

The Role of Ordering Parties in Public Works

— Coping with New Ways of Tendering and Contracting —

Taishi OHNO*

(UFJ Institute)

(Special Audit Staff, the Board of Audit of Japan)

1. Introduction

It has long been pointed out that public works orderers tend not to be motivated to make high-quality, low-cost and timely procurements, even though they are responsible for pursuing public interests as a proxy of the citizens and seeking best values when procuring goods and services.

Kanemoto (2000) indicates the following characteristics of public works orderers: (i) many of them have advanced technical capabilities, but lack management skills; (ii) public works are susceptible to various conflicting political pressures, reflecting a great variety of citizens; and (iii) public works orderers exclusively control ordering procedures in general and the principle of market mechanism does not operate in the ordering process. He further points out the following matters are important in reform of orderers' organizations: (i) to introduce competitions in the ordering process, (ii) to clearly define the authority, responsibilities and scope of work assigned to each person in charge of ordering and establish the criteria required for each role, (iii) to improve the bidding and contracting systems concerning consultants, and (iv) to enhance the openness and transparency of the ordering of public works.

In the case of local governments, especially, the open competitive bidding system is being introduced instead of the designated competitive bidding system that has so far prevailed; therefore, orderers must be capable of not only evaluating offer prices but also evaluating whether bidding entities will really be able to complete the works. Under these circumstances, the Research and Discussion Committee on the Orderers' Responsibilities (hosted by Jiro Kondo, Professor Emeritus, University of Tokyo) prepared the reports in 1999, 2000 and 2001, upon request of the Ministry of Construction (currently the Ministry of Land, Infrastructure and Transport), the Ministry of Transport (currently the Ministry of Land, Infrastructure and Transport) and the Ministry of Agriculture, Forestry and Fisheries. These reports recommended that, with respect to contractors for some kinds of public works, it be necessary to shift from price-based selections to technology-focused selections and enhance the management skills of orderers of national and/or local governments. For this purpose, the following plans, among others, were suggested: (i) for some kinds of public works, to introduce a comprehensive evaluation system to determine a successful bidder based on the overall evaluations of bidders' proposals for pricing and technologies, (ii) when examining bidders' qualifications, to evaluate a bidding entity not only in respect of its construction revenues, number of employees, etc., but also in terms of its technological ability, and to establish the structure capable of such evaluation, and (iii) to consider introducing a system of negotiation wherein a contractor, the contract

* Born in 1965. In 1997, completed a master's degree, Graduate School of Economics, Kyoto University. Working for Sanwa Research Institute Corporation (currently UFJ Institute) since 1990. Special Researcher at Construction Planning and Housing Audit Division, 3rd Bureau, Board of Audit of Japan since 2001. Member of Japan Economic Policy Association, Japan Public Choice Society, Society for Environmental Economics and Policy Studies, Japan Society of Civil Engineers, Network for Policy Analysis, Association for Public Policy Analysis and Management and others. Major publications include: "Public Investments and Road Policy" (co-authored), Keiso Shobo, 2001; "The Structure of National Budget" (co-authored), Toyo Keizai Inc., 1997; and "On the Consequences of the Different Ways of Appraisal among Similar Public Investments – A Comparison of Roads, Harbor Roads and Regional Farm Roads –", Government Auditing Review (in Japanese: No.25, March 2002; in English: Volume 10, March 2003).

conditions and a contract price will be determined through negotiations on pricing and technologies between an orderer and each contractor.

After that, a similar suggestion was made by the Research Committee for Public Procurement and Competition Policy (hosted by Akira Kaneko, Professor Emeritus, Keio University) of the Fair Trade Commission (2003b).

In this thesis, with respect to the above-mentioned comprehensive evaluation system, the negotiation-based system in the process of bidder selection, etc., orderers' consciousness and efforts are reviewed in Chapter 2. In Chapter 3, there is an overview of the status in the U.S., since the U.S. is advanced in adopting such systems. Subsequently, in Chapter 4, there is a survey of how to promote support for orderers and the scope of their responsibilities is considered, because orderers' insufficient systems may have been causing a delay in the adoption of new systems in Japan. In Chapter 5, how to deal with appeals systematically is reviewed, since bidders' complaints against orderers will inevitably increase if non-price factors are evaluated. In Chapter 6, currently realistic and likely measures are examined.

2. Orderers' Awareness of and Approach to the Improvement of Procurement Systems

(1) Orderers' awareness and approach

To begin with, let's look at parts of the results of a questionnaire survey conducted by the Fair Trade Commission (2003a), to review how local government orderers, who are the actual entities involved, feel about the requirement for diversification of bidding and contracting systems according to the types of public works, and the necessity of support from private enterprises to strengthen the orderers' system, as pointed out by Kanemoto (2000), the Research and Discussion Committee on the Orderers' Responsibilities (2001), and the Fair Trade Commission (2003b).¹⁾

According to this survey, in response to the question, "Is it necessary to try to make flexible operations of discretionary contracts, in terms of selection of contractors according to the actual situations of the respective projects?", an overwhelming majority of the organizations, as many as 48 (80%), answered "not necessary" and only 10 organizations (16.7%) answered "necessary" as shown in Chart-1.

Chart 1. Necessity of flexible operations of discretionary contracts according to the actual situations of the projects

Stance for operations of discretionary contracts	Number of organizations	
(1) Flexible operations are not necessary.	48	(80.0%)
(2) Flexible operations are necessary.	10	(16.7%)
(3) No answer	2	(3.3%)
Total	60	(100.0%)

Source: "Results of the Questionnaire Survey concerning Desirable Bidding and Contracting Systems for Local Governments (Summary)" distributed at the 2nd meeting of the Research Committee for Public Procurement and Competition Policy of the Fair Trade Commission, June 24, 2003.

Next, looking at the answers about the "basic understanding concerning proposal-based ordering systems such as the comprehensive evaluation bid system and the VE (Value Engineering) system," 38 organizations (60.3%) said, "The proposal-based ordering systems are not adequate for formulaic projects, since they will actually entail

1) The Fair Trade Commission conducted a questionnaire survey of the public works sections of 60 local governments (47 prefectures and 13 ordinance-designated cities). One of the purposes of this survey was to examine whether they were adopting bidding and contracting systems that are appropriate for the actual situations of the projects ordered. The base date set for answering was April 1, 2003.

an enormous increase of paper work, but we are ready to introduce these systems positively for the projects requiring sophisticated planning abilities and technological skills.” This answer overwhelms the rest of the answers in percentage (Chart-2).

Chart 2. Basic understanding concerning proposal-based ordering systems such as the comprehensive evaluation bid system and the VE (Value Engineering) system

Basic understanding concerning proposal-based ordering systems	Number of organizations	
(1) The proposal-based ordering systems are not adequate for formulaic projects, since they will actually entail an enormous increase of paper work, but we are ready to introduce these systems positively for the projects requiring sophisticated planning abilities and technological skills.	38	(60.3%)
(2) It is difficult to introduce these systems in the current trial stage where they have not been clearly defined, for example, in that the requirement to set the upper limit of the target price still remains.	6	(9.5%)
(3) It is difficult to introduce these systems, because it is difficult to form a scheme for fair and impartial evaluations of proposals.	5	(7.9%)
(4) It is desirable to introduce these systems as broadly as possible, since planning and design works for the projects practically depend on the abilities of private enterprises under the current situations of ordering operations.	2	(3.2%)
(5) It is difficult to introduce these systems, because of the opposition from the local industrial society.	0	(0.0%)
(6) Others	12	(19.0%)
Total	63	(100.0%)

Source: “Results of the Questionnaire Survey concerning Desirable Bidding and Contracting Systems for Local Governments (Summary)” distributed at the 2nd meeting of the Research Committee for Public Procurement and Competition Policy of the Fair Trade Commission, June 24, 2003.

In connection with the foregoing, when we see answers regarding the “progress of consideration to introduce the comprehensive evaluation bid system, etc.,” only 16 organizations (26.7%) have introduced or provisionally introduced the system, etc. Even after adding one organization (1.7%) which intends to introduce any of the systems and seven organizations (11.7%) which are under consideration, the number of organizations (in favor of introducing the systems) is still less than half of the total (Chart-3).

Chart 3. Progress of consideration to introduce the comprehensive evaluation bid system, etc.

Progress of consideration to introduce the comprehensive evaluation bid system, etc.	Number of organizations	
(1) Already introduced or provisionally introduced (including the cases of partial introduction)	16	(26.7%)
(2) Planning to introduce	1	(1.7%)
(3) Under consideration for introduction	7	(11.7%)
(4) Under discussions	7	(11.7%)
(5) Planning to discuss	8	(13.3%)
(6) Not yet determined	21	(35.0%)
Total	60	(100.0%)

Source: “Results of the Questionnaire Survey concerning Desirable Bidding and Contracting Systems for Local Governments (Summary)” distributed at the 2nd meeting of the Research Committee for Public Procurement and Competition Policy of the Fair Trade Commission, June 24, 2003.

In addition, seeing the answers to the question for the “basic understanding concerning introduction of the private sector’s abilities for ordering operations (planning and design, and project management),” 33 organizations (55.0%), or a majority of respondents, said, “The ongoing system is workable in general, since most of the projects ordered by local governments are formulaic ones, but we must make positive use of private consultants in the case of the projects requiring sophisticated planning abilities and technological skills” (Chart-4).

Chart 4. Introduction of the private sector’s abilities for ordering operations (planning and design, and project management)

Basic understanding concerning introduction of the private sector’s abilities for ordering operations	Number of organizations	
(1) The ongoing system is workable in general, since most of the projects ordered by local governments are formulaic ones, but we must make positive use of private consultants in the case of the projects requiring sophisticated planning abilities and technological skills.	33	(55.0%)
(2) In order to appropriately manage today’s highly-advanced projects, it is necessary to entrust actual operations to private consultants from the stage of planning and design or selection of contractors, for example, by adopting the CM (Construction Management) system (*), and orderers should concentrate on coordination matters. (*) In this system, an orderer enters into a management agreement with a CMR (Construction Manager) in the project planning stage and the CMR undertakes review of design, progress and quality management, cost management and so on as agent for the orderer.	4	(6.7%)
(3) In order to ensure fairness in ordering operations, it is necessary to strengthen the systems among public orderers, for example, by collaborations among multiple organizations, and to restrict introduction of the private sector’s vitality.	3	(5.0%)
(4) For small projects, the ongoing systems are workable, and for large projects, it would be sufficient if the scheme to order design and construction on a lump-sum basis were utilized; therefore it is unnecessary to expand introduction of the private sector’s vitality to the stage of ordering operations.	2	(3.3%)
(5) Others	18	(30.0%)
Total	60	(100.0%)

Source: “Results of the Questionnaire Survey concerning Desirable Bidding and Contracting Systems for Local Governments (Summary)” distributed at the 2nd meeting of the Research Committee for Public Procurement and Competition Policy of the Fair Trade Commission, June 24, 2003.

Finally, with respect to the question regarding “the most important task for realization of flexible procurement systems (one answer per respondent),” the following three choices are supported respectively by almost the same number of organizations: 1) “There are no outstanding problems with the existing systems, and it would be sufficient if operations of the ongoing designated competitive bid system, etc., were improved”; 2) “It is necessary to moderate the principle of single-year budgets to facilitate contracts on a multiple-year basis”; and 3) “It is necessary to moderate the prevailing principle of bidding systems (where the lowest-price bidder is selected in general) and build up the bidder selection procedures on a proposal basis or negotiation basis” (Chart-5).

The results of this questionnaire survey roughly show the following trend of orderers’ awareness and approach. For the local governments targeted in this survey, it seems that flexible operations of discretionary contracts are not required; instead, improvement of the ongoing designated competitive bid system is sufficient. Regarding the comprehensive evaluation bid system or other ordering systems based on technical proposals, they are considered unsuitable for formulaic projects because of an increase of paper work, so actual introduction of such systems has not been greatly pursued. However, regarding the projects requiring sophisticated planning abilities and technological skills, many local governments wish to introduce the ordering systems based on technical proposals,

including comprehensive evaluations and negotiations, and to utilize the private sector's support for ordering operations.

Chart 5. The most important task for realization of flexible procurement systems (one answer per respondent)

The most important task for realization of flexible procurement systems (: to select one of the choices)	Number of organizations	
(1) There are no outstanding problems with the existing systems, and it would be sufficient if operations of the ongoing designated competitive bid system, etc., were improved.	21	(35.0%)
(2) It is necessary to moderate the principle of single-year budgets to facilitate contracts on a multiple-year basis.	20	(33.3%)
(3) It is necessary to moderate the prevailing principle of bidding systems (where the lowest-price bidder is selected in general) and build up the bidder selection procedures on a proposal basis or negotiation basis.	18	(30.0%)
(4) It is necessary to moderate the rule of the upper limit of the target price.	1	(1.7%)
(5) It is necessary to moderate the requirements for discretionary contracts on the understanding that orderers properly fulfill their accountability.	1	(1.7%)
(6) Others (under consideration)	1	(1.7%)
(7) No answer	2	(3.3%)
Total	64	(100.0%)

Source: "Results of the Questionnaire Survey concerning Desirable Bidding and Contracting Systems for Local Governments (Summary)" distributed at the 2nd meeting of the Research Committee for Public Procurement and Competition Policy of the Fair Trade Commission, June 24, 2003.

(*) Due to multiple answers, the aforesaid total is not equal to the total number of the respondents.

There are some factors to be noted in interpreting the results of this survey: for example, (i) the survey does not ask about "diversification of bidding and contracting systems," but about "flexible operations of discretionary contracts"; and (ii) the local governments targeted in the survey are limited to relatively large-scale organizations such as prefectures and ordinance-designated cities.²⁾

Next, let's look at the results of the questionnaire survey conducted by the Research Institute of Construction and Economy (2003). The survey's target included cities with a population of 100,000 or more³⁾, in order to review the status of the introduction of the comprehensive evaluation bid system and negotiation-based contracting system by local governments.⁴⁾

Regarding the introduction status of the comprehensive evaluation bid system, we can see that most

2) In the meeting of the Research Committee for Public Procurement and Competition Policy where the results of this survey were reported, the following opinions were raised, among others: "It seems that local governments of the municipal level strongly recognize the necessity of flexible operations of discretionary contracts" and "It is difficult for large-sized local governments to promptly reform bidding and contracting systems. Such reform tends to show progress in the case of middle-sized cities with a population of 100,000 to 500,000 where a mayor can easily take his/her initiative." Refer to the "Summary of Proceedings of the 2nd Meeting of the Research Committee for Public Procurement and Competition Policy." (<http://www.jftc.go.jp/pressrelease/03.june/03062704.pdf>).

3) The target of this survey covered 295 organizations in total: 47 prefectures, 12 ordinance-designated cities, 30 core cities, 183 cities with a population of 100,000 or more, and 23 special wards of the Tokyo Metropolis. The response rate was 95.9% (283 organizations). The base date set for answering was January 31, 2003.

4) The Ministry of Land, Infrastructure and Transport, on behalf of the national government, set a target to adopt the comprehensive evaluation bid system for 20% or more of the total contract amounts for all the projects that will be ordered under the Ministry's direct control in fiscal 2003. The number of projects for which this bidding system was actually implemented is as per the following table. The number of projects for which the negotiation-based system was implemented had not been disclosed at the time this thesis was being written. Due to restrictions under the Public Accounting Law, it seems that, to date, there have been no cases where the negotiation-based system has been applied for national projects.

organizations have not yet adopted full-scale implementation or even trial implementation of the system (Chart-6). To see the progress in terms of the organization level, there have been more introductions in the city-level municipalities than in the prefectural governments, ordinance-designated cities or core cities.⁵⁾

Regarding the negotiation-based system, only one organization (Soka-shi, Saitama Prefecture) has implemented it; no other organization has ever implemented it nor has it prepared implementation manuals, etc. (Chart-7).

(2) Cases involving the negotiation-based system in Japan

According to the results of the survey by the Research Institute of Construction and Economy (2003), as reviewed in the preceding paragraph, the construction project for the new City Hospital implemented in fiscal 2002 in Soka-shi, Saitama Prefecture is the only case where the negotiation-based system was applied, among all the projects for public works ever done in Japan; no other organization has ever implemented that system, nor has it prepared implementation manuals, etc.

Chart 6. Introduction status of the comprehensive evaluation bid system by local governments (fiscal 2002)

(Unit: Number of organizations)

	Open and competitive bids		Public Invitation designated competitive bids		Project Interest Registration designated competitive bids		Designated competitive bids	
	Full-scale	Trial	Full-scale	Trial	Full-scale	Trial	Full-scale	Trial
Prefectures	2	1	0	2	1	0	2	2
Ordinance-designated cities	0	0	0	0	0	0	0	0
Core cities	0	1	0	0	0	0	0	0
Other cities	6	3	2	1	0	1	6	1
Special wards	1	0	0	0	0	0	0	0
Total	9	5	2	3	1	1	8	3

Source: Research Institute of Construction and Economy, "Survey of Actual Status of Bids in Local Governments" (Survey conducted upon request of the Ministry of Land, Infrastructure and Transport), July 2003.

(*) Including cases where implementation manuals have been prepared but for which actual results have not yet been reported.

Status of trial implementation of the comprehensive evaluation bid system by the Ministry of Land, Infrastructure and Transport
(Number of projects)

Type of bid	FY 1999	FY 2000	FY 2001	FY 2002
Open and competitive bids	1	2	5	82
Open-type designated competitive bids	1	3	30	290
Total	2	5	35	372

(Source) Research Institute of Construction and Economy, "Japanese Economy and Public Investments," July 2003, Vol. 41.

(*) The figures for fiscal 2002 are those as of January 2003. The projects for building and repairs are excluded. The figures for fiscal 1999 to fiscal 2001 are those published by the Ministry of Land, Infrastructure and Transport. The figures for fiscal 2002 are sourced from the bid information service provided by the Japan Construction Information Center.

5) This point is consistent with the opinion in the "Summary of Proceedings of the 2nd Meeting of the Research Committee for Public Procurement and Competition Policy" (as mentioned in footnote 2 in this thesis) that was raised in relation to the results of the questionnaire survey by the Fair Trade Commission.

Chart 7. Implementation status of the negotiation-based system by local governments

(Unit: Number of organizations)

	Total		Prefectures	Ordinance-designated cities	Core cities	Other cities	Special wards
Implemented (including the past results)	1	(0.4%)	0	0	0	1	0
Not yet implemented, but manuals prepared	0	(0.0%)	0	0	0	0	0
Not yet implemented, nor manuals prepared	274	(96.8%)	45	11	28	169	21
Unknown	5	(1.8%)	1	0	0	3	1
Others	2	(0.7%)	1	0	0	1	0
No answer	1	(0.4%)	0	0	0	1	0
Total	283	—	47	11	28	175	22

(*) Each ratio (%) is obtained by dividing the number of answers by the total number of organizations targeted in the survey.

(Source) Research Institute of Construction and Economy, "Survey of Actual Status of Bids in Local Governments" (Survey conducted upon request of the Ministry of Land, Infrastructure and Transport), July 2003.

According to Soka-shi (2002), under the system called the "bidding and contracting system based on examinations of price and technical proposals," the Soka-shi administration received proposals for cost reduction, schedule shortening and the construction method from bid applicants, examined them at public council meetings, then short-listed the bidders and implemented the bid. As a result of the examination, the top three companies were short-listed from a total of five applicants based on their pricing and technical aspects, and following the negotiations on pricing and the project schedule, one company was awarded the construction contract.⁶⁾ The contract price was based on the original design, but the technical proposals, etc., raised in the examination were discussed at great length after conclusion of the contract, resulting in the final contract price lower than the original one. As a consequence, the initial estimate for the basic design of 14,300 million yen, with a budget of 13,000 million yen, was successfully reduced to the contract price of 9,975 million yen.

Another famous case of the negotiation-based system for public works is Central Japan International Airport Co., Ltd. However, Central Japan International Airport is an organization outside the scope of application of the Public Accounting Law, since it is incorporated as a stock company. Under the initiative of its president, a former Toyota Motor Corporation executive, Central Japan International Airport formed a cost management team composed of third party experts in the project planning stage, and the team discussed a cost reduction plan whenever a package of design documents was completed. In the bidding stage, a construction company which had offered the lowest price was given the highest priority for negotiation. Reference estimates were also made, and negotiations were continued under the VE system until both sides mutually agreed upon pricing and quality. In this regard, the cost management team informed the lowest bidder of the company's target cost derived from the original information about prevailing construction unit prices accumulated by the team, and requested the bidder to submit a proposal to realize this target cost. When the negotiation with the lowest bidder ends unsuccessful, the negotiation with the second lowest bidder starts, and this procedure continues in a similar fashion. As a result of efforts made under

6) The five bid applicants were as follows: Maeda Corporation, a special purpose joint venture by Takenaka Corporation and Sato Kogyo Co., Ltd., Kajima Corporation, Konoike Construction Co., Ltd., and Penta-Ocean Construction Co., Ltd. Maeda, the Takenaka-Sato J/V and Kajima were short-listed, with Maeda finally winning the bid.

this system, the total project cost that was initially estimated at 768 billion yen seems likely to be reduced by more than 120 billion yen. In the Central Japan International Airport's case, the cost reduction was effectively made because the orderer collected information about construction materials by itself, without using the ready-made cost estimate information, and, further, because the cost management team of third party experts formed in the project planning stage had intensive discussions about cost reduction plans with the design sections, which usually tend to be unconcerned with cost reduction, at each time after completion of the respective design package.

Having reviewed some cases involving the negotiation-based system that is rarely found in Japan, let's look at some U.S. cases in order to review the concept of the best value, which underlies the negotiation-based system that has been adopted in the course of transition from competitions under price evaluation only to competitions which also include technical aspects.

3. Competitive Negotiation-Based Bids in the U.S. and the Concept of the Best Value

(1) Competitive negotiation-based bids in the U.S.

For the U.S. federal procurement, including public works, the bidding system had been formerly adopted to select the lowest-price bidder through submission of sealed bids, but it had become the usual practice to increase the price by contract amendments after the contract had been awarded. Based on the recognition that the principle of competition would no longer work under such conditions, the concept of the best value was created. This concept means making evaluations by taking into consideration bidders' past achievements, technological skills, financial ability, technical approaches, etc., in addition to the criteria of offer prices. Currently, the Federal Acquisition Regulation (FAR) as amended in 1997 contributes to promoting negotiations between contracting officials and contractors by virtue of its Chapter 15 "Contracting by Negotiation."

Competitive negotiation-based bids will be allowed in the following cases:

- (a) where time is an important factor;
- (b) where it is necessary to determine a contractor based on factors other than pricing; or
- (c) where it is expected that discussions with bidders will be necessary.

Following is a typical bidding process by negotiation. First, an information exchange meeting is set to provide information about the intended project to potential contractors and to receive information that can be used to improve the manner of project implementation from the potential contractors. In a pre-invitation-to-bid meeting that takes place before announcement of the invitation to bid, there is an opportunity not only to provide information about the specified project and a draft of the request for proposals to the potential contractors but also to receive their feedback. In most cases, a pre-proposal meeting is held, too, after announcing the invitation to bid so that there are opportunities for potential contractors to point out problems in the said invitation to bid and submit their improvement proposals.

After the invitation to bid, design work and short-listing of two or three construction companies are conducted simultaneously, and then a review of the construction feasibility of the design and examinations of construction companies' qualifications are made concurrently. In this process, the government requests two or three construction companies to make an assessment and, based on their feedback information, the government determines whether or not to proceed with the bid. In this connection, the government pays proper remunerations for such assessment work to all the companies making assessments. In return, this arrangement enables the government to avoid costs for re-design or costs arising from delays in the projects due to suspensions. At the time when approximately 90% of the design has been completed, the final qualification for construction companies is made and a successful bidder is determined. Unsuccessful bidders are paid the costs for their work in the aforesaid process only, but it is also advantageous for them in that they learn of the latest status of various projects and gain experiences by being involved in a part of the process. Another advantage for the government is that the principle of competition works in respect of pricing, since non-disclosure of other competitors' offer prices makes each bidder unaware of the number of participants or the contents of competitors' proposals and each bidder therefore exerts its efforts to offer the best proposal.

(2) The concept of the best value

In the case of evaluation to pursue the best value, the evaluation is made based on the factors specified in the invitation to bid, three factors of which must be reviewed in any instance: price, quality and past achievements. In this regard, it must be noted that each evaluation factor is sequenced in rank, but is not necessarily quantified or converted into a score. Even though each factor is scored by the technical evaluation committee, such evaluation is still subjective, and the level of the evaluation score is not necessarily a basis for selection of a contractor. Instead, the descriptive explanations for the evaluation results are rather required. The contents of these descriptions are considered to be important at the time of briefing, factual explanation, appeals, etc. The General Accounting Office (GAO) also recommends providing descriptive explanations for the selection of a contractor. This attitude is based on the view that the orderer's thinking process and judgment are reflected more in descriptions than by scores.

It is the Office of Federal Procurement Policy (OFPP) in the Office of Management and Budget (OMB) under the Executive Office of the President that is responsible for forming the procurement system of the Federal Government. The OFPP's guidelines state as follows: "Quite simply, best-value source selection involves subjective analysis. It cannot, and should not, be reduced to a mechanical, mathematical exercise".⁷⁾

4. The Necessity and Scope of Support for Orderers

(1) Required abilities for orderers

Although the introduction of the comprehensive evaluation system or negotiation-based system and the strengthening of the scheme for supporting orderers have been asserted to date, based on the recommendations made by the respective organizations, with regard to responsibilities of orderers, we can see from the results of the questionnaire survey mentioned in Chapter 2 of this thesis that sufficient progress in the introduction of such new bidding and contracting systems has not been made. For one reason, most projects especially in the municipal level are standard types, meaning there are not so many large projects requiring technical evaluations. Also, it is problematic to maintain conformity for the new bidding and contracting systems with the Public Accounting Law, the Budgets, Settlement of Accounts and Accounts Regulations, the Local Autonomy Law, the Enforcement Order for the Local Autonomy Law, etc.

However, even if the problems relevant to laws and ordinances are cleared, if the lack of the evaluation system and abilities of the orderer is preventing the introduction of the new systems, the best value will not be achieved. Regarding the case of Central Japan International Airport mentioned before, some people argue that the original estimate itself was too optimistic and the estimation ability of the parties involved may have been unreliable.

In the case of public works, national and/or local governments as orderers have to estimate the target price as the upper limit of the contract price, before commencement of a bid (Article 79 of the Public Accounting Law). The reference materials used by orderers in estimating the target price are "Cost Estimate Documents" issued by the Economic Research Association and "Construction Unit Price" issued by the Construction Research Institute. These issuers are both public service corporations under the jurisdiction of the Ministry of Land, Infrastructure and Transport.⁸⁾ While many orderers rely on both of these documents, unit prices for construction materials surveyed by these two foundations are standard market prices as of the date of survey. Even though they are revised monthly, information other than unit prices for materials is not updated so frequently. Therefore, it is said that it used to be possible for construction contractors to estimate the target price within a range of small errors, as long as the construction specification was fixed. Furthermore, the Economic Research Association and the Construction Research Institute had been repeating collusions in bids for the price survey projects for construction

7) Refer to http://www.arnet.gov/Library/OFPP/BestPractices/pbsc/step6_use-best.html.

8) The Economic Research Association is under the joint jurisdiction of the Ministry of Land, Infrastructure and Transport and the Cabinet Office.

materials ordered by the Ministry of Land, Infrastructure and Transport and other organs, and were eventually advised to cease and desist by the Fair Trade Commission on June 12, 2003 and accepted the advice on June 26, 2003. As seen in this case, the reliability of the orderers' estimates has already been jeopardized.

At this point, I would like to summarize the required abilities and technical skills for orderers once again, based on the Research and Discussion Committee on the Orderers' Responsibilities (2001). Each orderer must fulfill its accountability at each stage of planning, designing, bidding, contracting and construction work, and must be able to manage the overall project and properly evaluate the process and results. For this purpose, it is essential for orderers to have at least the following evaluation abilities:

- (a) Evaluation of the contents of the project: ability to properly evaluate the contents and characteristics of the project and identify the project risks;
- (b) Valuation of enterprises (evaluation of technical proposals): ability to evaluate technical proposals and select suitable contractors according to the contents of the project; and
- (c) Valuation of enterprises (evaluation of project achievements): ability to properly evaluate the company's ability to achieve project execution, utilizing specialized knowledge about the project.

In particular, orderers' cross-sectional cooperation is necessary for valuation of enterprises, since such valuations are considered to prove effective only when they are made by orderers at a certain level and their information is accumulated. The database thus created like corporate grade reports will greatly contribute to medium- or small-sized local governments that cannot afford sufficient human resources.

If an orderer is unable, by itself, to exert the evaluation abilities as mentioned above, it needs support from the private sector or others. The scope of support for the orderer should cover the following: evaluation of the contents of the project, etc.; the adoption of a bidding and contracting method and selection of a contractor; technical examinations, etc.; construction supervision, etc.; inspections (acceptance of the work); and evaluation of the project achievement. The Research and Discussion Committee on the Orderers' Responsibilities (2001) set up the expected situations for each support work category and considered a manner of distribution of the corresponding responsibilities between an orderer and a supporter (Chart-8). In each stage, there are differences between the responsibilities to be assumed by an orderer and those by a supporter, but the Committee shows a judgment that distribution of responsibilities is on a case-by-case basis for "(b) Bidding and contracting, and selection of a contractor." The court case mentioned and reviewed in the following chapter is an interesting example for disputing this point.

(2) Scope of responsibilities of organs supporting orderers

If an orderer relies on an organ supporting the orderer in the process of selection of a contractor, the supporting organ is put to the test of its ability and manner of examinations, as well as transparency and fairness of its examination process. A symbolic example in this connection is a lawsuit for claiming cancellation, etc. of the selection of a contractor for the PFI project for the Akasaka Dormitory for the Members of the House of Representatives, filed by Mori Building Co., Ltd. against the Speaker of the House of Representatives and the national government with the Tokyo District Court in May 2003. For this project, the BTO (Build, Transfer, and Operation) system has been adopted, so the contractor will make renovations of the Akasaka Dormitory, then transfer its ownership to the House of Representatives, and thereafter operate and maintain it. This lawsuit is the first administrative litigation concerning PFI projects⁹⁾, and the issues in dispute are (i) an evaluation unit of the PFI project and (ii) accountability concerning the examination.

With respect to the first issue addressing an evaluation unit of the PFI project, Mori Building points out that it is a breach of the PFI Law to have selected a proposal enabling to reduce the present expenditures without taking into consideration the government's future revenues. With respect to the second issue, accountability concerning

9) The issues concerning the whole of this lawsuit are detailed in Kaiyama (2003), PHP Institute (2003), etc. This thesis also depends on these materials for its review.

the examination, Mori Building argues that the examination by the examination committee is highly likely to have been conducted under the initiative of the Secretariat of the House of Representatives, the orderer, and that there are many unclear points in ensuring the adequacy and fairness of the examination.

Chart 8. Results of Review of Orderer's and Supporter's Responsibilities

	Exemplifications	Responsible party	
		Orderer	Supporter
(a) Evaluation of the contents of the project	(1) Although it is a project requiring the contractor's sophisticated technological skills, such judgment has not been made and a suitable contractor has not been selected as a result. Responsibility: To be determined on a case-by-case basis, by considering whether it would be foreseeable by a reasonable supporter or what the actual damage is.	△	△
	(2) Ordering without specifying necessary requirements in the special specifications has caused damage to third parties. (e.g. Failure to specify that murky water processing is required has caused damage to fish.) Responsibility: In this case, the supporter's breach of duty of reasonable care is presumed. If the supporter is incapable of compensation, an insurance system is necessary.		○
(b) Bidding and contracting, and selection of a contractor	(1) With respect to a project for which the VE system would be suitable, failure to adopt such a system has, as a result, brought about a high cost. Responsibility: To be determined on a case-by-case basis by considering whether it would be foreseeable by a reasonable supporter or whether it is reasonably possible to prove the reasoning for such high cost.	△	△
	(2) Overestimation has caused a return of the allocation. Responsibility: To be assumed by the supporter. (The supporter is deemed to have breached duty of reasonable care, since the cost estimation criteria are clear.) If the supporter is incapable of compensation, an insurance system is necessary.		○
(c) Technical examinations	(1) Although the construction method proposed by the contractor had been considered as appropriate as a result of the examination, damage has been incurred to adjacent residences during the construction stage. Responsibility: If it is unforeseeable by a reasonable supporter, the orderer is responsible. Otherwise, the supporter (or the contractor) is responsible.	△	△
	(2) As the selected construction method is not conforming to the technical standards, some work during the construction stage must be redone. Responsibility: Selection of a non-conforming construction method is deemed to have been caused by the supporter's breach of duty of reasonable care.		○
(d) Construction supervision	(1) A defect has occurred due to improper work. Responsibility: If the supporter fails to comply with the supervisory standards, the supporter may be held responsible. However, in this case, the contractor is primarily responsible for the defect, so repair of the defect is the contractor's responsibility. Therefore the supporter's responsibility is to be addressed in a different form, such as a penalty.		○
(e) Inspection (acceptance of the work)	Ditto		○
(f) Evaluation of project achievements	(1) Improper evaluation has caused the contractor to raise an objection. Responsibility: If the supporter fails to comply with the evaluation manuals for project achievements, the supporter may be responsible.		○

△ : The responsible party is determined on a case-by-case basis.

○ : The party is responsible.

(Source)The Research and Discussion Committee on the Orderers' Responsibilities, "Framework for Specific Measures for Fulfillment of Orderers' Responsibilities (2nd report)," March 2001.

Chart 9. Results of Examination for the Renovation Project for the House of Representatives' Akasaka Dormitory

Evaluation items	Score	Kajima Corporation group	Mori Building group	Obayashi Corporation group
1. Examination of conformity with requisite criteria, etc.	60	60.000	60.000	60.000
2. Examination by point-adding scoring	40	35.750	34.975	33.775
(1) Facility planning	28	25.950	24.100	24.150
1) Facility arrangement	16	14.700	13.000	13.500
2) Maintenance	4	3.800	4.000	3.800
3) Operational support	8	7.450	7.100	6.850
(2) Project planning	8	6.300	7.675	6.525
1) Composition of SPC ¹⁰⁾	2	2.000	2.000	2.000
2) Funding	3	2.200	2.975	2.425
3) Revenue and expenditure projection	3	2.100	2.700	2.100
(3) Others	4	3.500	3.200	3.100
Total (A)	100	95.750	94.975	93.775
Bid price (B) (yen)		31,802,629,508	37,376,320,000	36,300,838,000
Comprehensive evaluation (A/B x 10 ⁹)		3.010757333	2.54104738	2.583273697
Ranking		1	3	2

Source: The House of Representatives of Japan, "Results of Selection of the Contractor for the Project for Renovation, etc. of Akasaka Dormitory for the Members of the House of Representatives," March 11, 2003

As both issues provide some instructive viewpoints for considering the scope of responsibilities of orderers and supporters, I would like to review them in more detail. As for the first issue, the "multi-purpose construction system" is adopted in this Akasaka Dormitory project to allow private profitable facilities to be set up along with the public facility. Among these facilities, the objective of the PFI project is the portion providing public service (the Akasaka Dormitory, in this case) and the project for the private profitable facilities is positioned as a non-PFI project. The result of revenues and expenditures in public finance depends on whether we focus only on the cash flow produced from the PFI project portion as the government's expenditures for the project evaluation period of 30 years, or whether we should also take into consideration corporate taxes, etc., payable to the government from the source of non-PFI project portion.

Mori Building's proposal offers the cost to be paid by the government (the bid price) in the amount of roughly 37.4 billion yen for the operating period of 30 years, which is the highest of all three bidders. According to Mori Building, however, after deducting the amount of corporate taxes, etc., that are sourced from private profitable facilities to be concurrently established in the non-PFI project and paid to the government, the net amount borne by the government will be 19.7 billion yen, which is the lowest of the three. Further, Mori Building indicates that the integrated development, along with the surrounding area, will enable the national property to have the highest asset value of the three groups.

10) SPC stands for Special Purpose Company, which is established through investments by all the members composed of a successful bidder to implement the project.

In evaluating a PFI Project from VFM (Value for Money), orderers and supporting organs are required to clarify their stance for a unit of the project evaluation, i.e. whether the evaluation unit should be restricted to the cash flow only from a PFI project, or whether evaluation should be based on the government's revenues and expenditures covering the arrangement of its surrounding social infrastructure, recognizing that it is a specified project under the PFI Law.

Actually, the issue concerning an evaluation unit of a PFI project is not limited to this lawsuit alone. In the case of "service purchasing" projects frequently adopted in local governments' PFI projects, business taxes, etc., payable by special purpose companies (SPC), lead to the local governments' financial revenues. In such cases, however, those taxes payable by the companies are very often offset against an increase in purchasing prices expended by orderers (local governments). As a result, the impact has been inconsequential, so it has not been regarded as a big issue in considering orderers' financial revenues and expenditures.

In the second issue, it is required to clearly achieve transparency, fairness and adequacy in examinations. The selection of a contractor in the project mentioned above was made by an examination committee composed of academic experts, the House of Representatives' members, and others. The examination by the committee was conducted in accordance with the examination items based on the pre-announced "Criteria for Decisions of Contractors".¹¹⁾ It is clearly specified that a successful bidder must be determined in the comprehensive evaluation method in the following manner: each bidder's proposal is to be scored as the total figure (on a 100-point scale) of both the examination of conformity with requisite criteria, etc. and the examination by point-adding scoring; the total score so obtained is to be divided by the bidder's offer price (division method). In this regard, it can be said that transparency of the evaluation is maintained. Looking at the examination committee in question, it is composed of 10 members (including the chairman) including three members of the House of Representatives, one official of the Ministry of Land, Infrastructure and Transport, and one employee from its controlling public service corporation. From this we can see that the members on the orderer's side have a high ratio. In order to clarify the orderer's and the supporting organ's examination and selection ability, it is necessary to verify the following matters: who decided the composition of the committee; who prepared the weighting of the examination items; and how the examination was conducted among the committee members.¹²⁾

Again, if we consider in terms of the policy for distribution of responsibilities between an orderer and its supporter, as studied in the Research and Discussion Committee on the Orderers' Responsibilities (2001), the relationship between an orderer and its supporter is considered to be based on an entrustment agreement, and so the supporter is not required to assume defect liability, but whether or not the supporter has fulfilled its duty of reasonable care should be judged. As the supporter is possibly required to make compensation for damage in some cases, it is necessary to establish an insurance scheme in order to entrench the orderer supporting system. We can say that the case of the Renovation Project for the House of Representatives' Akasaka Dormitory proves such an assertion.

It should also be noted that the Mori Building group and the Obayashi Corporation group are ranked as the second and the third, respectively, in the total score of the examination items and that their rankings are reversed in the comprehensive evaluation after divided by their respective offer prices. When a difference is small in scoring for the examination items, the ranking in bid prices is likely to be carried over to the final ranking. As illustrated above, if the division method is adopted in the case where both technical and price aspects are comprehensively evaluated, one problem in evaluation would be that the ranking in the technical evaluation is easily reversed by the ranking in bid prices. I would like to mention that this issue must be noted when pursuing the best value in Japan.

11) The House of Representatives of Japan, "Criteria for Decision of the Contractor for the Project for Renovation, etc., of Akasaka Dormitory for the Members of the House of Representatives," July 2002.

12) As shown in Chart-9, the Mori Building group's proposal obtained the highest evaluation in business planning, which because of its small weighting did not give a great impact on the final examination result.

5. Designing an Appeal System

If we promote the comprehensive evaluation system to consider technical aspects along with prices for the purpose of pursuing the best value for the general public and further promote the system to allow negotiations with bidders in the evaluation process, it is expected that appeals will increase in the contracting process, especially from unsuccessful bidders, as compared to when evaluation is based only on offer prices. Currently, in Japan, each orderer establishes its own rules for responding to appeals. According to the Guideline for Improvement of Bids and Contracts for Public Works, establishing a third party organization is mentioned as a measure for appropriately treating complaints about bidding and contracting processes.

While the case of an appeal by way of a court action is mentioned in the foregoing chapter, another idea might be to assign the third party organ's role to the Board of Audit of Japan in the appeal system with respect to the public works implemented through execution of the national budget, with a view to realizing short-period, inexpensive solutions. In this respect, GAO's role in the U.S. appeal system will be useful for reference. In the U.S., any appeal arising in the contracting process can be filed with either the ordering organization in question or GAO and, if it is still unacceptable, the appeal can be brought before the concerned Federal District Court or Federal Court of Appeals.

GAO's function of examination of appeals against bids for public works was legislated in the "Competition in Contract Act" in 1984, and GAO received approximately 1,200 cases of those appeals in fiscal 2002. Among the three procurement stages, GAO examines appeals against the appropriateness of competition in the pre-award stage and the rationality of selection of a contractor in the award stage, and, in principle, does not examine those against project management in the post-award stage.

In examinations of appeals against public bids, GAO is obligated to satisfy the following two requirements: 1) to ensure the government's accountability and protect the right of due process for aggrieved bidders; and 2) to ensure that the government is able to continue procurement procedures without unreasonable interruption. To ensure these requirements, there are various measures and restrictions. For example, an appeal is subject to a strict time restriction; in principle, it must be filed within 10 days after occurrence of its cause. Instead, the concerned contract is automatically placed in suspension of execution, in order to provide the applicant with a provisional remedy. This mechanism ensures "bidder's right," the first of the two aforementioned requirements. On the other hand, GAO must make a decision within 100 days after receipt of an appeal, and after a lapse of the said 100 days, the automatic suspension of execution of the contract will lose its effect. This rule satisfies the "feasibility of continuance of the government's procurement procedures," the second of the two requirements. In fiscal 2002, GAO solved the appeals in 79 days on average, and in 41 cases, i.e., 16% of the cases reaching decisions, the appeals were affirmed.¹³⁾ For prompt solutions, GAO sometimes uses procedures for substitutive dispute settlements such as reconciliation, etc., after receipt of filing of appeals. GAO advises the government of the remedial actions or compensations according to the cases and 98% of them are executed as advised. Also, in many cases, at the time when a company has filed an appeal with GAO, the government reviews the action in dispute and takes remedial measures.

It is said that it is GAO's independence that lies behind such reliability of examinations of appeals. The Board of Audit of Japan is also positioned as a constitutional organ independent from the Cabinet and Article 35 of the Board of Audit Law¹⁴⁾ states that it is required to make a decision if any interested party files a claim for examination. It

13) For cases involving GAO's decisions in examinations of appeals, refer to the following URL:
<http://www.arnet.gov/Library/OFFP/BestPractices/pbsc/library/B284270.pdf>

14) Article 35 of the Board of Audit Law

(1) The Board of Audit shall examine the claims from the interested parties concerning the conduct made by officials in charge of fiscal transaction of the State, and in case the Board deems it necessary to correct such conduct in consequence, it shall notify its settlement decision to the competent authorities or other responsible persons.

(2) The competent authorities or responsible persons shall take appropriate measures based on the settlement decision made by the Board, when they are notified of it as provided for in the paragraph (1).

would be a good idea to make a positive use of the Board of Audit in designing the appeal system.

6. Conclusion

In this thesis, I have reviewed orderers' awareness and evaluation schemes in relation to the comprehensive evaluation system which considers technical aspects in addition to pricing, and the negotiation-based system that allows an orderer to negotiate with bidders in the process of selection of a contractor. It would be helpful for middle- or small-sized local governments in valuation of enterprises, for example, if functions of "CORINS: Construction Records Information Service" — a database of completed construction records to provide information to each local government which intends to order public works — were expanded.

In addition, I have discussed the importance of achieving transparency and fairness in an evaluation system and pointed out the role of the Board of Audit of Japan by introducing the U.S. case with respect to the desirable structure of an appeal system. Regarding fairness of evaluation systems, Japan Federation of Bar Associations (2003) investigated whether there was any legislation to restrict outplacement of local government officials to the local construction industry. It would be an effective measure to legislate prevention of collusion among politicians, bureaucrats and businesses, in order not to cause any suspicion in orderers' evaluation processes.

With respect to the comprehensive evaluation system, or the negotiation-based system to be adopted in the process of selection of a contractor, it is important to collect information about similar preceding cases in foreign countries and accumulate information about the actual cases of introduction in Japan, since presently there are few cases in Japan. In this process, it is necessary to accumulate best practices concerning evaluation criteria and the concept of the best value and condense them into a database together with corporate information. Furthermore, it may be reasonable to consider payments of fees for bidders' proposals in the selection process.

* This thesis embodies my personal opinion only and does not express the opinion of the Institute to which I belong. Any error that may be found in this thesis is solely attributable to myself.

(List of references)

- Michihiro Kaiyama, "Scholar's Analysis Series 132, PFI's Essence Questioned by Mori Building in the Lawsuit for the Akasaka Dormitory for the Diet Members," *Economist*, The Mainichi Newspapers, September 23, 2003 issue.
- Yoshitsugu Kanemoto, "Ordering System for Public Works," *Hitotsubashi Business Review* edited by Institute of Innovation Research, Hitotsubashi University (Toyo Keizai, March 2003), Vol. 47, No. 4.
- Fair Trade Commission, "Results of the Questionnaire Survey concerning Desirable Bidding and Contracting Systems for Local Governments (Summary)" distributed at the 2nd meeting of the Research Committee for Public Procurement and Competition Policy, June 24, 2003.
- Fair Trade Commission, "Report by the Research Committee for Public Procurement and Competition Policy: Aiming at complete competitiveness in public procurement," November 18, 2003.
- Research Institute of Construction and Economy, "Survey of Actual Status of Bids in Local Governments (Survey conducted upon request of the Ministry of Land, Infrastructure and Transport), July 2003.
- The House of Representatives of Japan, "Criteria for Decision of the Contractor for the Project for Renovation, etc. of Akasaka Dormitory for the Members of the House of Representatives," July 2002.
- The House of Representatives of Japan, "Results of Selection of the Contractor for the Project for Renovation, etc., of Akasaka Dormitory for the Members of the House of Representatives," March 11, 2003.
- Soka-shi, "Soka Information," July 5, 2002 issue.
- "Special Topic: Adequacy of Controversial Target Price," *Nikkei Construction*, Nikkei Business Publications, May 5,

2003 issue

“Special Topic: An Airport Made by Toyota,” *Nikkei Construction*, Nikkei Business Publications, September 26, 2003 issue.

Japan Federation of Bar Associations, “Investigation Report on Reform of Bidding Systems,” July 2003.

Research and Discussion Committee on the Orderers’ Responsibilities, “Interim Report,” April 1999.

Research and Discussion Committee on the Orderers’ Responsibilities, “Framework for Specific Measures for Fulfillment of Orderers’ Responsibilities (1st report) (Draft),” March 2000.

Research and Discussion Committee on the Orderers’ Responsibilities, “Framework for Specific Measures for Fulfillment of Orderers’ Responsibilities (2nd report),” March 2001.

PHP Institute, “The Lawsuit for the PFI Project Regarding the House of Representatives’ Akasaka Dormitory,” *PHP Policy Research Report*, June 2003, Vol. 6, No. 72.