

UNICE Position
on the In-house activities of Public Authorities

1. Introduction

The main principles of the public procurement directives¹ ("the Directives") are to open the market and to enable Contracting Authorities to obtain best value for money.

Most Contracting Authorities provide an in-house capability to perform some of the services, which they need in order to maintain their organisation. Certainly, a Contracting Authority must have the power to decide what it does for itself and what it outsources.

But in-house contracts - and performances arranged without a contract - ("Order" and "Ordering" are used in this paper to refer to all such arrangements, whether or not a formal contract exists) can all too easily lead to restriction or obstruction of competition. Such problems frustrate the single market and the part that public purchasing plays in it when such in-house capabilities are offered to other Contracting Authorities.

UNICE is committed to the opening of all markets, regrets that this has not happened evenly in all member States, and is very concerned by the abuse of in-house Orders. UNICE proposes a set of policies compatible with the public procurement rules, which, if followed in applicable law, will assure best value for money and will obviate the risk of damage to the public interest (i.e. the tax payers) and to industry in connection with the failure to open public markets and with unfair competition.

This paper addresses two main areas where there are problems:

- The use of subsidiary entities; and
- Contracting Authorities acting as Economic Operators²

2. Definition of in-house Orders in the public sector – the Teckal criteria

The Teckal judgement [ECJ C-107/98] offers a basis for a definition, which can be understood by all, of a legally separate entity, which can nonetheless be regarded by its parent Authority as being in-house. It thus sets out a test by which it is possible to determine whether a relationship between entities is or is not in-house. The essential elements of the judgement are that the parent Authority must:

"Exercise over the [entity] concerned a control which is similar to that which it exercises over its own departments and, at the same time the [entity must] carry out [most] of its activities with the controlling Authority or Authorities."

¹ COD 9270/02 dated 28 May 2002

² "Economic Operator" has the same meaning as that in the Directives and includes contractors, suppliers and service providers.

UNICE acknowledges this judgement, in which it is stated that the conditions when a Order does not need to be subject to the Directives, even if it is awarded to a legally distinct entity which is controlled by the contracting authority, are clear and restricted.

In UNICE's opinion, however, some additional conditions are necessary if the potential distortion to the public purchasing market which would flow from abuse of in-house Ordering is to be avoided. UNICE is, as always, conscious of the need to avoid imposing unnecessary bureaucratic burdens on Contracting Authorities; its proposals are designed to achieve a satisfactorily open market whilst leaving contracting authorities freedom to seek best value.

2.1 The Contracting Authority as purchaser

Looking at the Teckal principles, three conditions arise. With regard to any particular activity, a Contracting Authority which carries out that activity:

- within its own organisation, is **not** subject to the Directive;
- by contracting it to an entity which it owns and manages, and which provides most of its output to its parent (a "Tied Entity"), is **not** subject to the directive;
- by contracting it to any other entity, **is** subject to the directive.

But this is an area where the boundaries can all too easily become confused and where practices, habits and cultures can arise which conflict with the objectives of the directive. UNICE therefore proposes two further measures, neither of which is burdensome for contracting authorities:

- where a contracting authority carries out an activity through a Tied Entity and the Order (or the annual level of the activity) is above the threshold, the contracting authority shall publish an informative notice – not being a call for tender – disclosing the activity³;
- where there exists a competitive source of the activity, notwithstanding that the contracting authority's subsidiary is a Tied Entity, the Order must be offered for tender under the conditions of the directive⁴.

Some explanation of the thinking behind these proposals may be helpful. The requirement to disclose (bullet point 1) should not be a problem for the contracting authority – it applies only to activities above the threshold – but does make the market and the Commission aware of the scale of such activities.

The annulment of Tied Entity status where there is a competitive source available (bullet point 2) should also not be a problem for the contracting authority. It is, in a sense, the reverse of the condition in the existing Utilities directive whereby contracting entities – notably electricity companies selling white goods and telephone companies selling handsets – were not subject to the directive in areas where they were in open competition with other economic operators. The provision has two advantages: it ensures that contracting authorities remain aware of alternative sources for their needs, and it prevents the public market from being unnecessarily closed.

³ UNICE suggests three months in advance of initiation of the activity.

⁴ Where there is such competitive supply available, the works, supplies or services to be purchased are in most cases not directly related to the core competence or primary function of the Contracting Authority, but are usually common goods or services which are auxiliary to or in support of the exercise of the responsibilities of the parent authority. There is no objective reason, if the parent authority has "outsourced" some activities to an affiliated entity under its control, why the rules on opening-up public procurement markets should not apply for "common" goods or services outwith the core competence (or "speciality") of the parent Authority.

2.2 The Public Authority as Economic Operator

A further concern arises with subsidiaries of contracting authorities which are not Tied Entities and which seek to tender for contracts to other contracting authorities; Tied Entities cannot, of course, tender to other contracting authorities without losing their tied status. In UNICE's opinion, such an entity should, as a condition of qualifying to tender to contracting authorities – including its own parent – demonstrate that it is financially distinct from its parent and does not enjoy any material subsidy or support-including exemption from VAT or other taxation- which would have the effect of distorting the proper functioning of the directive.

3. UNICE proposal

This paper contemplates three possible organisational structures, which may be involved. They are:

- a division of a Contracting Authority
- a Tied Entity
- a non-Tied Entity

All Orders placed by a Contracting Authority to one of these three organisational structures should be subject to the following rules.

3.1 Rules for a Tied Entity

With regard to Orders awarded to entities owned by a Public Authority, UNICE suggests the following rules:

The provisions of the Directives⁵ to Orders awarded by a contracting authority to a legally distinct entity owned by that contracting authority (a "Tied Entity") would not apply if, and only if:

- *the Tied Entity had no autonomous decision-making powers because its parent exercises over that entity a control which is similar to that which it exercises over its own departments;*
- *the Tied Entity carries out 80% or more⁶ of its activities with its parent and*
- *there is no competitive source of the activity available.*

Whether or not such a Tied Entity is itself a contracting authority, it shall, when meeting its own needs, comply with the Directives.

⁵ Of course, an Authority remains always free to open competition for a contract, if it wishes so, even if itself or a body under its control can execute this contract. This could be useful in case of exceptional high demand, or in order to check the efficiency of the contracting authority's performance.

⁶ The same percentage is used in the Utilities Directive

3.2 Condition for participation of a Contracting Authority in public tenders through its organisational structure

In order to tender in a public procurement procedure, the Contracting Authority must tender via one of the organisational structures listed at the beginning of this section 3 and should answer the following question:

“Is its organisational structure transparently, financially separated from its parent Contracting Authority?”

- If the answer is YES, the organisational structure may tender.
- If the answer is NO, it may not.

In the latter case, the organisational structure may not tender, as a privileged financial situation may exist.

Transparent⁷, verifiable accounting will be essential so that the separation can be seen to be real; the existence of published trading accounts drawn up in accordance with international accountancy standards would thus probably be necessary. Furthermore the financial results must show that this entity or independent department is viable; a transparent accounting system must take all costs into consideration as for a comparable private entity.

⁷ See the Transparency directive (80/723)