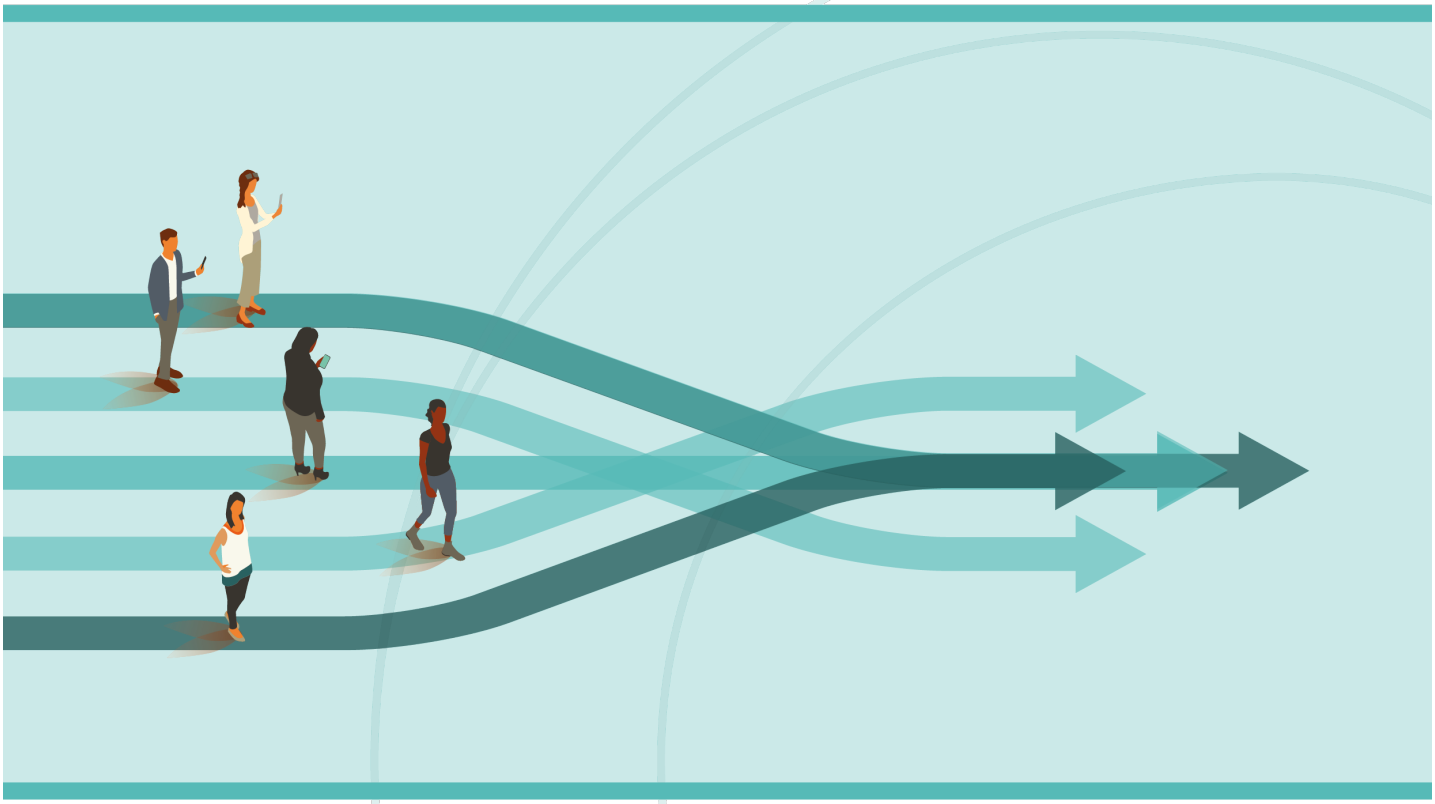
Government Commercial Function

Procurement Act 2023

Guidance: Valuation of Contracts



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Guidance on Valuation of Contracts

What is valuation of contracts?

1. Rules on estimating contract values are necessary as a result of there being different thresholds (and consequently different obligations on contracting authorities) for different types of contract. These rules provide a simple methodology for contracting authorities to estimate the financial value of their contract. This guidance focuses on valuing contracts in order to determine whether a contract is above or below the relevant threshold.

What is the legal framework that governs valuation of contracts?

2. Section 4 and Schedule 3 collectively provide the relevant rules on valuation of contracts.

3. Section 4 of the Procurement Act 2023 (Act) requires contracting authorities to estimate the value of contracts, in accordance with a methodology set out in Schedule 3, and restricts manipulation of the estimated value of a contract in order to avoid the requirements in this legislation. The effect is that authorities will have an estimated value for their contract and thus be able to determine whether they are above or below the relevant threshold and in turn determine which rules have to be followed.

4. Schedule 3 provides a methodology that contracting authorities must use when estimating contract value in order to discharge obligations under section 4. The provision also prevents contracting authorities from artificially subdividing contracts for the purposes of evading any of the requirements of the Act.

5. Schedule 3 also sets out how contracting authorities must estimate the value of a contract for the purposes of determining whether it is subject to the general rules regime for above-threshold contracts or the below-threshold regime.

What has changed?

6. As is the case with certain other basic definitions and concepts, the policy on valuation of contracts has not been substantively reformed. The rules imposed by the Act are therefore similar in intention and effect to the rules on estimating contract values set out in the previous legislation. The valuation methodology in Schedule 3 is also deliberately similar to that set out in the previous legislation.

7. There are some inevitable differences in the way these rules are set out in the Act. For example, the previous legislation did not address situations where an estimate was not possible. This modification was necessary in order to achieve and to be able to demonstrate full compliance with international agreements such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), but should not cause any significant changes in practice.

8. The concept of Separate Operational Units, which is an undefined term from the European Directives, has not been included in the Act. It is recognised that some contracting authorities will operate in highly delegated structures and some business units will need to act independently. This flexibility has been preserved using a simple anti-avoidance mechanism at Schedule 3, paragraph 4 which mirrors the analogous provision in the previous legislation and requires contracting authorities to aggregate requirements that can reasonably be aggregated for the purposes of their estimation, unless there are good reasons for not doing so. Clearly, disaggregating for the purposes of reaching a below-threshold value would not be a good reason, but otherwise the rules are flexible in this respect. The drafting leaves a wide discretion for contracting authorities not to aggregate when they have cause not to.

9. For development agreements, the valuation approach in the Act is consistent with the longstanding approach in the previous legislation in requiring the estimate to be made in respect of what an authority expects to pay. There is no change.

Key points and policy intent

10. Section 4 provides the essential obligation on contracting authorities to apply the methodology at Schedule 3 when estimating the value of a contract, in order to determine whether the contract is above or below threshold and consequently the relevant rules that must be followed. Section 4 also includes an anti-avoidance mechanism that makes it unlawful to exercise any discretion in valuing a contract with a view to avoiding the requirements of the Act.

11. Schedule 3 sets out the valuation methodology. The 'general rule' requires contracting authorities to estimate the maximum value payable under the contract, taking account of any potential variables such as options to supply additional goods/services/works or options to extend or renew the contract, and sets out a non-exhaustive list of matters that could be relevant to this estimation.

12. When calculating the estimated value of the contract, the contract value estimation should be inclusive of VAT. This change in practice has been in place since 1 January 2021 and is a result of the UK's independent membership of the WTO Government Procurement Agreement (GPA). Whilst the UK was a member of the EU, the value of contracts was calculated exclusive of VAT. The EU's GPA thresholds were reduced in comparison to other GPA members to take this into account. The UK is now subject to the standard GPA thresholds and shares the common GPA practice of valuing contracts inclusive of VAT.

13. The estimated value of the contract must include the value of any goods, services or works "provided by the contracting authority under the contract other than for payment" (Schedule 3, paragraph 1(2)(a)). This obligation may only be relevant to the calculation in a limited number of procurements but recognises that in some cases the contracting authority provides items for the contractor to use in delivering the contract and it is the value of these items which should be included in the estimation of the contract value. For example, in a motorways programme, the electronic equipment for the gantries may be supplied by the contracting authority to the contractor to ensure consistent equipment is

deployed across the network. In this example, the value of the electronic equipment provided would be included when calculating the estimated value of the contract.

Frameworks and concession contracts

14. There are provisions reflecting the slight differences in approach needed when estimating the values of frameworks and concession contracts.

15. Frameworks must follow the general rule in Schedule 3 in terms of how to estimate the value of the contract, but must also follow the particular valuation method set out for frameworks, which requires that the estimate of the framework is the value of all contracts that could be awarded under the framework. Open frameworks, which are schemes of successive frameworks on substantially the same terms, must be valued by including the value of all frameworks that could be awarded under the open framework (and therefore the value of all contracts that could be awarded under each of the frameworks in the scheme).

16. Concession contracts are not valued according to the general rule in the Act but must follow the particular valuation method set out for concession contracts. This involves estimating the maximum amount the supplier could expect to receive, taking account of a similar non-exhaustive list of variables in the general rule, with certain modifications more pertinent to concession contracts, such as amounts received on the sale of assets held by the supplier under the contract.

17. The reason for concession contracts being valued differently is because at least part of the value in concession contracts is in the right to exploit the works or services. As such, in addition to any amounts received as payment from the contracting authority, the contract valuation should include amounts a supplier expects to receive in the exploitation of the works or services. This might include, for example, anticipated revenue from users of a toll bridge

Anti-avoidance

18. The anti-avoidance mechanism at Schedule 3, paragraph 4 is designed to ensure contracting authorities do not artificially subdivide procurements in order to evade the rules. This involves a basic rule that contracting authorities should where possible seek to aggregate for the purposes of valuation, but this should not be a blunt instrument and so it permits exceptions where there are good reasons. For example, just because a contracting authority buys printers from a particular supplier, it does not mean they should necessarily buy all of their toner, paper and servicing from that same supplier if they believe they can get a better deal elsewhere.

19. The rules do not need to be prescriptive on this as the anti-avoidance measure works on the basis that rule-avoidance would never be a good reason. An example of a good reason for not aggregating could be:
    - where a business unit within a large contracting authority has a delegated budget and procures only for the purposes of that business unit;

- where there are many business units with their own needs that cannot feasibly be expected to know every procurement requirement of other business units within the wider organisation;
- where not aggregating would lead to better value outcomes.

Where estimation is not possible

20. The policy intention behind Schedule 3, paragraph 5, which provides that contracts whose value cannot be estimated are deemed above-threshold, arises from the need to ensure full compliance with international obligations on public procurement. In practice the situation is unlikely to arise and in general terms it is recommended that contracting authorities simply undertake the best valuation with the information available, following the detailed rules set out in Schedule 3.

What other guidance is of particular relevance to this area?

Guidance on thresholds
Guidance on mixed procurement

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