



# RUSSIAN DESK

## Set of optimization adjustments to Federal Law No. 44-FZ: important changes to state and municipal procurements for construction have been announced

On 26 January 2021, the Government of the Russian Federation introduced a draft law<sup>1</sup> to the State Duma aimed at “integrated improvements to the provisions of the Federal Law ‘On the Contract System in State and Municipal Procurement of Goods, Work and Services’”<sup>2</sup>. The main areas of improvement are the simplification, unification and digitalization of procurement procedures<sup>3</sup>.

Almost simultaneously with the Draft Law, the Russian Government also approved the Action Plan (Roadmap) for Transformation of the Business Climate in the Area of Urban Planning<sup>4</sup>. Section IV of the Roadmap is devoted to issues of state procurements for construction.

Without question, the Draft Law and the Roadmap share the common goal of reforming state procurements. However, at this stage the Roadmap stipulates a number of important initiatives that were not included in the Draft Law.

In this overview, we will look at the degree to which the planned reform will affect the construction industry. Due to the limited scope of the publication, we will omit purely procedural and technical amendments.

### 1. REDUCTION IN THE NUMBER OF PROCUREMENT METHODS

The Draft Law stipulates a reduction in the number of competitive methods for determining the supplier (contractor, provider) from ten to three – tender, auction, and request for quotation.

According to the Russian Government<sup>5</sup>, it is important to retain the methods for determining suppliers that are most widespread and frequently used by customers. Pursuant to this position, the other methods did not find wide recognition, are virtually never used by customers, and duplicate open tender procedures<sup>6</sup>. In particular, for this reason it was proposed that two-stage tenders, selective tenders and requests for proposal no longer be used.

Despite the consistently low share of open tenders in the total number of procurements<sup>7</sup>, the Russian Government and the Federal Antimonopoly Service of Russia (FAS) see potential in this procurement method in case of a change in the approach to determining non-financial criteria (see point 2 below).

The light use of complex procurement procedures can hardly be written off exclusively to duplication. Most likely, systemic factors are at work here, such as the insufficient qualifications of the public procurement authorities and their unwillingness to accept the additional costs and risks associated with the drafting of more complex tender documentation (including the risks of being held administratively and criminally liable).

In this respect, two-stage tenders, which are enjoying a resurgence in the Europe countries due to the implementation of digital building information modelling (BIM) in construction, deserve special attention. In this case, this trend is expressed not only in the increased complexity of the procurement target but also in the new opportunities for the public procurement authorities to structure the investment decision process<sup>8</sup>.

<sup>1</sup> Draft Law No. 1100997-7 “On Amending Certain Legislative Acts of the Russian Federation to Simplify and Optimize the State and Municipal Procurement Procedure for Goods, Work and Services and to Repeal Certain Provisions of the Legislative Acts of the Russian Federation” (the “Draft Law”).

<sup>2</sup> See the explanatory note to the Draft Law: <https://sozd.duma.gov.ru/bill/1100997-7>.

Hereinafter in the text, the term “Law on the Contract System” will Federal Law mean No. 44-FZ dated 5 April 2013 “On the Contract System in State and Municipal Procurement of Goods, Work and Services”.

<sup>3</sup> See the explanatory note to the Draft Law.

<sup>4</sup> Order No. 48-r of the Government of the Russian Federation dated 19 January 2021 “On Approving the Action Plan (Roadmap) for Implementing the Mechanism for Management of Systemic Amendments to the Legal Regulation of Business Activity ‘Transformation of the Business Climate’ ‘Urban Planning Activity’” (the “Roadmap”).

<sup>5</sup> See the explanatory note to the Draft Law.

<sup>6</sup> Based on the results for Q3 2020, the number of selective tenders equalled 7,541 (for all types of procurements), with a two-stage tender only being held in one instance (see the Analytical Report of the Ministry of Finance on the Results of Procurement Monitoring for the Third Quarter of 2020).

<sup>7</sup> For example, based on the results for 2018 open tenders made up 1.3% of the total number of procurement notices, 1% in 2019, and 2% in 2020 (based on data for Q1-3). See: Expert Report. The Procurement System in Russia. HSE, 2018, p. 21; Analytical Report of the Ministry of Finance on the Results of Procurement Monitoring for 2019; Analytical Report of the Ministry of Finance on the Results of Procurement Monitoring for the Third Quarter of 2020 (link given above).

<sup>8</sup> See, for example, the guidance on procurement methods prepared by order of the UK Government, in particular the two-stage open book guidance.

Admittedly, the Draft Law proposes certain mechanisms to compensate for the simplification of procurement procedures. To do so, the Russian Government suggests that:

- the existing additional requirements on procurement participants in selective tenders (i.e., participant qualification requirements) be extended to open electronic tenders;
- the customer be allowed to negotiate with potential participants at the procurement planning stage (before the procurement notice is issued).

The choice of the procurement method remains with the public procurement authority<sup>9</sup>.

## 2. PRE-QUALIFICATION SCREENING OF PROCUREMENT PARTICIPANTS

The Draft Law stipulates the introduction of “universal financial pre-qualification”, i.e., limit access to procurements of more than RUB 20 million<sup>10</sup> to those participants with experience, during the three years before the date of the filing of a procurement bid, of performing a contract concluded under the Law on the Contract System or the Law on Procurements by Certain Types of Legal Entities<sup>11</sup> with performed obligations worth at least 20% of the MSPC, and without the imposition of penalties on the contractor. The target under the contract used as evidence of successful experience does not necessarily have to coincide with the procurement target (herein lies its universality).

At the same time, the provisions of Part 2 of Article 31 of the Law on the Contract System stipulating that the Russian Government can establish requirements on experience performing a contract concluded on a target similar to that of the procurement being held (“special pre-qualification”) remain in force for procurements of certain types of goods, work and services.

The Draft Law envisages the use of “universal financial pre-qualification” exclusively in those cases when “special pre-qualification” has not been established. It is assumed that most procurements for construction work will be eligible for “special pre-qualification”.

We believe that while the establishment of requirements that procurement participants must have experience with targets comparable with the target of the procurement being performed covers some gaps in controlling access to tenders to only qualified participants, it does not make a tender the preferable method of procurement compared to (the often criticized) electronic auction. We remind you that, based on Article 33 of the Law on the Contract System, when procuring work related to construction, reconstruction, overhaul, and demolition of capital facilities the procurement documentation must contain design documentation approved by the client according to the established procedure.

Pursuant to Clause 68 of Article 112 of the Law on the Contract System, if procurement is performed through an open electronic tender on or before 1 January 2024, no quality criteria (functional, technological and environmental characteristics of the work) are established and the procurement participant must express in its bid its only consent to perform the work on the terms and conditions stipulated by the procurement documentation and, even more importantly, by the design documentation. In other words, tender participants can only really compete with one another in terms of price, which makes the tender procedure remarkably similar to an auction. However, in a tender they have far fewer opportunities to compete based on the cost criterion. Therefore, it is fair to assume that considerations involving the relative savings of budget funds will once again gain the upper hand, and electronic auctions will continue to predominate in construction procurements. However, procurements under lifecycle contracts (LCC) or turnkey contracts, i.e., when the drafting of design and estimate documentation is included in the scope of the contractor’s work, could become a definite niche for the optimal use of tenders<sup>12</sup>.

## 3. BUSINESS REPUTATION RATING

The Draft Law stipulates the introduction of a business reputation rating for procurement participants (hereinafter the rating of a procurement participant, which represents the overall assessment of the experience of the procurement participant formed on the basis of the contracts (agreements) concluded by such a participant with state and municipal clients, and with state companies.

For the time being, the issue of the procedure for establishing and using the rating of a procurement participant is still at discussion stage. The Draft Law merely stipulates the right of the Russian Government to approve the rules for establishing and the procedure for applying the rating of a procurement participant, and the instances when the rating should be applied. Information on this rating will be included in the Unified Register of Procurement Participants and will be made publicly available.

It is assumed that the rating will have an impact on the amount of security required to submit a bid and perform a respective contract (the higher the rating, the less the security required).

## 4. SECURING BIDS AND CONTRACT PERFORMANCE

The Draft Law specifies improvements to the procedure for securing bids and contract performance.

The Draft Law expands the range of organizations which may submit independent guarantees as security of the performance of obligations by procurement participants. Namely, it states that in addition to authorized banks (as stipulated by effective legislation), the following organizations may provide such guarantees:

- State Development Corporation VEB.RF;

<sup>9</sup> We remind you that from 1 September 2020 the holding of auctions for procurement of construction work is no longer mandatory (Resolution No. 921 of the Russian Government dated 25 June 2020); that being said, customers can still use this procurement method to purchase any types of goods, work and services. See the criticism of this approach in the Expert Report. The Procurement System in Russia, pp. 26, 28.

<sup>10</sup> This is a reference to the so-called maximum starting price of the contract (MSPC), in other words, the maximum contract price to be established in the procurement documentation at which the client is ready to conclude the contract. This price is adjusted based on the procurement results. It should be noted that the participants in a procurement may offer to conclude the contract at a price which is equal to or less than the MSPC.

<sup>11</sup> Hereinafter this is how we refer to Federal Law No. 223-FZ dated 18 July 2011 “On the Procurement of Goods, Work, and Services by Certain Types of Legal Entities”, which establishes the procurement principles for different types of state companies.

<sup>12</sup> These types of contracts are stipulated by Sub-Clauses 16 and 16.1 of Article 34 of the Law on the Contract System and include stages in the facility’s lifecycle prior to construction (engineering studies, design) or subsequent to construction (commissioning, operation, repairs, disassembly).

- credit assistance funds which are participants in the national guarantee system set up to support small and medium-sized enterprises.

The Draft Law also states that the period of information exchange between banks and operators of electronic platforms should be reduced to one hour, and that the monetary funds on the procurement participant's bank account should be blocked as security on the bid when submitting an application to participate in electronic procedures (and not after the completion of the period of acceptance of bids), so that in the event of insufficient funds the procurement participant will be able to replenish the account before the deadline for accepting bids, etc.

To take account of the specific aspects of provision of security by foreign entities acting as procurement participants, the Draft Law gives the Russian Government the authority to establish special conditions for such provision.

## 5. ANTI-DUMPING MEASURES

The Draft Law and the Roadmap call for a strengthening of anti-dumping measures during procurements in connection with a change in the requirements on securing contracts and mitigating the risks associated with a tender win by a contractor that is unable to perform its obligations under the contract professionally and on time. For example, the Draft Law specifies an additional minimum threshold for performance security if a participant is suspected of participating in dumping, i.e., a contract price is proposed that is 25% or more below the MSPC. In this case, this participant will have to provide security for contract performance of 1½ times the amount of contract performance security indicated in the procurement notice, but not less than the amount of the advance (pursuant to the current version of Article 37 of the Law on the Contract System) and no less than 10% of the MSPC (an innovation proposed by the Draft Law).

## 6. PERFORMANCE OF THE CONTRACT

The Draft Law introduces a range of amendments to the regulation of contract performance. For example, the term "individual stage of contract performance" is proposed, meaning part of the obligations of the supplier (contractor, provider) on the supply of goods, performance of work and provision of services stipulated by the contract, in relation to which the contract specifies the drafting of an act of acceptance of the results of the supply of goods, performance of work and provision of services.

As concerns construction contracts, this new term raises a number of questions. The transfer of risks to the client only after acceptance of the facility as a whole is a standard condition of state and municipal contracts. At the same time, KS-2 and KS-3 certificates are drafted for individual stages of work, solely for the purpose of settlements between the parties and control over the progress of work, but acceptance certificates in the sense of Article 753 of the Civil Code are not recognised.

In accordance with Article 110.2 of the Law on the Contract System, the result of the performance of work under a contract, the subject of which is the construction or reconstruction of a capital construction facility, is the constructed (reconstructed) capital construction facility in respect of which a ZoS<sup>13</sup> has been received. In other words, it is the completed construction (reconstruction) of the facility that is subject to acceptance.

Since the Draft Law unambiguously ties the completion of an individual stage of performance of a contract with the signing of an acceptance document, additional clarifications of the regulatory and supervisory authorities are required to avoid disputes between the parties as to the legal implications of the documentary confirmation of the performance of an individual stage of performance of the contract.

If the contract stipulates the identification of individual stages of performance of the contract, it is essential to determine the deadlines for the performance of each stage. This is also significant for changes to the contract price in cases where the deadline for the performance of an individual stage (individual stages) of performance of the contract is changed (see Clause 7 below).

In accordance with the Draft Law, the acceptance document will be automatically created and signed in electronic form in the EIS<sup>14</sup>. According to stipulated plans, this will mark the transition to a fully automated contract settlement system.

## 7. AMENDMENT OF THE CONTRACT

The Draft Law stipulates changes to the procedure for amending the material terms and conditions of the contract. While it retains the exhaustive list of grounds for such amendments (Article 95 of the Law on the Contract System), the Draft Law expands the list and changes the conditions for the use of such grounds, as follows.

It is stipulated that the grounds for amending the contract will apply by virtue of law, i.e., regardless of whether the procurement documentation and the contract stipulate such grounds.

The existing grounds for amending the terms and conditions of a contract, the subject of which is the performance of work on the construction, reconstruction, overhaul, and demolition of capital construction facilities (fourth paragraph of Clause 1 of Part 1, Sub-Clauses 8 and 9 of Article 95 of the Law on the Contract System), should also apply to lifecycle contracts and turnkey contracts.

New grounds are stipulated for amending the material terms and conditions of contracts:

- 1) if during the performance of a lifecycle contract or a turnkey contract, the cost estimate for work, determined based on a review of the accuracy of determination of the cost of work as part of a state expert review of the design documentation, exceeds the contract price. In such cases, the decision to increase the contract price is made by the Russian Government,

<sup>13</sup> ZoS – the Conclusion of the State Construction Supervisory Authority that the constructed (reconstructed) capital construction facilities meets the requirements of the technical regulations and design documentation, including requirements on energy efficiency and on the installation of energy metering devices in the capital construction facility, and the conclusion of the federal environmental supervisory authority in cases stipulated by Part 7 of Article 54 of the Urban Planning Code of the Russian Federation.

<sup>14</sup> Unified Procurement Information System.

the supreme executive body of the constituent entity of the Russian Federation, or the local administration, depending on the level of the client. However, if the state expert review determines the cost estimate of the work in an amount smaller than the contract price, then the contract price should be reduced to take into account the results of the expert review;

- 2) the contract price may be changed if there is a change to the deadline for completing an individual stage (individual stages) of the performance of the contract (see point 6 below).

The foregoing amendments to the terms and conditions of the contract are made only if the supplier (contractor) provides additional security, when this change results in new obligations for the supplier (contractor) that are not covered by the security already provided.

### 8. CANCELLATION OF THE CONTRACT

The changes to the contract cancellation procedure stipulated by the Draft Law mainly concern the translation to electronic form of the corresponding notices of the parties to a contract that has been concluded based on electronic competitive bidding (through the EIS; documents are signed with the advanced electronic signatures of authorized parties).

An important innovation is the increase (from 10 to 15 days) in the period before the client's decision to unilaterally repudiate the performance of the contract enters into force; during this period, the supplier (contractor) has the right to appeal the client's decision to the FAS. However, if this appeal by the supplier (contractor) is granted, the client has the right but not the obligation to withdraw its decision to unilaterally repudiate the contract. Of course, the supplier (contractor) retains the right to further appeal this decision in court.

### 9. LIMITATIONS ON THE RIGHT TO FILE AN APPEAL

The Draft Law stipulates a radical innovation to deal with so-called professional appellants<sup>15</sup>.

The use of "universal financial prequalification" (see point 2 above) has been stipulated to tackle this phenomenon in the appeal procedure. In other words, in the event of an appeal in a procurement where the maximum starting price of the contract exceeds RUB 20 million, the procurement participant must meet the requirements of "universal financial prequalification". Otherwise, their appeal will be rejected on formal grounds.

Other innovations of note include the stipulation that any appeal must be filed online (in the case of electronic auctions), in other words, an electronic form for filing an appeal with the procurement control body, with the use of EIS, has been established. The number of control agents has been expanded to include banks,

the State Development Corporation VEB.RF, regional guarantee organizations when they issue guarantees (see point 4 above).

### 10. OPEN-BOOK CONTRACTS

The Roadmap foresees "addressing, with due account of international experience, the possibility of procurement of work on the construction of technically complex and unique facilities on an open-book basis" (Clause 26 of the Roadmap).

The open-book method is proposed for use in determining the contract price "when it is impossible, at the stage of the conclusion of the contract, to determine the specific technological solutions, the scope, types, and timeframes for work stipulated by the design documentation, as well as the exact cost of the work to be performed and a firm contract price".

The decision to introduce state procurement using open-book contracts is not yet final and will be made only if it is deemed advisable.

In international practice, open-book contracts (also known as cost-plus contracts) are concluded in cases where there is a limited market for certain goods or work, and it is not possible to obtain a fair price in competitive bidding, where construction work must begin before the appearance of design documentation and be performed in parallel with design work (fast-track projects), and in certain other cases<sup>16</sup>. The emphasis is on the fact that such contracts allow the client to maintain flexibility and control as regards changes in the scope of work (and correspondingly the structure of expenses). On the other hand, this requires higher-quality administration of the contract on the part of the client and transfers the risks of cost overruns to the client<sup>17</sup>.

For now, it is difficult to say under what parameters open-book contracts will be included in the contract system, or indeed if they will be included at all. It is only clear that there are plans to include them only in respect of technically difficult and unique facilities.

According to the Law on the Contract System (in its current version), for technically difficult and unique facilities it is possible to hold two-stage tenders (Article 57 of the Law on the Contract System) and conclude lifecycle contracts and turnkey contracts. All of these cases are of interest for the use of open-book contracts, both from the standpoint of organising the procurement process, and from the use of a more flexible system of price formation. Moreover, the use of the open-book method creates the opportunity for a broader application of these types of contracts in government procurement<sup>18</sup>. The issue of changing design and construction processes in order to be able to carry out fast-track construction projects is also on the agenda<sup>19</sup>.

<sup>15</sup> In practice this is the name that the Federal Antimonopoly Service of Russia assigns to persons that file appeals against the actions of clients and other participants in the procurement system with the sole goal of drawing out the procurement procedure, frequently in league with alleged competitors in auctions/tenders. Based on statistics, FAS of Russia declares more than half the appeals submitted to the service to be unsubstantiated. For more details, see [Expert Report. The Procurement System in Russia. Higher School of Economics, 2018](#) (page 18).

<sup>16</sup> [V.I. Malakhov. Contract Modelling of Investment-Construction Projects.](#)

<sup>17</sup> <https://www.publicspendforum.net/blogs/peter-smith/2017/08/18/open-book-contracts-supplier-public-procurement/>.

<sup>18</sup> On problematic issues in the use of LCC in the area of road construction, see for example [S. Donin, Lifecycle Contracts in Road Construction: Realities and Prospects.](#)

<sup>19</sup> See, for example, <https://www.vedomosti.ru/realty/articles/2019/11/12/816019-kakie-tehnologii>.

## 11. NON-COMPETITIVE METHODS OF PROCUREMENT

Contradictory trends can be seen in the use of sole-supplier, non-competitive procurement, which have long been characteristic of this form of procurement.

On the one hand, the Draft Law plans to block abuse of this form of procurement at the regional level by abolishing the right of constituent entities of the Russian Federation to establish exclusive powers for certain state authorities, the institutions reporting to them, and also state-owned companies for the performance of specific works.

On the other hand, the Roadmap foresees the need to confer on the highest official of a constituent entity the right to make decisions on appointing a sole supplier to perform construction work. At the same time, an “exhaustive list of cases for making such decisions and the procedure for monitoring the justification for such decisions” should be established in the Law on the Contract System.

In addition, the Draft Law foresees the possibility of the procurement of construction work from a sole supplier using the resources of the reserve fund of the supreme executive authority of the constituent entity of the Russian Federation.

In general, it should be noted that procurements from a sole supplier in the construction sector does not occupy a critically important share of the market.

## CONCLUSION

To sum up, we will advance the proposition that the Draft Law does not constitute the finish line, but rather the latest zigzag in what has become the perpetual reform of the contract system.

Among the stated goals of the (latest) Draft Law are simplification, unification, and digitalisation, only the last of these is without criticism. The other goals can be cast in doubt, if one considers the

multiplicity of annual, or to be more precise quarterly, “correction packages” to the Law on the Contract System; by itself, this phenomenon strongly unbalances the procurement system. Clearly, establishing the stability of the rules of the game is what must be achieved first of all as a result of the reform of procurement legislation<sup>20</sup>.

Among positive developments in the construction sector, we can mention the regulatory interest in using integrated types of contracts for complex infrastructure projects, and the emphasis on the qualifications of construction contractors as an essential condition for the successful realisation of projects. However, doubts remain as to what extent the proposed changes, specifically the simplification of the methods of procurement and the formalisation of criteria for assessing participants, are capable, by themselves or taken in conjunction with other unresolved problems, of attracting solid construction contractors to carry out unusual projects.



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<sup>20</sup> The Accounts Chamber of the Russian Federation notes that the shortcomings of the existing Federal contract system include “a low level of trust among market subjects in the system of state and corporate procurement, the focus of efforts to improve the contract system on procurement procedures and not on achieving high performance of procurements and ensuring the necessary quality of goods, work, and services, and the complexity and instability of procurement legislation”. See the Report on the [Results of the Expert Analytical Measure “Monitoring of the Development of the System of State and Corporate Procurement in the Russian Federation for 2019”](#).

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