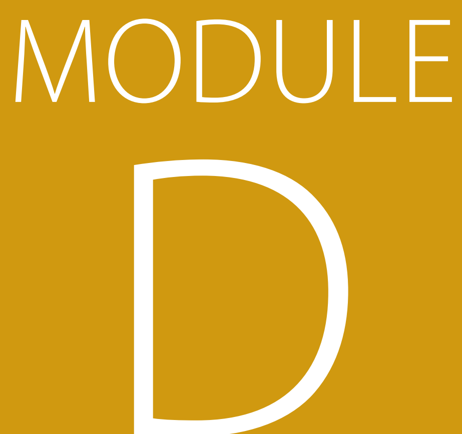

PUBLIC PROCUREMENT TRAINING FOR IPA BENEFICIARIES

Public procurement law – scope of application

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Public procurement law – scope of application

Contracting authorities (classical sector)

MODULE

D

PART

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SECTION 1 INTRODUCTION

1.1 OBJECTIVES

The objectives of this chapter are to identify:

1. The national and sub-national bodies that must apply the public procurement rules in the award of their works, supplies and services contracts
2. Those bodies that are part of the state, at the executive, legislative and judicial levels of government
3. Those bodies that do not fall within the general definition of state but which must nonetheless follow the procurement rules
4. The effect of falling within the definitions
5. The effect of a change in the constitution of a body that changes its position in respect of the definitions of the Directives (*e.g.* a public authority becoming a "body governed by public law" and vice versa)

1.2 IMPORTANT ISSUES

The most important issues in this chapter are understanding:

- That the procurement rules apply to "public" procurement, and that this is defined widely to cover the defined purchases of all public authorities
- That the European Court of Justice (ECJ) defines the concept of public authorities independently of any national definition, and makes that definition a functional one
- The way that each type of public authority is defined
- The conditions that apply to the different types of public authority before they are covered by the public procurement rules
- The possibility that the ability of a body to meet those conditions may change over time

This means that it is critical to understand fully:

- The definitions of the Directives in respect of the state and other public authorities
- The definition of the Directives in respect "bodies governed by public law"
- The interpretation given to these definitions by the ECJ
- The conditions that apply to a body before it may become a "body governed by public law"

1.3 LINKS

There is a particularly strong link between this chapter and the following modules or sections:

- Module A3 on the international regulation of procurement, where there is some overlap in the definitions used
- Module A4 on the economic benefits of centralised procurement
- Module B1 on the organisation of centralised procurement
- Module D2 on the contracting entities in the utilities sector
- Module E, to the extent that different procedures apply to contracting authorities in the classical sector and to contracting entities in the utilities sector

1.4 RELEVANCE

This information will be of particular relevance to the senior management of the body in question, since the status of the body under the Directives determines whether or not the provisions of those Directives apply. It will also be of particular relevance to those involved in procurement planning and strategic decision making, especially where the body at issue is a "body governed by public law" or where it may be possible to envisage the creation of publicly owned companies to carry out the functions of the public authority.

1.5 LEGAL INFORMATION HELPFUL TO HAVE TO HAND

In **Directive 2004/18**, please look at Article 1(9).

Localisation: In national law, please look at:

SECTION 2 NARRATIVE

2.1 INTRODUCTION

In this chapter, we will be looking at the definition of 'contracting authorities' for the purposes of the procurement rules. The major distinction that must be made is between the two main categories of public or contracting authority, as defined in Directive 2004/18/EC (the Directive), namely:

- state, regional or local authorities ('public authorities')
- bodies governed by public law

Contracting authorities may also be made up of associations formed by one or several of such authorities or by one or several bodies governed by public law.

Note: In the case of the classical sector, the preferred term is 'contracting authorities' because the bodies involved are public 'authorities' in the sense that they are, formally or informally, part of the state apparatus. In the utilities sector, on the other hand, the preferred term is 'contracting entities' since, as we will see in module D2, whilst they may also be public authorities, they can be private sector companies that happen to operate in the utilities sector under privileged conditions.

The importance of understanding these definitions is that they affect the applicability of the procurement rules that form the subject matter of this training. These rules only apply if a body falls within one of the definitions of the Directive. If the body in question does not fall within those definitions, its procurement will not be subject to the Directive. If the body does not fall within the definition but it nevertheless tries to follow the rules, this does not mean that any breach of the Directive's provisions that it commits would be open to challenge. The Directive either applies or does not apply; there is no 'in-between'.

Furthermore, once a body falls within the definition of 'contracting authority', all of its purchases of goods, works and services will be subject to the procedural requirements of the Directive, even if these purchases are made for the purposes of tasks that are not, or even mostly not, in the general interest. Once covered by the Directive, the authority is covered for all purchases within the definition of the Directive.

Especially in the case of a body governed by public law, the status of a contracting authority can change over time as a result of a change of its functions or a change in its legal status. The financing of the contracting authority may also change over time. These all have an effect on the inclusion of the body within the definition of the Directive, and therefore it is not possible to say, once and for all, whether a body is covered or not covered by the Directive. The situation may require review.

2.2 PUBLIC AUTHORITIES

Public authorities are defined as `state, regional or local authorities'. This definition covers all state entities and not only the executive authority of the state, i.e. state administrations and regional or local authorities. The term `the state' also encompasses all of the bodies that exercise legislative, executive and judicial powers. The same applies to bodies that, in a federal state, exercise those powers at federal level.

Case note: In the *Vlaamse Raad* case, the European Court of Justice (ECJ) also dismissed the argument that the procurement rules did not apply to legislative bodies because of the independence and supremacy of the legislative authority. (Case C-323/96 *Commission v Belgium* [1998] ECR I-5063)

The definition of the state is broad and the ECJ has taken a particularly functional approach. It thus looks more at the actual function of the entity concerned than at the formal categorisation that the entity has been given by internal law. In the famous *Beentjes* case, the awarding authority was a body with no legal personality of its own, whose functions and composition were governed by legislation and its members appointed by the provincial executive of the province concerned. It was bound to apply rules laid down by a central committee established by royal decree, whose members were appointed by the Crown. The state ensured observance of the obligations arising out of measures of the committee and financed the public works contract awarded by the local committee in question. The ECJ held that the term `state' must be interpreted in functional terms. As a result, a body such as the awarding authority – whose composition and functions are laid down by legislation and which depends on state authorities for the appointment of its members, the observance of the obligations arising out of its measures, and the financing of the public works contracts that it is its task to award – was held to fall within the notion of the state, even though it is not part of the state administration in formal terms.

Case note: The term `contracting authority' will be defined according to the functions of the body in question. (Case 31/87 *Gebroeders Beentjes BV v Netherlands ('Beentjes')* [1988] ECR 4635)

The state, regional or local authorities (the 'public authorities') are, by definition, contracting authorities for the purposes of the Directive. The Directive makes no distinction, in this respect, between public contracts awarded by a contracting authority for the purposes of fulfilling its task of meeting needs in the general interest and those contracts that are unrelated to such a task. There is thus no need, as in the case of bodies governed by public law, to distinguish between activities meeting needs in the general interest that are of an industrial or commercial character and those tasks that are not. All contracts awarded by a public authority are to be covered by the Directive, whatever their character.

[Localisation required: In [xxx], the concept of 'public authorities' would include...]

An 'association' of contracting authorities is not different from a contracting authority; it is merely a term used to describe the mechanism whereby public contracts are awarded by 'entities' that do not have their own legal personality or identity but are based on co-operation between public law bodies subject to the Directive, such as purchasing consortia between territorial public bodies. It means a group of contracting authorities.

2.3 BODIES GOVERNED BY PUBLIC LAW

A 'body governed by public law' does not have a simple definition; it depends rather on whether it has certain characteristics. These characteristics are expressed as conditions that need to be met in order for the body in question to be considered as a body governed by public law. It is similar in approach to the functional test adopted by the ECJ in respect of the definition of public authorities.

The main question centres around the three *cumulative* conditions required by the Directive to indicate the existence of a body governed by public law. The ECJ has consistently held that a body must satisfy all three of these conditions to fall within the definition. These conditions, as now set out in article 1(9) of the Directive, are that a body governed by public law is a body:

- established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character, and
- having legal personality, and
- financed, for the most part, by the state, or regional or local authorities, or other bodies governed by public law; or subject to management supervision by those bodies; or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the state, regional or local authorities or by other bodies governed by public law.

Annex III of the Directive includes a list of entities in each EU Member State that are considered to fall within the definition of 'body governed by public law'. The lists are intended to be as comprehensive as possible and are to contain the names of those bodies that the member state considers to fall within the definition at the time of adoption of the Directive. They are not exhaustive, however. Even if a body is not listed, it will nonetheless be covered if it meets all of the three conditions referred to above. The concept of a body governed by public law must be interpreted as having a broad meaning and, if a specific body is not listed in Annex III, its legal and factual situation must thus be determined in each individual case in order to assess whether or not it meets, for example, a need in the general interest.

[Possible localisation: where [XXX] becomes a member, insert: 'For [XXX] the list of such bodies includes OR is contained in [xxx]']

2.3.1 Condition 1: defining needs in the general interest

The term 'needs in the general interest' is not defined in the Directive, but the need for uniform application of Community law and of the principle of equality require that the terms of a provision of Community law must normally be given a consistent interpretation throughout the Community. The ECJ has, therefore, held that this term has to be given an autonomous and uniform interpretation throughout the Community. There are two main issues that are relevant, and these include the definition of (i) needs in the general interest and (ii) general interest needs not having an industrial or commercial character.

2.3.1.1 Needs in the general interest

'Needs in the general interest, not having an industrial or commercial character' are generally needs that are satisfied otherwise than by the availability of goods and services in the marketplace and that, for reasons associated with the general interest, the state chooses to provide itself or over which it wishes to retain a decisive influence. In general, the ECJ has looked towards state requirements with regard to the specific tasks to be achieved; the explicit reservation of certain activities to the public authorities; the obligation of the state to cover the costs associated with the activities in question; the control of prices to be charged for the services; the degree of monitoring or security required; and the 'public interest'.

There have been several examples:

- One example is of an entity established to produce, on an exclusive basis, official administrative documents, some of which required secrecy or security measures, such as passports, driving licences and identity cards, whilst others were intended for the dissemination of legislative, regulatory and administrative documents of the state. The public authorities fixed the prices, and a state control service was responsible for monitoring the security measures, where necessary. The documents were closely linked to public order and required guaranteed supply and production conditions that ensured the observance of standards of confidentiality and security. The body had been established for the specific purpose of meeting those needs in the general interest. (C-44/96 *Mannesmann* [1998] ECR I-73)
- An entity that was a public limited company set up by two municipalities, which was specifically entrusted with a series of tasks defined by law in the field of waste collection and cleaning of the municipal road network, carried out a need in the general interest. (Case C-360/96 *Gemeente Arnhem* [1998] ECR I-6821)
- The activities of funeral undertakers could be regarded as meeting a need in the general interest, especially since the exercise of the activity was subject to the issue of prior authority and the public authorities could fix the maximum prices for funeral services. (Case C-373/00 *Adolf Truley* [2003] ECR I-1931)
- In other examples, it was found that regional development agencies and other more specialised undertakings that were designed to attract investment to a particular location could fall within the definition of general interest since, by bringing together manufacturers and traders in one geographical location, they were not acting solely in the individual interest of those manufacturers and traders but were also providing consumers who attended the events with information that enabled them to make choices in optimum conditions. The resulting stimulus to trade was considered to fall within the general interest. (Cases C-223/99 and C-260/99 *Agorà* [2001] ECR 3605; case C-18/01 *Korhonen* [2003] ECR I-5321)

2.3.1.2 General interest needs not having an industrial or commercial character

The additional criterion for the purposes of this definition is that the general interest needs should not have an industrial or commercial character. These are generally activities that are carried out for profit in competitive markets. The ECJ (Case C-360/96 _Gemeente Arnhem_ [1998] ECR I-6821) held that

(i) the absence of an industrial or commercial character was a criterion intended to clarify and not limit the meaning of the term `needs in the general interest';

(ii) the term creates, within the category of needs in the general interest, a sub-category of needs that are not of an industrial or commercial character; and

(iii) the legislature drew a distinction between needs in the general interest not having an industrial or commercial character and needs in the general interest having an industrial or commercial character.

This does not mean, however, that a body governed by public law may *only* carry out tasks in the general interest not having an industrial or commercial character. It may do both. In the _Mannesmann_ case, for example, the entity involved had the task of providing the public authorities with official documents (a need in the general interest) but was also in the business of acting as a commercial printing company. It is also immaterial that an entity carries out other activities *in addition* to tasks in the general interest.

However, once an entity falls within the definition of a body governed by public law, any contract, of whatever nature, entered into by that entity is to be considered to be a public contract within the meaning of the Directive, and all of the entity's contracts are covered by the Directive. Even the fact that meeting needs in the general interest constitutes only a relatively small proportion of the activities actually pursued is irrelevant, provided that the entity continues to attend to the needs that it is specifically required to meet.

This also means that bodies governed by public law can carry out activities that are pursued for profit, provided they continue to carry out the general interest needs that they are specifically required to meet.

On the other hand, if a body governed by public law carries out other activities and these are provided in a competitive market, this may, in fact, indicate the absence of a need in the general interest, not having an industrial or commercial character. If an entity falls into this category, then the Directive will not apply.

This is a conceptually difficult distinction because whilst the existence of significant competition does not in itself prevent there being a need in the general interest not having an industrial or commercial character to be met, the very existence of such competition may be an indication that a need in the general interest does have an industrial or commercial character.

In the last resort, the problem is solved by looking more closely at the nature of the entity concerned rather than at the activity it carries out. The question becomes one of whether the entity is operating in an industrial or commercial manner. Thus, in the *Korhonen* case, the ECJ held that if the body:

(i) operates in normal market conditions,

(ii) aims to make a profit, and

(iii) bears the losses associated with the exercise of its activity,

it is unlikely that the needs that the body aims to meet are not of an industrial or commercial nature.

The relevant legal and factual circumstances have to be taken into account in each case, especially those prevailing when the body concerned was formed but also the conditions in which it carries out its activity, including the level of competition on the market, the issues of whether its primary aim is or is not the making of profits and whether it bears the risks associated with the activity, and any public financing of the activity.

2.3.2 Condition 2: legal personality

The existence of a legal personality is generally the clearest distinction between bodies that form part of the state, regional or local authorities and those that are considered to be bodies governed by public law. Most government ministries, departments and divisions do not have a separate legal personality. If a separate body is created as a company or enterprise, then it will have a legal personality that is separate from the state and it is likely to be seen as a body governed by public law if the other two conditions are also met.

It does not matter whether the body in question is subject to public or private law. The only issue is whether it has a legal personality.

Case note: Under Spanish law, public bodies constituted under private law (a category composed, in the Spanish legal system, of commercial companies under public control) were excluded from the scope of the Spanish rules governing procedures for awarding public contracts. The ECJ held that it was necessary to establish only whether or not the body concerned fulfilled the three conditions for establishing the existence of a body governed by public law and that a body's status as a body governed by private law did not constitute a criterion capable of excluding its being classified as a contracting authority for the purposes of the Directives. (Case C-214/00 *Commission v Spain* [2003] ECR I-4667)

2.3.3 Condition 3: dependency on the state

This third condition is contained in article 1(9)(c) of the Directive:

> Article 1(9)(c) of the Directive: "…financed, for the most part, by the State, regional or local authorities, or other bodies governed by public law; or subject to management supervision by those bodies; or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law."

This condition is used primarily to determine the degree of dependency of the body on the state. This dependency may, alternatively, be

- financial,
- managerial, or
- supervisory.

This condition is satisfied where only <u>one</u> of these three criteria is met.

2.3.3.1 Financial dependency

The term 'financed for the most part' means financed by 'more than half', but the term 'financed' is not as clear as it seems. The question concerns the actual degree of state dependency implied by the level of state financing. Not all payments made by a contracting authority have the effect of creating or reinforcing a specific relationship of subordination or dependency between that authority and another body. Only payments that are made to finance or support the activities of the body concerned, without any specific consideration, may therefore be described as public financing.

Example from case law:

In the case of a university, payments in the form of awards or grants for the support of research work that go to the institution as a whole may be regarded as financing by a contracting authority. Similarly, the payment of student grants in respect of tuition fees collected by the universities may also be classified as public financing. Since there is no contractual consideration for those payments, they are not to be regarded as financing by a contracting authority in the context of its educational activities. On the other hand, the position is quite different in the case of payments made, in the form of consideration, by one or more contracting authorities for the supply of services comprising research work or for the supply of other services, such as consultancy or the organisation of conferences. These 'sources of financing' are, in fact, sums paid by one or more contracting authorities as consideration for contractual services provided by the university, and it also does not matter that those activities of a commercial nature happen to coincide with the teaching and research activities of the university. The contracting authority has in fact an economic interest in providing the service.

(Case C-380/98 *The Queen v HM Treasury, ex parte The University of Cambridge* [2000] ECR 8035)

If the degree of dependency varies according to the sources of funding, then a change in the source of funding will affect the degree of dependency. Accordingly, the decision as to whether a body is a contracting authority must be made annually, and the budgetary year during which the procurement procedure is commenced is the appropriate period for calculating how that body is financed. Therefore, if at the beginning of the budgetary year in question it is estimated that more than half of the body's funding will be public financing, procurement for that year will be covered by the Directive.

Good practice note: The importance of predicting sources of funding

When working in an institution that is only partially funded by the state it would be wise to ensure that accurate funding forecasts are prepared whenever the proportion of state funding is likely to fluctuate. Compliance with the procurement procedures of the Directive is not without cost, and in those years when there is not a majority of state funding it might sometimes be possible to reduce those costs by adopting more flexible procedures.

2.3.3.2 Managerial dependency

This condition relates in effect to the direct participation of public authorities and officials in the management of the entity in question. The condition will be fulfilled, for example, where a body has been established by a government minister, where its memorandum and articles and any amendments must be approved by the minister, where the chairman and other directors are appointed and their remuneration determined by the minister, where the appointment of the body's auditors must be approved by the minister, and where the body is obliged to comply with state policy and any ministerial directives with regard to the remuneration, allowances and conditions of employment of its employees.

Example from case law:

Even where there is no legal provision expressly providing for state control over the award of public supply contracts by the body in question, the ECJ found that the state could nonetheless exercise such control, at least indirectly. It was the state that had set it up and entrusted it with specific tasks, and it was the state that had the power to appoint its principal officers. Moreover, the minister's power to give instructions to the entity, in particular requiring it to comply with state policy, and the powers conferred on that minister and on the minister of finance in financial matters gave the state the possibility of controlling its economic activity.

(Case C-306/97 *Connemara Machine Turf Co Ltd v Coillte Teoranta* [1998] ECR I-8761)

2.3.3.3 Supervisory dependency

This condition goes further than mere general supervision of an administrative or financial nature, and it must give rise to a dependency on the public authorities equivalent to the dependency that exists whenever one of the other alternative criteria is fulfilled. Namely, an equivalent dependency exists whether the body in question is financed, for the most part, by the public authorities or whether the latter appoint more than half of the members of the body's administrative, managerial or supervisory organs, thereby enabling the public authorities to influence the decisions of these organs in relation to public contracts.

The criterion of managerial supervision is not satisfied in the case of mere review since, by definition, such supervision does not enable the public authorities to influence the decisions of the body in question in relation to public contracts. Where the supervision of the activities of the body exceeds that of a mere review, the position will be different. That could be the case, for example, where the public authorities supervise not only the annual accounts of the body but also its conduct from the point of view of proper accounting, regularity, economy, efficiency and expediency and where those public authorities are authorised to inspect the business premises and facilities of that body and to report the results of those inspections to a public authority that holds all of the shares in the body concerned.

It is also appropriate to consider whether the various controls to which entities are subject render them dependent on the public authorities in such a way that the latter are able to influence the decisions of these bodies in relation to public contracts. It thus requires a degree of managerial supervision that permits the public authorities to influence or interfere with procurement procedures.

2.4 CENTRAL AND JOINT PURCHASING

The Directive has now formalised the practice current in a number of EU Member States in respect of centralised procurement. Public purchasers have recognised that they can benefit from economies of scale by buying their requirements in bulk. Even where the procurement needs of a single procuring contracting authority are relatively modest in respect of a given product or service, the combined needs of a number of such government purchasers may be significant. Government departments operating in similar sectors or in neighbouring locations have often found it beneficial to group together jointly to purchase specific items. This is most likely to be the case of products used daily, where the various purchasers do not have any requirements that are specific to the contracting authority or differential technical requirements. In some cases, joint purchasing could also be used as a means of purchasing more specialised equipment where technical compatibility is needed. In some cases, the task of making such bulk purchases may be entrusted to a single purchaser, with either one of the group of purchasers acting as agent for the others, or to a specially created contracting authority established with that function in mind: a central purchasing body.

For more information concerning the benefits of aggregating demand by means of centralised purchasing between several contracting authorities, see module A 4. For the organisation of centralised procurement within a contracting authority, see module B1.

For the purposes of the Directive, a central purchasing body is a "contracting authority" that "acquires supplies and/or services intended for contracting entities" or "awards public contracts or concludes framework agreements for works, supplies or services intended for contracting entities".

To ensure that a central purchasing body passes on the costs of its procurement to other contracting authorities, the Directive (article 1(10)) also provides

(i) that "Member States may stipulate that contracting authorities may purchase works, supplies and/or services from or through a central purchasing body", and

(ii) that contracting authorities purchasing works, supplies or services from or through a central purchasing body are deemed to have complied with the Directive insofar as the central purchasing body has complied with it.

Example: Office of Government Commerce

In the United Kingdom, for example, the Office of Government Commerce operates a centralised procurement system for particular common-use goods and services. It does so through its commercial arm, known as 'Buying Solutions'. This body offers a range of products and services, often available on the basis of a number of framework agreements, that have been procureed in accordance with the procedures of the Directive. Information on how this system operates can be downloaded from www.buyingsolutions.gov.uk.

Localised Example?: XXX

…Information on how this system operates can be downloaded from:

It is also possible that a number of contracting authorities will simply choose to aggregate their requirements and jointly conduct a contract award procedure (including a framework agreement). This form of joint purchasing could be done in the name of each of the contracting authorities or in the name of a single contracting authority acting on behalf of the others. To the extent that these contracting authorities simply act jointly, without the benefit of a special purpose vehicle or without nominating one of their number as agent for the others, they will be acting as an association of contracting authorities. This association, as we have seen, has only a residual function and would have no capacity itself to conduct the contract award procedure. The procedure would necessarily be conducted by all of the contracting authorities or by one or more acting on their behalf. For reasons of responsibility and legal certainty, it would be advisable to ensure that the arrangements be made explicit and, where appropriate, indicated in the contract award notice.

See module B2 for further discussion of co-operation arrangements between contracting authorities.

Example: Eastern Shires Purchasing Organisation (ESPO)

Again in the UK, ESPO is a joint committee of regional local authorities. It acts as a purchasing agent for its member authorities and other customers and provides a procurement and supply service (offering goods and services) to its members for a value of approximately 700 million GBP per annum. Information on how this system operates can be downloaded from: www.espo.org.

Localised Example?: XXX

...information on how this system operates can be downloaded from:

2.5 CONTRACTING AUTHORITIES AND THE WTO'S GOVERNMENT PROCUREMENT AGREEMENT (GPA)

As discussed in module A3, the EU is a signatory of the Government Procurement Agreement (GPA) of the World Trade Organisation (WTO). As a result of the negotiating approach taken by the EU (consisting of using the coverage of the Directives as a basis for GPA coverage), all contracting authorities that are public authorities for the purposes of the public sector Directive, namely public authorities and bodies governed by public law, are also covered by the GPA.

In practical terms, *compliance* with the Directives ensures compliance with the provisions of the GPA in respect of those entities that are also covered by the GPA. Since the Directives will apply in any event, no further action needs to be taken in respect of compliance with the procedural rules. The only obvious difference in application consists in the different threshold values that apply to contracts for goods and services awarded by the central government authorities listed in Annex IV and in the differential treatment accorded to certain defence products and services.

In terms of granting *access* to EU procurement markets, however, and of compliance with EU contract award procedures, for GPA purposes contracting authorities are obliged to do so only in respect of those entities, products and/or services of other GPA signatory states, as covered in the various country appendices to the GPA, that are not otherwise subject to the exclusion or reciprocity requirements set out in the notes to the appendices. This would only become an issue if a GPA contracting authority decided to exclude such a beneficiary on grounds that would otherwise constitute a breach of the Directives and/or the GPA. To determine the extent of access, it would be necessary to consult the specific country annexes.

SECTION 3 EXERCISES

EXERCISE 1 CLASS CASE STUDY

Arcadia municipality decides it wants to develop a business and commercial zone on an attractive plot of land at the edge of town, which it is calling Evergreen Park. It is considering setting up a non-profit organisation in the form of a private company, Apple Inc., in which it would own the majority of the shares to undertake the development in the hope that this will reduce the administrative burden of creating Evergreen Park. A neighbouring municipality, Eden Town, which has experience in such developments decides that, when the arrangements are in place for the development, it would itself like to bid for the contract to design the overall architectural scheme and undertake the general planning of Evergreen Park. Eden Town does not, however, have in-house capability for the landscaping requirements of the park. Having used them in the past, Eden Town decides that, before bidding for the contract, it should make sure that it can rely on the services of Greenfingers, a private landscaping company. It therefore enters into a contract with Greenfingers to supply the required landscaping services when and only if Eden Town wins the design contract.

You are the legal adviser to Arcadia municipality, and it has asked you to set its mind at rest on a number of issues that have been raised by the various parties during the negotiations. Prepare an opinion on each of the questions asked, supporting your arguments with relevant case law.

1. Does it make any difference to the application of the procurement rules whether Evergreen Park is developed by Arcadia municipality directly or by Apple Inc.?
2. Eden Town is a potential bidder. Does that mean that its contract with Greenfingers is not subject to the procurement rules?

You have enough information to answer (b) from the general principles. However, you might want to consider a further case: C-126/03 *Commission of the European Communities v Federal Republic of Germany ("City of Munich")* ECR [2004] I-11197

EXERCISE 2
INDIVIDUAL CASE STUDY

Until now, the municipality of Cleverton has provided municipal waste disposal services by way of an autonomous service unit of the municipality called the Cleanup Team. Although Cleanup Team was not set up formally as a company, it operated as if it were an independent company – despite the fact that its management was governed by rules put in place by Cleverton, and that traditionally all its funding came from the treasury department of Cleverton. Indeed, the Cleanup Team believed it was just like a company, and would also provide services to private sector clients and other municipalities in return for payment. By its 2008 year-end, it transpired that its receipts from these latter services accounted for 51% of all the income it received for that year (roughly EUR 3 million), an increase of more than 20% over the previous year. This was expected to increase further in 2009.

Having seen the projected financial results, Cleverton believed that it should put the Cleanup Team on a more proper financial footing and decided to create a limited liability company to take over its functions. It created Cleanup Limited, a wholly owned subsidiary, on 5 November 2008 and signed with it, on 10 November, a contract for the supply of municipal waste disposal services for 2009 to begin on 1 January 2009. The value of these services was in the order of EUR 1.5 million.

On 25 November 2008, the central government introduced much stricter and more sophisticated environmental regulations that would apply to the transport and disposal of municipal waste. The Cleanup Team had previously contracted out its routine environmental compliance work to a private sector company, Opportune Limited. In 2008, the value of this work had been about EUR 150 000. Realising that it did not have the expertise to meet these new regulations, the management of Cleanup Limited approached Opportune Limited directly to provide the services without following the procurement directives.

In February 2009, you are approached by Superclean Limited, a private waste disposal company with expert environmental knowledge, which feels that Cleverton has acted unlawfully. In particular, Superclean Limited believes that

(i) the Cleanup Team should never have contracted directly with Opportune Limited in any event; and

(ii) Cleanup Limited should have awarded the contract to Opportune Limited according to the procurement directives.

How do you reply?

EXERCISE 3
CENTRALISED AND JOINT PURCHASING

Split into 4 groups.

Using the Internet, 2 groups will search for organisations offering centralised procurement and 2 groups will search for organisations offering joint purchasing.

Search for these systems in your country, in neighbouring countries or in European member states.

Consider the following issues:

1. Is the purchase organised through a lead contracting authority, or by way of special purpose company?
2. What is the common feature of the participating organisations? For example, geographical proximity; sectoral cohesion; common use items, etc.
3. What services do they offer?
4. Do they use catalogues and/or framework arrangements?
5. What are the benefits of using these systems?
6. What might be the disadvantages? Consider, for example, technical specifications, time and place of delivery, terms of sale, etc.

Each group is to prepare a short report to be presented to the class.

SECTION 4
CHAPTER SUMMARY

SELF-TEST QUESTIONS

1. Why do we need to define contracting authorities?
2. What is the difference between contracting *authorities* and contracting *entities*?
3. Name the two broad categories of contracting authority.
4. What branches of government are covered?
5. What is the position in a federal state?
6. Explain the European Court of Justice's "functional" approach to the definition of public authorities.
7. Do public authorities need to be providing a service in the public interest before they are covered by the Directive? Yes/No
8. Is the position of bodies governed by public law any different?
9. Name the conditions that need to be met before an entity will be considered to be a body governed by public law.
10. Which of the conditions must be met? Are any optional?
11. Describe "needs in the general interest" using examples from case law.
12. Are "needs in the general interest" inconsistent with "needs having an industrial or commercial character"?
13. Are the activities of meeting "needs in the general interest" and "meeting needs in the general interest not having an industrial or commercial character" mutually exclusive? Can a body governed by public law do both?
14. If the body in question is mainly carrying out a commercial activity and only meets a need in the general interest incidentally, does that mean the Directive does not apply?
15. Explain the impact of the existence of competitive markets for the products or services provided by a body governed by public law.
16. What, in practice, is the means of deciding whether a body is pursuing needs in the general interest not having an industrial or commercial character?
17. Describe the different means of imposing state dependency on a body governed by public law.
18. Must all the state dependency conditions be satisfied?
19. Are the conditions of state dependency applied once and for all? Illustrate your answer by way of example.
20. What is meant by (i) centralised and (ii) joint purchasing? Describe their benefits and indicate when they might be used.

Public procurement law – scope of application

MODULE D

Contracting entities in the utilities sector

PART 2

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SECTION 1 INTRODUCTION

1.1 OBJECTIVES

The objectives of this chapter are to identify:

1. The bodies that must apply the public procurement rules in the award of their works, supplies and services contracts that operate in the utilities sector
2. Which of those bodies form part of the state and which fall outside the definition of "contracting authorities"
3. The mechanisms used to bring bodies other than "contracting authorities" within the scope of the Utilities Directive (**Directive 2004/17**)
4. The reasons for bringing such bodies within the scope of the Directive
5. The different utility activities ("relevant activities") that fall within the definition of the "utilities sector"
6. The effect of falling within and outside the definitions
7. The reasons why such bodies are not subject to the Directive 2004/18

1.2 IMPORTANT ISSUES

The most important issues in this chapter are understanding:

- That the Utilities Directive also applies procurement rules to entities that may not be public but that can be wholly private
- The logic behind application of the procurement rules, albeit more flexibly, to this sector
- The extent to which the rules apply in each of the defined utility sectors
- The central role played by the definition of "relevant activities"
- That the logic of including these sectors within the rules also gives way, in appropriate circumstances, to their exemption from the Utilities Directive

This means that it is critical to understand fully:

- The motivation for inclusion of the utilities sectors into the EU procurement regime
- The mechanism used to bring these sectors within the system
- The definitions of the covered entities
- The definition of "relevant activities"
- The specific and general exemption mechanisms

1.3 LINKS

There is a particularly strong link between this chapter and the following modules or sections:

- Module D2 on the contracting authorities in the classical sector
- Module E, to the extent that different procedures apply to contracting authorities in the classical sector and to contracting entities in the utilities sector
- Module A3 on the international regulation of procurement where there is some overlap in the definitions used

1.4 RELEVANCE

This information will be of particular relevance to the senior management of the body in question, since the status of the body under the Utilities Directive determines whether or not the provisions of the Directive apply.

1.5 LEGAL INFORMATION HELPFUL TO HAVE TO HAND

For this chapter, reference will be made to **Directive 2004/17** (the "Utilities Directive"). For the purposes of the scope of application discussed here, the relevant recitals and articles are:

Recital 2	Article 2
Recital 3	Article 3
Recital 4	Article 4
Recital 5	Article 5
Recital 6	Article 6
Recital 8	Article 7
Recital 9	Article 8
Recital 10	Article 9
Recital 25	Article 20
Recital 26	Article 30
Recital 27	
Recital 28	
Recital 29	
Recital 40	
Recital 41	

You may also find the following European Commission explanatory notes useful:

EXPLANATORY NOTE – Utilities Directive Definition of Exclusive or Special Rights
(Document CC/2004/33 of 18.6.2004)

EXPLANATORY NOTE – Utilities Directive Contracts Involving More Than One Activity
(Document CC/2004/34 of 18.6.2004)

For localisation: In national law, please look at:

SECTION 2 NARRATIVE

2.1 INTRODUCTION

As the name of the EC Directives suggests, the procurement directives were originally intended to cover *public* procurement, that is, contracts awarded by public authorities or other *public* bodies. As a result, the current Directive 2004/18/EC (as well as all of the previous directives that applied to the public sector) – hereafter referred to in this module as 'the Public Sector Directive or the Directive' – specifically excludes from its scope of application all public contracts that, under the Utilities Directive (Directive 2004/17/EC), are awarded by contracting authorities exercising one or more of the defined activities in the utilities sector (in the fields of water, energy, transport and postal services) and that are awarded for the pursuit of those activities (see article 12 of the Directive).

This exclusion was not made because the Community authorities did not want to cover public authorities operating in these sectors (they did), but because the bodies awarding such contracts were not always 'public entities'. Indeed, they were and are often wholly private undertakings, even though, in many EU Member States, activities in these sectors are entrusted to government agencies or to a combination of both private and public entities.

In some member states, it is (or was) the public authorities that also operated in these sectors, and so there was no reason, *in principle*, why these sectors should not also be covered by the public procurement system set up by the Public Sector Directive. However, this system did not 'capture' (*i.e.* cover) private companies, and there was some reluctance to covering these companies in the first place. The Community authorities could not simply impose the rules on the 'public' utilities because this would have created an uneven playing field, since the utilities would then only be covered in those member states where they were in public hands and not in member states where they were in private hands. This would have distorted competition, and the member states were not ready to take such half-measures.

By 1990, however, the Community regulator had come up with a means of applying the procurement rules to the utilities sector. It did so in a separate Utilities Directive, where it was made clear that not only were 'public' entities bound to follow Community rules with regard to their procurement of goods, works and services, but so were those private undertakings operating on the basis of special or exclusive rights. The paramount consideration in both public and private sectors is the extent to which contracting entities are subject to state influence, whether this influence is exercised directly or indirectly (*e.g.* the state's power to control the granting and operation of special or exclusive rights to private undertakings).

The rules were adopted in a separate directive because the provisions for the utilities sector were more flexible than those in the classical (public) sectors. It was recognised that the entities in these sectors were operating in a more commercial market so that, although the main principles of the public procurement rules needed to be respected, it was also necessary to provide some flexibility in order to take account of the reality of the environment in which their activities took place.

2.2. DEFINITION OF ENTITIES OPERATING IN THE UTILITIES SECTOR

The entities covered by the Community procurement rules fall within two broad categories. The first category consists of entities over which the state may exercise direct control. These are public authorities and bodies governed by public law. The second category, referred to, for the sake of convenience, as 'utilities', consists of defined *public* bodies and those *private* entities that operate in their relevant sectors on the basis of special or exclusive rights granted by a member state of the Community.

It is important to remember that, unlike in the case of the Public Sector Directive, where contracting authorities once caught by the definition must carry out all of their procurement according to that directive, public authorities, bodies governed by public law and other entities covered by the Utilities Directive are covered only to the extent that they carry out a relevant activity defined in the Utilities Directive. To fall within the scope of application of the Utilities Directive, they must (i) fall within the definition of an entity operating in a utility sector, and (ii) carry out a relevant activity (only or as one among many relevant and/or non-relevant activities).

Important note

Entities operating in the utilities sector, as defined in the Utilities Directive, are covered by the directive only to the extent that they carry out a relevant activity defined in the Utilities Directive.

As stated above, the Public Sector Directive excludes from its scope of application all public contracts that are awarded by contracting authorities under the Utilities Directive. It also makes clear that contracts that are excluded from the Utilities Directive do not, at the same time, re-enter the scope of application of the Public Sector Directive. As a result, public authorities carrying out relevant activities in the utilities sector are covered by the Utilities Directive, not by the Public Sector Directive.

There are three types of defined entity: (i) contracting 'authorities', (ii) public undertakings, and (iii) entities (usually privately owned) operating on the basis of special or exclusive rights.

2.2.1 Contracting 'authorities'

The definition of 'contracting *authority*' is the same in both the Public Sector and Utilities Directives. There are two main types of contracting authority, and the case law on this issue has resulted in a flexible definition. The two types are: 'public authorities' and 'bodies governed by public law'.

Refer to module D1 for an understanding of the scope of the definition of 'contracting *authorities*'.

2.2.2 Public undertakings

Public undertakings are defined in article 2(1)(b) of the Utilities Directive as any undertaking over which public authorities may exercise directly or indirectly a dominant influence by virtue of their ownership of the undertaking, their financial participation therein, or the rules that govern it. A dominant influence on the part of the public authorities is to be presumed when these authorities, directly or indirectly, in relation to an undertaking:

- hold the major part of the undertaking's subscribed capital, or
- control the majority of the votes attaching to shares issued by the undertaking, or
- can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body.

The distinction between public authorities and public undertakings flows from the recognition that the state may act either by exercising public powers or by carrying on economic activities of an industrial or commercial nature by offering goods and services in the market. In order to make such a distinction, it is necessary, in each case, to consider the activities exercised by the state and to determine the category to which those activities belong. In this respect, the European Court of Justice (ECJ) also takes a functional approach to the definition.

Example from case law

The concepts of 'bodies governed by public law' and 'public undertakings' are not mutually exclusive. The objective of the Utilities Directive is to extend the procurement rules to utilities not covered by the public sector directives and thus ensure that all the contracting entities operating in the utilities sectors are included within its scope, regardless of their legal form and the rules under which they were formed.

Case 283/00 *Commission v Spain* [2003] ECR I-11697

[Localisation possible: In (XXX), this might/will include entities such as (xxx)…]

2.2.3 Entities operating on the basis of special or exclusive rights

A critical reason for the exclusion of certain sectors from the scope of the earlier public sector directives (on works, supplies and services, respectively) was that the contracting entities involved in those sectors could not simply be classified as 'public' entities. Indeed, their legal status ranged from purely government-owned undertakings to private companies holding exclusive concessions. The task of the Community regulator was, therefore, to find a way of going beyond the traditional public/private distinction and to adopt a solution that would address the situations that led to the possibility of protectionist procurement procedures, regardless of the formal legal definition of the entities carrying out activities in those situations.

2.2.3.1 Rationale

One of the primary objectives of the EU procurement system is to protect the interests of economic operators established in an EU Member State that wish to offer goods or services to contracting authorities in another member state and to avoid the risk of preference being given to national tenderers or applicants whenever a contract is awarded by contracting authorities. This objective is not limited to the purely public sector but applies equally to the utilities sector, where both public and private entities are active. The European Commission, after researching the position in the sectors that were excluded at the time, came to the conclusion that there were, in essence, two objective factors that led to nationalistic purchasing attitudes.

Commission Communication

"…as regards the field of application, the proposal is based on the identification of those underlying, objective conditions which lead entities in the sectors to pursue procurement policies that are uneconomic in the sense that they do not ensure that the best offer from any supplier or contractor in the Community is systematically preferred but privilege national suppliers."

(COM (88) 376 final: *Communication from the Commission on a Community Regime for Procurement in the Excluded Sectors: Water, Energy, Transport and Telecommunications)*

The **first condition** identified refers to the 'qualified competitive environment' that exists in a situation where the entity concerned, whether public or private, is insulated from normal market forces. This means that the entity is in a position where it is able, and is often encouraged, to pursue goals that do not necessarily rely on purely commercial objectives. This position of relative privilege can arise in a number of ways, the main example being the grant to an entity of a formal legal monopoly of a geographical nature.

The **second condition** is the result of a situation where the services provided are made available by means of a technical 'network' that has a natural tendency to develop into a monopoly (a natural monopoly). This tendency is likely to be reinforced by the allocation of special rights or powers relating to the management of the network by the state. The ownership of an entity by the state and the control of its management or its financing are obvious indicators of state influence. However, private entities can also be subject to such influence. This may be the result, in particular, where the principal activity of the entity depends on state approval, for example by means of a concession or authorisation that grants to the entity concerned an exclusive right to carry out that activity within a specified geographical area or particular sector.

For the Community regulator, therefore, it is this type of approval that differentiates these privileged undertakings from 'ordinary' undertakings, which benefit from no special or exclusive rights and operate on a normal commercial basis in a completely open and competitive environment.

To overcome those objective conditions permitting the continued existence of uneconomic and protectionist procurement procedures, the Commission found its solution in a formula consisting of the identification of those situations in the relevant sectors in which, whatever the public or private status of the entities concerned, the objective conditions leading to nationalistic purchasing practices can be identified.

The Commission identified those situations by relying on the concept of special or exclusive rights.

2.2.3.2 Existence of special or exclusive rights

Article 2 of the Utilities Directive identifies the contracting entities that are covered by the proposals and groups the contracting entities in two categories, namely public authorities and public undertakings (as above) as the first category and undertakings operating on the basis of special or exclusive rights as the second category.

Article 2(2)(b) provides that the provisions of the Utilities Directive are to apply to:

- contracting entities that are not public authorities or public undertakings; and
- that have as *one* of their activities any of those referred to in articles 3 to 7 (discussed below) or any combination thereof; and
- that operate on the basis of special or exclusive rights granted by a competent authority of a member state.

Note: Covered Utilities

The Directive also provides, in annexes I-X, an illustrative (and non-exhaustive) list of entities in each of the EU Member States that are considered to fulfil the criteria discussed here. *[Localisation possible: In (XXX), this might/will include entities such as (xxx)]*

Article 2(3) of the Utilities Directive states that, for the purpose of the directive, special or exclusive rights are to mean rights deriving from authorisations granted by a competent authority of the member state concerned, by means of any legal, regulatory or administrative provision, the effect of which is to limit the exercise of activities defined in articles 3 to 7 to one or more entities, which substantially affects the ability of other entities to carry out such activity.

No 'special or exclusive rights' exist where they have been conferred upon the undertaking as a member of a class of undertakings carrying on an economic activity that is open to anyone. Indeed, exclusive or special rights must generally be taken to mean rights that are granted by the authorities of a member state to an undertaking or to a limited number of undertakings in a way *other than* the application of objective, proportional and non-discriminatory criteria, and this special or exclusive status substantially affects the ability of other undertakings to provide the same services in the same geographical area under substantially equivalent conditions.

Note: Grant of rights

Compare this approach to the approach taken by the regulator under the general exemption mechanism found in article 30 of the Utilities Directive and discussed below in section 2.3.6.

For further explanation, see the Commission's *Explanatory note – Utilities Directive: definition of exclusive or special rights* (Document CC/2004/33 of 18 June 2004).

2.3 DEFINITION OF RELEVANT ACTIVITIES

Unless exempted under article 30 (see section 2.3.6), contracting entities falling within the above definitions are covered by the Utilities Directive, but only to the extent that they carry out a relevant activity and only in relation to contracts awarded for the purpose of carrying out that activity. The relevant activities are discussed below.

Note: New definitions of 'relevant activities' – changes from the earlier directives

Previously, **telecommunications** was a relevant activity, but it has now been removed from the list. Following the success of the Community's telecommunications liberalisation initiative to introduce effective competition into the sector, the Commission no longer considers it necessary to regulate purchases by entities operating in this sector. Now **postal services** are included as a relevant activity.

2.3.1 Water

The relevant activity consists of the provision or operation of a fixed network intended to provide a service to the public in connection with the production, transport or distribution of drinking water.

In the case of a contracting 'authority', the supply of drinking water to networks that provide a service to the public is also a relevant activity for the purposes of the Utilities Directive. As for other contracting entities, whenever the supply of drinking water to such networks is one of their principal activities, then it is covered by the Directive.

The supply of drinking water is not considered as a principal activity and is not covered where:

- its production takes place because it is necessary for carrying out an activity other than a relevant activity; and
- such supply depends only on the entity's own consumption of drinking water and has not exceeded 30% of the entity's total production of drinking water on average for the preceding three years, including the current year.

In addition, the Utilities Directive also covers the award of contracts connected with hydraulic engineering, irrigation or land drainage, as well as the disposal or treatment of sewage. It applies in the context of hydraulic engineering, irrigation or land drainage provided that the volume of water intended for the supply of drinking water represents more than 20% of the total volume of water made available by such projects or by irrigation or drainage installations.

Exclusion

Contracts for the purchase of water awarded by entities listed in Annex I to the Utilities Directive (production, transport or distribution of drinking water) are not covered since procurement rules are inappropriate for the purchase of water, given the need to procure water from sources near the area where it will be used.

2.3.2 Energy

This activity concerns:

- the provision of electricity, gas or heat; and
- the exploitation of a geographical area for the purpose of exploring for and extracting oil, gas, coal or other solid fuels.

2.3.2.1 Electricity, gas or heat

This activity consists of the provision or operation of a fixed network intended to provide a service to the public in connection with the production, transport or distribution of electricity, gas or heat.

In the case of a public authority, the supply of electricity, gas or heat to networks that provide a service to the public is also a relevant activity for the purposes of the Utilities Directive.

As indicated above concerning water, in the case of other contracting entities, the supply of electricity, gas or heat to such networks is covered only where that activity is one of their principal activities. However, this condition applies differently to electricity, on the one hand, and to gas or heat on the other.

In the case of other contracting entities that supply electricity to such networks, this supply is not covered, as in the case of water supplies (above) where:

- production takes place because it is necessary for carrying out an activity other than a relevant activity; and
- such supply depends only on the entity's own consumption of electricity and has not exceeded 30% of the entity's total production of energy on average for the preceding three years, including the current year.

In the case of other contracting entities that supply gas or heat to such networks, this supply is not covered where:

- the production of gas or heat is the unavoidable consequence of carrying on an activity other than a relevant activity; and
- the supply of gas or heat to the public network is aimed only at the economic exploitation of such production and amounts to not more than 20% of the entity's turnover on average for the preceding three years, including the current year.

Exclusion

The Utilities Directive does not apply to contracts awarded for the supply of energy or of fuels for the production of energy. This exemption was included because of the lack of liberalisation in the Community energy market, which meant that energy could effectively not be traded across EU borders. The exemption refers to the purchase of fuels for the production of energy; it does not exclude the purchase of fuels for other purposes, such as transport.

2.3.2.2 Exploitation of a geographical area

The Utilities Directive applies to contracting entities that exploit a geographical area for the purpose of exploring for and extracting oil, gas, coal or other solid fuels.

In addition, a specific exemption was provided in the previous utilities directive for activities concerning the exploration and extraction of hydrocarbons. This exemption has not been retained in the current Utilities Directive, and no new exemption will be granted under this procedure, although the exemptions already granted under the procedure remain valid. Exemption will now be considered under the new general exemption mechanism of article 30 (see section 2.3.6 below).

Exclusion

As with the energy sector in general, the Utilities Directive does not apply to contracts awarded by contracting entities for the supply of energy or of fuels for the production of energy.

2.3.3 Transport services

The provisions of the Utilities Directive apply not only to the operation of transport networks but also to the operation of transport terminal facilities.

2.3.3.1 Transport networks

This activity consists of the operation of networks providing a service to the public in the field of transport by railway, automated systems, tramway, trolleybus, bus or cable.

A transport network is considered to exist where the service is provided under operating conditions laid down by a competent authority of an EU Member State, such as conditions concerning the routes to be served, capacity for the transport to be made available, or frequency of the service.

Previously, the provision of bus services was not covered whenever other entities were permitted to provide those services, either in general or in a particular geographical area, under the same conditions as those provided by the contracting entities. In practice, this meant that other contracting entities were obliged not only to be authorised to operate in the market for the services in question, without any legal barriers to entry for the provision of those services, but they also had to be in a position to actually provide those services under the same conditions as provided by the contracting entity.

The transport sector is now also subject to the general exemption procedure under article 30. Bus transport services that are not already subject to an exemption are required to seek an explicit exemption under article 30 (see section 2.3.6 below).

2.3.3.2 Terminal facilities

The exploitation of a geographical area for the purpose of providing airport, maritime or inland port, or other terminal facilities to carriers by air, sea or inland waterway is also a relevant activity.

However, the Utilities Directive covers only the operators of these terminal facilities. Carriers using such facilities are not covered.

On the other hand, contracts awarded by carriers that are also contracting authorities for the purposes of the Public Sector Directive, are subject to the provisions of that directive.

2.3.4 Postal services

Prior to the adoption of the Utilities Directive (2004/17/EC), contracts awarded for postal services to the public fell within the scope of the Public Sector Directives, to the extent that the entities in question were contracting 'authorities' for the purposes of those directives.

The difference now is that these entities are subject to the more flexible regime of the Utilities Directive and are also in a position to benefit from the general exemption procedure of article 30 (see section 2.3.6 below), which could apply where postal services are provided in a competitive market.

The Utilities Directive applies to:

- activities relating to the provision of postal services *[services consisting of the clearance, sorting, routing and delivery of postal items]; and*
- 'other services than postal services' *[mail service management services (services both preceding and subsequent to despatch, such as 'mailroom management services'); added-value services linked to and provided entirely by electronic means (including the secure transmission of coded documents by electronic means, address management services and transmission of registered electronic mail); and services concerning postal items not included in the main definition].*

This second category of services is covered only to the extent that the entity in question also provides 'postal services' and that the conditions provided for in the general exemption of article 30 are not satisfied in respect of those 'postal services'. As a result, the Utilities Directive applies only where the services are not provided on a competitive basis.

2.3.5 Scope and necessity of 'relevant activities'

A utility is covered only where it carries out a 'relevant activity', as defined above.

Exclusion

The Utilities Directive does not apply to the pursuit of such relevant activities in a third country or under conditions that do not involve the physical use of a network or geographical area within the Community. Such activities must be notified to the European Commission for information purposes.

What happens when an entity carries out a number of activities and awards a contract for a non-relevant activity?

Article 9 of the Utilities Directive provides a mechanism for distinguishing between various situations. The three paragraphs of this article describe essentially three situations:

- A contract that is intended to cover several activities is subject to the rules applicable to the activity for which it is *principally intended*.
- If one of the activities for which the contract is intended is subject to the Utilities Directive and the other to the Public Sector Directive and if it is objectively impossible to determine for which activity the contract is principally intended, the contract is to be awarded in accordance with the latter Directive (2004/18/EC).
- If one of the activities for which the contract is intended is subject to the Utilities Directive and the other is not subject to either the Utilities Directive or the Public Sector Directive, and if it is objectively impossible to determine for which activity the contract is principally intended, the contract is to be awarded in accordance with the Utilities Directive.

Article 9(1) of the Utilities Directive also includes an anti-avoidance provision. It provides that the choice between awarding a single contract and awarding a number of separate contracts may not be made with the objective of excluding the contract(s) from the scope of this Directive or, where applicable, the Public Sector Directive. This provision, which is clearly based on the intention of the contracting entity, would prevent a contracting entity from bundling together *all* contracts under the pretence that they were for the purposes of non-relevant activities when in fact only some were for the purposes of non-relevant activities.

For further explanation, see the Commission's *Explanatory note – Utilities Directive: contracts involving more than one activity* (Document CC/2004/34 of 18 June 2004).

2.3.6 General exemption of Article 30

As indicated above, the previous utilities directive included a series of exemptions in specific sectors where the entities concerned were supplying services in competitive markets, either because that was the reality of the specific market or because competition had been introduced by means of Community market liberalisation.

Given the degree of liberalisation in various sectors, the new Utilities Directive has now introduced a more general exemption provision, which grants an exemption from the provisions of the directive to those contracting entities carrying out an activity that, in the member state in which it is performed, is:

- directly exposed to competition;
- in a market to which access is not restricted.

The test of whether markets are competitive necessarily takes account of both the legal and factual situations in the member state in question and necessarily is to be addressed on a case-by-case basis.

2.3.6.1 Existence of competitive markets

When looking at the question of whether an activity is directly exposed to competition, the assessment is made on the basis of criteria that are in conformity with the Treaty provisions on competition, such as the characteristics of the goods or services concerned, the existence of alternative goods or services, the prices and the actual or potential presence of more than one supplier of the goods or services in question. This indicates very clearly whether the tests to be applied are the same as those applied when making the market analyses required by articles 81 and 82, as well as article 86, of the Treaty.

Further Details

Commission Decision 2005/15 sets out the more detailed requirements for applications under article 30. Annex I of the Decision sets out all of the information that would be necessary for the market analysis to be conducted, not all of which would be relevant to each specific situation.

Consideration is given to both legal and *de facto* barriers to entry. Since the liberalisation directives in the various sectors are designed to remove any remaining legal barriers to entry, the actual removal of those barriers through compliance with the various directives is sufficient to demonstrate the absence of any legal restrictions on access to the market for the activities in question. Access to a market is therefore deemed to not be restricted if the EU Member State has implemented and applied the provisions of Community legislation mentioned in Annex XI of the Utilities Directive, which contains a list of Community legislation designed to liberalise various utility sectors.

Currently the list refers to legislation in the following sectors: transport or distribution of gas or heat (Directive 98/30); production, transmission or distribution of electricity (Directive 96/92); contracting entities in the field of postal services (Directive 97/67); and exploration for and extraction of oil or gas (Directive 94/22).

No liberalisation legislation is currently listed for the production, transport or distribution of drinking water; contracting entities in the field of rail services; contracting entities in the field of urban railway, tramway, trolleybus or bus services; exploration for and extraction of coal or other solid fuels; contracting entities in the field of seaport or inland port or other terminal equipment; or contracting entities in the field of airport installations.

2.3.6.2 Exemption procedure under Article 30

The exemption is granted by means of a Decision by the European Commission, which is prompted by an application by an EU Member State, a contracting entity, or the Commission itself on its own initiative. The procedure of article 30 is supplemented by Decision 2005/15 ('the Decision'), which covers, among other issues, publication requirements, extensions, and procedures for forwarding decisions.

Application by an EU Member State

When an EU Member State intends to apply for an exemption for a given activity, it must notify the Commission and inform it of all relevant facts, in particular of any law, regulation, administrative provision or agreement that demonstrates that the activity in question is directly exposed to competition in markets to which access is not restricted.

If appropriate (*i.e.* where such a body exists and has issued such an opinion), it will include the position adopted by an independent national authority that is competent in the activity concerned. The exemption becomes effective (*i.e.* contracts intended to enable the activity concerned to be carried out are no longer subject to the Utilities Directive) if the Commission has either:

- adopted a Decision establishing the applicability of the conditions for exemption within the appropriate time limit; or
- not adopted a Decision concerning such applicability within that period.

If the exemption is sought on the basis of compliance with the EU liberalisation directives *and* if a competent independent national authority has established that the activity in question is directly exposed to competition in markets to which access is not restricted, the exemption will apply to the extent that the Commission has *not*, by means of a Decision, established the inapplicability of the conditions within the time limit.

The Commission is given a period of three months to come to a Decision, commencing on the first working day following the date on which it receives the notification or the request. The period may be extended once only and for a maximum of three months in duly justified cases, such as where the information contained in the notification or the request or in the annexed documents is incomplete or inexact or where the facts as reported undergo any substantive changes. However, where a competent independent national authority has established that the activity in question is directly exposed to competition in markets to which access is not restricted, then this extension is limited to one month rather than three months.

Application by a contracting entity

When the legislation of the EU Member State concerned so provides, contracting entities may also submit a request to the Commission for an exemption Decision. In that event, the Commission must immediately inform the member state concerned. The member state is then effectively required to follow the procedure as if it had made the application itself (see the preceding section) by informing the Commission of all relevant facts and including, where appropriate, the position of the competent national authority. The same procedure for taking the Decision and the same time limits apply. If, at the end of the time period laid down in paragraph 6 of article 30 of the Utilities Directive, the Commission has not adopted a Decision concerning the applicability of paragraph 1 to a given activity, the exemption becomes applicable.

Procedure at the Commission's initiative

The Commission may also begin, on its own initiative, the procedure for adoption of a Decision establishing the existence of competitive markets. In that event, the Commission immediately informs the member state concerned. There is no requirement for the member state to provide information, and there appears to be no time limit in respect of the Decision in this case.

2.4 CONTRACTING ENTITIES AND THE WTO'S GOVERNMENT PROCUREMENT AGREEMENT

As discussed in module A3, the EU is a signatory of the Government Procurement Agreement (GPA) of the World Trade Organisation (WTO). It is to be recalled that entity coverage under the GPA was generally based on the idea of reciprocity so that each member (signatory) would offer to the other members equivalent access to its government procurement in proportion to its size and to the size of the economy as a whole based on negotiations. Whilst this is not always obvious in the case of the public sector, the negotiations for coverage in the utilities sector were far more specific and sought to measure equivalence and reciprocity more accurately. As a result, not all of the utilities covered by the Utilities Directive are covered by the GPA. They are covered only where they have been explicitly included in the EU's Appendix to the GPA.

In the case of the utilities sector, only contracting authorities and public undertakings are covered, and not those entities operating on the basis of special or exclusive rights, which operate in defined activities. Even then, not all of the utilities sectors are covered. In the case of the utility sectors in the EU, the EU negotiated access to the contracts awarded only by public authorities and public undertakings defined in the Utilities Directive that carry out one or more activities in the fields of water, electricity, urban transport, and terminal facilities in ports and airports. In the case of the EU, the GPA does not apply to activities in the fields of gas and heat, extraction of oil, gas and solid fuels, transport by railway (other than urban railway), and telecommunications (also now excluded from the Utilities Directive itself).

The EU's General Notes to Appendix I to the GPA also set out some more significant exceptions in respect of certain contracts in the utilities sector. For example, until such time as reciprocal access is given to EU suppliers and service-providers, the EU will not extend the benefits of the GPA to, for example, Canada and the USA in respect of water activities; Canada and Japan in respect of electricity activities; and Canada, Korea and the USA in respect of airport terminal facilities.

In practical terms, compliance with the Directives ensures compliance with the provisions of the GPA in respect of those entities that are also covered by the GPA. Since the Directives apply in any event, no further action needs to be taken in respect of *compliance* with the GPA procedural rules. However, in terms of granting access to EU procurement markets, contracting entities for GPA purposes are obliged to do so only in respect of (1) those entities, and (2) those products and/or services from other GPA members as are covered in the various country appendices to the GPA and which are not otherwise subject to exclusion or reciprocity requirements set out in the notes to the appendices. As the exceptions are more significant in the utilities sector than in the public sector, in order to accurately determine the extent of access it would be necessary to consult the specific country appendices.

SECTION 3 EXERCISES

EXERCISE 1 GROUP DISCUSSION ON PUBLIC AND PRIVATE SECTOR PROCUREMENT

Split into groups of about 6 for a debate on the merits of public or private sector procurement practices in the utilities sector.

Half of the groups will take the position that all utilities should follow public procurement rules.

The other half will take the position that all utilities should be permitted to follow private sector procurement practices.

Issues to be addressed include (but are not limited to):

- the impact of state influence over the ability for the utility to operate in the sector;
- the mode of granting authorisations/licences to operate;
- the effect of the existence of a monopoly position (*de facto* or *de jure*)
- the nature of a natural monopoly;
- the fact that utilities may need to compete for customers in competitive markets;
- the commercial outlook of utilities.

The presentations should also consider why it is that private sector operators do not need procurement regulations such as those contained in the procurement Directives in order to be encouraged to pursue economic and efficient procurement practices.

Each group is to present their arguments and conclusions in turn. A vote is to be taken at the end.

EXERCISE 2
CASE STUDY – SUMMERCLIFF BUS & TOUR CO.

You are the procurement officer for Summercliff Bus & Tour Co., a bus transport company that provides two types of service, namely a bus service for the general public along an established route in a city centre, and a coach hire service for holiday trips or to attend special events.

You are contemplating two procurement activities in the forthcoming financial year:

(i) You intend to purchase a new fleet of buses and, to get the most out of the buses, you intend to use them both for the city route and for hire to local schools for transport to sports events.

- Are you obliged to follow the Utilities Directive?
- Would it make any difference if you decided not to use the buses for both purposes?
- Why?

(ii) The business is outgrowing the administration building you currently use and you are considering expanding by constructing new office space.

- What questions should you ask to determine whether you should follow the Utilities Directive?
- Your boss does not know whether to simply build a new headquarters to house the whole company, or whether he should build an annex to house part of the operations. Would you have any opinion from a procurement perspective?

Your boss is not sure whether he wants to comply with the procurement rules at all. He had heard that there was a special exemption for buses operating on competitive routes, which is the case for Summercliff. Is he right?

EXERCISE 3
GENERAL EXEMPTION MECHANISM (HOME STUDY)

Please consider the following three Commission Decisions:

1. Commission Decision 2005/15 of 7 January 2005 on the detailed rules for the application of the procedure provided for in article 30 of **Directive 2004/17/EC** of the European Parliament and of the Council co-ordinating the procurement procedures of entities operating in the water, energy, transport and the postal services sector.

   (OJ 2005 L7/7)

2. Commission Decision 2006/211 of 8 March 2006 establishing that article 30(1) of **Directive 2004/17/EC** of the European Parliament and of the Council co-ordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors applies to electricity generation in England, Scotland and Wales.

   (OJ 2006 L76/6)

3. Commission Decision 2006/422 of 19 June 2006 establishing that article 30(1) of **Directive 2004/17/EC** of the European Parliament and of the Council co-ordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors applies to the production and sale of electricity in Finland, excluding the Åland Islands.

   (OJ 2006 L168/33).

Answer the following questions:

(i) How important were the energy sector liberalisation Directives to the two exemption decisions?

(ii) Based on the two exemption decisions, would you say that the criteria listed in Annex 1 of Decision 2005/15 are mandatory or illustrative?

(iii) What do the two exemption decisions tell you about the value of determining the product and geographic markets at issue?

(iv) What do they tell us about the identity of the independent national authorities referred to in article 30?

SECTION 4
CHAPTER SUMMARY

SELF-TEST QUESTIONS

1. What are the three types of contracting entity in the utilities sector?
2. Why was the utilities sector originally excluded from the scope of the EC public procurement rules?
3. Was the original exclusion a matter of principle or a matter of practicality?
4. Explain the relevance of government influence.
5. How did the Community regulator bring the utilities sector within the ambit of the rules?
6. In the case of contracting "authorities", are the Public Sector and Utilities Sector Directives mutually exclusive?
7. Is there a difference between "bodies governed by public law" and "public undertakings"?
8. What are "special" or "exclusive" rights? Are "special" rights different from "exclusive" rights?
9. Is it enough that a contracting entity falls within the definition of "utility"?
10. What is the purpose of considering "relevant activities"?
11. Name the four main relevant activities.
12. Why were telecommunications dropped from the list of "relevant activities"?
13. If a contracting entity also carries out non-relevant activities, is it still covered by the Directive for purchases for those activities?
14. If an exclusion was granted before the adoption of **Directive 2004/17**, does it remain in force or is it replaced by the general exemption of article 30?
15. Explain the reasons for including the general exemption mechanism.
16. What considerations will apply to the award of the exemption?
17. Who may apply for the exemption, and how?

Public procurement law – scope of application

MODULE D

PART 3

Contracts covered

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SECTION 1 INTRODUCTION

1.1 OBJECTIVES

The objectives of this chapter are to explore, explain and understand:

1. The different types of contract that are covered by the rules
2. The contracts not covered by the procurement rules
3. The means of distinguishing between the different types of contract
4. The general treatment given to the different types of contract

1.2 IMPORTANT ISSUES

The most important issues in this chapter are understanding:

- The essential characteristics of a "procurement contract"
- The nature of the contracts covered
- The scope of the contracts covered
- The effect of combining contract types

This means that it is critical to understand fully:

- The elements of a contract
- The characteristics of arrangements that do not constitute contracts
- The aim or purpose of a contract

1.3 LINKS

There is a particularly strong link between this chapter and the following modules or sections:

- Module C4 on the award of concession contracts
- Modules D1 and D2 on the internal structure of the contracting authorities and contracting entities
- Module D4, applying value thresholds to the contracts that become subject to the rules
- Module E – all parts, on procedures that apply to the various contract types

1.4 RELEVANCE

This information will be of particular relevance (i) at a strategic level where decisions as to the type of contract to be employed may be used to affect the type of contract and, therefore, type of procedure that is appropriate and (ii) at the operational level, where the type of contract at issue will determine the applicable thresholds, possible exemptions, and types of procurement methods to be used.

1.5 LEGAL INFORMATION HELPFUL TO HAVE TO HAND

In addition to the provisions of the Directives, it may also be useful to have at hand:

- [Localise: the (national law relating to concessions);
- The section of the applicable local law that applies to services contracts]

SECTION 2 NARRATIVE

2.1 INTRODUCTION

Note: This narrative discussion has general application for both the Public Sector and Utilities Directives, and so the term "Directives" is used except where the context requires otherwise.

The Directives cover three main types of contract:

- works
- supplies
- services (other than works), including design contests

There is no separate category for consultancy services, which are dealt with essentially in the same way as are other services.

Some contracts will often contain elements of one or more of the above types of contract. Thus, a contract to construct a building might include design services and certain necessary supplies. Similarly, a supply contract may include siting and installation services. The Directive contains specific rules that are used to classify these 'mixed contracts'.

A number of contracts are entirely excluded from the scope of the Directives (but not necessarily of the Treaty), either because of their nature (*i.e.* where it would be inappropriate to apply the provisions of the Directives) or because they are the subject of different systems of regulation or administration. Some contracts, the new 'reserved contracts', receive special treatment as a result of the identity of those supplying the goods, works or services under them. These exempted and reserved contracts, which are subject to specific eligibility requirements, are discussed in module D4.

Even if not excluded, contracts will only be subject to the provisions of the Directives where their value exceeds the relevant monetary value set out in the Directives – the EU financial threshold. These thresholds reflect the level at which it was assumed by the Community Legislator that cross-border trade was likely (although it is possible that, depending on the circumstances, tenderers may be interested in below-threshold contracts in other EU Member States – it is to be recalled that the general principles apply to the award of these contracts in any event). In order to prevent creative methods of calculating the value of the contracts to be awarded, the Directives also apply rules and methods of calculation as well as prohibition of methods designed to circumvent the Directives by splitting, aggregating or packaging contracts in such a way that the contracts do not properly fall within the appropriate provisions. Thresholds are discussed in module D5.

One important distinction made by the Directives is between 'contracts' and 'concessions', the latter being treated differently from contracts. Special rules apply to the award of works concessions in the Public Sector Directive, while services concessions are excluded from the scope of both the Public Sector Directive and the Utilities Directive.

Finally, it should be mentioned that the latest Public Sector Directive also resolves the previous uncertainty over the position of framework agreements, which – although they may still be contracts for works, supplies or services (or treated as such) and are therefore no different in nature by reason of their method of award – require separate treatment.

2.2 'PROCUREMENT' CONTRACTS

The Directives do not give any particular definition of a 'procurement' contract, but only certain contracts fall within the scope of the Directives. The Directives refer to 'public works' contracts, 'public supply' contracts and 'public services' contracts, [Localisation may be required if the definitions in the local law are different] but there are some general characteristics that are common to all types of contract covered by the Directives.

The Directives apply to contracts for pecuniary interest concluded in writing between an economic operator and a contracting entity, as follows:

- The contract must be for pecuniary interest, *i.e.* for money or money's worth. There must be a financial consideration, no matter how it is paid.
- The contract must be in writing. In the very unlikely event that a contract that falls within the Directives is not in writing, it will be subject to the general application of the rules contained in the Treaty, as discussed in module A1.
- The contract must be between two parties: the economic operator and the contracting entity. There are situations in the public sector, however, where agreements are not made between two separate and distinct parties, and therefore there is no contract according to this definition. Arrangements made between departments of the same organisation, for example, would not ordinarily be covered by the procurement rules. This is because there would normally not be any contractual relationship between the various departments of a single organisation. This part of the definition has attracted some interest recently and is considered in the next sub-section.

2.2.1. Internal arrangements within the contracting entity

Where there is a purely internal arrangement between departments of the same public sector organisation, there will generally be no contract. However, as indicated in module D1, even public sector organisations can make use of private sector structures, such as companies, to carry out public services. These structures/companies can also be used to provide services directly to the public organisation that controls them. Where they are part of the same legal structure, these arrangements are not 'contracts' for the purposes of the Public Sector Directive (in the utilities sector, the existence and treatment of separately owned affiliated undertakings is specifically foreseen, and therefore the issue concerns mainly the public sector). As soon as these structures become separate legal entities, however, any arrangement between them becomes a 'contract' between two parties, with one being a contracting entity, and the other an economic operator.

When this happens, the procurement of goods, works and services between the 'parent' contracting entity and the 'owned' economic operator becomes a procurement contract between those parties. This means that the contract must be awarded using the provisions of the Public Sector Directive so that the contracting entity may not make a direct award of a contract to its own company.

This situation has been explicitly recognised in the utilities sector, where it is often the case that a contracting entity owns a number of subsidiaries. Under the Utilities Directive, there is an explicit 'affiliated undertakings' exemption. The effect of this exemption is to exclude the intra-group (*i.e.* between the parent and subsidiary or between the various subsidiaries) that is providing goods, works and services from the scope of the Utilities Directive, subject to certain conditions. There is no equivalent provision in the Public Sector Directive. This means that where there is a contract, the award of that contract, whether or not it is to a wholly-owned company, will be subject to the procedural rules.

This situation has been confirmed by the European Court of Justice (ECJ). The ECJ also provides an exemption, however. In the rather important case of *Teckal*, the ECJ held that it was sufficient to apply the arrangements set out in the Directive "if the contract was concluded between, on the one hand, a local authority and, on the other, a person legally distinct from that local authority". It then went on to say, however, that the situation would be different if, in effect, the contracting entity controlled the company as if it were one of its departments. This would take the arrangement outside the scope of the Public Sector Directive.

Case note:

"The position can be otherwise only in the case where the local authority exercises over the person concerned a control which is similar to that which it exercises over its own departments and, at the same time, that person carries out the essential part of its activities with the controlling local authority or authorities."

(ECJ Case C-107/98 *Teckal Srl v Comune di Viano and AGAC di Reggio Emilia* [1999] ECR I-8121)

This decision has also been applied to inter-administrative agreements, that is to say, not to contracts between a contacting authority and a company in which it has a financial interest but to contracts between different public authorities. Thus contracts between two public authorities are not excluded simply because both parties are public authorities; to be excluded, one of the authorities must also satisfy the *Teckal* test, *i.e.* it must exercise over the other public authority a control that is similar to the control that it exercises over its own departments, and the latter authority must carry out the essential part of its activities under the control of the controlling local authority or authorities.

In a subsequent case, the private company (economic operator) at issue was only partly owned by a public authority, while the remaining shares were held by private parties. It was argued that the very small minority share held by the public authority (24.9%) still gave the contracting entity control over the company, which was sufficient to take the contract outside the Public Sector Directive. The ECJ disagreed because the existence of a private interest was incompatible with the public interest objectives presumed to be pursued by public authorities and because the capital presence of a private undertaking would give that undertaking an advantage over its competitors and thus risk distorting competition and violating the principle of equal treatment (in respect of other tenderers).

Case note:

"The participation, even as a minority, of a private undertaking in the capital of a company in which the contracting authority in question is also a participant *excludes in any event* the possibility of that contracting authority exercising over that company a control similar to that which it exercises over its own departments."

(ECJ Case C-26/03 *Stadt Halle* [2005] ECR I-1)

2.2.2 When does a contract arise?

When a new contract is awarded, there is normally little difficulty in identifying it. Sometimes, however, this is not obvious. For example, an existing contract might be amended or renewed. A contract may also be amended during its execution. All of these situations give rise to new obligations between the parties and may change the terms of the original contract.

If the result of the changes is so extensive that the renewed or amended contract is fundamentally different from the original contract, then it may be the case that a new contract will be established. If there is a new contract and all of the elements of a contract are present, then the contract should be subject to the procurement rules, *i.e.* it must be awarded according to the provisions of the Directives. This means that a simple extension, renewal or even amendment might not be permitted if it is made without competition.

The practical difficulty will be in determining when a change in the contract will give rise to a new contract, thus creating an obligation to apply the Directives, and when it will not. The Directives are silent on the issue and there is very little case law in this regard.

In some cases, the Directives do provide a solution. Options can be included in contracts, and these options might foresee an extension or renewal of the contract following satisfactory performance, for example. If the value of the option or the renewal is taken into account in the calculation of the estimated price of the original contract, it will be covered by the original competition and there will be no need to apply the Directives again. See module D5.

Similarly, some contracts can be renewed automatically until terminated by one party or the other or by mutual agreement, or they may simply be concluded for an indefinite period of time. These are 'indefinite' contracts, and the Directives provide a mechanism for calculating the value of such contracts for the purposes of the applicable thresholds. See module D5.

The case of contract variations (*i.e.* where the contract needs to be varied/amended during its execution) is less clear. Even where variations are anticipated, as is often the case with works contracts, there will still be a question of whether those variations are acceptable as part of the original contract or whether they go beyond the terms of the original contract and become, in effect, a new contract.

The issue came before the ECJ in the case of _Pressetext_ (Case C-454/06 *Pressetext v Austria* [2008] ECR I-4401), where the ECJ provided a number of indicators:

- Amendments to the provisions of a public contract during the execution of the contract constitute a new award of a contract when they are *materially different* in character from the original contract and therefore demonstrate the intention of the parties to renegotiate the essential terms of that contract.
- An amendment may be regarded as being material when it introduces conditions which, had they been part of the initial award procedure, would have allowed for the admission of tenderers other than those initially admitted or would have allowed for the acceptance of a tender other than the one initially accepted.
- An amendment may also be regarded as being material when it extends the scope of the contract considerably to encompass services not initially covered.
- An amendment may also be regarded as being material when it changes the economic balance of the contract in favour of the contractor in a manner that was not provided for in the terms of the initial contract.

2.2.3 Contracts and concessions

A concession is a contract of the same type as the contracts defined in the Directives except that consideration for the works or services to be carried out, for example, consists either solely in the right to exploit the work or service or in this right together with payment.

A concessionaire often accepts the operational and financial risk of providing a public service, in the broadest sense, in return for the chance of making a profit through the exploitation of the 'service'. A contractor seeks to make a profit by means of the fixed payment received for the execution of the contract. Public-private partnerships (PPPs) will sometimes include the award of a concession.

Concessions are used, for example, to carry out and finance major infrastructure projects, notably in respect of the construction of a road network, bridges or tunnels, where the concessionaire is remunerated by way of tolls charged to users. They are also used, however, simply to provide for the operation and maintenance (rather than construction) of facilities by concessionaires, such as where an operator is given the concession to operate an existing railway or underground railway infrastructure. The former types of concession are examples of works concessions; the latter is an example of a services concession.

Only public works concessions are dealt with comprehensively in the Public Sector Directive. Article 17 of the Public Sector Directive now explicitly excludes coverage of public services concessions. The general principles of the Treaty continue to apply, however.

Case note:

The general Treaty principles, including the principles of non-discrimination and transparency, must be applied to the award of public services concessions.

(ECJ Case C-275/98 *Unitron* [1999] ECR I-8291)

2.2.4 Framework agreements and contracts

Under article 1(5), a framework agreement is an agreement between a contracting entity and one or more suppliers, contractors or service providers, the purpose of which is to establish the terms – in particular with regard to prices and, where appropriate, the quantity envisaged – governing the contracts to be awarded during a given period. Such agreements are used frequently in practice where a purchaser has a continuing or recurring need to purchase the same or similar products or services and wishes to avoid the costs associated with awarding a new contract each and every time that it needs to purchase additional supplies.

The difficulty raised by the definition of framework agreement is that it may or may not be a 'contract' for the purposes of the Directives, *i.e.* the parties to the agreement do not always undertake binding commitments to buy or sell but merely set out the terms that would apply to any future contracts that they might conclude. Whether there is a contract or not will depend on national law.

If there is no binding contract at the stage of the framework agreement, the issue of establishing a contract would arise when orders are placed under the agreement so that each agreement call-off would amount to a separate contract. Ordinarily, therefore, the Directives would apply to each call-off above the threshold. These individual orders could also be aggregated if individually they fell below the thresholds (see module D5).

What the Directives do is to effectively enable a non-binding framework agreement to be treated in the same way as a binding framework contract. Thus, if the contracting entity chooses to award the framework agreement under the provisions of the Directives as if it were a binding contract, then the subsequent call-off 'contracts' may be awarded without competition.

Where the non-binding framework agreement has not been awarded pursuant to the provisions of the Directives, however, each contract above the threshold value will be treated as a contract falling within the terms of the Directives and will be subject to their procedures. Individual contracts that have been awarded pursuant to a framework agreement are subject, as any other contract that has been awarded subject to the Directives, to the requirement of the publication of a contract award notice in the *Official Journal of the EU*. In addition, a framework agreement could be entered into with multiple suppliers, followed by a mini-tender when call-offs were required. The procedures for awarding framework agreements are covered in module C4.

The Directives further provide that contracting entities may not misuse framework agreements in order to hinder, limit or distort competition, although they do not refer to any particular cases of misuse. The duration of framework agreements is limited to four years, except in exceptional circumstances justified by the subject of the framework agreement.

2.3 WORKS CONTRACTS

Works contracts are defined as those contracts that:

- have as their object either the execution or both the execution and design of works related to one of the activities referred to in Annex I; or
- have as their object the realisation, by whatever means, of work corresponding to the requirements specified by the contracting entity.

The possibility of including design works in a works contract means that 'design and build' contracts may fall within the definition of a works contract. This could include, for example, contracts covering the planning and financing of a project as well as its execution. Where design and construction are awarded separately, the design services would be a priority service (category 12) or could, alternatively, be awarded by means of a design contest.

For the second part of the definition, a 'work' is the outcome of building or civil engineering works taken as a whole that is sufficient in itself to fulfil an economic and technical function (see 2.3.2 below for details). This definition is relevant for a number of reasons, notably in the context of the realisation of works by any means and for the purposes of assessing the threshold values and, consequently, when deciding whether a single requirement for works has been split up with a view to bringing contracts below the relevant threshold value.

2.3.1 Building and civil engineering activities

Annex I of the Public Sector Directive (Annex XII of the Utilities Directive) gives a list of professional activities as set out in the general industrial classification of economic activities within the European Communities (NACE). The Common Procurement Vocabulary (CPV) is often recommended for use in the contract award notices, and the annexes to the Directorates provide for each NACE code a corresponding reference to the relevant CPV code, even though the CPV is not binding. Article 1(14) of the Public Sector Directive explicitly provides that, in the event of any difference of interpretation between the CPV and the NACE, the NACE nomenclature will apply. The following list, contained in the annexes, covers building and civil engineering. In summary, the list includes:

- general building and civil engineering work and demolition work;
- construction of flats, office blocks, hospitals and other buildings, both residential and non-residential (to include such activities as roofing, construction of chimneys, waterproofing, restoration and maintenance of outside walls, etc.);
- civil engineering: construction of roads, bridges, railways, etc. (to include such activities as earth-moving, hydraulic engineering, irrigation, and sewage disposal);
- installation: fittings and fixtures (to include activities such as gas fitting and plumbing, installation of heating and ventilating apparatus, electrical fittings, etc.);
- building completion works (to include such activities as plastering, joinery, painting and tiling).

See module E2 on the use of NACE and CPV codes in the contract notice.

2.3.2 Realisation of a work by whatever means

A works contract would also fall within the definition of the Directives where the party signing the agreement was not, in fact, the contracting entity itself, but a company acting as an agent on its behalf. This would apply, for example, in the construction industry where an engineering and construction company was taken on as management contractor providing engineering design, procurement, construction and project management services to the contracting entity. The management contractor would be obliged to follow the procurement rules when awarding contracts for works since it would be providing work corresponding to the requirements specified by the contracting authority. The contracting entity would obtain such work 'by whatever means'.

This provision concerning the realisation, by whatever means, of work corresponding to the requirements specified by the contracting authority also covers other arrangements that are common among developers, whereby a developer or builder constructs buildings on its own land and subsequently transfers or agrees to transfer the land together with the buildings to the contracting entity. This might, at first sight, appear to be a contract for the acquisition of land (a type of contract that is excluded from the Directives – see module D4), but the fact that the buildings are often constructed according to the contracting entity's specifications would bring the arrangement within this definition of a works contract.

This provision also covers situations where a contracting entity is in some way obliged to purchase works from a developer who owns the particular land. In some respects, a public purchaser has no possibility of contracting with anyone else, and so the idea that it can apply the procurement rules appears to be purely academic. Such would be the case, for example, with urban regeneration and development projects, which often involve complicated relationships between local authorities and developers and which are regulated by a series of national and local planning laws and regulations. Development may be undertaken by the public authorities on land that they do not own or it may be undertaken by the private sector in areas designated by the public authorities for development.

The relationships are complicated and raise problems in the procurement context because, even in the case of private development, there will inevitably be public intervention since, as designated development areas, developers will often be required, in return for planning consent, to contribute to consequential 'public' requirements, such as by providing feeder roads or even major highways, parking spaces, sewerage and utility networks, street lighting, and leisure parks and gardens. In some cases, there will be requirements concerning the provision of social or affordable housing.

The question is essentially to determine the degree of intervention by the public authority that would imply that it was requiring and paying for works (by whatever means) that complied with its own 'public' requirements. Where the degree is determinative, then the procurement rules will apply. In practice, however, the public authority may not be able to select the private sector partner because the developer who owns the land and development will be able, legally, to insist on carrying out the work.

This issue arose in the case of *La Scala* (Case C-399/98, [2001] ECR I-5409), where a private developer was restoring the La Scala opera house as part of a wider urban development project. The ECJ made several findings (in respect of the public sector works directive at issue):

- The fact that the direct execution of infrastructure works forms part of a set of urban development regulations is not sufficient to exclude the direct execution of works from the scope of the Directive when the elements required to bring it within the scope of the Directive are present.
- Therefore, once there is a contract for pecuniary interest between two independent parties for public works above the threshold, those works will fall within the scope of the Directive.
- The fact that the works were directly executed did not preclude the existence of a contract since, where infrastructure works are executed directly, a development agreement must always be concluded between the municipal authorities and the owner or owners of the land to be developed.
- In this case, there was a public works contract that should have been put out to tender, even though the works could only be executed by the owner of the land.
- The Directive could still be given full effect if the national legislation allowed the municipal authorities, in order to discharge their own obligations under the Directive, to require the developer holding the building permit, in accordance with the agreement it had concluded with them, to carry out the work contracted for in accordance with the procedures laid down in the Directive.

The legal solution, therefore, when the contracting authority was in effect captive to the developer, was for the authority to require the developer to comply with the Directive so that it would in turn be able to discharge its own obligations under the Directive. In other words, the solution would be to make the developer the agent of the procuring entity and force it to apply the provisions of the Directive.

However, even if the developer itself happened to be a contracting entity obliged, in any event, to follow the Directives, it would not mean that the authority awarding the initial contract could avoid applying the rules of the Directives. The Directives apply at both stages.

Case note:

"A contracting authority is not exempt from using the procedures for the award of public works contracts laid down in the Directive on the ground that, in accordance with national law, the agreement may be concluded only with certain legal persons, which themselves have the capacity of contracting authority and which will be obliged, in turn, to apply those procedures to the award of any subsequent contracts."

(ECJ Case C-220/05 *Auroux* [2007] ECR I-385)

2.3.3 Public works concessions

As indicated above, only public works concessions are covered by the Public Sector Directive.

2.3.3.1 Definition

A 'public works concession' is a contract of the same type as a public works contract except for the fact that the consideration for the works to be carried out consists either solely in the right to exploit the work or in this right together with payment. It must thus first fall within the definition of a works contract before the form of the consideration becomes relevant. In considering 'exploitation', significant weight will be given to the element of risk transfer between the public authority and the concessionaire. The absence of risk transfer will suggest the existence of a contract subject to the full rigour of the Directive rather than a concession subject to the Directive's special provisions on concessions.

Important note:

For the purposes of the Directive, a public works concession is, first, a public works contract, and second, it is subject to alternative payment methods. As a result, the award of a public works concession is, by definition, within the scope of the Directive. It is then subject to a special procedure. Public works concessions are thus not outside the scope of the procurement rules. In addition, the principles of the Treaty will apply to the award of public works concessions, whether or not a special procedure applies.

Modern 'concessions' often contain a mix of works and services, *i.e.* they include not only the construction of infrastructure or facilities but also the operation of those facilities. The means of distinguishing between these different elements is discussed further in section 2.7 below.

2.3.3.2 Procedure for the award of a works concession

The Directive sets out a special procedure for the award of a works concession contract by a contracting authority. The special procedure imposes fewer detailed requirements on the contracting authority than does any of the four main competitive procedures. See module C4 for full details of the procedural requirements for the award of a works concession contract.

2.3.3.3 Subcontracting by concessionaires

- The Directive contains specific rules on subcontracting, and contracting authorities have the option of either requiring a concessionaire to subcontract a specified percentage of the contract to a third party or of requesting information from economic operators participating in the tender process to specify the percentage of the contract that they would subcontract if awarded the contract. See module C4 for further information.

2.3.3.4 Obligations of concessionaires

The Directive applies specific conditions on the award of contracts by concessionaires to third parties. A distinction is made between the obligations that apply to concessionaires depending on whether they are themselves contracting authorities.

Where contracts are awarded by concessionaires that are themselves contracting authorities, the concessionaires are bound to comply with the provisions of the Directive in respect of public works contracts. Where contracts are awarded by concessionaires that are not contracting authorities, a more limited set of provisions applies. See module C4 for further information.

2.3.4 Subsidised works or services contracts

The Directive makes special provision for two types of contract: first, in respect of works or services contracts that are subsidised by contracting authorities for more than 50%; second, in respect of design and construction contracts concluded in the context of a public housing scheme.

2.3.4.1 Contracts subsidised by more than half

Where a private entity does not fall within the definition of a body governed by public law, it may still in certain circumstances be treated as if it were such a contracting authority when it awards a contract that is subsidised by a public authority.

This is the case when certain works or services contracts are subsided by public authorities for more than 50%.

In such cases, EU Member States are required to take the necessary measures to ensure that the contracting authorities awarding such subsidies comply with the Directive whenever the contract is awarded by one or more entities other than themselves.

This provision only applies to certain contracts:

- works contracts (falling within the definition of the civil engineering activities contained in Annex I to the Directive) whose value meets or exceeds the normal threshold value for works contracts; and
- services contracts, connected to such a works contract, whose value meets or exceeds the normal threshold value for services contracts.

However, the Directive applies *only* in respect of activities where the contracts involve building work or connected services with a 'public' dimension. Those activities are defined as works and connected services for hospitals, facilities intended for sports, recreation and leisure, school and university buildings, and buildings used for administrative purposes.

See module C4 for information on the detailed requirements.

2.3.4.2 Subsidised housing schemes

Article 34 applies to public contracts relating to the design and construction of a subsidised housing scheme where the size and complexity of the scheme and the estimated duration of the work involved require that planning be based from the outset on close collaboration within a team comprised of representatives of the contracting authorities, experts and the contractor responsible for carrying out the works.

In such cases, a special award procedure can be adopted for selecting the contractor that is the most suitable for integration into the team, but the contracting authorities are required to follow a set of basic procedures and must, in any event, treat economic operators equally, without discrimination and transparently.

No particular procedure is mandated, but the contracting authorities are required to advertise the scheme in accordance with the Directive's rules on advertising and transparency (articles 35 and 36):

- the contract notice must contain as accurate as possible a description of the works to be carried out so as to enable interested contractors to form a valid idea of the project;
- the contracting authorities must comply with the minimum time limits set out in article 38 of the Directive, depending on the overall procedure that they have adopted (open or restricted);
- the contracting authorities may provide additional information in accordance with similar provisions applying to open procedures (article 39);
- they may also use electronic means of communication (article 42).

In selecting contractors, the contracting authorities are bound by the qualitative selection criteria referred to in articles 45 to 52 and must set out in the contract notice the personal, technical, economic and financial conditions to be fulfilled by the candidates.

Contracting authorities are also bound by the duty to inform the unsuccessful candidates and tenderers of the reasons for their lack of success (article 41) and to keep written records of the procedures (article 43).

See module C4 for detailed information on the requirements.

2.4 SUPPLIES CONTRACTS

The definition of supplies is rather more straightforward than that of works or services. 'Public supply contracts' are defined in article 1(2)(d) as contracts – other than works – involving the purchase, lease, rental or hire purchase, with or without option to buy, of products. In addition, the delivery of such products may include siting and installation operations.

The range of products covered by the Directives can be seen in the various nomenclatures used to describe products for the purposes of advertising. See, for example, the Common Procurement Vocabulary (CPV).

2.5 SERVICES CONTRACTS

The term 'service contracts' essentially refers to contracts other than works or supply contracts that have as their object the provision of services referred to in Annex II of the Public Sector Directive (Annex XVII of the Utilities Directive). A number of services are specifically excluded, mainly because they are not amenable to purchase through the rules provided by the Directives. These services are described in module D4.

However, further distinction is made in the relevant annexes between what may be called 'priority services' (Annex IIA of the Public Sector Directive) and 'non-priority' services (Annex IIB).

The services covered are defined by reference to the United Nations' Central Product Classification (CPC), and the annexes referred to above set out the services by name, together with the relevant CPC category. Other classifications are also used for various purposes: for example, the Classification of Products by Activity (CPA) and, more recently, the Common Procurement Vocabulary (CPV). Only the CPC reference is binding. Furthermore, the annexes state that in the event of any difference of interpretation between the CPV and the CPC, the CPC nomenclature will apply.

See module E2 for further information on CPV and CPC.

2.5.1 The two-tier approach

The Directives make a distinction between priority and non-priority services. This distinction is not made on the basis of the nature of the particular activity but rather on the potential that exists for the provision of the services concerned across national borders and on the clear capability of those services to affect trade between member states.

This distinction becomes most readily apparent in the case of services, where those listed in Part IIB as non-priority, whilst capable of attracting localised competition, are less amenable to international competition, either because of the nature of the services (*e.g.* legal and administrative services that are based on familiarity with national laws and jurisdiction) or because of the location in which they need to be provided (*e.g.* hotel and restaurant services).

This does not mean that competition for such contracts is not possible, certainly at local or national level, or even that international competition for them is inconceivable, but only that the nature of the services or their value is such that this is less likely. [Localisation required if appropriate: "For example, in XXX, competitive procedures are also applied for the purchase of [xxx] and [xxx] which, under the Directives, are non-priority services. Within XXX, competition is both possible and desirable for these services.]

The priority services are subject to the detailed award procedures and other provisions of the Directives.

The non-priority services are subject only to a basic transparency regime that requires adherence to the Directives' rules on non-discriminatory technical specifications and the obligation to publish the results of the award.

2.5.2 Priority services

These priority services are listed in Annex IIA of the Public Sector Directive. They are:

1. Maintenance and repair services (CPC: 6112, 6122, 633, 886);
2. Land transport services[1], including armoured car services, and courier services, except transport of mail (CPC: 712 (except 71235) 7512, 87304);
3. Air transport services of passengers and freight, except transport of mail (CPC: 73 (except 7321));
4. Transport of mail by land[2] and by air (CPC: 71235, 7321);
5. Telecommunications services (CPC: 752);
6. Financial services: (a) insurance services and (b) banking and investment services[3] (CPC: ex 81, 812, 814);
7. Computer services and related services (CPC: 84);
8. Research and development services[4] (CPC: 85);
9. Accounting, auditing and bookkeeping services (CPC: 862);
10. Market research and public opinion polling services (CPC: 864);
11. Management consulting services[5] and related services (CPC: 865, 866);
12. Architectural services; engineering services and integrated engineering services; urban planning and landscape engineering services; related scientific and technical consulting services; technical testing and analysis services (CPC: 867);
13. Advertising services (CPC: 871);
14. Building-cleaning services and property management services (CPC: 874, 82201 to 82206);
15. Publishing and printing services on a fee or contract basis (CPC: 88442);
16. Sewage and refuse disposal services; sanitation and similar services (CPC: 94).

2.5.3 Non-priority services

The non-priority services are listed in Annex IIB of the Public Service Directive. They are:

17. Hotel and restaurant services (CPC: 64);
18. Transport services by rail (CPC: 711);
19. Water transport services (CPC: 72);
20. Supporting and auxiliary transport services (CPC: 74);

[1] Except for rail transport services covered by category 18

[2] Except for rail transport services covered by category 18

[3] Except financial services in connection with the issue, sale, purchase or transfer of securities or other financial instruments, and central bank services. Also excluded: services involving the acquisition or rental, by whatever financial procedures, of land, existing buildings or other immovable property or concerning rights thereon; nevertheless, financial service contracts concluded at the same time as, before or after the contract of acquisition or rental, in whatever form, shall be subject to this Directive.

[4] Except research and development services other than those where the benefits accrue exclusively to the contracting entity for its use in the conduct of its own affairs on condition that the service provided is wholly remunerated by the contracting authority.

[5] Except arbitration and conciliation services

21. Legal services (CPC: 861);
22. Personnel placement and supply services[6] (CPC: 872);
23. Investigation and security services, except armoured car services (CPC: 873 (except 87304));
24. Education and vocational education services (CPC: 92);
25. Health and social services (CPC: 93);
26. Recreational, cultural and sporting services (CPC: 98);
27. Other services[7].

2.5.4 Mixed priority and non-priority services contracts

The Directives apply an explicit value test to services contracts that contain both priority and non-priority services.

Contracts will be for priority services where the value of the priority services contained in the contract is greater than the value of the non-priority services.

In other cases, it will be a non-priority services contract, so that a contract in which the share of non-priority services is equal to or greater in value than the share of priority services will be a non-priority services contract.

There is no obligation to separate out the priority and non-priority services and to award them as separate contracts, which could lead to a contract for largely non-priority services, even if it contained a large proportion (say 49%) of priority services, being awarded as a contract for non-priority services. Such a separation of services could also turn out in the opposite way, so that the value of priority services would be greater than the value of non-priority services. The result would be the application of the procedures of the Directives to even the non-priority services.

This provision cannot be used, however, to avoid the application of the Directives.

Case note:

A contracting authority may not "*artificially* group in one contract both priority and non-priority services *without there being any link arising from a joint purpose or operation,* with the sole purpose of increasing the proportion of non-priority services and thus avoiding the full application of the Directives."

(ECJ Case C-411/00 *Felix Swoboda* [2002] ECR-567)

Therefore, when assessing whether priority and non-priority services have been packaged together correctly or split up, consideration will be given to the artificiality of the exercise as well as to the intention of the contracting entity. If the services naturally combine to achieve a single purpose, then splitting them up would be artificial. In other cases, where the services do not naturally combine to achieve a single purpose, then there can be no objection to awarding them separately.

6 Except employment contracts

7 Except contracts for the acquisition, development, production or co-production of programmes by broadcasting organisations and contracts for broadcasting time

2.6 DESIGN CONTESTS

Design contests are those national procedures providing the contracting entity with a plan or design that is selected by a jury on the basis of a competition, with or without the award of prizes.

Such contests are held mainly in the fields of town or area planning (with particular regard for the public sector), architecture, civil engineering and data processing. They are often used in the case of the construction of notable public buildings and are being used more and more frequently for the design of projects such as IT infrastructure projects.

These contests may be part of a procedure leading to the award of a service contract or may be held independently under a separate procedure since there are no inevitable results when undertaking a design contest.

The rules only apply where the total amount of contest prizes and payments to participants meets the appropriate threshold.

On the other hand, where the contests form part of a procedure for the award of other contracts, the threshold value consists of both the value of contest prizes and payments *and* the value of the services contract that might be awarded to the winner where the rules of the competition provide that the resulting services must be awarded to one or the other of the winners of the design contest. The resulting services must be a 'direct functional link' between the contest and the contract concerned, and therefore a mere connection in terms of the subject matter of the contract does not suffice. Furthermore, this provision applies only where the rules of the competition specify that the resulting services *must* be awarded to one or the other of the winners of the design contest.

See module C4 for further information on such contests.

2.7 MIXED CONTRACTS

The Directives contain provisions on how to categorise a contract containing elements of works and/or supplies and/or services.

The distinctions are relevant in the case of mixed supplies and services contracts, notably where the services included are non-priority services. If the contract can be categorised as a non-priority services contract, then it would remain largely unregulated, even if it also contained supplies.

It is an issue also in the case of works contracts that contain elements of supplies or services, given the much higher thresholds that apply to works contracts. The way in which mixed contracts are categorised depends on the mix.

2.7.1 Supplies/services

Essentially, contracts containing elements of both supplies and services will be treated as one or the other type of contract depending on the value represented by each element.

The contract will be considered to be a services contract where the value of the services performed is greater than the value of the products supplied. Where the value is equal, it will be considered as a supplies contract.

The definition makes no distinction between priority and non-priority services, with the effect that, where the value of non-priority services in a mixed contract is greater than the value of supplies, the whole contract will be treated as a contract for non-priority services.

Supplies contracts that also cover, as an incidental matter, siting and installation operations, will be defined as supplies contracts.

2.7.2 Works/services

In the case of works and services, the Directives do not provide for a value test, as above, but include a test based on the principal object of the contract, as opposed to considerations that are merely incidental to that object.

A contract having as its object services (either priority or non-priority) and including activities within the definition of 'works' that are only incidental to the principal object of the contract is to be considered to be a service contract.

The 'principal object' test is clearly inspired by the decision of the ECJ in the *Gestión Hotelera* case, as discussed below.

Case note:

The case concerned two invitations to tender, one in respect of the installation and opening of a casino, the other in respect of the operation of a hotel. The contracting authority intended to arrange for the installation of a casino in the premises of a hotel owned by the municipality. It wanted, however, to award the contract to the company that, following competitive selection, would assume responsibility for the operation of the hotel business. Despite the works component, it was clear for the ECJ that the main object of the award of the contract was, first, the installation and opening of a casino and, secondly, the operation of a hotel business. Those objects constituted services concessions and thus were outside the scope of the Directives.

(Case 331/92 *Gestión Hotelera* [1994] ECR I-1329)

2.7.3 Works/supplies

Under the Directives, supplies contracts that also cover, as an incidental matter, siting and installation operations, are defined as supplies contracts. For example, in the case of the purchase of a crane to be installed on a dockside, the object of the contract is the *supply* of the crane and not the works required to site it, even if those works are considerable.

This 'principal object' test, which mirrors the way in which works and services contracts are to be distinguished, would appear to apply even if the value of siting or installation services is greater than the value of the supplies itself, since it is a test based on the object of the contract and not the value-based test applied to distinguish between supplies and services.

SECTION 3
EXERCISES

EXERCISE 1A
CLASS CASE STUDY

These are the original facts from the Class Case Study (Exercise 1) for module D1:

Arcadia municipality decides it wants to develop a business and commercial zone on an attractive plot of land at the edge of town which it is calling Evergreen Park. It is considering setting up a non-profit organisation in the form of a private company, Apple Inc., in which it would own the majority of the shares to undertake the development in the hope that this will reduce the administrative burden of creating Evergreen Park. A neighbouring municipality, Eden Town, which has experience in such developments decides that, when the arrangements are in place for the development, it would itself like to bid for the contract to design the overall architectural scheme and undertake the general planning of Evergreen Park. Eden Town does not, however, have in-house capability for the landscaping requirements of the Park. Having used them in the past, Eden Town decides that, before bidding for the contract, it should make sure that it can rely on the services of Greenfingers, a private landscaping company. It therefore enters into a contract with Greenfingers to supply the required landscaping services when and only if Eden Town wins the design contract.

Additional facts for this exercise are as follows:

The land on which Evergreen Park is to be built is owned by Monolith, a private developer who had previously begun a similar project but ran out of money. There are some buildings and amenities on the land but it is mostly an evergreen site. It tells Arcadia that it will only sell the land if it is given the construction contracts for the development.

Question: Since Arcadia has no option but to give the construction contracts to Monolith, does that mean that it can avoid the procurement rules?

EXERCISE 1B
CASE STUDY

These are the original facts from the Individual Case Study (Exercise 2) for module D1:

Until now, the municipality of Cleverton has provided municipal waste disposal services by way of an autonomous service unit of the municipality called the Cleanup Team. Although not set up formally as a company, the Cleanup Team operated as if it were an independent company, despite the fact that its management was governed by rules put in place by Cleverton and that traditionally all its funding came from the treasury department of Cleverton. Indeed, the Cleanup Team believed it was just like a company and would also provide services to private sector clients and other municipalities in return for payment. By its 2008 year-end, it transpired that its receipts from these latter services accounted for 51% of all the income it received for that year (roughly EUR 3 million), an increase of more than 20% over the previous year. This was expected to increase further in 2009.

Having seen the projected financial results, Cleverton believed that it should put the Cleanup Team on a more proper financial footing, and decided to create a limited liability company to take over its functions. It created Cleanup Limited, a wholly owned subsidiary, on 5 November 2008 and signed with it, on 10 November, a contract for the supply of municipal waste disposal services for 2009, to begin on 1 January 2009. The value of these services was in the order of EUR 1.5 million.

On 25 November 2008, the central government introduced much stricter and more sophisticated environmental regulations that would apply to the transport and disposal of municipal waste. The Cleanup Team had previously contracted out its routine environmental compliance work to a private sector company, Opportune Limited. In 2008, the value of this work had been about EUR 150 000. Realising that it did not have the expertise to meet these new regulations, the management of Cleanup Limited approached Opportune Limited directly to provide the services without following the procurement Directives.

Additional facts for this exercise are as follows:

Rather than risk simply selling its know-how in this new area, however, Opportune Limited offered to enter into partnership with Cleanup Limited, which would protect its know-how. As a result, it agreed to provide ongoing environmental services to Cleanup Limited at the going market rate (of approximately EUR 300 000 per annum), but in return for a 10% stake in Cleanup Limited. The transfer of shares took place in the middle of December 2008 and the contracts were in place by 30 December 2008.

Question: Superclean also believes that Cleverton should not have given a contract to Cleanup Limited without following the provisions of the procurement Directives. How do you respond?

Note: You have enough information to answer this question from the general principles. However, you might want to consider a further case: C-29/04 *Commission of the European Communities v Republic of Austria ("Mödling")* [2005] ECR I-9705.

EXERCISE 2
MIXING AND MATCHING

Provide 1 example each of practical situations where you would find a mix of:

- supplies and services
- works and supplies
- works and services

1. Explain why these components are mixed.
2. Consider whether they could be separated, and why.
3. Devise procurement plans that will, legitimately,

    (i) maximise and

    (ii) minimise

    application of the Directives.

EXERCISE 3
GROUP DISCUSSION ON COMPETITION IN NON-PRIORITY SERVICES

Split into groups of about 6 for a debate on the question of whether competition for non-priority services is possible and/or desirable at a national level.

One group will take the position it is possible and/or desirable.

The other group will take the position it is not possible and/or desirable.

Issues to be addressed include (but are not limited to):

- the objective of the Directives is to foster interstate trade
- the nature of some services is amenable to competition across borders
- competitive procurement is beneficial even if international competition is unlikely
- the effect of procurement taking place in border areas

In considering the issues, take the example of

- legal services
- hotel and catering services
- vocational training
- security services

Each group is to present their arguments and conclusions in turn. A vote is to be taken at the end.

SECTION 4
CHAPTER SUMMARY

SELF-TEST QUESTIONS

1. Are oral contracts covered by the Directives? Explain what principles apply.
2. Who are the parties to a public contract?
3. Can a public sector authority be a party?
4. Can a company owned by public sector authority be a party?
5. What is the test that applies when a public authority wishes to contract with a company it owns without following the procurement rules?
6. Does an extension to a contract have any effect on the application of the procurement rules?
7. If a contracting authority wants to provide for a renewal on the basis of good performance, is there anything that should be done when awarding the original contract to make that easier?
8. Explain how the European Court of Justice (ECJ) would look at a contract variation under the procurement rules.
9. Are concessions covered by the Directive?
10. Explain the fundamental difficulty of dealing with framework "arrangements" under the procurement rules. How do the Directives deal with this difficulty?
11. Describe a works contract.
12. What is the significance of the phrase "the realisation, by whatever means, of a work corresponding to the requirements specified by the contracting authority"?
13. What are the problems associated with urban regeneration projects? How does the ECJ deal with them?
14. In the case of public works concessions, does the Directive apply only to the award of the concession?
15. What rules apply?
16. Describe supply contracts.
17. Describe services contracts.
18. What is the significance of the separation of services into priority and non-priority services?
19. Does the categorisation of non-priority services mean that competition is never possible for such services?
20. What rules apply when a services contract includes both priority and non-priority services?
21. What are mixed contracts?
22. How do you classify a mixed supplies/services contract?
23. How do you classify a mixed works/services contract?
24. How do you classify a mixed works/supplies contract?

Public procurement law – scope of application

MODULE D

Exemptions

PART 4

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SECTION 1 INTRODUCTION

1.1 OBJECTIVES

The objectives of this chapter are to explore, explain and understand:

1. Which contracts are not covered by the procurement rules
2. Why some contracts are exempted and others not
3. The mechanisms for determining when contracts are exempted
4. The connection between the exemption and type of contract at issue
5. How exemptions will be interpreted by the European Court of Justic

1.2 IMPORTANT ISSUES

The most important issues in this chapter are understanding:

- The reasons for exclusion
- The scope and extent of the exclusions
- The specific nature of the exclusions

This means that it is critical to understand fully:

- The primary purposes of the procurement rules that underpin the inclusion and/or exclusion of contracts
- The limits of exclusion
- The effects of particular exclusions

1.3 LINKS

There is a particularly strong link between this chapter and the following modules or sections:

- Modules D1 and D2 on the internal structure of the contracting entities
- Module D3 on contracts that are covered by the rules
- Module E – all parts, on procedures that apply to the various contract types

1.4. RELEVANCE

This information will be of particular relevance (i) at a strategic level, where decisions as to the type of contract to be employed may be used to affect the type of contract and, therefore, type of procedure that is appropriate; and (ii) at the operational level, where the type of contract at issue will determine the applicable thresholds, possible exemptions, and types of procurement methods to be used.

1.5 LEGAL INFORMATION HELPFUL TO HAVE TO HAND

In addition to the provisions of the Directives, it may also be useful to have at hand:

- [Localise: the provisions of national law relating to exemptions;
- If applicable, reference to any national law that applies to defence procurement]

Further, reference should be made to **Directive 2009/81** on the co-ordination of procedures for the award of certain public works contracts, public supply contracts, and public service contracts in the fields of defence and security

SECTION 2 NARRATIVE

2.1 INTRODUCTION

Even where contracts fall within the general definition of a public contract, some of these contracts will be excluded from the scope of the Directives for a number of reasons. Some are excluded because they are not, by their nature, amenable to competition. Some are excluded because governments wish to exclude them from competition for specific reasons. Some of the exclusions apply only to contracts of a specific type. There is also a category of 'reserved' contracts that, although not excluded, do benefit from preferential treatment.

In addition, article 12 of the Public Sector Directive provides an exemption for those public contracts that are otherwise covered by the Utilities Directive or for public contracts that, although covered by the Utilities Directive in principle, are exempt from the provisions of that directive. Contracts specifically excluded in the utilities sector will be discussed separately.

General note

As exemptions from the normal rules of the Directives, any exemption will be interpreted strictly by the European Court of Justice (ECJ).

(Cases C-20/01 and C-28/01 *Commission v Germany* [2003] ECR I-3609)

2.2 EXEMPTIONS BY REASON OF CHOICE

This section concerns procurement of a military nature, procurement requiring secrecy, and procurement that, by agreement, is subject to different procurement rules. All three types of exemption concern the Public Sector Directive.

2.2.1 Defence procurement

Defence procurement has not been entirely exempt from the procurement rules since they were introduced, but the public sector directives have always provided for a partial exemption for this kind of procurement. However, it was not and still is not the identity of the contracting authority that determines whether or not procurement is to be exempt from the procurement rules. Thus, the exemption is not given because it is the Ministry of Defence carrying out the procurement; the exemption applies only to the subject matter of the procurement, *i.e.* to products that are of a military nature.

Until 2009, certain military products were explicitly exempt from the provisions of the Public Sector Directive and were not subject to any alternative provisions. Since 2009, however, those exempt products and related services are now covered by Directive 2009/81, which applies a more flexible and confidential regime to the procurement of military supplies and related works and services (although EU Member States have until August 2011 to transpose this directive).

Important note

The procurement of certain military supplies and related works and services is now covered by Directive 2009/81. All other public contracts awarded in the fields of defence and security remain covered by the Public Sector Directive.

Directive 2009/81 amended the Public Sector Directive to the effect that the Directive now applies to "public contracts awarded in the fields of defence and security with the exception of contracts to which Directive 2009/81/EC applies". This amendment did not change, however, the substance of the exemption. Directive 2009/81 applies essentially the same definitions to the contracts that are exempt from the Public Sector Directive. It merely provides an alternative procurement regime so that the procurement of such products is no longer entirely excluded from the scope of Community procurement rules and principles.

Whilst the provision of security devices and equipment, such as weaponry and surveillance equipment, is more clearly susceptible to exclusion on the basis of security arguments, many supplies are less easily excluded on the same basis. The supply of uniforms, pharmaceuticals and medical equipment are examples of purchases that may not be so easily justified, although there may be particular instances where, even for such purchases, security is an issue.

The exemption thus applies (and Directive 2009/81 now applies) to contracts awarded by contracting authorities in the field of defence where the products to be supplied are subject to the provisions of article 296(1)(b) (formerly article 223(l)(b)) of the Treaty.

According to that article, a member state may take such measures as it considers necessary for the protection of the essential interests of its security, which are connected with the production of or trade in arms, munitions and war materials. The article is subject to the condition that the measures do not adversely affect the conditions of competition in the common market regarding products that are not intended for specifically military purposes.

This article makes a clear distinction between purely military equipment and equipment that, although used in the context of defence, is not specifically 'military', such as dual-use products (*i.e.* products that may have both civil and defence applications, *e.g.* computers, clothing, blankets, food and medicine).

The provision does not apply to works or services, although it probably applies to such activities as repair and maintenance services *connected with* the procurement in question, and only to those products that are specifically subject to article 296(1)(b).

A list of such products was included in a Council Decision of 15 April 1958, which was not published but is readily available. Whilst Directive 2009/81 also makes explicit reference to this list, it also does not reproduce the list. Products that appear on the list but are nevertheless not intended for specifically military purposes and all other products not covered by the list are subject to the procurement rules.

European Court of Justice:

"It is for the member state which seeks to rely on those exceptions to furnish evidence that the exemptions in question do not go beyond the limits of such cases."

(C-414/97 *Commission v Spain* [1999] ECR I-5585)

Unlike the Directives, the Government Procurement Agreement (GPA) of the World Trade Organisation (WTO) generally exempts purchases of military equipment by defence departments or ministries, except in the case of specified 'dual-use' products listed in the relevant annexes (reproduced in Annex V of the Directive). All products not specifically listed are exempt, and this exemption continues to apply under Directive 2009/81.

In addition, article XXIII of the GPA states that the agreement does not prevent a party from "taking any action or not disclosing any information which it considers necessary for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement *indispensable for national security* or for national defence purposes" [emphasis added]. This provision may also be relied upon under Directive 2009/81.

In terms of compliance with GPA obligations of European central government authorities, the dual-use items referred to in Annex V of the Directive are subject to procurement under the terms of the Directive, subject to the application of the exemption.

Directive 2009/81 extends the exemption of both that Directive and the Public Sector Directive to contracts awarded in a third country, with local economic operators, for the deployment of military forces or for the conduct of or support to a military operation outside the territory of the European Union.

2.2.2 Contracts requiring secrecy measures

The Directives do not apply to public contracts (i) that are declared secret, or (ii) the execution of which must be accompanied by special security measures in accordance with the laws, regulations or administrative provisions in force in the member state concerned, or (iii) when the protection of the essential interests of that state's security so requires.

2.2.3 Contracts governed by other rules

The Directives does not apply to contracts that are governed by different procedural rules and awarded:

- pursuant to an international agreement concluded in conformity with the EEC Treaty between a member state and one or more third countries and covering works, supplies or services intended for the joint implementation or exploitation of a project by the signatory states;
- to undertakings in a member state or a third country in pursuance of an international agreement relating to the stationing of troops;
- pursuant to the particular procedure of an international organisation.

The last provision refers to organisations in which states are members. It would include, for example, organisations such as the United Nations, European Bank for Reconstruction and Development, or World Bank. The World Bank, in particular, provides grants and credits to various countries for the procurement of works, goods and services. The procurement of these items is generally subject to the World Bank's own procurement guidelines, except where the national procurement systems are considered to be equivalent and, therefore, acceptable. Many of the new EU Member States have benefited from World Bank assistance and may still be beneficiaries of World Bank financing. To the extent, therefore, that the World Bank continues to impose its own guidelines, this provision will provide the requisite exemption from the Directives.

See module A3 for further information on procedures of international organisations, such as the World Bank.

In the case of defence procurement, the public contracts otherwise subject to Directive 2009/81 now benefit from this exemption by virtue of article 8 of that Directive.

2.3 EXEMPTIONS DUE TO THE NATURE OF THE CONTRACT

2.3.1 Contracts for the acquisition of land

The Directives exclude contracts for the acquisition or rental, by whatever financial means, of land, existing buildings or other immovable property, or for the acquisition of rights thereon.

These contracts are excluded because they relate to immovable property, which is naturally dependent on the geographic location. Such contracts take place essentially in local markets and their objects generally rule out any real prospect for cross-frontier competition. The exclusion applies only to contracts concerning the purchase of land or buildings, however.

General note

In practice, this exemption often becomes relevant in cases of urban regeneration, where the public and private sectors are jointly executing development projects that contain public elements. This issue is described in more detail in module D3.

Financial services contracts concluded at the same time as, before or after the contract of acquisition or rental, in whatever form, are subject to the Directive. The Directive also covers any other associated services, such as contracts for the sale of land or property on a fee basis (estate agency contracts) to which the priority service category 14 applies.

In the case of defence procurement, the public contracts otherwise subject to Directive 2009/81 now benefit from this exemption by virtue of article 9(a) of that directive.

2.3.2 Exclusions relating specifically to services

These exclusions apply to specific circumstances, based on the award of exclusive rights to certain authorities to carry out certain services as well as on the nature of a number of specified services.

- **Services contracts provided on the basis of exclusive rights**

  The Directives do not apply to services contracts awarded to contracting authorities or to an association of contracting authorities on the basis of an exclusive right, which they enjoy pursuant to a published law, regulation or administrative provision that is compatible with the Treaty. This exclusion does not apply to those situations in which the contracting authority provides the service in-house (effectively to itself) since, in those cases, there is no contract (see module D3).

  Rather, the exclusion covers situations where the right to provide a service to a contracting authority is granted exclusively to another contracting authority. Thus there is no competition at all from private service-providers, either from within the member state itself or from other member states. Since such services may be provided in return for remuneration and on the basis of an agreement between the contracting authorities concerned, they would be contractual arrangements falling within the terms of the Directives, were it not for this explicit exemption.

The exclusion depends on the granting of an exclusive right, pursuant to a published law, regulation or administrative provision that is compatible with the Treaty. It applies to an ongoing provision of services that has been reserved to a specific public authority. Examples might be public auditing authorities, which other contracting authorities are obliged to employ to conduct audits of their activities, or public inspection authorities, which provide technical inspection services of works acquired by contracting authorities.

- **Broadcasting material and time**

The Public Sector Directive (it is not relevant in the utilities sector) excludes contracts for the acquisition, development, production or co-production of programme material by broadcasters as well as contracts for broadcasting time. This covers the production of audio-visual works, such as films, videos and sound recording, including for advertising purposes, and the purchase of services for the purchase, development, production or co-production of off-the-shelf programmes as well as other preparatory services, such as those relating to the preparation of scripts or to artistic performances necessary for the production of programmes.

The exemption also covers broadcasting time (transmission by air, satellite or cable, now defined as any transmission and distribution using a form of electronic network). In principle, the contracting-out of audio-visual production, for example for information, training or advertising purposes, would be covered, but it is granted an exemption insofar as it is connected with the broadcasting activities of broadcasting organisations that are public authorities.

The exemption is justified on the grounds of the cultural and social significance of programming material, so that national broadcasters remain free to procure programme material from whomever they wish and according to the procedures of their choice. The exclusion does not apply to the supply of technical equipment necessary for the production, co-production and broadcasting of such programmes.

The provision of broadcasting time is also, in principle, covered by the Directives, but it is again excluded from the scope of the Public Sector Directive since the need to obtain broadcasting may have implications in respect of public security or health protection. Broadcast information on crime prevention and detection, traffic conditions, civil emergencies and communicable diseases, for example, may need to be disseminated as widely and as quickly as possible. Given the nature of these examples, there may be no contractual basis at all for the use of broadcasting time, which is likely to be provided on the basis of the exercise of the member state's official authority.

- **Arbitration and conciliation services**

The recitals of the Directives state that it is inappropriate to include the procurement of contracts for arbitration and conciliation services in the Directives because competitive bidding for such services would interfere with the joint selection of arbitrators and conciliators by the parties to a dispute. These parties would, in any event, want to select arbitrators and conciliators on the basis of their competence and experience and within relatively short time frames.

- **Certain financial services**

The Directives exclude contracts for financial services in connection with the issue, sale, purchase or transfer of securities or other financial instruments and in connection with central bank services. This exclusion refers to contracts that constitute transactions concerning government bonds, for example, and activities related to public debt management.

Also included in the derogation are contracts awarded to financial intermediaries to arrange the above financial transactions, as these services are specifically excluded from the scope of investment services (category 6 of the list of priority services – see module D3 for an explanation of priority and non-priority services). The exclusion is based on the fact that such services are closely connected with national monetary policies, tend to be heavily regulated, and are generally reserved to a small number of qualified and registered undertakings. Transactions are also carried out within very short time-limits.

- **Employment contracts**

Whilst the Community protects those persons in employment relationships and guarantees the right of Community citizens to move freely throughout the Community for the purposes of taking up employment and establishing themselves, such relationships do not fall within the scope of the procurement rules.

Even if employees may be recruited from all over the Community, the employment market is generally a localised one and subject to local conditions of employment, taxation and social regimes. These relationships are usually permanent (full or part-time) relationships, even if they are entered into for short periods of time.

These relationships are not entered into for the purposes of trade. The Directives are concerned with cross-border trade and thus with the freedom of individuals and companies to provide services throughout the Community and, where appropriate, to establish themselves in other member states, with a view to providing services to purchasers in those member states.

- **Research and development contracts**

The Directives exclude research and development service contracts other than those where the benefits accrue exclusively to the contracting authority for its use in the conduct of its own affairs, on condition that the service provided is mainly remunerated by the contracting authority.

This provision is intended, essentially, to exclude from the procurement procedures research and development contracts of an altruistic nature, which are for the benefit of society as a whole. The exclusion would not apply, on the other hand, where the benefits accrued to the contractors themselves. To avoid an interpretation that would lead to abuse of this provision, the European Council and the European Commission adopted, in the context of the former Services Directive, an interpretative declaration, stating that *any* fictitious sharing of the results of research and development or any symbolic participation in the remuneration of the service provided would not prevent the application of the Directive.

The negotiated procedure may be used with prior publication of a contract notice in respect of works that are performed solely for the purpose of research, testing or development and not with the aim of ensuring profitability or recovering research and development costs. The negotiated procedure without publication of a contract notice may be used in respect of supply contracts when the products involved are manufactured solely for the purpose of research, experimentation, study or development. See module C4 for further information on the availability and use of these procedures.

This provision does not extend to quantity production so as to establish commercial viability or recover research and development costs.

2.4 RESERVED CONTRACTS

The Directives introduced a new category of 'reserved' contracts, which are not excluded from the scope of the Directive but are subject to specific conditions of eligibility being imposed on the participants.

EU Member States may reserve the right to participate in public contract award procedures concerning sheltered workshops or may provide for such contracts to be performed in the context of sheltered employment programmes, where most of the employees concerned are handicapped persons who, by reason of the nature or seriousness of their disabilities, cannot carry on occupations under normal conditions. For further details, see module C5.

UTILITIES

Exemptions specific to the utilities sector

The Utilities Directive provides for sector-specific exemptions in a number of utility sectors, based essentially on the degree of competition in these markets. Such exemptions apply in respect of the purchase of fuel and energy for the production of energy; purchases of water; bus transport services; and upstream oil and gas exploration and exploitation. The Utilities Directive has also introduced a new general exemption mechanism for activities exposed to competition in markets to which access is not restricted. These exemptions are discussed in module D2.

The Utilities Directive also contains a series of other exemptions specific to the utilities sector:

- **Activities outside the Community**

  The Directive does not apply to contracts awarded by contracting entities for purposes other than the pursuit of their relevant activities, or the pursuit of such activities in a third country, in conditions that do not involve the physical use of a network or geographical area within the Community.

  The contracting entities must notify the Commission, at its request, of any activities that they consider to be excluded under this provision. The Commission may periodically publish, for information purposes, lists of the categories of activities that it considers to be covered by this exclusion, and it will respect any sensitive commercial aspects that the contracting entities may point out when forwarding this information.

- **Affiliated undertakings exemption**

Where 'undertakings' are made up of a number of mutually owned or mutually dependant companies, the Utilities Directive provides for a specific exemption for purchases made between these companies under certain conditions. These purchases are treated as 'in-house' contracts, known as intra-group transactions. Since the amendment to the Utilities Directive in 2004, the exemption now covers works and supplies contracts in addition to services contracts.

The contracts excluded are those that have been awarded to affiliates, whose essential purpose is to act as central service-providers to the group to which they belong, rather than selling their services commercially on the open market.

The Utilities Directive excludes two categories of contracts. These contracts are awarded:

- by a contracting entity to an affiliated undertaking; or
- by a joint venture, formed exclusively by a number of contracting entities for the purpose of carrying out relevant activities, with [one of those contracting entities] or with an undertaking that is affiliated to one of these contracting entities.

  This provision relates, for example, to the provision of common services, such as accounting, recruitment and management; the provision of specialised services embodying the know-how of the group; and the provision of a specialised service to a joint venture.

The exclusion from the provisions of the Utilities Directive is subject, however, to two conditions:

(i) *the economic operator must be an undertaking affiliated to the contracting entity:* an affiliated undertaking, for the purposes of article 23(1) of the Utilities Directive, is one in which the annual accounts are consolidated with those of the contracting entity, in accordance with the requirements of the seventh company law Directive. In the case of contracting entities not subject to that Directive, an affiliated undertaking is any undertaking over which the contracting entity may exercise, directly or indirectly, a dominant influence, in the same way as a public authority may exercise a dominant influence over a public undertaking. This will also be the position where it is the undertaking exercising a dominant influence over the contracting authority or where both the undertaking and the contracting entity are subject to the dominant influence of a third undertaking.

(ii) *the economic operator must exist essentially to provide services to the group and not to sell them on the open market:* since a number of such economic operators do, in fact, have their own marginal commercial activities, the Directive lays down criteria according to which the acceptability of such commercial activities may be gauged. The exclusion only applies if at least 80% of the average turnover of the affiliated undertaking achieved within the Community for the preceding three years has been derived from the provision of works, supplies or services to undertakings with which it is affiliated.

The 'average turnover' relates to that turnover resulting from the works, supplies or services provided and not from the general or total turnover of the undertaking. Where more than one undertaking affiliated to the contracting entity provides the same or similar services, supplies or works, the above percentages are calculated by taking into account the total turnover derived respectively from the provision of services, supplies or works by those affiliated undertakings.

The Commission is empowered by article 23(5) to monitor the application of this article and to require the notification of certain information:

- names of the undertakings or joint venture concerned;
- nature and value of the contracts involved;
- such proof as may be deemed necessary by the Commission that the relationship between the undertaking(s) or joint venture to which the contracts are awarded and the contracting entity meet the required conditions of the exemption.

- **Purchases for re-sale or hire**

The Directive excludes from its scope of application any contracts that have been awarded for purposes of re-sale or hire to third parties. This exclusion is intended to include contracts for goods where the contracting entity intends to sell or hire the equipment purchased in a competitive market.

These contracts will only be excluded if the contracting entity enjoys no special or exclusive right to sell or hire the subject of such contracts and if other entities are free to sell or hire the same goods under the same conditions as the contracting entity.

The contracting entities must inform the Commission, at its request, of the categories of products that they regard as excluded under this provision. The Commission may also periodically publish lists of the categories of activities that it regards as excluded by this provision whilst respecting any sensitive commercial aspects that the contracting entities may point out when forwarding the information.

SECTION 3
EXERCISES

EXERCISE 1
INDIVIDUAL CASE STUDY ON DEFENCE PROCUREMENT

You are the procurement officer for the Ministry of Defence. You have been asked by your commanding officer to purchase a number of items. Explaining your reasons, which rules and which procurement procedures would you use for the purchase of the following items (or which questions would you ask to determine the outcome):

1. Blankets
2. Uniforms
3. Radar equipment
4. Guns and ammunition for general use
5. Guns and ammunition for use by your soldiers in Afghanistan
6. Guns and ammunition for use in joint operations with the United States in Iraq
7. Guns and ammunition for use in joint operations with NATO forces of which you form part
8. Repair and maintenance services for your transport vehicles
9. Repair and maintenance services for your combat vehicles
10. Construction of new storage facilities at your bases in Europe
11. Construction of secure munitions storage facilities at your bases in Europe
12. Purchase of housing estate to house your soldiers at their base

EXERCISE 2
CLASS CASE STUDY

Look once more at the case study referred to in Exercise 1 of module D3.

Explain how the exemption of contracts for the acquisition of land and existing buildings might affect the outcome of this case study.

EXERCISE 3
GROUP DISCUSSION ON RESERVED CONTRACTS

Split into groups of no more than 6 for a debate on the question of reserved contracts.

Half of the groups will take the position that use of reserved contracts applies positive discrimination in a way that distorts the primary purposes of the Directives.

The other half will take the position that use of reserved contracts is a legitimate secondary objective that can be achieved while maintaining the integrity of the Directives.

Issues to be addressed include (but are not limited to):

- what are the secondary objectives sought
- whether the pursuit of such objectives have an economic impact
- whether this implies a trade-off between the economic goals of the Directives and pursuit of the secondary objective
- whether this is relevant to the procurement rules
- what other similar objectives might be contained in the Directives that have a similar effect
- whether this is a political objective
- whether national policies with similar objectives can also be pursued by procurement legislation

Each group is to present their arguments and conclusions in turn. A vote is to be taken at the end.

SECTION 4
CHAPTER SUMMARY

SELF-TEST QUESTIONS

1. Provide three reasons to explain why some contracts are excluded from the scope of the Directives.
2. How does the European Court of Justice interpret exclusions?
3. Why do you think defence purchases have always been excluded?
4. Explain what difference of approach took place in 2009.
5. Does the defence procurement exclusion apply automatically to contracting authorities of a military nature?
6. What is the difference between defence procurement and secret procurement?
7. What is meant by the phrase "governed by different procedural rules"?
8. Why are contracts related to the acquisition of land excluded?
9. Why are contracts of employment excluded?
10. Why are conciliation and arbitration services excluded?
11. Explain the treatment of research and development contracts, *i.e.* when are they excluded and when are they not excluded?
12. List the contracts excluded in the utilities sector.
13. What are affiliated undertakings and why are contracts with such undertakings excluded?
14. What are the conditions that apply to the affiliated undertakings exemption?
15. Give an example of a product that a utility might purchase for resale or hire.
16. What are "reserved" contracts?
17. Are reserved contracts excluded from the scope of the Directives?

MODULE D

PART 5

Thresholds

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SECTION 1 INTRODUCTION

1.1 OBJECTIVES

The objectives of this chapter are to explore, explain and understand:

1. How and why EU financial thresholds are set
2. What the EU financial thresholds are
3. How the EU financial thresholds are calculated

The focus of this module is on understanding the EU financial thresholds rather than national financial thresholds for lower-value contracts (*i.e.* those contracts below the EU financial thresholds). Please see the comment in Section 2 of this module on low-value contracts below the EU financial thresholds.

In this module, references to "thresholds" and "financial thresholds" are to the EU financial thresholds unless otherwise specified.

1.2 IMPORTANT ISSUES

The most important issues in this chapter are understanding:

- That the financial thresholds differ according to both 1) the type of authority awarding the contract and 2) the type of contract to be awarded
- The starting assumption for the calculation of thresholds is to include all payments (financial and non-financial) for the maximum potential period of the contract
- That the method for calculation of thresholds is constructed to prevent contracting authorities from splitting contracts or requirements in an effort to avoid application of the Directive

This means that it is critical to understand fully:

- What the financial thresholds are
- The different types of contracting authority, the different types of contract (see module D3), and how those factors combine for the purpose of calculating thresholds
- The basic principles applying to the calculation of thresholds
- The detailed rules applying to the calculation of thresholds, particularly for repeat purchases and purchases of a similar type

If this is not properly understood, you may select the wrong threshold and so fail to award a contract in accordance with the requirement of the Directive.

1.3 LINKS

There is a particularly strong link between this chapter and the following modules or sections:

- Module D1 on contracting authorities
- Module D3 on contracts covered
- Module E2 on advertisement of contract noticesr

1.4 RELEVANCE

This information will be of particular relevance to those procurement professionals who are responsible for procurement planning and involved in the preparation of contract notices.

It will also be of particular relevance to those persons who, within the line management of a contracting authority, have the responsibilities and decision-making powers, including delegation powers, with regard to procurement (*e.g.* to decide on the packaging of the procurement).

1.5 LEGAL INFORMATION HELPFUL TO HAVE TO HAND

Adapt for local use

The legal requirements relating to thresholds are set out in **Directive 2004/18/EC** at Chapter 1, articles 7 to 9:

- Article 7
  - confirms that the Directive applies to contracts that are of a value equal to or greater than the specified thresholds
  - states that the value is calculated exclusive of VAT
  - specifies different threshold levels for different types of contracting authority and for different types of contracts
- Article 8 contains provisions relating to the application of financial thresholds for contracts that are subsidised by contracting authorities at a level in excess of 50%
- Article 9 sets out the methods for calculating the estimated value of public contracts, framework agreements and dynamic purchasing systems

Commission Regulations are also published regularly to amend the Directive to update the financial threshold levels each time that they change (see Narrative section). See, for example, Commission Regulation (EC) No. 1422/2007, which entered into force on 1 January 2008.

Utilities

A short note on the key similarities and differences applying to utilities is set out at the end of Section 2 of this module.

SECTION 2 NARRATIVE

Note: Except where specified otherwise, the narrative in this module D5 discusses the rules applying to contracts that are of a certain type and value, which means that they are subject to the full application of Directive 2004/18/EC ('the Directive'), and the term 'contract' should be interpreted accordingly. For commentary on contracts falling outside the application of the Directive or only partially covered by the Directive, see module D3. For low-value contracts under the EU thresholds, please see the comment box below.

2.1 INTRODUCTION

Adapt all of this section for local use – using relevant local legislation, references to local thresholds where relevant, processes and terminology.

The EC Treaty can affect all public procurement, however small, but the Directive only applies to contracts of a specified type and of a value that meets or exceeds the relevant EU financial threshold.

Module D3 explains the types of contracts that are covered (and not covered) by the Directive. This module D5 explains what the financial thresholds are and how the value of contracts is calculated in order to establish whether the financial thresholds are met.

Note

In this module, unless otherwise specified, the terms 'financial threshold' and 'threshold' refer to the EU financial thresholds and not to national financial thresholds, except to the extent that they match the EU financial thresholds.

In this module, where reference is made to 'sub-threshold' contracts, this means contracts that are below the EU financial thresholds.

See the comment below on sub-threshold contracts.

The EU financial thresholds are set with the aim of identifying contracts for which there is likely to be interest and competition from economic operators functioning across the borders of EU Member States (and economic operators in countries that are signatories to the Agreement on Government Procurement (GPA) of the World Trade Organisation (WTO), where the type of contract is covered by the GPA and where GPA thresholds are met – see module A3 for further information on the interaction between the GPA and EU procurement requirements).

The EU financial thresholds are also set so as to ensure that the administrative costs of applying a full EU tender procedure are justified as being proportionate to the value of the contract being advertised.

There are a number of financial thresholds; different thresholds apply to different types of contracting authorities and also to different types of contracts. Contracting authorities therefore need to understand which type of contracting authority they are and what they are purchasing.

The main aims of the provisions relating to the calculation of the value of the contracts are to ensure (1) that there is a genuine and transparent pre-estimate of the value of the contract to be awarded, and (2) that the contracting authority does not attempt to avoid the application of the Directive, for example by splitting a requirement or a contract into smaller sub-threshold packages or contracts.

There are some quite complex provisions governing the calculation of the value of contracts. These provisions are different for works contracts and supply and service contracts.

The provisions cover how the value of an individual contract is calculated and also how similar or repeated requirements are treated. These include provisions covering the situation where a contracting authority awards a number of contracts for a particular project or a number of contracts for similar supplies or services. The term often used to refer to the requirements involved when taking into account a number of contracts or a number of repeated or similar requirements is 'aggregation'.

There are also specific provisions covering the calculation of the value of framework agreements, dynamic purchasing systems, design contests, and works concession contracts.

Low-value contracts (sub-threshold contracts)

Adapt all of this section for local use – using relevant local legislation, local thresholds, processes and terminology. Briefly set out the requirements of the local legislation for sub-threshold contracts.

This module describes the requirements for calculating whether contracts are of a value that signifies that they must be advertised using a contract notice published in the *Official Journal of the European Union* (see module D3 for more information on the types of contract covered).

These requirements are therefore relevant for all contracts, even those that may appear to be below the EU financial thresholds, in order to establish whether or not the Directive applies.

It is particularly important to bear in mind the implications of the aggregation provisions. These provisions mean that, for example, a number of similar contracts, all of which are below the EU financial threshold, may still be subject to the Directive. This is because the total value of all of the contracts must be aggregated if certain conditions are met, and the total value may then exceed the EU financial threshold. The Directive will then apply to each of the contracts.

The Directive will then apply to each of the contracts.

Statistics demonstrate that the majority of contracts that are awarded by contracting authorities are not subject to the requirement to advertise in the *Official Journal of the European Union (OJEU)*. For example, they may be a type of contract that is not subject to those obligations or they are of low value and therefore do not meet the EU financial thresholds.

EU Member States have generally opted to introduce their own rules for sub-threshold contracts and other contracts that are not subject to the detailed procurement requirements of the Directive. Individual contracting authorities may also be permitted or required to publish and follow their own internal purchasing rules, which may include the introduction of additional national and/or local financial thresholds.

Amend/adapt to reflect national and local thresholds and the type of process required.

National and/or local financial thresholds may trigger different types of requirements in terms of advertising and tender processes. For example:

- Direct invitations, which may be allowed for very low-value contracts;
- Simplified procedures, such as competitive quotes or requests for proposals from a specified number of economic operators, or local advertising and a local competitive process for medium-value contracts that are below the EU threshold levels.

2.2 STATUTORY FINANCIAL THRESHOLDS

2.2.1 Setting the financial thresholds

The financial thresholds are listed in articles 7 and 8 and are expressed in euros (EUR). The financial thresholds are generally fixed for a period of two years and are amended every two years, with effect from 1 January. The amendments are made by means of European Commission Regulations. There are provisions allowing for the amendment of the financial thresholds at other times.

See the Additional Note below on the setting of thresholds for further information on why the thresholds are set every two years and then applied for a fixed period.

The current financial thresholds can be found on the Commission's website: www.simap.europa.eu. The table below, from the simap website, indicates all of the financial thresholds.

Insert screen grab of current threshold table on simap.europa.eu website.

Additional notes on setting of thresholds

Alignment with GPA thresholds: When the thresholds are set, usually every two years, they are re-aligned with the GPA threshold levels. The GPA thresholds are set using the GPA currency, which is called 'Special Drawing Rights' (SDR). The re-alignment involves rounding some of the EUR equivalents to the SDR up or down to the nearest EUR 1000. See modules A3 and D1 for information on the link between the GPA and the EU procurement regime.

EU Member States outside the euro zone: For EU Member States that are not in the euro zone, the thresholds are converted into the national currency at the time of publication of the new thresholds, which is usually every two years. The European Commission issues a Communication notice, published in the *OJEU*, which sets out the corresponding values of thresholds. The threshold is then fixed at that rate and does not change until the thresholds are next changed, which will normally be in two years. There is therefore no ongoing variation to reflect changes in currency exchange rates.

The following sections explain each of the thresholds in more detail.

2.2.2 General thresholds for works, supplies and services contracts

The table below shows the current general thresholds for work, supplies and services contracts (amounts shown are as at 1 January 2010 – they may need to be updated to reflect changed thresholds). These are not the only thresholds, but they are the thresholds that are most commonly referred to in practice, as they apply to the majority of types of contracts advertised by contracting authorities.

The table includes notes, which are explained below.

Type of contract (see note 2)	Type of contracting authority (see note 2)	
	Central government	Other authorities
Works	EUR 4 845 000	EUR 4 845 000
Supplies	EUR 125 000 (with some exceptions for defence purchasers – see note 3)	EUR 193 000 (and defence purchasers for certain supplies– see note 3)
Services (for nearly all priority services - see note 4)	EUR 125 000	EUR 193 000
Services (Non-priority and specified Part A services - see note 5)	EUR 193 000	EUR 193 000

Note 1:

Type of contracting authority: There are two types of contracting authority for the purposes of the financial thresholds.

Central Government: Contracting authorities that are classified as central government bodies are listed in Annex IV of the Directive.

The financial thresholds are generally lower for these central government bodies than for other contracting authorities. This is because the World Trade Organisation's Government Procurement Agreement (GPA), which is binding on EU Member States, applies lower thresholds to central government bodies that award contracts covered by the GPA. See module A3 for further information about the GPA and contracting authorities.

Other authorities: the 'other authorities' are contracting authorities as defined by the Directive that are not central government bodies listed in Annex IV. This category normally includes regional and local authorities.

Note 2:

Types of contract: The thresholds are different for works contracts and supplies and services contracts, as the thresholds are far higher for works contracts. This difference reflects the aim of ensuring that the administrative burden of a full EU process is proportionate to the contract and the need to identify contracts that will be of cross-border interest. The thresholds are referred to in articles 7(a) (b) and (c) of the Directive.

Note 3:

Supplies contracts in the defence sector: Where a central government body is operating in the field of defence and is purchasing supplies that are not listed in Annex V, then the higher supplies threshold applies. This is because these types of supplies are not subject to the GPA.

Where a central government body is operating in the field of defence and is purchasing supplies that are listed in Annex V, then the lower supplies threshold applies. This is because these types of supplies are subject to the GPA. See article 7(a) and (b).

Note 4:

Priority services – specified Annex II A services: The thresholds referred to in the table for service contracts apply to all services of a type listed in Annex II A ('priority services'). See module D3 for further information on priority and non-priority services.
For contracting authorities that are not central government bodies, the higher threshold applies to the award of priority services.

In the majority of cases, central government bodies will apply the lower threshold for the award of priority services (including contracts awarded for priority services as a result of design contests).

The higher threshold applies to the award by central government bodies of the following priority services (including contracts for the following services awarded as the result of design contests):

- Research and development services specified in Category 8 of priority services
- Telecommunications services in Category 5 of priority services as follows:
- Television and radio broadcasting services
- Interconnection services
- Integrated telecommunication services

Note 5:

Non-priority services: Module D3 explains that the Directive applies fully to priority services contracts but only partially to the types of services listed in Annex II B ('non-priority services').

The limited provisions relating to non-priority services (including services awarded as a result of design contests) are triggered by the higher threshold for both central government bodies and other contracting authorities. See article 7(b) of the Directive.

This higher threshold is due to the fact that these services are not covered by the GPA.

2.2.3 Works concession contracts, subsidised contracts, and contracts awarded by concessionaires (articles 7, 8 and 63)

The thresholds for works concession contracts, subsidised works contracts, and contracts awarded by works concessionaires are the same for central government bodies and other authorities. See modules C4 and D3 for further information on these types of contracts.

For subsidised services contracts, the higher threshold applies for both central government bodies and other authorities. See modules C4 and D3 for further information on subsidised services contracts.

Type of contract	Type of contracting authority	
	Central government	Other authorities
Works concession contracts, works contracts awarded by concessionaires and subsidised works contracts	EUR 4 845 000	EUR 4 845 000
Subsidised services contracts	EUR 193 000	EUR 193 000

2.2.4 INDICATIVE NOTICES/PRIOR INFORMATION NOTICES (ARTICLE 35)

A contracting authority may opt to publish indicative notices (also referred to as prior information notices) on an annual basis for supplies and services contracts and on a contract-specific basis for works contracts. Indicative notices/prior information notices are used to pre-warn economic operators of forthcoming opportunities. Where a contracting authority publishes an indicative notice/prior information notice sufficiently well in advance of the contract-specific contract notice, it can then take advantage of some reductions in statutory time scales for the submission of tenders.

See module E2 for further information on the publication and use of indicative notices/prior information notices and on reductions in statutory time scales.

The thresholds applying to the publication of indicative notices/prior information notices are shown below. In the case of works contracts, they are calculated on a contract-specific basis, using the rules in articles 7 and 9 of the Directive. In the case of supplies and services contracts, the thresholds are calculated by using the total estimated value of contracts of each type (services or supplies) to be awarded over the following 12 months.

Indicative notice/prior information notice		
Type of contract	Type of contracting authority	
	Central government	Other authorities
Works contracts	EUR 4 845 000	EUR 4 845 000
Supplies and services contracts	EUR 750 000	EUR 750 000

Summary tables of thresholds

Type of contract	Type of contracting authority (see note 2)	
	Central government	Other authorities
Works	EUR 4 845 000	EUR 4 845 000
Supplies	EUR 125 000 (with some exceptions for defence purchasers)	EUR 193 000 (and defence purchasers for certain supplies)
Services (for nearly all priority services - see note 4)	EUR 125 000	EUR 193 000
Services (Non-priority and specified Part A services - see note 5)	EUR 193 000	EUR 193 000
Works concession contracts, works contracts awarded by concessionaires and subsidised works contracts	EUR 4 845 000	EUR 4 845 000
Subsidised services contracts	EUR 193 000	EUR 193 000

Indicative notice/prior information notice

Indicative notice/prior information notice		
Type of contract	Type of contracting authority	
	Central government	Other authorities
Works contracts	EUR 4 845 000	EUR 4 845 000
Supplies and services contracts	EUR 750 000	EUR 750 000

2.3 CALCULATING THE FINANCIAL THRESHOLDS – BASIC PRINCIPLES (ARTICLE 9)

The methods for calculating the estimated value of public contracts, framework agreements and dynamic purchasing systems are set out in article 9 of the Directive.

There are a number of core principles that apply to the calculation of the estimated value of all contracts:

2.3.1 Total amount payable/total value

The calculation is based on the total amount payable or the total value of the contract. The assumption is that all financial and non-financial elements that may be paid will be included.

2.3.2 Calculation of the total amount payable includes third-party payments

The total amount payable is not limited to the total amount payable by the contracting authority.

When applicable, payments to be made by other contracting authorities, organisations and individuals also need to be included when calculating the estimated value of a contract.

2.3.3 Calculation of the total amount payable is not limited to just financial payments

Calculation of the total amount payable is not limited to just financial payments but also includes non-financial payments, such as part-exchange.

Example

A contracting authority awards a contract for the provision of lease vehicles. As part of the overall arrangement, the supplier will take any old vehicles owned by the contracting authority and dispose of them, with the supplier retaining the sale proceeds.

The value of the contract must be calculated to include the estimated sale proceeds of the old vehicles as well as any payments to be made by the contracting authority to the supplier.

In practice, where this occurs a supplier may offer lower lease payments for the new vehicles in order to take into account any sale proceeds from old vehicles.

2.3.4 Options and renewals

The estimated value of the contract must take into account the estimated total amount, including all options and renewals, even if those options or renewals are not subsequently exercised (article 9(1)).

Example

A local authority proposes to enter into a contract for architectural services for an initial period of three years, at an estimated value of EUR 50,000 per year. The local authority includes a provision in the contract allowing the contracting authority to renew the contract on expiry of the initial three-year period for up to two further 12-month periods. The total period of the contract could therefore be three, four or five years, at an estimated value of EUR 50,000 per year.

The local authority must take into account the maximum potential value of the contract, which is five years at EUR 50,000 per year. The total value of the contract is EUR 250,000 and therefore over the financial threshold for service contracts for local authorities, and so the Directive will apply.

2.3.5 Value-Added Tax Excluded

The estimated value of the contract is based on the total amount payable (or total value) excluding value-added tax (article 9(1) of the Directive).

2.3.6 Prizes and other payments

The estimated value of the contract must take into account the estimated total amount, including all prizes and other payments made to all candidates or tenderers (article 9(1)).

2.3.7 Timing

The estimate must be valid at the moment when the contract-specific contract notice is dispatched to the Office of the *Official Journal of the European Union (OJEU)* or, where such a notice is not required, at the moment when the contracting authority commences the contract award procedure (article 9(2)).

2.3.8 No sub-division to avoid application of the Directive

No works project or proposed purchase of supplies or services may be subdivided to prevent that project or purchase from entering into the scope of the Directive (article 9(3)).

Comment

Care does need to be taken about assumptions regarding the nature of payments to be made, as can be seen from the following case of the European Court of Justice (ECJ). In this case it was argued that a contract with a charitable organisation that had only been established for the reimbursement of costs was not a public contract for the purposes of the procurement directive in force at the time.

Case note: The nature of payments

The case of *Commission v Italy C119-06* concerned the award of framework contracts for the provision of health care-related transport services.

In 1999 the region of Tuscany and public health organisations in the region awarded a number of framework contracts to charitable (non-profit) organisations, including the Italian Red Cross, for the provision of health-related transport services. The contracts were for a combination of Annex A and Annex B transport services. The contracts were subsequently renewed for a period for four years (2004 to 2008).

The ECJ considered a number of issues, including an argument that, as the contracts only involved the direct reimbursement of costs, there had been no payment or consideration for the purposes of the procurement rules and therefore no public contract had been awarded.

The ECJ decided that, even though a contract may only involve the reimbursement of costs, this did not mean that it fell outside the application of the procurement directive. The obligations under the contract need to be considered as a whole, and the contract can still be regarded as a public contract for the purposes of the procurement directive even if the payment is merely for the reimbursement of costs.

Based on the facts of the case, the ECJ held that payments under the contract were not limited to the reimbursement of costs alone. The fixed payments under the contract meant that the providers were more than reimbursed for costs incurred.

2.4 CALCULATING THE FINANCIAL THRESHOLDS – RULES APPLYING TO SPECIFIC CONTRACTS AND CIRCUMSTANCES

2.4.1 Works contracts – works and related supplies must both be taken into account

When calculating the estimated value of a works contract, the contracting authority must take into account both the cost of the works plus the estimated value of the supplies necessary for executing the works that are placed at the economic operator's disposal by the contracting authority (article 9(4) of the Directive).

Example

A local authority intends to award a public works contract for the construction of a new office building. The estimated value of the works is EUR 4,500,000. The authority intends to provide EUR 1,000,000 worth of building materials for the economic operator to use on the project.

The total estimated value of the contract must take account of both the works and the estimated value of the related supplies made available by the contracting authority. The total value is therefore EUR 5,500,000, which means that the contract is over the works threshold and therefore the Directive will apply.

2.4.2 Contracts awarded at the same time in lots – works, supplies and services (Article 9 (5))

Works: Where there is a proposal for a particular work, which may result in a number of related works contracts being awarded at the same time for the particular project in the form of separate lots, then the estimated value, for the purposes of calculating the relevant financial thresholds, is the total value of all of the lots.

Supplies: Where a proposal for the acquisition of similar supplies may result in a number of supplies contracts being awarded at the same time in the form of separate lots, then account must be taken of the total estimated value of the lots for the purposes of calculating the relevant threshold.

Services: Where there is a proposal for the acquisition of similar services, which may result in a number of services contracts being awarded at the same time in the form of separate lots, then the estimated value, for the purposes of calculating the relevant financial thresholds, is the total value of all of the lots.

Where the aggregate (total) value of the lots is equal to or exceeds the relevant financial threshold, then the Directive applies to the award of each lot. This is the case even if some or all of the individual lots are under the relevant financial threshold.

Comment

In this context the term 'lots' is not limited to lots that are identified as lots by the contracting authority in the *OJEU* notice. The term includes separate contracts, which are not necessarily referred to as 'lots' in the contract notice but which are for similar types of purchases.

Case note

Case *C-412/04 Commission v Italy* concerned an Italian law regulating the award of works contracts.

Under Italian building permit and planning arrangements, a private person/company could carry out works infrastructure and other works on behalf of a local authority as part of a development arrangement. The value of the works contract could then be set off against the cost of the contributions payable by the private person/company to the local authority in respect of the relevant building permits for that development.

The law required the private person/company to award the works contract in accordance with the public procurement directive, where the value of the works contract, assessed individually, exceeded the EU financial threshold.

The ECJ held that the law was in breach of the procurement directive in force at the time and that the value of the contracts should be the total value of all of the works contracts to be awarded by the private person under a particular building permit or planning arrangement.

2.4.3 The small-lot exemption (Article 9(5))

Review carefully and amend to reflect local law and the way in which the EU procurement rules link with local thresholds for contracts below the EU thresholds. The waiver for small contracts is not always included in national legislation implementing the Directive.

There is a waiver to this general rule for 'small' contracts in the context of lots where the aggregate value of all of the lots means that the financial thresholds are exceeded. The provisions of the Directive can be waived for one or more individual lots where:

- the estimated value of the individual lot is less than EUR 80,000 for supplies and services contracts; or
- the estimated value of the individual lot is less than EUR 1,000,000 for £works contracts;

and where in both cases:

- the total (aggregate) value of those small lots to which the waiver is applied does not exceed 20% of the value of all of the lots.

Amend if new thresholds mean that the exercise does not work.

Example

A local authority wishes to award a number of contracts for the cleaning of schools, civic buildings and council offices. Each contract will be for two years. It intends to advertise by using a single contract notice and to split the requirements into six lots. The estimated values below represent the total value for the two-year contracts:

- Lot 1: four secondary schools for an estimated value of EUR 75,000
- Lot 2: six primary schools for an estimated value of EUR 85,000
- Lot 3: five primary and three secondary schools for an estimated value of EUR 90,000
- Lot 4: two nursery schools for an estimated value of EUR 40,000
- Lot 5: two office buildings for an estimated value of EUR 35,000
- Lot 6: one main civic building for an estimated value of EUR 85,000

The total value of all six lots is EUR 410,000.

Lots 1, 4 and 5 are below the EUR 80,000 threshold.

20% of EUR 410,000 is EUR 82,000.

The contracting authority could therefore apply the small-lot exemption to: Lot 1 only, Lot 4 only, Lot 5 only or Lots 4 and 5 combined. In each case the total value of the lot or lots would not exceed EUR 82,000.

Good practice note

It is important to note that the value of the small lots to which the exemption is applied must still be taken into account when calculating the total value of all of the lots for the purposes of establishing whether the threshold has been met or exceeded. The small-lot exemption cannot be used to bring the total value below the threshold.

Example

A contracting authority wishes to award works contracts for the construction of a new civic building. The total value of the works is EUR 5,100,000 and the works are split into two lots; one contract for EUR 4,600,000 (below the works financial threshold) and one contract for EUR 500,000 (also below the works financial threshold and also less than 20% of the total contract value). The contracting authority must aggregate the two contracts, which means that the total value exceeds the financial threshold for works contracts and therefore the Directive applies in full.

2.4.4 Calculating the value of supply contracts (Article 9 (6) and (7))

There are specific rules covering the way in which the value of supply contracts is calculated for the purposes of establishing the total estimated contract value.

- **For supply contracts relating to the lease, hire, rental, or hire-purchase of products**
  - **Where the term is fixed**, then the total value is expressed in the Directive as the total estimated contract value for contracts up to 12 months long, and as the total estimated contract value including residual payments for contracts in excess of 12 months. This means that in all cases the total estimated contract value applies.
  - **Where there is no fixed term or where the term cannot be defined**, then the value is the estimated monthly value multiplied by 48.

Example

A health organisation enters into a contract for the hire of a mobile x-ray machine. The mobile x-ray machine is required to provide extra capacity while a new hospital is being built. The building programme for the new hospital has been unexpectedly delayed due to unforeseen problems on the site.

At the start of the hire contract it is not certain for how long the mobile x-ray machine will be required; the period of hire will end when the new hospital is completed, but a final building completion date has not been agreed.

The hire contract is for an initial period of 24 months and is then automatically renewable by the health organisation after the initial 24-month period on a quarterly basis.

In this case the estimated value will be the monthly value of the hire contract multiplied by 48.

- **For supply contracts that are regular in nature or are expected to be renewed** within a given period, the calculation is based on either of the following two approaches. The contracting authority has a choice:
- **Either** the total actual value of the successive contracts of the same type awarded during the preceding 12 months or financial year, such value being adjusted if possible to take account of the changes in quantity or value that might occur in the course of the 12 months following the initial contract;

Note

This method is only available if the contracting authority has actually had a requirement for this type of supply in the previous 12 months.

- Or the total estimated value of the successive contracts awarded during the first 12 months following the first delivery or during the financial year if that period is longer than 12 months.

The choice of method applied must not be made with the intention of excluding the contracts from the application of the Directive.

Example

A local authority has a requirement for a regular supply of recycled paper for use in its photocopiers and printers. Last year it purchased recycled paper every eight weeks from a number of suppliers. The total value of these purchases amounted to just below the EU financial threshold for supplies.

The authority expects its requirements in the next 12-month period to be double the value of last year's requirements. It intends to make purchases every four weeks from a number of suppliers.

The authority has a choice about how to calculate its requirements. If it uses last year's figures, then the estimated value will not exceed the EU procurement thresholds. However, if it adds up the total value of the successive contracts that it intends to award in the next 12 months, the EU procurement threshold will be exceeded.

If the authority relies on last year's figures, knowing that next year's requirements will be in excess of the EU financial thresholds, then it is likely to be regarded as acting with the intention of avoiding the application of the Directive. It must therefore use the total estimated value of purchases of recycled paper from all suppliers over the next 12-month period as the basis for calculating the total value of the contract.

Practical note: In these circumstances it would be sensible for the authority to consider setting up a framework agreement if that option is available under national law.

2.4.5 Calculating the value of specific types of service contracts (Article 9 (8)(a))

There are specific rules covering the way in which the value of service contracts is calculated for the purposes of establishing the total estimated contract value:

- **Insurance services:** the value includes the premium payable and any other forms of remuneration;
- **Banking and other financial services:** the value includes the fees, commissions, interest and other forms of remuneration;
- **Design contests:** the value includes fees, commission payable and other forms of remuneration; where a design contest is run, then the value includes all prizes or other payments to candidates and tenderers.

2.4.6 Calculating the value of service contracts (Article 9 (8)(b))

For contracts that do not indicate a total value but for which the term is fixed for 48 months or less, then the total price is the total estimated value of the full term of the contract.

Example

A fire authority intends to enter into a maintenance contract for fire engines for a period of 24 months. The contract cost is made up of (1) a fixed monthly payment, which is paid irrespective of how much work is undertaken; plus (2) a variable payment based on actual maintenance work undertaken. The total value of the contract is therefore uncertain.

The total value of all of the fixed monthly payments to be made over the 24-month period amounts to just below the EU financial threshold for services.

The fire authority uses information from previous maintenance contracts to estimate the likely value of the variable payments. It then calculates the total estimated price by adding (1) the total value of the fixed payments over 24 months, plus (2) the genuine pre-estimate of the variable payments over 24 months. The total estimated price is above the EU financial threshold and therefore the Directive applies.

For service contracts that do not indicate a total value and are either without a fixed term or the fixed term is more than 48 months, then the value is the total estimated monthly value multiplied by 48.

The choice of method applied must not be made with the intention of excluding the contracts from the application of the Directive.

Comment: Contracts that are for a similar or the same type of supplies and services

Article 9 refers to the requirement to aggregate contracts that are for 'similar' (article 5(b)) or for the 'same type' (article 7(a)) of supplies or services. It is not entirely clear what this provision means.

A sensible interpretation would be to consider the nature of the supplies and services required and to establish whether those requirements could normally be supplied by the same supplier or service-provider.

For example, in a contract for the lease of cars, it would be common for leasing companies to provide a range of various types of vehicles, and so it would be commercially reasonable to package the requirement in a single contract or in a series of aggregated supplies.

For specialist vehicles, such as ambulances, fire engines or rubbish collection vehicles, there is a separate specialist supplier market, and so each type of vehicle could be the subject of a separate procurement procedure.

Similarly, requirements for general office cleaning services should be aggregated, but two contracts for specialist cleaning of hospital operating theatres and for cleaning of technical laboratories would not necessarily have to be aggregated.

Comment and good practice note

Where the aggregation of the value of a number of contracts or lots results in the application of the Directive, then the requirements of the Directive, except where the small-lot exemption applies, apply to the award of all of the aggregated contracts.

This means that if the contracting authority establishes that the Directive applies to a series of contracts and then decides to split the award into two separate procedures, with the value of the contract(s) to be awarded under those procedures being sub-threshold, the Directive will still apply to each of the two procurement procedures.

2.4.7 Calculating the value of framework agreements and dynamic purchasing systems (Article 9 (9))

The total value to be taken into account is the maximum estimated value of all of the contracts envisaged for the total term of the framework agreement or dynamic purchasing system. The total value excludes value-added tax (VAT).

2.4.8 Calculating the value of works concessions

The value of a works concession contract is calculated using the same principles as those applying to other works contracts, in particular the requirement to take into account all sources of funding, including third-party sources.

UTILITIES

Utilities

This short note highlights some of the major differences and similarities in the requirements applying to utilities in relation to thresholds.

Adapt all of this section for local use – using relevant local legislation, processes and terminology.

The main legal requirements relating to financial thresholds are set out in articles 16 and 17 of Directive 2004/17/EC (Utilities Directive).

Article 16 confirms that, subject to the exclusions in articles 19 to 26 or the provisions of article 30, the Utilities Directive applies to contracts that have a total value (excluding VAT) exceeding the specified thresholds.

Article 17 sets out the rules governing the calculation of thresholds.

1. Thresholds

There are two thresholds for utilities, which are shown in the table below.

The financial thresholds are listed in article 16 and are expressed in euros (EUR). The financial thresholds are generally fixed for a period of two years and are amended every two years, with effect from 1 January. The amendments are made by means of European Commission Regulations. There are provisions allowing for the amendment of the financial thresholds at other times.

Utilities – contract notices	
Type of contract	
Works contracts, concession contracts, works contracts awarded by concessionaires, subsidised works contracts	EUR 4 845 000
Supplies and services contracts	EUR 387 000

Utilities – Indicative notices	
Type of contract	
Works	EUR 4 845 000
Supplies and services	EUR 750 000

2. General principles applying to the calculation of thresholds

Timing: the rules for utilities relating to the time when the estimated value is calculated differ from the rules under the Public Sector Directive 2004/18 (the Directive). The time for estimating the value depends upon the way in which the procedure is launched. The relevant times are as follows:

- Qualification system: the date on which the selection commences
- Periodic Indicative Notice: the date of dispatch of the contract notice to the *OJEU*
- Other cases: the date when the contract notice would be sent to the OJEU if the call for competition requirement applied and the utility decided to satisfy the call for competition through such a contract notice.

Total amount payable: The estimate must take into account the total amount payable. The total excludes VAT but includes:

- any form of option or renewal;
- all prizes and payments;
- any non-financial payments.

No avoidance: No works project or proposed purchase of supplies or services may be subdivided to prevent that project or purchase from entering into the scope of the Utilities Directive (article 17(2)).

3. Calculation of thresholds

3.1 Works contracts – works and related supplies and services must all be taken into account

When calculating the estimated value of a works contract, the contracting authority must take into account both the cost of the works plus the estimated value of both the supplies and services necessary for executing the works that are placed at the economic operator's disposal by the contracting authority (article 17(4) of the Utilities Directive). This differs from the provisions under article 9(4) of the Directive (2004/18), which requires the inclusion of only the estimated value of supplies and not that of services.

3.2 Works contracts and unrelated supplies and/or services

Article 17(5) of the Utilities Directive specifically provides that where supplies and/or services are not necessary for the performance of a works contract, then the value of those supplies and services is not to be added to the value of the works contract if by doing so the procurement of those supplies and/or services would be removed from the scope of the Directive.

3.3 Contracts for supplies and services

Article 17(8) of the Utilities Directive includes a provision that is not included in article 9 of the Directive. This article requires that where there is a contract involving a mix of supplies and services, then the basis for calculating the estimated value of the contract is the total value of the supplies and services, regardless of their respective shares.

This article also provides that the calculation is to include the value of the siting and installation of operations.

3.4 Aggregation of lots

Article 17(6) of the Utilities Directive contains similar provisions to those in article 9 of the Directive. This article confirms that where proposed contracts for works or services or similar supplies may result in contracts being awarded at the same time in separate lots, then the value of those lots must be aggregated.

Where the total value exceeds the EU financial thresholds, then the Directive will apply.

3.5 The small-lot exemption

There is a waiver in article 17(6) of the Utilities Directive to the general aggregation rule for 'small' contracts in the context of lots. The provisions of the Utilities Directive can be waived for one or more individual lots on the same basis and for the same financial values as under article 9(5) of the Directive (2004/18).

3.6 Calculating the value of supply and services contracts (Article 17)

There are specific rules covering the way in which the value of supply and services contracts are calculated for the purposes of establishing the total estimated contract value.

For supply or services contracts that are regular in nature or are expected to be renewed within a given period, the calculation is based on either of the following two approaches. The contracting authority has a choice:

- **Either** the total actual value of the successive contracts of the same type awarded during the preceding 12 months or financial year, such value being adjusted if possible to take account of the changes in quantity or value that might occur in the course of the 12 months following the initial contract;

Note

This method is only available if the contracting authority has actually had a requirement for this type of supply in the previous 12 months.

- **Or** the total estimated value of the successive contracts awarded during the first 12 months following the first delivery or during the financial year if that period is longer than 12 months.

For supply contracts relating to the lease, hire, rental or hire-purchase of products, the value taken as a basis for calculating the estimated contract value is to be as follows:

- **In the case of fixed-term contracts**, the total value is expressed in the Utilities Directive as being the total estimated contract value for contracts of up to 12 months, and the total estimated contract value including residual payments for contracts in excess of 12 months. This means that in all cases the total estimated contract value applies.
- **For supply contracts without a fixed term or where the term cannot be defined**, the value is the estimated monthly value multiplied by 48.

3.7 Calculating the value of specific types of service contracts (Article 17(10))

There are specific rules covering the way in which the value of service contracts is calculated for the purposes of establishing the total estimated contract value:

- **Insurance services:** the value includes the premium payable and any other forms of remuneration;
- **Banking and other financial services:** the value includes the fees, commissions, interest and other forms of remuneration;
- **Contracts involving design tasks:** the value includes fees, commission payable and other forms of remuneration.

3.8 Calculating the value of service contracts (Article 17(11))

- **For contracts that do not indicate a total value but for which the term is fixed for 48 months or less**, the total price is the total estimated value of the full term of the contract.
- **For service contracts that do not indicate a total value and are either without a fixed term or with a fixed term of more than 48 months**, the value is the total estimated monthly value multiplied by 48.

3.9 Calculating the value of framework agreements and dynamic purchasing systems (Article 17(3))

The total value to be taken into account is the maximum estimated value of all of the contracts envisaged for the total term of the framework agreement or dynamic purchasing system. The total value excludes VAT.

SECTION 3
EXERCISES

Adapt all of this section for local use – using relevant local examples, legislation, processes and terminology. You could add to the exercises to allow discussion of local thresholds below the EU thresholds

EXERCISE 1
PREPARATION AND GROUP WORK

You work in the procurement department at the Ministry of Education (which is a central government department for the purposes of calculation of the EU financial thresholds). The Head of the Ministry's Information Technology (IT) Department sends an email to your boss asking for advice on a number of proposed purchases over the next year. Your boss asks you prepare a written reply to send to the Head of the IT Department.

Please prepare outline answers to the questions raised in the email – answers should explain in a simple way the reasons for your advice.

Then discuss the answers in your small group. Nominate a spokesperson for your group who will speak for the group in the feedback session.

email 1

Amend figures if necessary when new thresholds are published, to ensure that 80 laptops are sub-threshold but 90 laptops are over the EU financial threshold for central government and to refer to the two threshold levels in the final sentence.

From: headIT@mined.gov
To: headprocure@mined.gov

Subject: IT procurements

URGENT

Dear Head of Procurement,

As you know we are planning a number of IT procurements over the next few months. I need to know from you whether we will have to advertise the procurements in the OJEU. Details are a bit vague on some of the procurements but here is the information that I have on the two main ones.

The first procurement is for about 80 high-specification laptop computers. The average price for a top-of-the-range model is EUR 1 600 plus VAT if we bulk purchase. We would like to buy all 80 laptops in one go. I understand that a figure of EUR 133 000 is relevant somehow – and the EU rules do not apply for purchases below that level. I assume that it is OK to go ahead and run a competition without advertising in the OJEU? We would like to include an option to add a few extra laptops to the order, perhaps 10 more. As we are not sure about these additional laptops, I assume that it is still OK and we are still under the financial limits? Please confirm the position.

Our second major procurement is for computer peripherals – printers, leads, ink, discs, etc. We think that it might be easier to package these all together in a single contract for 3 years, as most suppliers can supply all of the items. However, the total cost for a 3-year contract would be about EUR 250 000. We don't want to have to advertise in the OJEU if we don't have to, so can we split the contract into smaller parts for different types of purchases and avoid the OJEU route?

Many thanks,

Head of IT

P.S. – One of my friends who works for the town council says that it is not the figure of EUR 133 000 that matters, but it is the EUR 206 000 which triggers the requirement for an OJEU advertisement. Is he correct? Can you explain this, please?

The Head of IT gets back to you with another email

email 2

Amend figures if necessary when new thresholds are published, to ensure that the costs are over the EU financial threshold for central government but two contracts fall within the small lots provisions.

From: headIT@mined.gov
To: headprocure@mined.gov

Subject: IT procurements

URGENT

Dear Head of Procurement,

Thanks for your replies to my first email – all very useful.

I have a further question: We are going to be purchasing a large number of basic desktop PCs for use in our schools. We want to test the market to see if we can benefit from large-scale purchasing from major suppliers, but we think there might also be some good deals available from smaller suppliers.

We would like to split the purchases into 4 separate contracts, by geographical area. Suppliers could then bid for some or all of the contracts. All of the contracts will be for much less than the EUR 133 000 financial threshold. Our current rough estimates for the contracts are as follows:

Area A	EUR 20 000
Area B	EUR 60 000
Area C	EUR 50 000
Area D	EUR 40 000
Area E	EUR 10 000

My questions are: does the requirement to advertise in the OJEU apply? If there is a requirement to advertise in the OJEU, is there any way we could ensure that the contracts for Area A and Area E don't have to be awarded using a full European procurement process?

Many thanks,

Head of IT

EXERCISE 2
INDIVIDUAL CASE STUDY

You work in the procurement department at a town council. The council is involved in an urban regeneration project for the town centre.

Please answer the following questions, giving reasons for your answers.

1. The Council is providing 55% of the funding for the construction of a new sports facility. The Council is providing the funding to a private sector urban regeneration company. The estimated construction costs are EUR 6 000 000. Will the urban regeneration company have to advertise the construction contract in the OJEU and comply with the Directive in the contract award process?
2. The Council decides to redevelop the local cinema and theatre complex, which is next to the urban regeneration area. The estimated cost is EUR 5 200 000. The Council will award the contract and make available to the successful construction contractor, for use on the project, a large amount of building materials, including local marble. The estimated value of the building materials is EUR 600 000. Will this contract be over the relevant EU financial threshold?
3. The Council decides to run a design competition for the architectural designs of the cinema and theatre complex. It offers 3 prizes of EUR 10 000 each. The winning architect will, in addition, be awarded a contract worth EUR 100 000 for the design services. Will the design contest have to be advertised in the OJEU?

SECTION 4
CHAPTER SUMMARY

SELF-TEST QUESTIONS

1. How often are the EU financial thresholds set?
2. Why are the thresholds for central government contracting authorities often lower than the thresholds for other contracting authorities?
3. Why are the thresholds for works contracts so much higher than the thresholds for services and supplies contracts?
4. At what time must the estimate be valid?
5. What is the threshold for a contract for the following?
   - 5.1. the construction of a new office building by a central government department
   - 5.2. the construction of a new school by a local authority
   - 5.3. the purchase of stationery by a central government department
   - 5.4. the purchase of a new boat (not a warship) by the government's defence department
   - 5.5. the purchase of photocopiers by a local hospital
   - 5.6. the purchase of architects' services by a local authority
   - 5.7. the purchase of legal services by a central government department
6. Is the threshold for a Prior Information Notice for works contracts calculated using the total estimated value of the contracts for a 12-month period?
7. When you calculate the total value of a contract, can you exclude the value of payments made by third parties for the contract?
8. What is the value of the following contracts for the purposes of calculating whether they exceed the financial threshold:
   - 8.1. A 3-year contract for the supply of stationery at an estimated value of EUR 100 000 per year
   - 8.2. A 2-year contract for cleaning services with an option to extend for a further 1 year where the estimated annual value is EUR 75 000
   - 8.3. A contract for design services worth EUR 150 000, awarded as a result of a design competition where there were 4 prizes awarded of EUR 20 000 each
9. A local authority intends to purchase 20 photocopiers over the next 12 months. Each photocopier is estimated to cost approximately EUR 7 000. Will these purchases be subject to the full application of the Directive?

10. A local authority intends to award construction contracts for two new administrative buildings and a separate canteen for the occupants of those new buildings. The local authority intends to use a single procurement process but divide the contract into lots:

Lot 1	Administrative building 1	estimated value of EUR 2 200 000
Lot 2	Administrative building 2	estimated value of EUR 3 300 000
Lot 3	Canteen	estimated value of EUR 500 000

10.1. Is the relevant financial threshold exceeded so that the Directive applies in full?

10.2. Can the local authority award Lot 3 for the Canteen without complying with the full requirements of the Directive?

11. What is the value, for the purposes of calculating whether the EU financial threshold is exceeded, of a contract for the supply of stationery without a fixed term where the estimated value is EUR 5 000 per month?

12. What is the value, for the purposes of calculating whether the EU financial threshold is exceeded, of a contract for insurance services estimated to cost EUR 200 000 plus commission of 10% of the total contract value?

13. How is the value of framework agreements calculated?