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UK Public Procurement Law Digest: The "Teckal" principle and In-house Arrangements

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Courts give guidance on the scope of the procurement exclusion applicable to "in-house" arrangements

It is a well-established principle of EU procurement law that the open advertising and tendering rules for public contracts do not apply where a public body obtains services from "in-house" sources. This is the so-called *Teckal* principle. Two recent decisions, one made by the Court of Appeal in England and another made by the European Court of Justice, clarify how the *Teckal* principle operates, and remove any doubt as to whether the exemption applies to procurements in the UK.

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What are the cases?

The cases are:

- *Brent London Borough Council v Risk Management Partners Limited and London Authorities Mutual Limited and Harrow London Borough Council [2009] EWCA Civ 490* ("***Brent v RMP***"), a decision made by the English Court of Appeal in respect of a claim brought by an insurance provider against a local authority, which abandoned a procurement process after having decided to satisfy its insurance requirements through a mutual insurance company that it had established together with a number of other local authorities.
- *Case C-480/06 Commission v Federal Republic of Germany* ("***Commission v Germany***"), a decision made by the European Court of Justice ("**ECJ**") in respect of a claim brought by the European Commission that Germany had breached the public procurement rules by allowing a group of local authorities to enter into an arrangement for waste disposal directly with another local authority without undergoing a tender process.

Why are these cases important?

Basic law is that any public body in the EU wishing to obtain services from the private sector has to comply with public procurement rules, which require open and non-discriminatory advertising, tendering, and contract award. 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 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 which entered into a contract with a consortium set up by a number of municipalities without going out to tender.

In *Teckal*, the ECJ for the first time 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; 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]

Brent v RMP clarifies that the *Teckal* exemption does apply to public procurement in the UK, *i.e.*, that the rules of public procurement may be bypassed if a contracting authority directly enters into a contract with another entity in circumstances where the conditions for the *Teckal* exemption are satisfied. This case also sets out a number of important guidelines on how the *Teckal* exemption operates:

- the question of ownership is not alone decisive in determining whether the requisite level of control is exercised over the proposed service provider by a contracting authority. Any private sector part-ownership (no matter how minor the stake is) of the proposed service provider is likely to defeat the application of the *Teckal* exemption;
- the *Teckal* exemption could still apply even where multiple contracting authorities share the control over the proposed service provider; and
- the controlling contracting authority must possess "*a power of decisive influence over both strategic objectives and significant decisions*" over the proposed service provider for the *Teckal* exemption to apply (*i.e.*, the more independently the entity in question is able to act, the less likely it is for the *Teckal* exemption to apply).

Commission v Germany effectively extends the scope of the *Teckal* exemption, with the result that the public procurement rules may not apply if a contracting authority directly enters into an arrangement for mutual cooperation with other contracting authorities as long as:

- the arrangement in question is "*governed solely by considerations and requirements relating to the pursuit of objectives in the public interest*"; and
- no private sector entity is disadvantaged vis-à-vis its competitors.

The developments seen in both of these cases are welcome news for contracting authorities who 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.

However, contracting authorities that contemplate such "public sector alternatives" (as well as bidders who wish to challenge a contracting authority's decision to opt for a public sector alternative) should bear in mind that 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, without more, automatically lead to the conclusion that the proposed arrangement is exempt from the rules of public procurement.

As demonstrated by these cases, 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 could be legitimately bypassed. In any event, it should be noted that an arrangement between a contracting authority and a public body which offers services "*on the market*" could still be caught by the public procurement rules.[2]

It is worth noting in passing that UK-based central government bodies have a further possible available argument where they wish to procure services from another department or agency. Constitutionally, the principle of the "indivisibility of the Crown" still means that central government departments are not legally distinct entities in terms of the ability to enter into contracts. Although somewhat eroded, that principle could still be used to support the proposition that the public procurement rules do not apply to agreements or arrangements between different central government departments.

What happened in these cases?

Brent v RMP

A number of London local authorities, including Brent London Borough Council ("**Brent**"), became dissatisfied with the lack of competition and the premiums charged by commercial insurance providers as well as the way in which claims were handled. The local authorities jointly set up the London Authorities Mutual Limited ("**LAML**"), a mutual insurance company, which was to be controlled by, and run for the benefit of, participating London local authorities.

Brent had a series of insurance policies which were due to expire in March 2007 but Brent could not be certain that LAML would be able to provide cover from the expiration of Brent's then-current insurance policies. Accordingly, Brent initiated a procurement process in accordance with the Public Contracts Regulations 2006 ("**PCR**"), inviting tenders for various insurance coverage divided into seven lots.

In February 2007, Risk Management Partners Limited ("**RMP**"), an insurance agent with a track record of providing insurance to the UK public sector, duly completed and submitted its tender. However, in March 2007, Brent decided to abandon the procurement process in respect of six out of the original seven lots, as Brent had decided to award the insurances for these six lots to LAML.

RMP subsequently sued Brent in June 2007, alleging that Brent did not have the legal authority to participate in LAML, and that Brent acted in breach of the public procurement rules by awarding the contract to LAML (which had not participated in the procurement process). The High Court initially agreed with RMP and gave judgment in favour of RMP. Brent went on to appeal to the Court of Appeal against the decision of the High Court. Both before the High Court and the Court of Appeal, in arguing that it had not acted in breach of the public procurement rules, Brent relied on the *Teckal* exemption.

Where the *Teckal* exemption applies, a contracting authority does not have to go through the tender process prescribed by the law. Two basic conditions must be satisfied for the *Teckal* exemption to apply, and they are as follows:

- the contracting authority must control the entity to which it intends to award the contract as if that entity was its own department (the first condition); and
- the entity in question must carry out the essential part of its activities with the contracting authority which controls that entity (the second condition).

The Court of Appeal reviewed the relevant case law on the application of the *Teckal* exemption and noted, among other things, as follows:

- it is for the contracting authority which seeks to rely on the *Teckal* exemption to prove that the two conditions of the *Teckal* exemption have been met;
- where there is a private sector participation in a contracting authority's project (*e.g.*, the entity to which the contracting authority intends to award the contract is partly controlled by private sector shareholders), the *Teckal* exemption cannot be applied;[3]
- control, which is the requisite element of the first condition of the *Teckal* exemption, may be exercised by the contracting authority alone, or jointly in conjunction with other contracting authorities;
- in order to satisfy the first condition of the Teckal exemption, the controlling contracting authority (or contracting authorities) must possess "*a power of decisive influence over both strategic objectives and significant decisions of the other legal entity*" (*i.e.*, the more independently the entity in question is able to act, the less likely it is for the *Teckal* exemption to apply); and
- ownership of the entity in question tends to determine (without being decisive) the key issue of "control"

which is the requisite element of the first condition of the *Teckal* exemption.

RMP essentially argued that the *Teckal* exemption did not form part of English law (because of the way in which the PCR, which implemented the relevant European Directive in the UK, was drafted), and that even if it was incorporated into English law, the *Teckal* exemption did not apply to the arrangement between Brent and LAML. Like the High Court, the Court of Appeal held that the *Teckal* exemption did form part of English law and could be applied to contracts which would otherwise be covered by the PCR, but on the facts of the case, concluded that the first condition of the *Teckal* exemption was not satisfied.

In reaching this conclusion, the Court of Appeal noted that LAML's board had an extensive authority to conduct its own business, including the power to "*terminate the membership of a Participating Member*" as well as the power to "*establish, collect, manage and redistribute both capital contributions and premiums of local authorities*", whilst the participating local authorities' control over LAML existed primarily in the form of "*the power of a majority of participating members to call a general meeting*" and "*the power to direct the Board by special resolution by a 75% majority*", which was, in the views of the Court of Appeal, insufficient to satisfy the first condition of the *Teckal* exemption.

Brent also separately argued that RMP's complaint was brought out of time, but like the High Court, the Court of Appeal disagreed with Brent, holding that RMP's complaint was brought within the 3-month limitation period prescribed by the PCR because the grounds for bringing the proceedings did not arise until Brent made the irrevocable decision to abandon the procurement process and RMP became aware of it.[4]

Commission v Germany

In December 1995, four district councils ("**Landkreise**") in lower Saxony, directly and without going through a tender process, entered into a contract with Stadtreinigung Hamburg ("**Hamburg**") in connection with the disposal of their waste at a waste incineration facility operated on behalf of Hamburg. The preamble to the contract described the arrangement between the four Landkreise and Hamburg as a "regional cooperation agreement for waste disposal". Under the contract, in return for Hamburg providing waste incineration capacity for them, the four Landkreise were obliged to make available to Hamburg the spare landfill capacities that the four Landkreise were not utilising.

The European Commission took the view that, among other things, horizontal cooperation between contracting authorities, such as the arrangement seen in this case, was not excluded from the scope of the procurement rules, and that the Landkreise could not benefit from the *Teckal* exemption due to the fact that none of the four Landkreise exercised any effective control over Hamburg. In November 2006, the European Commission brought infringement proceedings against Germany, seeking a declaration that Germany had failed to fulfil its obligations under the controlling Directive then in force.[5]

Germany sought to defend its position by arguing, among other things, that the arrangement was the culmination or extension of the internal administrative arrangements made by the administrative authorities concerned and went beyond an ordinary arrangement under a conventional service contract, because the four Landkreise were obliged to make unused landfill capacities available to Hamburg in return for the waste treatment by Hamburg. Germany also argued that this reciprocity in the arrangement was sufficient to satisfy the first condition of the *Teckal* exemption.

The ECJ noted that the controlling Directive then in force made it clear that a "service provider" to whom a contracting authority awards a contract could be "*any natural or legal person, including a public body, which offers services*"[6] and, therefore, the mere fact that the service provider in a given arrangement was a public body which was distinct from the beneficiary of the services did not preclude the application of the controlling Directive to that arrangement.[7]

It was not disputed that none of the four Landkreise exercised a degree of control over Hamburg which was necessary to satisfy the first condition of the *Teckal* condition. However, the ECJ also noted that at the heart of the arrangement between the Landkreise and Hamburg was the establishment of a framework for cooperation with the aim of ensuring the performance of a public task which all parties concerned were obliged to perform (*i.e.*, waste disposal), and that there was no financial gain in the arrangement, because the charges payable for the waste incineration service under the contract amounted to no more than the reimbursement of the charges born by the Landkreise and paid by Hamburg to the operator of the waste incineration facility.

The ECJ went on to find that:

- "*a public authority has the possibility of performing the public interest tasks conferred on it by using its own resources, without being obliged to call on outside entities not forming part of its own departments, and that it may do so in cooperation with other public authorities*"; and
- "*Community law does not require public authorities to use any particular legal form in order to carry out jointly their public service tasks*" (*i.e.* it was not necessary for there to be a special purpose vehicle or some other body corporate governed by public law to be established to act as the "service provider" where multiple public authorities seek to cooperate with each other in performing their public interest tasks)[8] and that an arrangement for such co-operationdoes not undermine the principal objectiveof the EU public procurement rules(*i.e.*, the free movement of services and the opening-up of undistorted competition in all the Member States) as long as:
    - the arrangement in question is "*governed solely by considerations and requirements relating to the pursuit of objectives in the public interest*"; and
    - the principle of equal treatment is observed "*so that no private undertaking is placed in a position of advantage vis-à-vis competitors*".

Applying these principles to the facts of the case, the ECJ concluded that there was nothing to indicate that Germany sought to circumvent the rules on public procurement, and ruled in Germany's favour by dismissing the European Commission's action.

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Footnotes

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

[2] This is due to the way in which key terms such as "service provider" and "economic operator" are defined in Directive 2004/18/EC of 31 March 2004 (see note 6 below). It should be noted that Public Contracts Regulations 2006, which implemented this Directive in the UK, is less explicit as to whether or not a public body can be a "service provider" or an "economic operator", but any conflict between the Regulations and the Directive is likely to be interpreted so as to give effect to the principles set out in the Directive.

[3] This point should be borne in mind by authorities and bidders which seek to create special purpose vehicles (SPVs) for the onward sale or commercial exploitation of solutions developed pursuant to a public services contract. Such SPVs are likely to fall outside the benefit of the *Teckal* exemption and, therefore, any other public bodies which might in the future want to buy services from such SPV will be unable to do so without going through the procurement regime.

[4] This aspect of the Court of Appeal's decision reinforces the current position that, for the purposes of the time limit for bringing proceedings against contracting authorities, where the flawed decision (*e.g.*, a decision to adopt incorrect evaluation criteria) was capable of being remedied by the contracting authority prior to the submission of the final tender, the clock does not start until the contracting authority actually implements its decisions (*e.g.*, the flawed evaluation criteria are actually applied in selecting the successful bidders); see *Henry Bros (Magherafelt) Ltd and others v Department of Education for Northern Ireland (No. 2) [2008] NIQB 105*, which is discussed in Sourcing Update, 4 February 2009. Also see *Amaryllis Ltd v HM Treasury [2009] EWHC 962 (TCC)*, which is discussed in Sourcing Update, 17 June 2009 (www.mofo.com/news/updates/bulletins/15695.html).

[5] Directive 92/50/EEC of 18 June 1992, which is succeeded by Directive 2004/18/EC of 31 March 2004.

[6] From Article 1(c) of Directive 92/50/EEC. This expression is mirrored in Article 1(8) of Directive 2004/18/EC, which defines "service provider" as "*any natural or legal person or public entity or group of such persons and/or bodies which offers on the market… services*".

[7] In reaching this conclusion, the ECJ referred to *Case C-84/03 Commission v Spain*, where the ECJ previously held that Spain had failed to correctly implement another predecessor Directive on public procurement by creating an absolute exclusion from public procurement law for cooperation agreements concluded between public authorities and the other public undertakings.

[8] It is to be noted that the European Commission stated to the court that "*had the co-operation at issue here taken place by means of the creation of a body governed by public law to which the various local authorities concerned entrusted performance of the task in the public interest of waste disposal, it would have accepted that the use of the facility by Landkreise concerned did not fall under the rules on public procurement*".
