Client Alert.

21 December 2012

UK Public Procurement Law Digest:
In-house Tender Rules for Mutuals and Shared Services

By Alistair Maughan

Many government entities across Europe deliver services through municipal or public-owned companies. Such entities are less common in the UK, although the issue is increasingly on the agenda, with a strong preference expressed in the UK government's current ICT and services delivery policy for the use of "mutuals" and procurement via shared services.

Against this background, the European Court of Justice has clarified previous rulings on the conditions that apply to the procurement of services on an "in-house" basis by a public authority, especially where the public authority has only a minority shareholding in the selected in-house publicly-owned service provider.

BACKGROUND

It is a central tenet of EU law that any public body in the EU wishing to obtain services from the private sector has to comply with public procurement rules, which require the procedures for contract advertising, tendering and award to be open and non-discriminatory. As a generally-accepted rule, a public body does not have to comply with public procurement rules where it is only utilising its own internal resources to satisfy its requirements.

But what if a public body wishes to obtain services from another public body? Do the rules of public procurement still apply in such cases? This question was addressed by the European Court of Justice (ECJ) in *Case C-107/98 Teckal Srl v Comune di Viano, Azienda Gas-Acqua Consorziale di Reggio Emilia* ("*Teckal*"), which concerned a complaint made against an Italian local authority that entered into a contract with a consortium set up by a number of municipalities without going out to tender.

In *Teckal*, the ECJ held that a public body could bypass the EU procurement rules and directly enter into a contract with a service provider so long as:

- the public body controls the service provider in question as if it was that public body's own department (known as the "similar control" test); and
- the service provider in question carries out the essential part of its activities with the contracting authority which controls that entity.

This decision created what is now known as the *Teckal* exemption. The *Teckal* exemption allows contracting authorities a greater scope of cooperation amongst themselves without having to rely on a much narrower, existing exemption which applies only where services were provided by a contracting authority based on certain exclusive rights held by that contracting authority.[1]

[1] See Article 18 of Directive 2004/18/EC, as well as Regulation 6(2)(l) of the Public Contracts Regulations 2006.

Previously in this *Procurement Law Digest*, we have written about cases[2] which explain how the *Teckal* rule applies to contracting authorities that may wish to exploit the concept of shared services or other forms of cooperation within the public sector as an alternative to procurement of services from the private sector.

The mere fact that the service provider to which a contracting authority intends to award the contract also happens to be a public body or a quasi-public body does not, by itself, automatically lead to the conclusion that the proposed arrangement is exempt from the rules of public procurement. The nature of the relationship between the contracting authority and that service provider (as well as the manner in which the service provider in question is set up and organised, and provides the services) needs to be carefully examined before the public procurement rules can be legitimately bypassed.

The combined effect of *Brent v RMP* and *Commission v Germany* was to set out guidelines on how the *Teckal* exemption operates. These guidelines included the clarification that the *Teckal* exemption can still apply even where multiple contracting authorities share control over the proposed service provider.

But those prior cases did not finally resolve the issue of what level of "control" is required to trigger the *Teckal* exemption where a number of different contracting authorities share ownership in the joint entity.

WHAT IS THE CASE?

The ECJ's ruling resulted from a series of joined cases *Econord SpA v Comune di Cagno and others*, which were a reference to the ECJ for a preliminary ruling from an Italian court.

The case arose under an Italian law which allows municipal authorities the right to enter into agreements with each other in order to provide or procure shared services. The law goes on to provide that where the management of networks or other facilities is separated from the provision of the underlying services, the local authorities must use a publicly-owned corporate vehicle to do such management. The authorities' must exercise a level of control over that vehicle comparable to that exercised over their own departments, and the joint enterprise company must carry out the essential part of its activities with the controlling public bodies.

Under this law, the Varese Municipal Council incorporated an in-house company (Aspem SpA) to manage public hygiene services in that region of Italy. In 2005, various other municipal councils in the local area also entered into agreements with Varese Municipal Council for the management of their own urban hygiene services by Aspem.

Varese Municipal Council continued to hold a large majority of shares in Aspem, although a total of 318 shares were divided amongst 36 other different municipal councils in the region. As is typically the case in relation to a jointly-owned entity, the local authorities and municipal councils entered into a shareholders' agreement under which they had the right to be consulted on the activities of the company, and to appoint a member of the supervisory council and the management board.

The local authorities proceeded to award contracts to Aspem to manage the urban hygiene services in their respective areas – and did so on the understanding that those contracts fell within the *Teckal* exemption. These contract awards were challenged by a private sector contractor, Econord SpA.

[2] See our July 2009 update The "Teckal" Principle and In-house Arrangements.

The Italian court referred a series of questions to the ECJ about this arrangement and, eventually, the ECJ made a ruling on how the *Teckal* exemption ought to be applied in situations where, as here, different public bodies award a contract for shared services to a single joint-enterprise company, part-owned by each of them.

The ECJ examined closely the issue of what level of involvement by a public body in a jointly-owned company will fulfil the "similar control" test laid down by *Teckal*.

The jointly-owned company must be subject to a level of control enabling the individual shareholding public bodies to influence that entity's decisions. Public bodies must be capable of decisive influence over both the strategic objectives and the significant managerial decisions of that entity. The fact that a public authority is only a minority shareholder does not automatically rule out the application of the *Teckal* exemption.

So, where a number of public bodies use a common publicly-owned entity for the purposes of delivering a set of shared services, it is not essential that each of those authorities themselves have an individual power of sole control over the entity. However, it is important that the control exercised over the delivery vehicle not be based solely on the controlling power of the majority shareholder.

The ECJ held that if a minority shareholding public body does not possess the slightest possibility of involvement in control of the delivery vehicle, that would be seen as a violation of EU rules, because it would mean that a mere subscription to shares in the jointly-owned delivery vehicle would exempt the contracting authority from the obligation to hold an open procurement, even though it took no part in exercising any control over the activities of the delivery vehicle.

The ECJ's conclusion, therefore, was that where a number of public bodies jointly establish a delivery vehicle with responsibility for providing shared services in their regions or areas, the "similar control" test established by *Teckal* does permit that control to be exercised jointly by the authorities and is fulfilled where each of those authorities not only holds the capital of that entity, but also plays a meaningful role in its managing bodies (*e.g.*, its board of directors or supervisory board).

For a copy of Morrison & Foerster's consolidated digest of recent cases and decisions affecting UK public procurement law, please click here.

Contact:

Alistair Maughan
+44 20 7920 4066
amaughan@mofo.com

About Morrison & Foerster:
We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for nine straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.