croatia is regulated by the Public Procurement Law of October 3, 2007 (henceforth referred to as the PPL). The PPL entered into force on 1 January 2008, with the exception of some provisions that will become effective only when Croatia becomes a member state of the European Union (such as publication of notices in OJEU, obligations concerning reporting to the European Commission, and statistical information). Six regulations (secondary legislation) were also adopted during January and February 2008, concerning the (exemplary) list of persons obliged to apply the Law, forms of announcements and records of public procurement procedure, methodology for preparation, assessment and implementation of investment projects referred, terms and conditions for the application of the Common Procurement Vocabulary (CPV), preparation and handling of the tender documents and tenders, forms, methods and conditions of education in the field of public procurement, implementation of the preventive and instructive activities and content of and method for delivering public procurement reports for the previous year.

The PPL implements provisions of the Public Sector Directive (2004/18), Utilities Directive (2004/17) and two Remedies Directives (89/665 and 92/13). The PPL regulates: 1) public procurement procedures; 2) the competences of the Public Procurement Office, which is the main regulatory body for public procurement, and of the State Commission, responsible for supervision of public procurement procedures; and 3) legal protection concerning public procurement procedures.

Attached to the PPL are seven annexes, which correspond more or less to the annexes to the Public Sector Directive and the Utilities Directive. They concern: list of activities (public works) in construction sectors, lists of services (priority and non – priority), list of products for the purposes of defence, technical specifications, information to be included in notices, features concerning publication and requirements relating to electronic tools.

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The organization of the State Commission, which is the review body for public contracts, is regulated in a separate law (No. 117/03).

Principles for awarding public contracts

The PPL requires that, regardless of public contract value, the following principles should be applied throughout procurement proceedings: freedom of movement of goods, freedom of establishment, freedom to provide services, principle of competition, efficiency, equal treatment, non-discrimination, mutual recognition and proportionality. The PPL does not provide for any national (domestic) or local preferences. All suppliers, regardless of their origin, are to be treated equally. Exception is made with regard to sectoral (utilities) procurement where, in accordance with the Utilities Directive, “Community” preference is provided (cf. Article 58 of the Utilities Directive).

Also, the PPL provides for the possibility to reserve the right to participate in a public procurement procedure to candidates or tenderers where more than 50% of the total number of employees are handicapped persons (cf Article 19 of the Public Sector Directive).

Scope and coverage of the PPL

The PPL applies to all public contracts above the value of 70,000 HRK .

The PPL covers public works contracts, public supply contracts and public works contracts. Their definitions are consistent with the definitions of the EU Directives.

The PPL applies a two-tier approach to public service contracts, distinguishing between Annex A services (“priority services”), subject to all provisions of the PPL, and Annex B services (“non priority services”), covered only by provisions on notices and technical specifications.

The PPL does not cover works concessions – they are not mentioned in the PPL at all.

Obligated to apply the PPL are the following contracting authorities: the government bodies of the Republic of Croatia, local and regional self-government bodies, bodies governed by public law (the PPL does not use the term “body governed by public law”, although the definition applied is consistent with the definition of bodies governed by public law in the EU directives), and associations of the above-mentioned bodies. The PPL applies also to contracts awarded by bodies that are not contracting authorities but where contracts are subsidized directly by contracting authorities for more than 50%. A non-exhaustive list of contracting authorities is provided by an implementing regulation.

With regard to contracts covered by the Utilities Directive, the PPL applies to contracting authorities as defined above, public undertakings and any other contracting entities that operate on the basis of special or exclusive rights. All of the above-mentioned are obliged to follow the PPL (Part III) when procuring products, works or services for the purpose of performing the activities referred to in Articles 106 – 111 of the PPL. Definitions of public undertakings, special or exclusive rights as well as sectoral activities are consistent with the Utilities Directive.

The scope of the PPL is compliant with the *acquis* (with the exception of works concessions).

The PPL applies both to contracts the value of which (net of VAT) exceeds thresholds for the application of the EU Directives and to contract of lesser value.

The application of specific procedural rules depends on whether the value of the contract in question is estimated to be:

- 1) above EU thresholds – obligatory publication of notices in OJEU, time periods for submission of tenders or request to participate consistent with EU directives, etc.;
- 2) below EU thresholds but above 150,000 HRK for supplies or services and 300,000 HRK for works – same procedures as in 1) but with shorter time periods (e.g. 26 days in open procedure instead of 52), only national publication (HR Official Gazette), additional exemptions from the PPL;
- 3) below thresholds referred to in point 2 but above 70,000 HRK - same procedure as in 1 and 2, to be applied only when the conditions specified in PPL have been met but with further shortening of deadlines, obligatory publication of notices in HR Official Gazette;
- 4) below 70,000 HRK - facultative application of procedures from the PPL.

It transpires that, as far as contracts that are not subject to EU rules (because their value is below the thresholds of Directive 2004/17) are concerned, the same thresholds apply both for contracting authorities in the public sector and for contracting entities awarding contracts in utilities sectors. In other words, there is no higher threshold for utilities than for public sector bodies.

All thresholds referred to above, in accordance with EU rules, are expressed net of VAT. The PPL does not provide for detailed provisions concerning the estimation of public contracts' value – EU rules are implemented by implementing regulation.

The PPL provides for all exemptions allowed by EU law with regard to both public sector and utilities procurement. Also, the PPL provides for additional exceptions, albeit below the EU thresholds, only for the following: 1) procurement for purposes of resale or lease provision of services or performance of works to third parties in the public sector; 2) procurement the aim of which is to secure the emergency prevention of damage or rectification of consequences of damage resulting from *force majeure*; and 3) procurement conducted by embassies and consulates.

Exemptions provided for contracting entities (utilities sectors) are consistent with the Utilities Directive.

While relying on the specific derogation, contracting authorities (entities) are nevertheless bound to publish in the Official Gazette, before awarding the contract covered by the exemption, a notification of the commencement of the procedure. Rigorous application of this requirement may lead to an absurd situation when the contracting authorities publish notices on the commencement of procedures concerning employment contracts, arbitration and conciliation contracts, contracts related to broadcasting time, etc. It is also striking that the PPL requires publication of commencement notice in the case of negotiated procedure without notice and concerning contracts exempted from the PPL but it does not require analogous publication in the case of B – services which, at least partially, are provided in the competitive market (cf. Article 31 (1) item 6).

There is no exact equivalent of defence procurement exemption from EU law in the PPL. Article 10 states that the PPL applies to public contracts awarded by contracting authorities in the field of defence. However, unlike its equivalent in the Public Sector Directive, the PPL only allows the contracting authority to decide to not “issue a contract notice” (but not to dispense itself with application of the PPL in general) if that notice would be contrary to the interests of security and if the authority considers that decision to be necessary to protect the essential interests of security relating to the production or trade in weapons, ammunition and war material, and provided that such a decision does not result in any distortion of competition in the common market for products with no particular military purpose. It is observed that the above-mentioned exemption relates only to the contract notice and not to the application of the PPL in general. It implies then that the contracting authority relying on the exemption from Article 10 of the PPL is bound to respect other procedural rules, such as the publication of the decision at the commencement of the procedure or in the contract award notice (cf. Article 31 (1) item 6 of the PPL). It is not clear whether such was indeed the intention of the legislator or if it was just a case of poor drafting.

Public procurement procedures

All procedures, including new ones (competitive dialogue) provided for by the new generation of directives, are regulated in the PPL. Contracting authorities may apply, on a regular basis, open or restricted procedures, and in the case of complex contracts, defined in line with the Public Sector Directive, also the competitive dialogue. Provided that the conditions exhaustively regulated by the PPL are met, contracting authorities may have recourse also to negotiated procedures with or without publication. As for the conditions for the negotiated procedure, they are in general compliant with EU rules. Minor deviations were, nevertheless, noticed in certain conditions for the negotiated procedure. According to Article 16 para. 1 item 1, the contracting authority need not publish a contract notice if this notice included “only the economic operators whose tenders have not been excluded during the prior open, restricted procedure or competitive dialogue due to the failure of supplier to meet qualification criteria” – EU rules are a bit more strict here since they require inclusion in the negotiated procedure of “all of and only” suppliers satisfying qualification criteria (cf. Article 30 of the Public Sector Directive).

The negotiated procedure without notice is allowed, among other conditions, when in response to open or restricted procedure or competitive dialogue there were no tenders or all submitted tenders were unsuitable. The problem is that the term “unsuitable” tender has a very specific meaning under the PPL – it means a tender price which exceeds the amount that the contracting authority may spend for the subject matter of public procurement. It results then that the contracting authority would not be authorised to apply the

negotiated procedure without notice when the tenders submitted were within the budget available but did not comply with the requirements of the contracting authority. In such a case, however, recourse to a more competitive negotiated procedure with notice is nevertheless possible – it transpires thus that the PPL is stricter than EU rules.

Contracting entities (utilities sectors) may apply open, restricted or negotiated procedure, provided they publish a call for competition, and, if circumstances defined by the PPL occur, also the negotiated procedure without notice.

The PPL implements also electronic procedures and tools from the EU directives. Thus, selection of the best tender may be preceded by electronic auctions; contracting authorities may also apply dynamic purchasing systems. Electronic communication between contracting authorities and suppliers is equated with the traditional, paper-based one (the choice of the method is left to the contracting authority). However, submission of tenders in electronic form requires application of advanced electronic signature.

Contracting authorities may also use framework agreements. Their definitions and *modus operandi* are generally compliant with EU law.

Qualification criteria and documents required

With regard to the qualification of suppliers to take part in the procedure, the PPL provides, first of all, mandatory and facultative reasons for exclusion. Obligatorily are to be excluded from the procedure: 1) suppliers who have been subject of a conviction by final judgment for criminal acts of participation in a criminal organisation, corruption, fraud or money-laundering or the corresponding acts in accordance with the legal provisions of the country in which they are established; 2) suppliers who have not fulfilled obligations relating to the payment of all mature taxes and obligations relating to the payment of pension and health insurance contributions and other state-level taxes and obligations. The contracting authority is obliged also, provided that it had been set as a condition of suitability, to exclude suppliers who meet the conditions referred to in Article 46 (2) (which implements provisions of Article 45 (2) of the Public Sector Directive). Contracting authorities may also establish criteria related to financial and economic standing of suppliers and of technical and professional ability of suppliers. Documents which may be requested as proof of meeting those conditions reflect the evidence defined in the Public Sector Directive.

Contract award criteria

In accordance with EU rules, the selection of best tender may be based either on the criterion of the lowest price only or on the most economically advantageous tender. Evaluation criteria which may be taken into account in the latter case (provided on exemplary basis) reflect the list in the Public Sector Directive. All criteria applied should be presented together with relative weighting (in descending order of importance only if, for objective reasons, weighting is not possible) and published in the contract notice or at the latest in the tender dossier. The PPL provides also for the procedure concerning abnormally low tenders. In line with EU jurisprudence and Directive 2007/66, which amended Directives 89/665 and 92/13, the PPL provides for a “standstill” period – minimum time which must elapse between notification to the suppliers of the decision on the award of contract and the conclusion of the contract. The PPL provides one generally applicable 12-day standstill period (5 days in smaller value contracts), while in the Directive it is, depending on the method of communicating the results of the procurement to suppliers, either 10 or 15 days.

Review measures and procedure

Legal protection issues in the field of public procurement are regulated in part V of the PPL. They are applicable to all contracts subject to the PPL (that is to say, to contracts valued at least 70,000 HRK). The PPL provides for a two-stage review procedure whereby appeals against decisions (or failure to act) of the contracting authority are addressed to the State Commission but lodged with the concerned contracting authority. The time period for the submission of an appeal is 8 days (3 days in the case of contracts of lesser value). As such, this time period is shorter than the minimum required by Directive 2007/66. The organization of the review system basically complies with the requirement of the *acquis*.

Simplified procedures for low-value contracts

There is a separate chapter in the PPL regulating the procedure for lesser value. Basically, contracting authorities apply the same procedures as for larger value contracts, with shorter time periods for the submission of tenders or for requests to participate (for instance, in the open procedure it is at least 10 days). With regard to the negotiated procedure, it is allowed only if the conditions (the same as for contracts of larger value) have been met. Thus, the PPL does not provide for any additional flexibility with regard to small-value contracts. There is also a shorter “standstill period” than in the case of larger-value contracts.

The PPL implements in a comprehensive way all of the relevant EU rules (with the exception of those for public works concessions). Minor deviations, albeit still existing, do not impact on the generally positive perception of the compliance of the law with the acquis. Of course the PPL will have to be amended in order to make it completely compliant with the requirements of Directive 2007/66 (minimum standstill period, deadline for submission of appeals). The PPL also complies with the fundamental principles of EU law, including in the case of contracts that are, due to their value, exempt from the scope of the EU Directive. Strikingly, national legislators do not require any competitive procedure in the case of B – services. Whilst the non-application of provisions concerning publication in OJEU of the contract notice and other procedural provisions in the EU Directives is legitimate in the light of the EU Directives, the complete lack of transparency and competition may be in contradiction to the latest ECJ jurisprudence.

In addition to the rules that are provided for by the EU Directives, the PPL regulates such issues as: publication of the decision on the commencement of the procedure for the negotiated procedure without notice and contracts exempt from the PPL; tender and contract security; and time period for the adoption of the award decision. Generally, the law is well structured, although the order of specific provisions could better reflect the order of procurement activities (provisions related to the description of the subject matter of public procurement – the technical specification appears in the middle of the text of the law). It is also observed that implementation of the PPL in practice may be hindered by the fact that very formal, rigid rules, which are envisaged in EU law for contracts of considerable value, are required also for contracts of lesser value. Practically the same procedures apply for relatively small-value contracts (ca. 10,000 EUR) as for contracts covered by EU Directives. The PPL imposes also additional burdens on contracting authorities, such as publication of the decision on the commencement of the procedure in the case of non-competitive procedures or application of a derogation from the law. Whilst this increases transparency and allows better monitoring of procurement processes, from the point of view of economic operators (who may not, in response to this publication, present their offers) it does not change anything.

Unfortunately, the legislative situation in the area of concessions and PPPs remains unsatisfactory.

3. Central Public Procurement Organisation

In early 2008, the Public Procurement Office (PPO) underwent an operative shutdown, and its functions and staff were transferred to the newly created Public Procurement Systems Directorate within the Ministry of Economy. To implement the new structure, heads of departments have been appointed, the systematisation of the staff in the four departments has been carried out, and ten new members of staff will be appointed in 2008.

The Directorate for the Public Procurement System (PPD) has been entitled with, inter alia, proposing, preparing and coordinating the process of drafting acts and other public procurement regulations, analysis of the implementation of regulations in the public procurement system through preventive and instructive activities, filing requests for the initiation of misdemeanour procedures, preparation of the PPP policy for submission to the government, and publishing the *e-Public Procurement Bulletin* and professional publications.

The following departments have been created within the Directorate for Public Procurement:

- Department for the Analysis of Public Procurement Procedures
- Department for the Development and Education of the Public Procurement System
- Department for Public-Private Partnerships
- Department for Electronic Support to the Public Procurement System

The Public Procurement Office (PPO) needs to be further strengthened in order to be in a better position to champion effectively the support to the implementation and development of an efficient public procurement system. In particular, it needs to increase its staff and to reorganise its functions and tasks, while reconsidering some of its current functions, such as the extensive collection and maintenance of registries.

4. Procurement Operations and Practices

According to the data published in the *Official Gazette*, Public Procurement Section, there were 16,555 publications of public procurement procedures in 2007.

The ratio of the number of published public procurement procedures compared to the number of appeal cases received indicates that appeals were filed in 3.85% of published public procurement procedures.

	Published	Appeals	%
Total	16,555	637	3.85

There is evidence that many contracting authorities still have to address significant problems in connection with the practical aspects of the implementation of the existing PPL. Many contracting authorities complain about insufficient expert support in understanding the law, despite the informal support by telephone of the PPO. Contracting authorities seemed to be generally well aware (and supportive) of the aims of the law, but continue to find it burdensome and at times difficult to understand.

Many contracting authorities considered that their staff levels – particularly staff qualified in procurement – were too low to cope with the volume of work, and there was little evidence of systematic internal training or development of procurement staff. There was a general perception that many suppliers did not understand the law, or were insufficiently professional in the submission of documents.

Since the implementation of the new PPL, extensive training has been organised by the PPO and by Chambers of Commerce in terms of workshops and seminars to support the correct application of the law, involving participants mainly from the central administration.

For the purpose of creating sufficient training capacity in the future, it would be advisable to encourage a wider role of the private sector in the provision of procurement training. There are many good examples from EU Member States that could be useful in this regard. Institutionalisation of public procurement training is another important method in order to ensure long-term sustainability.

The overly formalistic approach in the conduct of procurement proceedings continues to be seen as an important problem. It is likely that many of the problems will be remedied with the new PPL, where a number of simplifications have been introduced, especially in the qualification phase, but old practices have a tendency to continue to be followed.

Much remains to be done to equip purchasers so that they derive economic benefits from the opening up of procurement. The capacity of procurement officers to deliver value-for-money needs to be enhanced by further professional training.

5. Audit and Complaint Review Procedures

5.1 External Audit

The State Audit Office (SAO), in accordance with the provisions of the State Audit Act, is responsible for the audit of the functions of all state-funded bodies. Its primary focus is on the legality, financial probity and effectiveness of these bodies' performance. Part of its function is to assess compliance with the PPL.

The audit of procurement contracts is carried out by the general auditors (who audit the accounts of over 700 bodies each year). These auditors have received both formal and informal training in auditing, including procurement issues.

The external audit of public procurement procedures is conducted ex post with regard to public procurement procedures that have already been concluded. The audit of public procurement activities undertaken in accordance with the new law has not yet begun.

The SAO submits its reports to parliament, and these reports are also made generally available on the Internet. Where necessary, the SAO reports to the prosecuting authorities any irregularities that appear to be criminal.

5.2 *Review of Complaints*

The PPL establishes a three-tier system of reviewing complaints lodged by disappointed suppliers:

- In the first stage, the complaint is submitted to and then reviewed by the contracting entity itself.
- The complainant who is dissatisfied with the decision of the contracting authority may appeal this decision to the State Public Procurement Review Commission.
- The decision made by the Review Commission may be appealed to the Administrative Court.

The complaint may be submitted by any contractor, supplier or service provider who claims to have suffered damage or a loss of rights or who is likely in the future to suffer loss or damage resulting from an alleged breach.

The complaint is submitted directly to a contracting authority in written form. The complaint can be lodged in response to any decision of the contracting authority. The complaint must be made in writing no more than three days from notification of the decision. Complaints can also be made within eight days of a published notice of a decision to award a contract using the negotiated procedure without a call for competition. Receipt of the complaint automatically suspends action by the authority. The Review Commission is required to make a decision on the complaint within 15 days.

Once the complaint has been submitted, the contracting entity cannot conclude the procedure and sign the contract, unless the contracting authority has made a successful application to the Review Commission to the effect that failure to award the contract will involve "... the potential occurrence of disproportionate damages... [to the authority]". The authority must notify suppliers of any such application, and the Review Commission must decide on the application within seven days. The PPL makes it clear that a positive decision would only be granted exceptionally. The authority must notify suppliers of the outcome within three days.

All decisions of the Review Commission are subject to judicial review by the Administrative Court.

Appeal Cases in 2007

Cases transferred from 2006*	48
Newly received cases	637
TOTAL	685

Typical subjects for complaint have included poor adherence to the PPL's complex procedural rules, poor justification of the use of award criteria other than lowest price, errors in qualification (sometimes with the intention of preference), and inadequate procurement time scales. In many cases, procedural errors were associated with more serious breaches of the principles of transparency and non-discrimination.

In summary, the current complaint review system seems to work efficiently, and its mechanisms are admirably transparent. The confidence of suppliers in the review system seems to be reflected in the relatively large number of complaints filed.

6. **Capacity to Further Develop the System**

The public procurement system of Croatia has reached another higher level of functionality since Sigma's 2007 assessment report. Extensive efforts have been invested in the elaboration of a completely new legal framework transposing the EC Directives 2004/17 and 18, but also with the objective of modernising the procedures and rules outside the scope of the Directives. The PPL has also been supplemented by the issuance of secondary legislation and the preparation of operational tools in the form of guidelines and website information. A number of training activities have been conducted to support capacity-building at operational level.

Unfortunately, the same positive picture does not apply yet to the area of concessions/PPPs. Further efforts to build institutional capacity and improve the legal framework are needed in the near future.

However, there will continue to be a further and extensive need to strengthen the central capacity by allocating sufficient resources to the expansion of the PPO and supporting the creation of a functional and effective organisation structure. Support for the implementation of the new PPL and for the introduction of new business models, such as frameworks and e-procurement, will become major challenges in the coming years and will require the full attention and commitment of the PPO, as well as ongoing support by the government to the PPO, in terms of providing resources and stability.

7. Summary and Next Steps

The public procurement system of Croatia underwent a number of significant changes at the beginning of 2008. After the adoption of a completely new law on public procurement, the greatest priority should now be given to providing written guidance to contracting authorities and suppliers and to finalising the elaboration of secondary legislation to assist in the practical application of the law. All contracting authorities interviewed at the time of the assessment highlighted the need for more in-depth training in the field of public procurement. The activities concerning training, which took place after the adoption of the new law (seminars organised by the PPA), were not sufficient – it seems that there is a persistent need for more practical training. Further work to improve the professionalism of contracting authorities to assist in the implementation of open procurement, based on the principles of non-discrimination and value-for-money, is also necessary.

Still, a number of steps and actions are needed in the short and medium terms.

Priority should be given to the following actions:

A. Should be applied (or started in the short term (or next 12 months):

- Support to the implementation of the new PPL will be a priority area in 2008, which would imply the preparation of operational tools, such as practical guidelines, and the continuous arrangement of training and information campaigns.
- The role and capacity of the PPO is crucial for the progress of the continuous public procurement reform work, and there is a strong need for further capacity enhancement. The future organisation and location of the PPO within the administration should be reviewed in order to secure its long-term independence and functionality. There is also a need to consider other office facilities than the existing ones.
- The law on concessions should be amended in order to meet EC requirements and good international practice. The unit(s) on concessions and PPPs should be made operational.

B. Should be applied (or started) in the medium term (or next two years):

- The public procurement system should be further modernised by a wider use of the new instruments and methods provided by the new PPL.
- The procurement function should be further strengthened and professionalised at operational level by institutionalising training and education in public procurement and by introducing new ways of organising and managing procurement processes.
- Consideration should be given to the establishment of a public procurement consultation forum to promote the dialogue and exchange of information within the procurement community.
- The amended Remedies Directives need to be implemented in the Croatian legislation.