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The Government Procurement Chapter of NAFTA

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THE GOVERNMENT PROCUREMENT CHAPTER OF NAFTA

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I. INTRODUCTION

The NAFTA provisions dealing with Government Procurement[1] strongly reflect GATT's influence. There are, however, three major differences between the GATT Government Procurement Code[2] and NAFTA's Chapter Ten.

NAFTA covers all government procurement contracts for services while, up to now, GATT does not. The matter of services continues to be a major GATT issue. Only services related to procured goods become subject matter of the relevant GATT code, and only as long as the value thereof does not exceed the value of the goods.

The second difference is that NAFTA goes into much greater detail than GATT in almost every topic. In order to make the parties' obligations clear and accurate, NAFTA even sounds repetitive at times.

Furthermore, because GATT is more internationally oriented, it has an article providing for developing countries.[3] Thus, the third major difference is that NAFTA has no article regarding this issue. It does refer, however, in the Annexes section of the Agreement, to adjustments Mexico must make in both economic and legal aspects within a given time frame.

Similar comments are applicable to differences between the quite short and simple Chapter 13 of the United States-Canada Free Trade Agreement ("FTA")[4] and NAFTA. In fact, the FTA reaffirms the parties' rights and obligations under the GATT Government Procurement Code. Modifications to the Code were to be automatically incorporated into NAFTA unless the parties agreed otherwise.

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1. North American Free Trade Agreement, Oct. 7, 1992, U.S.-Mex.-Can., ch. 10 [hereinafter NAFTA].

2. The General Agreement on Tariffs and Trade, April 10, 1947, Procurement Code, *reprinted in* BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 3 (Stephen Zamora & Ronald A. Brand eds., 1990).

3. *Id.* art. XVIII.

4. Jan. 2, 1988, U.S.-Can., ch. 13, *reprinted in* BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 353 (Stephen Zamora & Ronald A. Brand eds., 1990).

II. POINT OF VIEW ANALYSIS

Upon studying NAFTA, and in particular the Government Procurement Chapter, one may be tempted to make a business-oriented analysis. In other words, one may to try to find the advantageous and disadvantageous provisions for one or the other country as a party to NAFTA. Yet, unless one enjoys a certain expertise and some background on the specific NAFTA subject of study and of the touchy issues developed during the NAFTA negotiations, and unless one makes a careful study of the annexes thereto, a business-oriented analysis becomes very difficult, if not impossible.

Even though one may be able to satisfy such requirements, there is a major risk of getting involved in an unending political debate. Difficulties in this regard were made obvious by the mere fact that the parties had to agree to hold negotiations towards substantial liberalization in 1998, as well as to hold negotiations regarding when and if a GATT agreement on the subject will be reached.

Consequently, this paper has only two major targets in mind: first, to describe briefly the NAFTA Government Procurement subject matter, and second, to see to what extent the balanced, non-discriminatory, predictable, and transparent government procurement objectives were achieved.

III. NAFTA GOVERNMENT PROCUREMENT PROVISIONS

The NAFTA Chapter Ten article headings are used for the following discussion.

A. Scope, Coverage, and Valuation

Federal government entities and federal government enterprises are both obligated to follow the NAFTA Government Procurement provisions. These entities and enterprises are listed in Annex I to Chapter 10 in a schedule for each party. Exceptions in the areas of transportation, public utilities, research and development, and others are also included in the Annexes. State or other political subdivision government entities are not obligated to follow these provisions; however, the three parties are committed to take the necessary measures in order eventually to make them subject to said provisions.[5]

Goods and services valued at $50,000 and above, and construction contracts of $6,500,000 and above, contracted with Government Entities are subject to NAFTA Chapter 11 rules. Such minimums are increased to $250,000 and $8,000,000, respectively in the case of Government Enterprises. Values will be indexed to the United States inflation rate every two years.

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5. NAFTA, *supra* note 1, annex 1002.3 (State and Provincial Entities) provides that "coverage under this Annex will be addressed following consultations with state and provincial governments under the terms and conditions set out in Article 1024 (Further Negotiations)."

Procurement includes not only the purchases of goods and services, but also lease or rental agreements (with or without purchase options), and excludes government financial and fiscal services. Separation of contracts in order to reduce their value is prohibited and rules to compute the value of renewable contracts are contemplated. Also, rules to compute the value of indefinite lease or rental contracts are established.

Modifications to "Coverage" may be made as long as the other parties are notified and appropriate compensatory adjustments are made. Parties will have recourse to dispute settlement under NAFTA's Chapter 20. Government reorganizations and divestitures which are considered to be illegitimate by one of the parties can be questioned under the terms of Chapter 10.[6]

B. National Treatment

Only the Rules of Origin established in Chapter 3 of NAFTA may be used to differentiate among parties' suppliers. Therefore, the degree of foreign affiliation or ownership may not be used to discriminate in the award of contracts, unless the supplier is owned or controlled by citizens of a non-party country or does not have a reasonable level of business activity in the territory within which it is originally allowed to do business.

C. Article 1007: Technical Specifications

Performance criteria and international standards, rather than design or descriptive characteristics, will be used in describing procurements. References to industrial property rights shall not be made, unless there is no other way to describe the procurement; but use of the words "or equivalent" should be made in any event. No advice may be obtained in preparing technical specifications from any party involved directly or indirectly in the procurement and which could result in a conflict of interest.[7]

D. Article 1009: Qualification of Suppliers

Conditions for participation in bids must be adequately publicized in advance and be limited to those that are of the essence. Suppliers' business activity in the relevant party territory shall not prevail over global business activity when judging suppliers' capacity. Enough time to qualify must be given to all potential suppliers, even when not listed as such. Changes in or elimination of supplier lists must be published, as well as rejections for lack of acceptable qualifications. Qualification procedures must be uniform or the need for making an exception duly evidenced.

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6. *Id.* art. 1022(4) (Rectifications and Modifications); *id.* art. 1023 (Divestiture of Entities).
7. *Id.* art. 1007(4).

E. Article 1010: Invitation to Participate

Minimum information requirements, such as the nature and quantity of goods or services desired, including future needs, time frames in which options may be exercised, and estimated publication time for recurring agreements, where applicable, must be contained in all invitations to participate. A statement regarding whether bidding is to be open or selective in nature, the date for starting delivery, the address for filing the application and tender, as well as where additional information may be obtained, the submission language, required information and documentation from suppliers, and terms of payment must be published as part of the invitation.

Published notices regarding planned procurement do not eliminate the obligation of having subsequently to publish formal invitations to the suppliers. In the case of selective tendering procedures, annual classified publications of the list must be made together with requirements for qualification and methods to verify such requirements. Validity periods and renewal formalities must also be disclosed.

F. Article 1012: Time Limits for Tendering and Delivery

Time limits should not be used to make foreign supplier qualification more difficult. In principle, the period to receive tenders should never be less than forty days. This period may be reduced to twenty-four days in subsequent publications regarding recurring contracts or to ten days in the event of an emergency.

G. Article 1013: Tender Documentation

In addition to the requirements mentioned in connection with suppliers' qualifications, tender documentation must include the names of those persons authorized to be present at the opening of tenders and the criteria used in awarding contracts.

H. Article 1014: Negotiation Discipline

Negotiation of a procurement is allowed in order to identify the strengths and weaknesses of tenders, as long as the criteria established in the notices and modifications are provided to all suppliers.

I. Article 1015: Submission, Receipt, Opening, and Awarding

Submission is to be made in writing, directly or by mail. If other communication media is acceptable, it must include all required information and must be confirmed by letter. Information initially provided prevails, however, over letter confirmation. Telephone communication is not allowed and electronic transmission requires a confirmation by a letter or signed copy. Correction of unilateral errors is allowed as long as it does not result in discriminatory practices.

Abnormal prices may be questioned. The "public interest" may be used to deny a contract. Prior business activities in the relevant territory may not be argued as the sole reason for awarding a contract. No later

than seventy-two days following the award of a contract, notice thereof must be published and must include: a list of the goods and services awarded, the entity awarding, the date of the award, the winning supplier, the highest and lowest tenders, and the procedure used in making the award, unless disclosure might prejudice legitimate commerce, fair competition, or law enforcement.

J. Article 1016: Limited Tendering

Limited tendering is allowed in the absence of sufficient tenders, where collusion has been discovered in connection with one or more tenders, or where there is a lack of conformity with essential requirements. Limited tenders are also permitted to assure the protection of patents, copyrights, or proprietary or confidential information where there exists one sole supplier, in the event of extreme urgency, or in connection with additional deliveries by original suppliers when doing otherwise would compel the purchase of equipment or services not meeting acceptable standards. Limited tenders are also permitted in cases where a prototype has been developed upon request. Similarly, an exception can be made for purchases on the commodity market or where exceptionally advantageous prices are available in the short term for non-routine purchases or in the case of a winner in an architectural contest, if awarded in accordance with NAFTA's Chapter 10.

A report on each such contract awarded shall be prepared and shall remain at the disposal of authorities of the relevant party.

K. Article 1017: Bid Challenge

Parties must allow any aspect of a bid to be challenged, and a minimum period of ten working days from publication may be authorized for such purpose. A challenge must be resolved fairly and in a timely manner. The reviewing authority must have no substantial interest in the outcome of the challenge, must expeditiously investigate the challenge, and may delay the awarding of the contract pending resolution of the challenge, except in urgent cases or when the public interest is affected. Recommendations made by the reviewing authorities should be given effect by the relevant government entity, but challenge procedures must be made available to interested parties.

L. Article 1018: Exceptions Applicable to All Parties

Information dealing with essential security interests, the procurement of arms and ammunition or war materials, need not be disclosed, nor measures dealing with public morals, life, health, or protection of intellectual property rights. Exceptions for goods or services produced by handicapped persons, philanthropic institutions, or prison labor may not be interpreted as infringing NAFTA Chapter 10.

M. Articles 1019 and 1020: Provision of Information and Technical Cooperation

Parties must publish the legal procedures and practices applicable to Government Procurement. In addition, statistics listing the government

entities involved, goods and services contracted with the value thereof, and derogations to rules must be published. Exceptions may be allowed where fair competition or commercial interests could be prejudiced.

Cooperation between government and suppliers, personnel training, and the dissemination of information on procurement systems and market opportunities is contemplated in the Agreement, as well as information having to do with small business opportunities.

N. Annexes

The Annexes to NAFTA's Chapter 10, in addition to listing the government entities and enterprises covered by the procurement regulation, deal mainly with the agreed upon temporary or permanent exceptions to the Government Procurement rules. Such exceptions are made by means of "set asides" and "offsets." "Set asides" are exceptions made by each party regarding the procurement of certain kinds of products or services by specified government entities or where sourced from specified suppliers. An example of United States and Canadian "set asides" are goods and services produced by small and minority businesses. "Offsets" are made when a percentage of certain government contracts is excluded from the rules established by NAFTA's Chapter 11. Mexico, for example, permits government entities to impose a local content requirement that up to forty percent of labor intensive, turnkey projects be contracted locally.

IV. CONCLUSION

NAFTA's Chapter 10 provides the basis upon which the parties can establish a balanced, non-discriminatory, predictable, and transparent legal framework within their own countries. However, the use of non-defined terms such as "foreign affiliation," "substantial business activities," "promptly," "public interest," "proprietary information," "timely manner," and "essential security interest" may result in future inconsistencies between implementing legislation enacted by the parties.

The Annexes to NAFTA's Chapter 10 list the specific, negotiated, temporary, or indefinite exceptions to the rules. However, only when NAFTA enters into effect will the parties be able to determine fully whether or not such exceptions were wisely negotiated.

GOVERNMENT PROCUREMENT AFTER NAFTA: A MEXICAN PERSPECTIVE

CARLOS VALENCIA BARRERA*

As a result of the North American Free Trade Agreement ("NAFTA"),[1] the Mexican government will undertake a complete renovation of its procurement system. The current system is still branded as mystical and confusing, given the government's broad discretionary authority and the absence of clear and comprehensive rules. These trademarks, however, are common to government procurement processes throughout the world. Chapter 10 consequently deals with this issue, which could basically be identified as how to balance the governments' need for discretionary authority to be able to make the right choice in the procurement process, with the suppliers' need and expectation of clear and predictable ground rules.

Chapter 10 provides a statement of purpose and speaks eloquently on the subject of procurement. Its purpose is to develop a balanced, non-discriminatory, predictable, and transparent government procurement process. To this effect, Chapter 10 provides that technical specifications should not be used as trade barriers. It also provides that tendering procedures shall be nondiscriminatory and shall allow equal access to tender information. Further, it requires the prompt qualification analysis of a would-be bidder and the prompt notice to him of the grounds for rejection. It requires that the invitation to a bid be comprehensive and that the tender documentation contain all information necessary to permit the supplier to submit a comprehensive answer. It also requires that as a general rule, with certain exceptions, the award will go to the supplier that is determined to be fully capable to undertake the contract and whose tender is either the lowest or the most advantageous.

Once the procurement processes are standardized, any rectification or modification to these processes and procurement practices will be subject to compensatory adjustments, with exceptions. One would be a bona fide government reorganization; for example, the decentralization of a government procurement office, or the divestiture of a government entity, unless that entity remains under government control.

Several transitional provisions are important. Through 1994, two major procurement entities of the Mexican government, the national electric company, the Comision Federal de Electricidad ("CFE"), and the national

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1. Oct. 7, 1992 draft, U.S.-Can.-Mex.

oil company, Petroleos Mexicanos ("PEMEX") shall only make available fifty percent of the total annual procurement value above the threshold of goods and services, including construction services.[2] Similarly, the Mexican government will only make available fifty percent of the total annual procurement, excluding CFE and PEMEX purchases of goods, services, and construction services. There will be a decrease of five percent beginning in 1995 and lasting until the year 2003, when it will be zero percent.[3]

Another exception exists for pharmaceuticals. There is an eight year window for access to unpatented drugs or drugs under an expired patent, which are procured by the major purchasers of pharmaceutical products, namely the Mexican Social Security System and the Ministry of Health. This is the only exception in this chapter that would undermine NAFTA's commitment to the protection of patents and intellectual property under Chapter 17.

Local content rules are prominent among the transition provisions. Procurement entities, however, may impose local content requirements which may not exceed forty percent in the case of labor intensive turnkey contracts or major integrated projects, or twenty percent in capital intensive contracts or major related products.

What happens if the procurement obligations are breached? The parties will basically have two options. One option will be to seek compensation through more market opportunities; the other option would be to settle the dispute via the institutional arrangements in dispute settlement procedures.

The final provision that I would like to comment on is that which allows Mexico a "best efforts" mechanism to comply with the obligations under this chapter from the date of effectiveness of NAFTA through January 1, 1995.[4] The provision provides that the parties' recognition that Mexico may be required to undertake extensive retraining of personnel, to introduce new data maintenance and reporting systems, and to make major adjustments to the procurement systems of certain entities in order to comply with the obligations of this chapter. The parties also recognize that Mexico may encounter difficulties in making the transition to procurement systems in full compliance with the obligations of this chapter.

The parties shall, therefore, consult, on an annual basis for the first five years that the Agreement is in effect, to review transitional problems and to develop mutually agreeable solutions. Such solutions may include, when appropriate, temporary adjustments to the obligations of Mexico under this chapter, such as those related to reporting requirements. In addition, the United States and Canada shall cooperate with Mexico in providing technical assistance as appropriate and shall aid Mexico's transition.

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2. *Id.* annex 1001.2a.
3. *Id.*
4. *Id.*

In conclusion, once Chapter 10 of NAFTA is fully implemented, Mexico should have a procurement system which, in a perfect world (or at least a perfect North America), affords a clear and adequate bidding system for the supply and procurement of government goods and services. One of my major questions, however, is what happens to all of those entities that have fallen out of the Mexican government via privatization? I believe that it may very well be more difficult to sell to those entities than to sell to the newly revamped Mexican government.

GOVERNMENT PROCUREMENT AFTER NAFTA: AN AMERICAN PERSPECTIVE

JOHN SCANLON*

The front end of government procurement problems, from an American point of view, is the "Buy American" provision.[1] I would like to discuss what that means to us in terms of Mexican bidders coming in and being able to bid on American government procurements, and Americans being able to go into Mexico and do likewise. Then I would like to discuss Annex 1001.2b of the North American Free Trade Agreement ("NAFTA"),[2] which is where the exceptions to the thresholds in the articles are established. Some of those are temporary, others are not, and others are left to consultation and agreement in the future.

The Buy American Act of 1933, which had some significant amendments in 1988, very specifically prefers domestic products for United States government agency procurements. It defines certain terms. An "unmanufactured product" is one that is mined or produced in the United States. A "manufactured product" is one that is manufactured from articles that are mined or produced in the United States. "Components" mean articles, materials, and supplies incorporated into the end products. "Domestic end product" means either an unmanufactured product that is mined, produced, or grown in the United States, or one that is manufactured in the United States provided that the American component value exceeds fifty percent of the value of all other components. An "end article" is an article, material, or supply to be acquired in a government procurement.

The Buy American Act does not apply to articles, materials, or supplies to be used outside the United States. If the articles, materials, or supplies are not mined, produced, or manufactured in sufficient or reasonably available quantities or satisfactory quality in the United States, the Buy American Act can be waived. Since 1980, however, with the passage of the Trade Agreements Act of 1979,[3] there have been significant inroads into the preference that is contained in the Buy American Act.

Title 3 of the Trade Agreement Act of 1979 brought into our law the Agreement on Government Procurement which was negotiated as the Tokyo Round of GATT[4] negotiations. That provision stated that where

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1. 41 U.S.C. § 10a-c (1988).

2. Oct. 7, 1992 draft, U.S.-Can.-Mex., annex 1001.2b [hereinafter NAFTA] (General Notes and Schedules of Canada, Mexico, and the United States).

3. Trade Agreements Act, Apr. 12, 1979, 1235 U.N.T.S. 258.

4. General Agreement on Tariffs and Trade, Apr. 10, 1947, 55 U.N.T.S., *reprinted in* BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 3 (Stephen Zamora and Ronald A. Brand eds., 1990) [hereinafter GATT].

the President has found sufficient rights of reciprocity, certain countries would be entitled to bid upon American government procurements because we had essentially open access to their government procurement bidding process.[5] A threshold was established above which the procurement was valued. Above that threshold, a bid could be offered by anyone, American citizen or not, using American materials or not, and the bid would be evaluated without regard to the Buy American Act. As of January 1, 1992, that threshold is worth $176,000 (U.S.).

In light of the currency fluctuations that have been taking place in Europe, the threshold is going to change, probably in the beginning of 1993. Certain terms under Title 3 of the Agreement on Government Procurement are defined differently than in the Buy America Act. For example, under Title 3, "designated end product" is a product that is wholly the growth or product of a manufacturer of the designated country, or articles consisting in whole or in part of materials from other countries that have been substantially transformed in the designated country. Title 3 and the Agreement on Government Procurement does not pertain to service contracts; the Buy American Act does.

The list of countries that are designated countries for the Agreement on Government Procurement is found in the Purchases Under the Trade Agreements Act of 1979.[6] There were forty-five countries listed in the 1992 edition of the *Code of Federal Regulations*. Three were added in September of 1992; Spain, Greece, and Portugal. That provision means that those countries were designated in the Act. If the procurement value threshold were exceeded, they could bid without regard to any restrictions of the Buy American Act.

Canada had a different restriction that came about as part of the U.S.-Canada Free Trade Agreement. Its threshold was $25,000. Israel was given a $50,000 threshold by virtue of the Free Trade Agreement with Israel. What Chapter 10 of NAFTA has done is to put Mexico at parity with Israel. NAFTA Annex 1001.2c restates the Canadian threshold as being $25,000, notwithstanding the $50,000 threshold that is mentioned in the early articles of the chapter.

NAFTA Annex 1001.2b lists the federal entities of all three countries that are subject to this Act under Chapter 10; the Mexican National Oil Company, Petroleos Mexicanos ("PEMEX"), is subject to this chapter, with some stated exceptions. Annex 1001.2c restates the Canadian and American threshold levels.

If one has a protest, Chapter 10 provides for a bid protest procedure. There is a slight problem, however, in that there are no procedures that have been agreed upon. It simply states that each party will develop procedures. As it does not say when, if NAFTA were enacted tomorrow there would not be any procedures whereby one could protest a bid with either party to the treaty. Presumably that will come as part of the

5. *See* Trade Agreements Act, *supra* note 3.
6. 48 C.F.R. § 25.401 (1991).

implementing legislation, or we will see one of those references provided by the Department of Defense, the Department of Treasury, or another agency. But bid challenge procedures are needed; otherwise, we are not really sure where we go to resolve a dispute about a bid award under this chapter. Those procedures have to be developed in order to provide the bid protest mechanism.

Finally, I will talk about NAFTA Annex 1001.2b, which deals with each of the three countries having made certain exceptions or reserved certain areas for their own bidding processes. This annex deals with Mexico's ability to set aside certain values. NAFTA article 1001.2b deals with the ability of PEMEX and the Mexican national electric company to reserve fifty percent of their procurements above the threshold levels to domestic awards. Thus, fifty percent of what those two agencies will procure are going to be reserved. Annex 1001.2b excepts these two agencies. The rest of the Mexican government entities and enterprises are allowed to set aside $1 billion U.S. 1994 dollars in 1994, which increases to $1.2 billion in 2002. After 2002 that set-aside increases to $3 billion U.S. 1994 dollars. Annex 1001.2b must be read in conjunction with Annex 1001.2a to find out how much of the Mexican procurement budget will be available to non-Mexican bidders. Two of the largest agencies have taken fifty percent right off the table, and these set-asides will last up to the year 2002.

DISCUSSION OF GOVERNMENT PROCUREMENT

QUESTION: To what extent can foreign firms, before ratification of the North American Free Trade Agreement ("NAFTA"),[1] bid on Mexican government procurement contracts?

ANSWER, *Lic. Muggenberg*: There is a provision stating that when any government entity or enterprise is to contract something, it should take the local needs or the local suppliers into consideration, but this is not mandatory. Thus, it depends on the government entity procuring supplies or services. The law also provides that if a foreign supplier is to be chosen, the Mexican Ministry of Commerce and Industrial Promotion ("SECOFI") has to be consulted. It is not only the law and the regulations that should be taken into consideration. There are many norms or specific rules which go into much detail, even providing standard form agreements to be used by the government entities. These allow the suppliers to become aware of the most basic terms and conditions of the procurement agreements.

ANSWER, *Mr. Scanlon*: Contrast Licenciado Muggenberg's answer for Mexico with the answer that exists for the United States. The U.S. agencies listed in the Buy American Act of 1933[2] cannot buy an end-product from a non-AGP (Agreement on Government Procurement) country. Mexico is not such a country. NAFTA will give Mexico the status of an AGP country without calling it that. That is the effect, and it is very important. Although American governmental agencies listed in the Act cannot buy end-products from Mexico, their contractors can buy components, subject to the Buy American Act requirement that at least fifty percent of the value of the components of the resulting end article comes from American sources.

1. Oct. 7, 1992 draft, U.S.-Can.-Mex.
2. 48 C.F.R. § 25.401 (1991).