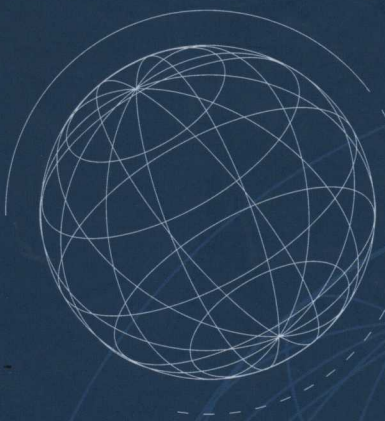
WORLD TRADE ORGANIZATION

The WTO Regime on Government Procurement: Challenge and Reform

Edited by Sue Arrowsmith and Robert D. Anderson



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Addressing purchasing arrangements between public sector entities

What can the WTO learn from the EU's experience?

PING WANG, ROBERTO CAVALLO PERIN AND DARIO CASALINI

1. Introduction

While public procurement typically involves public sector entities[1] acquiring supplies, works and services from the private sector, public sector entities may themselves become the suppliers in public procurement for various reasons. To give some examples:

- A municipal hospital may acquire maintenance services from the engineering department of the same municipality for convenience, a typical in-house provision;
- Central government ministries may be obliged to procure financial services from the designated state-owned bank which enjoys exclusive statutory right to provide such services;
- Government agencies may be instructed to procure from central purchasing bodies in order to leverage the government's aggregate buying power and simplify procurement of commonly used goods and services;
- As a form of local government reorganization and outsourcing to improve management and governance, a municipality may acquire refuse collection and waste disposal services from a separate public body set up by it individually or jointly with other municipalities to take advantage of economies of scale; or
- A state-run university may want to purchase buses from a state-owned manufacturer simply because it offers better value for money in comparison with private suppliers.

1 For the purpose of discussion in this chapter, the term 'public sector entities' will be used in a broad sense as including the state, regional or local authorities, public bodies as well as public undertakings or state-owned enterprises.

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These purchasing arrangements between public sector entities give rise to a number of legal issues that need to be addressed, often collectively, by procurement, competition and state aid rules. The primary concern for procurement regulation is the coverage of such arrangements: whether they fall under the definition of covered procurement in the first place. If the answer is affirmative, the question then arises to what extent such arrangements may nevertheless be excluded from the application of procurement rules, i.e. how far contracts can be awarded between public sector entities without a call for competition due to their specific nature, for instance where the public entity is the exclusive provider designated by law or in case there is a close organizational link between the entities.[2] The increasing organizational complexity within the public sector and the rising use of forms of delegation of power from state, regional or local authorities to new entities established ad hoc in order to carry out such authorities' public tasks, raise the problem of defining the boundary of procurement rules in order to establish whether a relationship between public entities must be qualified as an organizational pattern falling outside, or a contractual relation entirely subject to, procurement regulation.

This primary issue of coverage will be analysed in this chapter in the context of procurement rules adopted by international and regional trade organizations, namely EU procurement directives[3] and the WTO Agreement on Government Procurement (GPA),[4] with the primary objective of opening up closed national procurement markets. The following discussion will seek to ascertain, through the analysis of relevant legal texts and case law, what should be the appropriate balance to be struck between ensuring market access, undistorted competition and transparency on

2 Other legal issues not addressed in this chapter include, *inter alia*, whether the competition law has been violated when a public sector entity entrusts a task to another public sector entity or to a body linked with the public sector in an exclusive arrangement (Article 106 of the Treaty on the Functioning of the EU, ex Article 86 EC, provides that '[I]n the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109'); and whether the tender from a public entity shall be rejected as abnormally low due to the fact that the public tenderer is the recipient of state aid (Article 55(1)(e) EC Directive 2004/18).

3 See, in general, S. Arrowsmith, *The Law of Public and Utilities Procurement*, 2nd edn (London: Sweet and Maxwell, 2005).

4 Signed in Marrakesh on 15 April 1994 and entered into force on 1 January 1996. See, in general, S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), chapters 4–16.

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the one hand, and respecting the autonomy of national governments in providing goods and services for public interests in accordance with the principle of subsidiarity on the other hand. The decision to procure through a purely public sector framework rather than through the market may well be based on legitimate interests such as a desire for closer control over the service provision that can be provided through a contractual framework with an external provider, or a greater trust in the public sector ethos above commercial arrangements as a way of ensuring quality in service provision.

For the purpose of this analysis, the application of EU procurement directives to purchasing arrangements between public sector entities is arguably a valuable benchmark for the WTO GPA to draw guidance. As elaborated in section 2,[5] the EU procurement directives provide a clear definition of 'public contracts', which has been interpreted by the ECJ as excluding from the coverage traditional in-house arrangements. In addition, the ECJ has ruled that the so-called 'in-house providing' exception also applies to 'quasi-in-house' contracts made by a contracting authority with certain public organizations that are legally distinct from, but institutionally linked to, itself (section 2.2). The 'in-house providing' exception, as a rapidly evolving area of case law, has been expanded by the ECJ recently to cover cooperation arrangements among public sector entities where institutional links are not apparent (section 2.3). Furthermore, the directives contain a specific exemption with regard to services contracts where services are provided by another contracting authority with an exclusive right (section 2.4); and a specific exemption for contracts with central purchasing bodies (section 2.5). The Utilities Directive contains an 'affiliated undertakings' exemption (section 2.6). It can be argued that purchasing arrangements between public entities have been substantially addressed by EU procurement rules, with the ECJ in the driver's seat.

In contrast with the extensive EU experience in this area, section 3 will highlight the difficulties faced by the GPA in regulating purchasing

5 See, in general, Arrowsmith, note 3 above; K. Weltzien, 'Avoiding the Procurement Rules by Awarding Contracts to an In-House Entity – Scope of the Procurement Directives in the Classical Sector', *Public Procurement Law Review*, 14 (2005), 237; F. Avarkioti, 'The Application of EU Public Procurement Rules to "In House" Arrangements', *Public Procurement Law Review*, 16 (2007), 22; T. Kaarresalo, 'Procuring In-House: The Impact of the EC Procurement Regime', *Public Procurement Law Review*, 17 (2008), 242; K. Pedersen and E. Olsson, '*Commission v. Germany*: A New Approach to In-House Providing?' *Public Procurement Law Review*, 19 (2010), 33–46.

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arrangements between public entities, largely due to the lack of general rules on coverage and polarizing practices of GPA Parties. It is argued that the issue deserves serious attention, taking into consideration the future accession of countries with large public sectors such as China. Section 4 will draw conclusions on the extent to which the WTO can learn from EU experience in regulating/deregulating purchasing arrangements between public sector entities. It is submitted that, although EU procurement law offers valuable guidance, it is difficult for the GPA to follow suit unless its coverage is defined in a principled rather than ad hoc manner in the first place.

2. The application of EU procurement directives to purchasing arrangements between public sector entities

2.1. Introduction

The EU public procurement regime now in force is the outcome of progressive development over a period of several decades, with a view to opening up the public sector market to competition as an ideal means of promoting economic efficiency. The backbone of current EU procurement rules is Directives 2004/18 (on classic public sector procurement) and 2004/17 (on utilities sector procurement).[6] The directives apply to 'public contracts' defined as 'contracts for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the execution of works, the supply of products or the provision of services' within the meaning of the directives.[7] The term 'economic operator', a simplified term for contractor, supplier and service provider, covers 'any natural or legal person or *public entity* or group of such persons and/or bodies which offer on the market, respectively, the execution of works and/or a work, products or services' (emphasis added).[8] Therefore, the directives do not preclude the possibility that covered public contracts may be awarded by one public entity to another.

6 Directive 2004/18, OJ L134/114–240 and Directive 2004/17, OJ L134/1–113. See, in general, Arrowsmith, note 3 above.

7 Directive 2004/18, OJ L134/114–240 (classical sector) Article1(2)(a); and Directive 2004/17, OJ L134/1–113 (utilities sector) Article 1(2)(a).

8 Directive 2004/18, Article 1(8) and Directive 2004/17, Article 1(7) contain a similar provision referring to 'contracting entities' which include contracting authorities.

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2.2. The 'in-house providing' exception

2.2.1. The basic principle

However, when the public entities in question are legally unified, i.e. form part of the same department, the ECJ has clarified that there will be no public contract involved and therefore no need to apply procurement rules.[9] The underlying rationale is that the procuring public entity should have 'the possibility of performing the tasks conferred on it in the public interest by using its own administrative, technical and other resources, without being obliged to call on outside entities not forming part of its own departments'.[10] Therefore, the ECJ put a limit on the application of EU procurement rules excluding purely 'in-house' procurement.

The scope of this exception depends on how big the 'house' is. Apart from two branches from the same government department, can two government departments, legally distinct from each other but nonetheless affiliated to the same state, be regarded as being 'in the same house'? It is apparent that different states have contradicting views on this. On the one hand, the Norwegian Ministry of Modernization argued that 'the state must be regarded as one legal person, and that it should be able to procure supplies and services from its own departments and directorates without competition'; on the other hand, Denmark only regards purchasing arrangements within the same sphere of authority as in-house procurement.[11] It is observed that in the Swedish courts, all government authorities are considered as being part of the same legal entity regardless of how independently they may act, while municipalities and county councils are considered to be separate legal entities.[12]

The ECJ has made clear that the 'house' can neither be as big as the state nor be as small as within one legal entity, in the landmark Teckal case.[13] As a starting point, in the absence of an express exception,[14] the

9 Case C-26/03, *Stadt Halle, RPL Recyclingpark Lochau GmbH v. Arbeitsgemeinschaft Thermische Restabfall und Energieverwertungsanlage TREA Leuna* ('*Stadt Halle*') [2005] ECR I-0001, at para. 48.

10 Ibid.

11 Letter from the Ministry of Modernization of 18 January 2005 to the Ministry of Finance regarding the state's centre for economic governance and its participation in procurement procedures. Quoted from Weltzien, note 5 above, at 238. As explained below in section 3.2, Canada takes a view similar to that of the Norwegian Ministry of Modernization.

12 Pedersen and Olsson, note 5 above, at 41.

13 Case C-107/98, *Teckal Srl v. Comune di Viano (Reggio Emilia)* ('*Teckal*') [1999] ECR I-8121.

14 The available express exceptions will be addressed below in sections 2.3–2.5.

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ECJ ruled that it is sufficient *in principle*, for a public contract to exist, that the contract has been concluded between 'two separate persons'[15] or 'a local authority on the one hand and a person legally separate from the latter on the other hand'.[16] However, purchasing arrangements between two legally distinct public entities may nevertheless be outside the scope of EU procurement rules in the case where the contracting authority exercises over the supplying public entity 'a control which is similar to that which it exercises over its own departments and, at the same time', the supplying public entity 'carries out the essential part of its activities with the controlling local authority or authorities'.[17]

Therefore, through *Teckal* and a long line of subsequent case law,[18] the ECJ has established and continues to fine-tune one of the most significant exceptions to the EU procurement rules – the so-called 'in-house providing' exception. The exception is twofold. First, it excludes from the application of procurement rules purely 'in-house' contracts – those performed with a contracting authority's own internal resources. Second, it also excludes 'quasi-in-house' arrangements – contracts performed by a

15 Case C-107/98, *Teckal*, note 13 above, at paras. 49–50.

16 Case C-349/97, *Commission v. Spain* [2003] ECR I-3851, at para. 204.

17 Case C-107/98, *Teckal*, note 13 above, at para. 50.

18 Case C-107/98, *Teckal*, note 13 above, *Public Procurement Law Review*, 9 (2000), CS41; Case C-94/99, *ARGE Gewässerschutz v. Bundesministerium für Land- und Forstwirtschaft* ('*ARGE Gewässerschutz*') [2000] ECR I-11037, *Public Procurement Law Review*, 10 (2001), NA54; Case C-349/97, *Commission v. Spain*, note 16 above; Case C-26/03 *Stadt Halle*, note 9 above, *Public Procurement Law Review*, 14 (2005), NA72; Case C-84/03, *Commission v. Spain* [2005] ECR I-139, *Public Procurement Law Review*, 14 (2005), NA78; Case C-231/03, *Consorzio Aziende Metano v. Comune di Cingia de'Botti* ('*CONAME*') [2005] ECR I-7287, *Public Procurement Law Review*, 14 (2005), NA153; Case C-458/03, *Parking Brixen GmbH v. Gemeinde Brixen, Stadtwerke Brixen AG* ('*Parking Brixen*') [2005] ECR I-8585, *Public Procurement Law Review*, 15 (2006), NA40; Case C-29/04, *Commission v. Austria (Mödling)* [2005] ECR I-9705, *Public Procurement Law Review*, 15 (2006), NA52; Case C-410/04, *Associazione Nazionale Autotransporto Viaggiatori (ANAV) v. Comune di Bari, AMTAB Servizio SpA* [2006] ECR I-3303, *Public Procurement Law Review*, 15 (2006), NA217; Case C-340/04, *Carbotermo v. Comune di Busto Arsizio* ('*Carbotermo*') [2006] ECR I-4137, *Public Procurement Law Review*, 15 (2006), NA150; Case C-220/05, *Jean Auroux v. Commune de Roanne* [2007] ECR I-385, *Public Procurement Law Review*, 16 (2007), NA65; Case C-337/05, *Commission v Italy (Augusta Bell Helicopters)* [2008] ECR I-2173, *Public Procurement Law Review*, 17 (2008), NA187; Case C-220/06, *Asociación Profesional de Empresas de Reparto y Manipulado de Correspondencia v. Administración General del Estado* ('*Asociación Profesional*') [2007] ECR I-12175, *Public Procurement Law Review*, 17 (2008), NA204; Case C-295/05, *Asociación Nacional de Empresas Forestales ('Asemfo') v. Transformación Agraria SA (Tragsa)* [2007] ECR I-2999, *Public Procurement Law Review*, 16 (2007), NA123; Case C-324/07, *Coditel Brabant SA v. Commune d'Uccle and Région de Bruxelles-Capitale* ('*Coditel Brabant*'), Judgment of 13 November 2008, not yet reported, see the note in *Public Procurement Law Review*, 18 (2009), NA73.

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public entity legally distinct from the contracting authority but (i) under its control, similar to that which it exercises over its own departments, and, at the same time, (ii) the in-house provider must carry out the essential part of its activities with the controlling contracting authority or authorities. Whenever both requirements are met, the services are awarded on account of the control exercised by a public authority over a provider who is only 'formally' and not 'substantially' a third party, whose mission is to provide services for its controller or on behalf of it, regardless of the fact that the provider is subject to public or private law and established pursuant to contract, statute, regulation or administrative provisions. While the exclusion of purely in-house procurement can arguably be derived from the definition of public contracts contained in the directives, the exclusion of 'quasi-in-house' arrangements does not have a formal legal basis in the procurement directives and has encountered difficulties in its codification as further explained below.

Attention can now turn towards the detailed analysis of the two cumulative conditions for the 'in-house providing' exception to apply, namely the 'similar control' test and the 'essential part of its activities' test as interpreted by the constantly refining case law. It can be argued that these conditions have been interpreted by the ECJ in many respects in such a way as to make it difficult to rely on the in-house provision.

2.2.2. The 'similar control' test

The 'similar control' requirement provides that the in-house provider 'has no discretion' whatsoever and that, in the end, the public authority is the only one to make decisions concerning that company. Moreover, use of the expression 'in-house' indeed reveals the intention to make a distinction between activities which the authority carries out directly – by means of internal structures 'belonging to the house' – and those that it will entrust to a third-party operator.[19]

The 'similar control' requirement identifies the powers of influence required by the parent contracting authority in order to pursue fully 'its public interest objectives', regardless of whether this influence is exercised by means of private or public law powers, or by means of a single power or the joint effects of different powers.

Therefore, the 'similar control' requirement represents the parent public authority's ability to make the most relevant decisions on the

19 Opinion of Advocate General Bot in Case C-220/06, *Asociación Profesional de Empresas de Reparto y Manipulado de Correspondencia v. Administración del Estado* [2007] ECR I-12175 at 75.

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management and manufacturing process of the in-house provider, thus excluding a bilateral negotiation on terms and conditions of the supply of works, products or services. This 'similar control' implies the power of the parent contracting authority to set unilaterally – in pursuing its own (public) interests – the manufacturing and supplying conditions to the extent of precluding full management discretion on the part of the in-house provider.[20] The right of the provider to put an end to the contract with the contracting authority at any time seems to have been considered decisive in not finding an in-house arrangement.[21]

It appears that the 'similar control' requirement, as developed by ECJ case law, does not imply a direct shareholding of the controlling authority in the in-house provider's capital. Sometimes, the intervention of an intermediary holding company 'may, depending on the circumstances of the case, weaken any control possibly exercised by the contracting authority',[22] whereas at other times, the intermediary holding company is not relevant to the determination of whether the similar control' requirement is met.[23]

When the in-house provider's capital is wholly owned by the controlling authority that appoints it to carry out its services, this 100 per cent shareholding, in the absence of evidence to the contrary, is an indication that the 'similar control' requirement is met, above all where the in-house provider carries out all its activity solely for the controlling authority.[24] The absence of other shareholders permits the presumption of a lack of 'external' interests that may prevent the controlling authority from pursuing the public interests within the in-house context.

In a situation where a group of contracting authorities holds shares in the in-house provider's capital, a deeper examination as to whether the powers of influence in the in-house entity management entitle each contracting authority to exert a 'similar control' over it is required, in so far as only some of the shareholding authorities might exercise a 'similar control', while others might not participate in the in-house relationship, thus being unable to dispose direct awards to the in-house organization in compliance with EC law.[25] An excessive fragmentation of capital shareholdings does not prevent each shareholder from exerting a 'similar

20 Case C-295/05, *Asemfo*, note 18 above, at 59.
21 Case C-220/06, *Asociación Profesional*, note 18 above.
22 Case C-340/04, *Carbotermo*, note 18 above, at 39.
23 Opinion of Advocate General Sixt-Hackl in Case C-26/03, *Stadt Halle*, at 6–10, 59.
24 See Opinion of Advocate General Kokott in Case C-458/03, *Parking Brixen*, note 18 above, at 74–5.
25 Case C-107/98, *Teckal*, note 13 above; Case C-231/03, *CONAME*, note 18 above; Opinion of Advocate General Cosmas in Case C-107/98, *Teckal*, note 13 above, at 16.

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control', it only requires an in-depth analysis of whether the minority shareholders are entitled to influence the provider's decision-making.[26]

The holding of in-house provider capital shares by entities other than the parent public authorities introduces economic interests which may affect and interfere with the exercise of 'similar control' by the parent public authorities, thus harming the pursuit of the above-mentioned public interests.[27] The actual presence of a third-party private shareholder must be considered when ascertaining whether the 'similar control' requirement is met, and, if satisfied, the relationship between the awarding contracting authority and the public–private company would fall within the in-house exception under EC law.[28]

According to ECJ case law, the 'similar control' condition fades if the private minority shareholder acquires considerable rights of veto over important decisions or the power to appoint one of two managing directors having identical rights,[29] or whenever the by-laws decree a wide breadth of business objectives, the possibility of expansion of the geographical scope of a company's activities to the whole of a national or foreign territory and the opening of the company to other capital.[30] Equally, it seems that the 'similar control' requirement will not be met by the mere holding of a majority in a company's general assembly or the power to appoint more than half of the managerial or administrative board members – irrespective of whether this power is provided for by the company by-laws or by a corporate agreement – where the managing director is appointed by the private minority shareholders.[31] A shareholders agreement or the applicable national company law may render

26 Case C-324/07, *Coditel Brabant*, note 18 above, at 31; Case C-340/04, *Carbotermo*, note 18 above, at 37; and Case C-295/05, *Asemfo*, note 18 above, at 57.

27 Advocate General Kokott in her Opinion in Case C-458/03, *Parking Brixen*, note 18 above, at 74, argued that 'if a private third party has a holding, even a minority holding, in an undertaking, the consideration given to the economic interests of that undertaking may prevent the public body from fully pursuing its public-interest objectives'.

28 In Case C-26/03, *Stadt Halle*, note 9 above, at 19, the circumstances that the private minority shareholder had 'certain specific rights' seemed to turn decisive.

29 Such powers, entitled to the private shareholder, prevent the City of Mödling from exerting a 'similar control' even if the latter has the majority of votes in the general assembly: Opinion of Advocate General L. A. Geelhoed in Case C-29/04, *EC Commission v. Austria*, note 18 above, at 36, 39 and 46.

30 Case C-458/03, *Parking Brixen*, note 18 above, at 65–7.

31 Unless the public authorities were entitled to exert decisive management instruction over the in-house entity: Case C-94/99, *ARGE Gewässerschutz*, note 18 above, commented by M. Ohler, *Public Procurement Law Review*, 10 (2001), NA54; Case C-29/04, *Commission v. Austria*, note 18 above; Case C-458/03, *Parking Brixen*, note 18 above, at 64.

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the majority shareholder powers of control ineffective, binding or limiting the power to appoint the managerial board or narrowing the managing director's discretion, thus blunting public authority influence[32] on the in-house provider's strategic objectives and significant decisions.[33]

The 'similar control' exercised over the in-house provider must be effective, but it need not be exercised individually. Therefore, where a number of public authorities own a sole in-house provider organization to which they entrust the performance of one of their tasks, the control which those public authorities exercise over that entity may be exercised jointly.[34] It follows that the form of pure cooperation or association among local authorities taken by the in-house provider must be evaluated in conjunction with the effective 'similar control' exercised by the awarding authority: the 'similar control' requirement is thus met when the contracting authorities enjoy detailed powers of influence over the in-house provider, sufficient to support a finding of an in-house provision relationship.[35]

2.2.3. The destination of the essential part of an in-house provider's activities

The in-house provider must carry out the essential part of its activities for its parent and controlling public authority, thus limiting its economic freedom and autonomy as an enterprise and market competitor, in the sense that only a very small portion of its activities can be pursued outside the in-house relationship in order to reap the benefit of economies of scale and scope.[36]

The wording of the examined criterion is not univocal in ECJ decisions and in the Advocate General's Opinions, where it is referred to as the 'main

32 Case C-26/03, *Stadt Halle*, note 9 above, at 19, where 'the private minority shareholding exceeded the threshold of 10 per cent above which, in accordance with the German legislation on limited companies, there is a minority with certain specific rights'.

33 Case C-324/07, *Coditel Brabant*, note 18 above, at 34; Case C-458/03, *Parking Brixen*, note 18 above, at 65; Case C-340/04, *Carbotermo*, note 18 above, at 38.

34 M. Dischendorfer, 'The Compatibility of Contracts Awarded Directly to "Joint Executive Services" with the Community Rules on Public Procurement and Fair Competition', *Public Procurement Law Review*, 16 (2007), NA129.

35 Case C-371/05, *Commission v. Italy*, judgment of 17 July 2008, not yet reported; Case C-324/07, *Coditel Brabant*, note 18 above, at 41.

36 R. Cavallo Perin and D. Casalini, 'L'in house providing: un'impresa dimezzata', *Diritto Amministrativo*, 1 (2006), 51 et seq. According to Avarkioti, note 5 above, at 33, 'there is no fear that such undertaking may compete [in favourable terms] with other undertakings in tender procedures for public contracts'.

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part' as well as the 'essential part' of the activities carried out by the in-house provider.[37] It follows that any other activity towards third entities may only be of accessory, ancillary, secondary or marginal significance. Notwithstanding some uncertainty in assessing the criteria eligible to meet this requirement, there are some fixed points in its still developing interpretation.

The starting point in assessing the requirement should be the activities effectively performed by the in-house provider as opposed to the potential activities which the latter could undertake – according to the law, its own by-laws or the act of delegation issued by the controlling authorities – which should not form the basis of calculation. Therefore, in case of several controlling authorities, the activities to be taken into account are those effectively carried out for all these authorities taken together.[38]

Moreover, the measurement of the main or essential part of the in-house provider's activity has to be performed both from a qualitative and a quantitative point of view. Considering the qualitative perspective, it seems to be necessary to examine what kind of tasks the company is entitled to carry out. It is doubtful whether the circumstances that the provider is operating in a competitive market or that it is carrying out entrusted tasks based on a concession or delegation which transfers a granted and protected demand to the provider could be relevant, as the ECJ has clearly stated that it does not matter who is the beneficiary (the contracting authority or the users), who pays for the services (the contracting authority or the customers) and where those services are provided.[39]

From a quantitative perspective, the income or turnover of the entity turns out to be decisive in assessing the essential part of the in-house provider's activities: considering all the activities performed, those awarded by the controlling authorities must be predominant. To that extent, it appears impossible to define a percentage threshold in advance as a general rule to apply automatically, whereas a case-by-case approach seems more suitable.

The destination of the essential part of the in-house provider's activities is meant to express a very close functional and economic dependence of the latter on the controlling authorities so that the repeal of the entrusting

37 Avarkioti, note 5 above, at 22, 32; Kaarresalo, note 5 above, at 252.

38 Case C-340/04, *Carbotermo*, note 18 above, at 69–72; Case C-295/05, *Asemfo*, note 18 above, at 59, 65; Case C-324/07, *Coditel Brabant*, note 18 above, at 27; Case C-371/05, *Commission v. Italy*, note 35 above.

39 Case C-340/04, *Carbotermo*, note 18 above.

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of works, products and services deprives the in-house provision relationship of its own consideration and averts the in-house provider's permanence as an economic operator even on the markets where it used to carry out subsidiary or secondary activities.

2.3. Inter-municipal association and cooperation agreements: is this concept a new dimension of the 'in-house providing' exception?

As discussed above in section 2.2, the 'in-house providing' exception established in *Teckal* and the subsequent case law excludes from EU procurement rules a significant proportion of purchasing arrangements between public sector entities, in particular, procurement from a public entity jointly set up by a number of municipalities, provided that the conditions on control and destination are met. However, the so-called *Teckal* doctrine has its own limit. It arguably only applies to institutionalized purchasing arrangements/cooperation between public sector entities and will not cover purely contractual (non-institutionalized) cooperation arrangements.

For example, municipalities A and B, instead of jointly setting up a public body to provide the waste disposal service they need, sign a contract providing that A will allow B to use its surplus landfill capacity and B will allow A to use its new incineration facility. A will direct payment to B to cover B's fees, and B, on A's behalf, will pay the private operator of the facility C. The contract is arguably a public contract since it involves pecuniary interest and is concluded between two municipalities legally distinct from each other. It is difficult for the *Teckal* type of 'in-house providing' exception to apply since A has not acquired control over B through this arrangement. On the other hand, however, should A and B choose to set up a public body D to replace C as the operator of the facility, the arrangements, the same in essence but different in form, would arguably have a chance to benefit from the 'in-house providing' exception, provided that the criteria of control and destination have been met. This limit of the *Teckal* doctrine arguably restricts the national/local government's ability to organize the fulfilment of their public service obligations at the national/local level in the most convenient manner and has caused legal uncertainty and confusion.

Such confusion was demonstrated in the *Commission v. Spain* case.[40] In transposing EU procurement directives into its national law, the

40 Case C-84/03, *Commission v. Spain*, note 18 above.

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Spanish government excluded, *a priori*, from the scope of the implementing legislation, all 'agreements concluded either between the general State administration and the Social Security, autonomous communities, local bodies, their autonomous bodies and any other public body, or between public bodies themselves'. Such a wide exclusion was rejected by the ECJ and considered as an incorrect transposition of the procurement directives.[41] However, the ECJ has not gone further to clarify to what extent various cooperation agreements, the normal way for public sector entities to establish relations between them, may be exempted beyond the limited boundary of the *Teckal* type of 'in-house providing' exception. As a consequence, certain EU Member States, notably Sweden, have gone to the other end of the spectrum: the ECJ's ruling in *Commission v. Spain* (C-84/03) has been understood in Sweden to mean that municipalities and county councils as a general rule have to conduct a public procurement procedure before entering into contracts of pecuniary interest with each other, regardless of the content or circumstances of the contract.[42]

The power of establishing forms of cooperation among territorial public authorities is an expression of the freedom of self-government enjoyed by the latter in almost every European national legal system and therefore recognized in the European Charter on Local Self-Government of 1985. As for the public procurement sector, these forms of cooperation can be traced back to the core definition of contracting authority since the very first European directive on public procurement already included among the traditional contracting authorities (state, regional or local authorities) the 'associations formed by one or several of such authorities'. Therefore, it is imperative that the ECJ shall police the boundary between procurement regulation and the freedom of self-government with caution and clarity.

Encouragingly, some guidance has at last been provided by the ECJ in the recent *Commission v. Germany* case.[43] The case concerned a twenty-year arrangement for waste disposal concluded in Germany between four administrative districts of Lower Saxony and Stadtreinigung Hamburg (the City of Hamburg Cleansing Department), without any call for tenders. Stadtreinigung Hamburg reserved part of its new incineration facility's capacity for the districts. The districts paid annual fees to the Cleansing Department, and the latter passed the payment on to the facility's

41 *Ibid.*, at para. 40. 42 Pedersen and Olsson, note 5 above, at 41.
43 Case C-480/06, *Commission v. Federal Republic of Germany*, judgment of 9 June 2009, not yet reported.

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private operator. The districts also made available to Stadtreinigung Hamburg their excess landfill capacity to alleviate the lack of landfill capacity of the City of Hamburg. The Commission was of the opinion that the district councils had entered into a public service contract and should have complied with the procurement directives. According to the Commission, the 'in-house exception' could not apply because the districts had no control over Stadtreinigung Hamburg. Although the ECJ accepted that the *Teckal* type of exception did not apply since the districts had no control over Stadtreinigung Hamburg or the operator of the incinerator (paragraph 36), it nonetheless concluded that the Community procurement rules in general did not apply to the municipal cooperation agreement in question.

In reaching that conclusion, the ECJ did not set out any general principle as a basis for this exclusion, but confined itself to listing the factual features of the arrangement in question. It emphasized the fact that the arrangement provided for cooperation between entities to enable the public service activity of the disposal of waste to be carried out, including that the arrangement had the effect of making feasible the creation of a waste-processing facility with a significant capacity and that the arrangement itself contained commitments from the administrative districts to provide certain amounts for processing (paragraph 38). It also pointed out that the arrangement provided for other commitments by the administrative districts that were directly related to this public service objective of waste disposal – for example, making available to Stadtreinigung Hamburg the landfill capacity they did not use themselves to alleviate any lack of capacity of the City of Hamburg facility (paragraph 41) and providing for the parties to assist each other in various other ways so as to meet this objective, for instance by the administrative districts reducing the waste sent to the treatment facility envisaged in the arrangement in case of capacity problems (paragraph 42). The ECJ also, however, referred to the fact that in this case, the arrangement provided that payment by the administrative districts should be made only to the party operating the facility under a contract with Stadtreinigung Hamburg, and did not involve financial transfers to Stadtreinigung Hamburg itself (paragraph 43). Payments would be made to Stadtreinigung Hamburg only to the extent of reimbursing it for the charges that it paid to the operator for the use of the facility by the districts. It can also be noted that the Commission had in fact accepted that had this task been entrusted to a body governed by public law created for this purpose, the Community public procurement rules would not apply. The ECJ emphasized that the position was

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no different because the arrangement in this case took the different legal form of an agreement (paragraph 47). The ECJ also highlighted that there was nothing in this case to indicate that the authorities were contriving to circumvent the procurement rules (paragraph 48).

Although the ECJ relied on factual features of the arrangement in question instead of establishing formal criteria, Kristian Pedersen and Erik Olsson argued that the ECJ has in fact, by applying the underlying purpose of the *Teckal* doctrine, established a new type of 'in-house providing' exception applicable to the situation of purely contractual (non-institutionalized) cooperation agreements between public authorities, to work alongside the *Teckal* doctrine which is limited to institutionalized cooperation arrangements.[44] Based on the factual features noted by the ECJ, the new test is argued to consist of the following elements: (i) the arrangement is set up by entities forming part of the state (in its wide EC law definition) without any involvement of private parties; (ii) the services provided for in the contract are to a large extent non-commercial and are therefore in themselves of little or no interest for a private party; (iii) the arrangement is not created as a way of avoiding the application of the public procurement rules.[45] Whether those features may be rationally generalized in such a manner remains unclear.

The factual features relied upon by the ECJ were expressed in a non-hierarchical fashion. However, it is suggested that the ECJ may have been particularly influenced by the fact that the arrangement in question did not involve real financial transfers to Stadtreinigung Hamburg, which was only acting as a 'hub' or agent passing on the payment from the districts to the incinerator operator. Stadtreinigung Hamburg, in fact, is not the real service provider. The contract between the four districts and Stadtreinigung Hamburg merely arranged tasks of waste disposal without touching upon the actual performance and implementation of such tasks. Therefore, the contract in question, unlike the contract between Stadtreinigung Hamburg and the incinerator operator which will most likely be covered by EU procurement rules, did not prejudice any private undertaking as against its competitors (paragraph 51) – presumably because any person would be able to tender for the actual waste disposal function. This might suggest that inter-municipal cooperation/non-institutionalized arrangements can only be excluded from the application of EU procurement rules to the extent that such arrangements will, after all, lead to a public contract falling under the coverage of the directives. Should this be the decisive factor for the ECJ to exclude the arrangement in question, it

44 Pedersen and Olsson, note 5 above, at 44. 45 Ibid.

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would significantly limit the scope of this new exception. It will arguably work in a similar fashion to the exception for procurement from central purchasing bodies as explained below in section 2.5: the exception may be invoked only when the 'hub' or agent, a public entity such as Stadtreinigung Hamburg or a central purchasing body, complies with EU procurement rules in its procurement of supplies, services or works to be passed on.

2.4. Exception relating to service contracts awarded on the basis of an exclusive right

In addition to the 'in-house providing' exception largely developed through ECJ case law, the EU procurement directives contain a number of express but exhaustive exceptions regarding purchasing arrangements between public sector entities which will be discussed in the following sections.[46] The first one to be considered is the exception relating to service contracts awarded on the basis of an exclusive right. EU procurement directives provide that they shall not apply to public service contracts awarded to a contracting authority 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 which is compatible with the Treaty'.[47]

Several limits of the exception are noteworthy. First, it only applies to public service contracts, and cannot be implicitly extended to public supply or works contracts.[48] Second, the awardees of the service contracts must be a 'contracting authority' or an association of them,[49] therefore service contracts awarded to a public entity which is not a 'body governed by public law' will not be excluded by virtue of this exception. Third, there must be a published *law, regulation or administrative provision* compatible with the EU Treaty that designates the contracting authority as the exclusive provider of the service in question.

46 The exhaustive nature of the expressly listed exceptions was confirmed by the ECJ in Case C-107/98, *Teckal*, note 13 above.

47 Article 18 of the EU classical sector Directive (2004/18); Article 25 of the EU utility sector Directive (2004/17).

48 See note 46 above.

49 'Contracting authorities' are defined as state, regional or local authorities, bodies governed by public law, associations formed by one or several such authorities or one or several of such bodies governed by public law. Article 1(9) of the EU classical sector Directive (2004/18); Article 2(1)(a) of the EU utility sector Directive (2004/17).

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Regarding the second limit, there was doubt as to whether a publicly listed company, established by several local municipalities exclusively to provide waste collection and road cleaning services, might be regarded as a 'body governed by public law' 'meeting needs in the general interest, not having an industrial or commercial character'.[50] This issue was addressed by the ECJ in the *Arnhem* case.[51] The ECJ made it clear that 'the concept "needs in the general interest, not having an industrial or commercial character" does not exclude needs which are or can be satisfied by private undertakings as well' (paragraph 53); and 'the status of a body governed by public law is not dependent on the relative importance, within its business as a whole, of the meeting of needs in the general interest not having an industrial or commercial character' (paragraph 58). The broader the term 'body governed by public law' gets interpreted by the ECJ, the less restrictive the second limit will be.

The third limit, at first glance, may cause concern since there is a danger that a Member State's government might deliberately confer an exclusive right on its public bodies to provide certain services so as to avert the application of EU procurement rules. However, that concern is arguably addressed since the EU Treaty contains a special provision in the context of competition law restricting the margin of Member States' discretion in granting exclusive rights.[52]

2.5. Exception relating to contracts with central purchasing bodies

A 'central purchasing body'[53] is defined as a contracting authority which 'acquires supplies and/or services intended for contracting authorities' or

50 According to the EU Directives cited in the note above, 'a "body governed by public law" means any body: (a) established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character, (b) having legal personality and (c) 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'.

51 Case C-360/96, *Gemeente Arnhem v. BFI Holding BV* ('*Arnhem*') [1998] ECR I-6821, [2001] 1 CMLR 6.

52 Article 106 of the Treaty on the Functioning of the EU, ex Article 86 EC, provides that 'in the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in article 18 and articles 101 to 109'.

53 See Arrowsmith, note 3 above, at 15.162.

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'awards public contracts or concludes framework agreements for works, supplies or services intended for contracting authorities'.[54] Contracting entities, including government authorities, bodies governed by public law and public undertakings, which purchase works, supplies and/or services from or through a central purchasing body, shall be deemed to have complied with the directive in so far as the central purchasing body has complied with it.[55]

The exemption applies only if the central purchasing body has followed the directive in making its own purchases. It is not clear what happens here if the central purchasing body gets the supply from a general stock, e.g. a warehouse. Does this mean that the central purchasing body must have complied with the directive in making all its purchases from that stock in order for the purchase from the central purchasing body to be lawful? From a practical perspective, contracting authorities will only wish to rely on this provision for making direct purchases from a central purchasing agency if they can be confident that the agency has itself complied with the directive.[56]

It is noteworthy that the definition of central purchasing body requires the body to be a contracting authority – it cannot be a private company. The reasoning behind this is that the central purchasing body will generally have followed the directive itself in making its own purchases, so it is not necessary for the directive to apply to those purchases again.

2.6. The 'affiliated undertakings' and 'joint venture' exemptions in the Utilities Sector Directive

The EU Utilities Directive (2004/17)[57] contains an additional provision (Article 23), excluding from the application of the Utilities Directive only (i) contracts awarded by a contracting entity or a joint venture formed exclusively by such entities to carry out a utility activity, to an affiliated undertaking (the so-called 'affiliated undertaking exemption'); and (ii) contracts awarded by such a joint venture to one of its partners, as well as

54 Article 1(10) of the EU classical sector Directive (2004/18); Article 1(8) of the EU utilities sector Directive (2004/17).

55 Article 11 of the EU classical sector Directive (2004/18); Article 29 of the EU utilities sector Directive (2004/17).

56 S. Arrowsmith, 'An Assessment of the New Legislative Package on Public Procurement', *CMLR*, 41 (2004), 1312.

57 See Arrowsmith, note 3 above, at 15.13.9.

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contracts awarded by a contracting entity to such a joint venture of which it forms part (the so-called 'joint venture exemption').

For the 'affiliated undertaking exemption' to apply, two cumulative criteria must be fulfilled. The first is the requirement of an 'affiliation' (Article 23(1)). An undertaking will be regarded as affiliated to a contracting entity if (i) its annual accounts are consolidated with those of the contracting entity; or (ii) the contracting entity has control over the undertaking; or (iii) the undertaking has control over the contracting entity; or (iv) both are subject to the control of another undertaking. It is noteworthy that the 'control' test here means dominant influence by virtue of ownership, financial participation, or the rules which govern it. This test differs significantly from the 'similar control' test in the 'in-house providing' exception discussed above in section 2.2.2 in the sense that the control test to establish affiliation includes reverse control and mutual third party control and is much easier to fulfil.

The second criterion is the so-called '80 per cent rule' (Article 23(2)). It requires that at least 80 per cent of the average turnover of the affiliated undertaking with respect to services, supplies or works, depending on the contracts being considered for exclusion in question, for the preceding three years, derives from the provision of such services, supplies or works, to undertakings with which it is affiliated. This criterion also differs from the 'destination of the essential part of activities' test in the 'in-house providing' exception discussed above in section 2.2.3 in the sense that the '80 per cent rule' test is more straightforward and arguably easier to fulfil.

The European Commission is empowered to monitor the application of both the 'affiliated undertaking exemption' and the 'joint venture exemption' by requiring the undertakings concerned to notify it of the nature and the value of the contracts involved (Article 23(5)).

2.7. Conclusion on the EU framework

To sum up, EU procurement rules have provided a comprehensive framework to deal with purchase arrangements between public sector entities. This framework consists of some express and exhaustive exceptions contained in the directives and the 'in-house providing' exception developed through case law. This framework and its detailed application reflect the balance struck by the EU legislator and ECJ between ensuring market access, undistorted competition and transparency on the one hand, and respecting the autonomy of national governments in providing goods and services for public interests on the other. According to Advocate General Kokott, 'such extensive interference in the organisational sovereignty of

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Member States and, in particular, in the self-government of many municipalities is – even from the point of view of the market-opening function of procurement law – entirely unnecessary'.[58] It is this balance as reflected in the directives and the case law that provides guidance for the GPA which aims at opening up the procurement market of its parties.

3. Purchasing arrangements between public sector entities under the GPA

3.1. The general approach

Contrasting with the systematic approach of the in-house providing exception under the EU procurement directives explained above in section 2, the GPA, which also aims at opening up national procurement markets, has not expressly addressed the issue of purchasing arrangements between public sector entities in its texts and there is no WTO case law to clarify the situation. As discussed below in section 3.2, in the absence of a general rule on coverage, the GPA approach to in-house provision is unsurprisingly of an inconsistent and ad hoc nature, leaving its Parties with significant and unchecked discretion. However, as explained in section 3.3, the current situation will arguably become unsustainable due to the fact that countries with large state sectors are negotiating accession, most notably China, and the EU has grown impatient with the imbalance in concessions offered by major Parties which has been impeding the progress of the current GPA reform. It is arguably at this stage that the probability of the GPA learning from the EU's approach to purchasing arrangements between public sector entities will be assessed. While, as discussed below in section 3.4, there are significant obstacles, the EU's experience in this regard arguably points out a feasible way forward.

3.2. Relevant GPA provisions and Parties' derogations

As a starting point, neither the current GPA (hereinafter GPA 1994) nor the provisionally adopted revised text (hereinafter GPA 2007)[59] provides a clear and workable definition of covered procurement, or specific

58 Opinion of Advocate General Kokott in Case C-458/03, *Parking Brixen*, note 18 above, at 42, 71 and 80.

59 GPA/W/297, 11 December 2006. The GPA 2007 was agreed on 8 December 2006 and its entry into force is still subject to a mutually satisfactory outcome to the coverage expansion negotiations which have not yet been concluded. See www.wto.org/english/news_e/news06_e/gproc_8dec06_e.htm, last visited on 15 February 2010.

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exceptions on in-house provision such as those contained in the EU procurement directives discussed above in section 2.

The scope of covered procurement is broadly defined under GPA 1994 as 'procurement by any contractual means, including through such methods as purchase or as lease, rental or hire purchase, with or without an option to buy, including any combination of products or services' (Article I.2). However, it is not clear what procurement is in the first place. Certain Parties, such as Canada, even include in their Annexes their own version of the definition of covered procurement.[60] The new definition of 'covered procurement' introduced in GPA 2007 only added a new condition of 'for governmental purposes' and a new general exclusion regarding procurement 'with a view to commercial sale or resale, or for use in the production or supply of goods or services for commercial sale or resale'.[61] The GPA did not further define the term 'public contract' or 'contractual means' with reference to covered entities. This is inevitable as the GPA Parties have failed to agree on a general definition of covered public entities and resorted to the so-called 'positive list' approach.[62] It can be argued that Parties under the current and revised GPA have significant discretion to adopt derogations with respect to the 'in-house'

60 Canada's General Notes to Annexes state that '[P]rocurement in terms of Canadian coverage is defined as contractual transactions to acquire property or services for the direct benefit or use of the government. The procurement process is the process that begins after an entity has decided on its requirement and continues through to and including contract award. It does not include non-contractual agreements or any form of government assistance including but not limited to co-operative agreements, grants, loans, equity infusions, guarantees, fiscal incentives and government provisions of goods and services, given to individuals, firms, private institutions, and sub-central governments. It does not include procurements made with a view to commercial resale or made by one entity or enterprise from another entity or enterprise of Canada.' *Canada, Appendix I, General Notes to Annexes*, Note 2, WT/Let/330, 1 March 2000.

61 Article II (Scope and Coverage) paragraph 2 provides that '[F]or the purposes of this Agreement, covered procurement means procurement for governmental purposes: (a) of goods, services, or any combination thereof: (i) as specified in each Party's Appendix I; and (ii) not procured with a view to commercial sale or resale, or for use in the production or supply of goods or services for commercial sale or resale; (b) by any contractual means, including purchase; lease; and rental or hire purchase, with or without an option to buy; (c) for which the value, as estimated in accordance with paragraphs 6 through 8, equals or exceeds the relevant threshold specified in Appendix I, at the time of publication of a notice in accordance with Article VII; (d) by a procuring entity; and (e) that is not otherwise excluded from coverage in paragraph 3 or in a Party's Appendix I.'

62 For critics, see Arrowsmith, note 4 above, chapter 5; P. Wang, 'Coverage of the WTO's Agreement on Government Procurement: Challenges of Integrating China and other Countries with a Large State Sector into the Global Trading System', *Journal of International Economic Law*, 10 (2007), 887–920.

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type of procurement since Article II.2 GPA 2007 provides that 'covered procurement means procurement . . . that is not otherwise excluded from coverage in a Party's Appendix I'. However, it is noteworthy that GPA 2007 has introduced a new exception regarding '*non-contractual agreements* or any form of assistance that a Party provides, including *cooperative agreements*, grants, loans, equity infusions, guarantees, and fiscal incentives' (Article II.3, emphasis added). Although not further defined in GPA 2007, it is arguable that the municipal cooperation arrangement for waste disposal concluded in Germany between four administrative districts of Lower Saxony and Stadtreinigung Hamburg discussed above in section 2.3 may fall under such exclusion.

According to the GPA's broad definition of covered procurement and the new exception introduced in GPA 2007, it is certainly possible to argue that typical in-house provision, such as a ministry purchasing from an affiliated agency, does not involve procurement 'by contractual means' and thus falls outside the GPA scope even though an agreement laying down payment schedules has been entered into. This is certainly the understanding of Canada which considers 'cooperative agreements', among other forms of government assistance, as 'non-contractual agreements', thus not covered by the GPA.[63]

Under the EU procurement rules, the ECJ, through its case law, provided the legal certainty and maintained the balance between competition/transparency and legitimate public interest in excluding certain purchasing arrangements between public entities as highlighted above in section 2.2. However, the WTO panels and the Appellate Body have not been able to achieve the same, due to the lack of opportunity and arguably of a teleological approach to interpretation as analysed below. The resulting legal uncertainty has led the GPA Parties to adopt a variety of ways to treat purchasing arrangements between public entities.

For example, Canada excludes from its self-defined term of 'procurement' all purchasing arrangements between public entities defined as 'procurements . . . *made by one entity or enterprise from another entity or enterprise* of Canada' (emphasis added).[64] This is a very broad exclusion which does not require the public entities in question to have institutional (i.e. one has control over the other similar to that which it exercises over its own department) and activity (one supplies the essential part of its goods/services to the other) links. This arguably reflects the view that

63 See note 60 above.
64 *Ibid.*, Canada, *Appendix I, General Notes to Annexes*, Note 2, WT/Let/330, 1 March 2000.

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the state as a whole shall be regarded as 'one legal person', so purchasing arrangements between any public entity/enterprise, directly or indirectly, affiliated to the state shall be regarded as 'in-house' non-contractual agreements, thus not subject to procurement rules.[65]

In contrast, the EC has not included in its Appendix I derogations aiming at the incorporation of statutory or case-law-based 'in-house providing' exceptions mentioned above in section 2 except limited reference to exceptions contained in the domestic law of Finland and Sweden. The EC's General Notes to Appendix I provide that the GPA 'shall not apply to contracts awarded to an entity in Finland which itself is a contracting authority within the meaning of the Public Procurement Act: "Laki julkisista hankinnoista" (1505/92), or in Sweden within the meaning of the "Lag om offentlig upphandling" (1992:1528), *on the basis of an exclusive right* which it enjoys pursuant to a law, regulation or administrative provision or to contracts of employment in Finland and Sweden' (emphasis added).[66] As explained above in section 2.4, EU procurement directives contain general exceptions related to in-house provision on the basis of exclusive rights that apply to all Member States including, but not limited to, Finland and Sweden.[67] The reason for this limited reference is not clear.

However, on the other hand, EEA Members other than the EC, namely Switzerland, Liechtenstein and Norway, governed by identical procurement rules,[68] have incorporated in their Appendix I more detailed derogations in line with those found in the directives. For example, they excluded procurement of services from public entities that enjoy special or exclusive rights connected with the service provided,[69] and services procured from entities with which the procuring entity has a 'parent' or subsidiary relationship.[70]

65 See note 11 above.

66 EC, *Appendix I, General Notes and Derogations from the Provisions of Article III*, Notes 11, 12, WT/Let/438, 11 January 2003.

67 Article 18 of the EU classical sector Directive (2004/18); Article 25 of the EU utility sector Directive (2004/17).

68 For procurement rules under the European Economic Area Agreement, see Arrowsmith, note 3 above, chapter 20 at 20.8, 20.21–20.22.

69 For example, Switzerland, Appendix I Annex 4 Note 3; Liechtenstein, Appendix I Annex 4 Note 1.

70 For example, Switzerland, Appendix I Annex 4 Note 2; Liechtenstein, Appendix I Annex 4 Note 2; Norway, Appendix I Annex 3 Note 1. Liechtenstein's Appendix I Annex 4 Note 2 provides that the GPA does not apply to service contracts which a contracting entity awards to an *affiliated undertaking* or which are awarded by a joint venture formed by a number of contracting entities for the purpose of carrying out an activity within the meaning of Annex 3 or to an undertaking which is affiliated with one of these contracting entities. At least 80 per cent of the average turnover of that undertaking for the preceding

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3.3. The increasing significance of the issue

It can be argued that these different types of derogation made by existing GPA Parties excluding purchasing arrangements between public entities might give rise to abuse if adopted by acceding countries with a large state sector such as China.[71]

For example, excluding procurement of services from an exclusive public sector supplier can normally be justified on the grounds that the procuring entity is under a legal obligation to do so and no real competition will be possible in such a situation anyway. However, if the state's discretion to grant exclusive rights to public sector suppliers is not properly checked by competition law (as is the case in EU, explained above in section 2.4), as well as democratic institutions and political pressure, the scope of such exclusion based on exclusivity might be unduly wide and the effectiveness of the GPA coverage would be undermined.

Excluding procurement of services from an entity with which the procuring entity has a 'parent' or subsidiary relationship (an affiliated undertaking) can normally be justified on the ground that such procurements are in fact internal administrative arrangements rather than procurement from an external entity, and procuring entities should retain such freedom and flexibility for their commercial operation. However, it is crucial to define the scope of affiliated undertakings carefully to prevent circumvention. For example, most Chinese state enterprise groups have local branches that are registered as separate juristic persons and obtain substantial business outside the group. It is important for the GPA and its Parties to consider using some kind of mechanism like the EU Utilities Directive's 'affiliated undertaking' and 'joint venture' exceptions, as discussed above in section 2.6, as a benchmark to examine any proposed Chinese derogation. If all procurement from such a subsidiary company were to be excluded without proper qualification, the effectiveness of the GPA coverage would be undermined.

three years has to derive from the provision of such services to undertakings with which it is affiliated. Where more than one undertaking affiliated with the contracting entity provides the same service, the total turnover deriving from the provision of services by those undertakings shall be taken into account.

71 China submitted a formal application to become party to the GPA on 28 December 2007. See GPA/93 of 14 January 2008, available at www.wto.org. For news coverage of the application, see http://finance.sina.com.cn/g/20071228/18121896035.shtml, visited on 1 January 2008. For analysis, see Wang, note 63 above; P. Wang, 'China's Accession to the WTO Government Procurement Agreement: Challenges and the Way Forward', *Journal of International Economic Law*, 12 (2009), 663–706.

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The most serious concern is associated with the Canadian approach of excluding all purchasing arrangements between public sector entities. Such derogation is likely to have a significant detrimental effect, especially in the context of acceding countries with a large state sector. Unlike in Canada,[72] intra-public sector procurement is not the exception but the norm in former centrally planned transitional economies such as China and Mongolia where state enterprises still account for the majority or a considerable proportion of business undertakings and remain the sole or major supplier regarding certain goods or services. Should these acceding countries with a large state sector be allowed to exclude all purchasing arrangements between public entities from covered procurement, their offer tabled for GPA accession would be very limited.

Furthermore, it can be argued that the slow progress of the current concession negotiation among existing GPA Parties highlights the need for a principled approach under the GPA to exceptions and exclusions, including those related to purchasing arrangements between public entities. The revised text of the GPA (GPA 2007) was agreed on 8 December 2006 and its entry into force is subject to a mutually satisfactory outcome of the coverage expansion negotiations which were initially set to be concluded in 2007. However, due to the 'diverging level of ambition among the GPA Parties', the negotiations are still ongoing. Frustrated by the slow progress, the EU threatened in 2007 that, unless other Parties' offers are substantially improved and 'the issue of exceptions and exclusions addressed', a revised EU offer might entail a reduction in coverage, possibly as compared to its current coverage under the GPA 1994.[73] Consequently, the Commission, at the request of the Council,[74] submitted a 'revised – more limited' offer in February 2008.[75]

72 It can be argued that the impact of Canada's exclusion of all intra-public sector procurement is limited since Canadian federal enterprises listed in its Annex 3 are limited in number and most of them, such as Canada Post Corporation, Defence Construction (1951) Ltd, enjoy certain exclusive rights in their line of business anyway.

73 R. D. Anderson, 'Renewing the WTO Agreement on Government Procurement: Progress to Date and Ongoing Negotiations', *Public Procurement Law Review*, 16 (2007), 255–73; 'EU Warns It Could Pull Back GPA Commitments Over SME Treatment', *Inside US Trade*, 2 March 2007.

74 2780th External Relations Council meeting, Brussels, 12 February 2007, No. 6039/07, p. 6.

75 EC Commission, *Report from the Commission concerning negotiations regarding access of Community undertakings to the markets of third countries in fields covered by the Directive 2004/17/EC*, COM/2009/0592 final, 28 October 2009, available at http://eur-lex.europa.eu/.

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While the Eu is complaining about other Parties' derogations, such as those regarding procurement set-aside for small to medium sized enterprises (SMEs), it is important for the EU to acknowledge that unless the need for such derogations, as well as those related to purchasing arrangements between public entities, is addressed in the GPA text in a principled manner, the divergence among Parties' practice is arguably inevitable, as explained above in section 3.2. It is worth re-emphasizing that the scope of covered procurement for EU Member States under the procurement directives is not identical to that under the GPA. On the one hand, under certain circumstances, the scope under the EU rules is broader that that under the GPA due to the fact that other GPA Parties fail to offer reciprocal market access: for example, procurement of private utilities enjoying exclusive rights is subject to EU procurement directives but not the GPA. This will not create any problem in general.

However, on the other hand, it is problematic when the scope of covered procurement under the GPA is broader vis-à-vis the EC. This is likely to happen when an exception introduced in the EU procurement directives has not been duly incorporated into the EC's GPA Appendix I by derogation. For example, in 2004, the EC Utilities Directive introduced a general exemption for procurement associated with utilities activities directly exposed to competition on markets to which access is not restricted.[76] Since the EC has not yet introduced an equivalent exemption in its Appendix I, it is awkward but theoretically possible that certain procurement by EC utilities exempted under the EC procurement rules will still be subject to the GPA. As explained above in section 3.2, the 'in-house provision' exceptions under the EU procurement rules are in a similarly awkward situation.

Therefore, in order to maintain the balance of concessions of GPA Parties, there is arguably a strong need to unify their approach to justifiable derogations in order to eliminate discrepancies not only among Parties but also between GPA obligations and domestic procurement rules.

4. Relevance of the EU approach for the GPA

However, there are arguably a number of significant obstacles for the GPA to follow the EU's approach to purchasing arrangements between public entities. First of all, the GPA lacks a principled approach to coverage.

76 Directive 2004/17, note 6 above.

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Instead of relying on common definitions of covered procurement and entities aided by interpretation provided through judicial process, the GPA has left this arguably most important aspect in the hand of its Parties, counting on the deterrent provided by reciprocal negotiations. As explained above in section 2, the degree of 'control' between public entities plays an important role in the EU procurement rules to determine what kind of purchasing arrangements between public entities shall fall within the scope of directives in the first place and which should be excluded by virtue of statutory exceptions and those developed in the case law. The EU approach has been that the control test to exempt an in-house providing arrangement is significantly more difficult to fulfil in comparison with the control test to include a public entity in the first place. The factor of 'competition' also plays an important role, as highlighted in section 2.4 regarding the exception for contractual cooperation arrangements. However, such factors play only a minimal role in the context of the GPA. The idea that the factor of 'government control' can be used to define the entity coverage of the GPA as a general rule was rejected by the Panel ruling in the *Korea – Government Procurement* case.[77] The Panel's hands were arguably tied by the absence of common coverage rules in the GPA based on government control and competition.

Second, the GPA lacks the institutional framework, in particular an active judiciary to develop jurisprudence regarding the treatment of purchasing arrangements between public entities. As explained above in section 2.2, the ECJ has played a vital role in shaping the 'in-house providing' exception. The Panel's approach in the *Korea – Government Procurement* case arguably indicates that the WTO panels and the Appellate Body lack the tradition of judicial activism to fill in the gap in the GPA and practically lack the opportunity to do so.[78]

Third, in order for the judiciary to strike a balance between ensuring market access, undistorted competition and transparency on the one hand, and respecting the autonomy and self-government of national governments in providing goods and services for public interests on the other, both sides of the equation must be present in the instrument forming the legal basis of such an appraisal. While under EU law, subsidiarity is a

77 Panel report, *Korea – Measures Affecting Government Procurement*, WT/DS163/R, adopted 19 June 2000, DSR 2000:VIII, 3541.

78 There has been so far only one adopted panel report regarding the GPA since its entry into force sixteen years ago.

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recognized general principle, the GPA is silent on the extent to which autonomy of the organization of public services shall be taken into consideration. It is the GPA Parties themselves that are responsible for safeguarding their rights to self-government by negotiating necessary derogations, instead of the WTO acting as the mediator and the authority. In other words, while the ECJ is driving the case law on in-house provision forward, equipped with common rules and general principles, the WTO is staying put, empty handed. How can the GPA succeed in addressing the issue of purchasing arrangements between public entities effectively?

Last but not least, it must be acknowledged that even the EU has encountered difficulties in codifying the ECJ case law on the 'in-house providing' exception in the procurement directives. The European Commission tried to formulate an exemption to incorporate the 'spirit' of the *Teckal* judgment.[79] However, this attempt failed, arguably because the Member States were not able to unite in a common and simple wording, taking into account the many different organizational variations throughout the Union.[80] This failure highlights the sensitivity and difficulty in legislating on purchasing arrangements between public entities. As explained above in section 2.2, countries maintain polarized views on the scope of 'in-house' arrangements. While the EU has left the issue in the hands of its court, it is difficult to blame the GPA for not addressing the issue explicitly in its texts.

However, the obstacles mentioned above do not mean that EU experience in dealing with purchasing arrangements between public entities is of no value to the GPA. Various express exceptions contained in EU procurement directives are certainly worthy of consideration for incorporating into the GPA text in any future review. In GPA Parties' negotiations with acceding countries, especially those with a large state sector, the boundary of the 'in-house providing' exception as constantly refined by the ECJ, as well as statutory exceptions, can at least serve as a

79 The wording of the proposed Article 19(a) was: 'This Directive shall not apply to public contracts awarded by a contracting authority to a legally distinct entity owned exclusively by that contracting authority, if the entity concerned does not have autonomous decision-making powers in relation to the contracting authority on account of the latter exercising over that entity a control which is similar to that which it exercises over its own departments; [and] the entity carries out all its activities with the contracting authority which owns it.' COM (2002) 26 final, 6 May 2002.

80 See Weltzien, note 5 above, at 252.

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reference point to minimize the detrimental effect of any derogations in this regard.

5. Conclusion

The issue of purchasing arrangements between public entities poses a significant challenge to procurement regulation, including those contained in international and regional trade agreements aiming at opening up closed national procurement markets.

While EU procurement rules have provided a comprehensive legal framework to deal with the issue consisting of listed statutory exceptions and the 'in-house providing' exception developed through case law, the GPA has no general rules on coverage, no specific provisions to address the issue and broad derogations for individual parties. It can be argued that the status quo under the GPA in this regard is unsustainable for the future, taking into consideration the accession of countries with large state sectors such as China. The risk of circumvention is too great to be ignored. Furthermore, unless the need for legitimate derogations, including those related to purchasing arrangements between public entities, is explicitly addressed in the GPA text in a principled manner, divergence among Parties' practice is inevitable, and this has created obstacles for the adoption of the new revised GPA.

Although the EU procurement directives' approach is far from perfect, especially with regard to the uncertainty surrounding the exclusion of contractual cooperation arrangements between public entities, it has much to offer as a basis for future GPA review to improve the text and for current accession negotiations to draw guidance from. Of course, there are practical difficulties for the GPA to follow the approach of the EU procurement directives directly, which should not be underestimated. In the absence of common rules on coverage based on such factors as 'control' or 'competition', of general principles such as subsidiarity, and of a 'brave' judiciary, it is unlikely that the GPA jurisprudence on purchasing arrangements between public entities will be developed at the same pace and level of intensity as the ECJ's. However, that does not preclude the possibility for the WTO to use the EU experience as a benchmark and reference point for future reform.

Ultimately, a fine balance has to be struck by both the EU and the WTO between ensuring market access, undistorted competition and transparency on the one hand, and respecting the autonomy of national

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governments in providing goods and services for public interests on the other. While under the current GPA, the task has been left entirely in the hands of its Parties, a more principled approach to the treatment of purchasing arrangements between public entities and to its coverage as a whole, which will greatly enhance its effectiveness, should be preferred.

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