Procurement in the utilities sector

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The utilities sector consists of the water, energy, transport and postal sectors. Under the EU Utilities Directive, state-owned and commercial entities are obliged to apply the EU procurement policy when they purchase goods, services and works to pursue an activity in one of these sectors.

Introduction

The first EU Directive for state/government procurement (a Classical Directive) was adopted in 1971 and regulated public procurement (PP) of works. This was followed by a Directive regulating the procurement of goods in 1976 and a Directive regulating the procurement of public services in 1992. All the earlier Directives were replaced by a new EU Directive in 2004, which is still in force.¹

The utilities sector was, however, excluded from these provisions, and remained unregulated for many years. Using as a basis the first legal provisions for the utilities sectors on the articles in the Treaty regarding free movement of goods, persons, services and capital, the EU Member States finally adopted a Directive to regulate procurements in these sectors in 1990.

The reason given for adopting a Utilities Directive was to fully establish the Internal Market, an area without internal barriers in which free movement of goods, persons, services and capital was to be guaranteed. Three years later, in 1993, a new Directive for the utilities sectors came into force.² These earlier Utilities Directives were replaced by a new Directive in 2004, at the same time as the Classical Directive, and both are still in force.³

One of the reasons why the utilities sectors were, and still are, excluded from the state/government procurement directives was that the entities providing utilities services in some countries were governed by public law, in others by private law. This made it difficult to adopt common rules for all entities.

Another reason as to why these entities did not purchase on the basis of Community-wide competition was the closed nature of the markets in which they operated. The EU Member States themselves gave special or exclusive rights granted by and through their national authorities to their own companies or to private companies for the supply to, provision or operation of different kinds of national networks. It was also the EU Member States themselves that gave special or exclusive rights for the exploitation of given geographical areas and for the provision or operation of public telecommunications networks and services.

A third reason given was that national authorities could influence the behaviour of the entities to which they gave special or exclusive rights, including participation in their capital and representation in their administrative, managerial or supervisory bodies. The reasons stated in the directives also hint as to why it took such a long time to adopt common provisions for utilities; the EU Member States were reluctant to give up the power of controlling and regulating these areas themselves.

There are generally major differences between the organisations involved in and the operations carried out in the classical sector

1. Directive 2004/18/EC.
(state/government procurement) and in the utilities sectors. Because of these differences, the utilities sectors have been given major exceptions from the standard EU policies on procurement, such as twice-as-high thresholds for goods and services and the option of buying directly without competition from an affiliated undertaking or a joint venture. The reasons for these exceptions are that entities in the utilities sectors are often organised in a different way to those of authorities; the public entities more often resemble how private companies are organised, with subsidiaries and so on in company groups. An example of different application of the utilities PP policy in two markets is discussed in the boxes below.

Due to the differences between the sectors, in the EU Member States in the EBRD region it is necessary that any organisation carefully examine if it is encompassed by the classical sector or the utilities sector. There is a major risk that contracting authorities in the classical sector will try to take advantage of the more liberal exemptions in the Utilities Directive. Such mistakes can mean that the whole procurement process must start over, or worse, that a delivered contract is revoked in court and the goods have to be returned and remuneration repaid.

Practice in the UK – utilities in a privatised environment

Has your country adopted a new separate law to implement the 17/2004/EC directive?
The UK has implemented the Utilities Directive (2004/17/EC) through the Utilities Contracts Regulations 2006 (Statutory Instrument (S.I.) 2006 No. 6). These Regulations also provide for the enforcement provisions of the Utilities Remedies Directive (92/13/EC).

Has your country fully implemented the 17/2004/EC directive or its mandatory instruments only?
The UK Regulations (S.I. 2006 No. 6) fully implement 2004/17/EC.

What are the main differences between state and utilities public procurement in your country?
First, the public procurement rules are different and for the utilities sectors more flexible. As stated above, the Utilities Regulations implement the Utilities Directive but there are separate regulations which implement 2004/18/EC for public sector bodies. The Utilities Regulations implement the more flexible regime of the Utilities Directive in its entirety, including the higher thresholds.

Second, most UK utilities are private sector companies and operate in a fully commercial environment. It is not surprising, therefore, that there have been three successful applications to remove utilities from the scope of the rules under the exemption mechanism of Article 30 of the 2004/17/EC. Article 30 allows for exemption, where market access is free and competitive conditions apply. The exemptions cover oil and gas exploration, power generation and energy supply.

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Practice in Poland – utilities largely owned by the public

Has your country adopted a new separate law to implement the 17/2004/EC directive?
Polish Public Procurement Law (PPL) of 29 January 2004 (Journal of Laws of 2010 No 113, item 759 with amendments) regulates all aspects of PP procedure, from the commencement of the process until the conclusion of the contract. It refers both to the so-called “classical” sector (2004/18/EC Directive) as well as to utilities (2004/17/EC). It also provides for detailed rules concerning legal protection measures in that respect. PPL comprises 203 articles divided into several titles and chapters devoted to different instruments and aspects of the PP process. Specific rules concerning utilities are contained in Title III (“Specific Provisions”) and Chapter 5 (“Utilities”); however it is important to note that there are a lot of references to the provisions contained in other parts of the PPL, notably to Title I (“General Provisions”) and Title II (“Award Procedures”).

There are several acts of secondary legislation issued in order to implement and make more precise provisions of the PPL. Due to the fact that utilities are comprised in the PPL, most of the implementing regulations are to be followed also in this regard.

Has your country fully implemented the 17/2004/EC directive or its mandatory instruments only?
Polish legislators decided to implement all the instruments provided for in 2004/17/EC Directive, apart from one. PPL does not contain direct provisions regarding the qualification system (art. 53 of 2004/17/EC); however the establishment of such systems is possible.

It is worth mentioning that some of the mechanisms, in spite of being implemented, have not been commonly used in practice. This is the case for dynamic purchasing systems (art. 15 of 2004/17/EC) and central purchasing bodies (art. 29 of 2004/17/EC) and is due to the fact that both instruments are relatively new in Poland, so for the time being there is a lack of guidelines or best practice in this regard.

On the other hand, recently there has been a growth in the use of electronic means, including electronic auctions, in the PP procedures that may contribute to the development of the above mentioned mechanisms in the near future.

Regarding the procedure for establishing whether a given utility activity is subject to 2004/17/EC Directive (art. 30 of 2004/17/EC), PPL does not allow the contracting entity to submit a request directly to the European Commission. According to PPL, only the authority competent for that activity – indicated in the Council of Ministers implementing regulation – acting either on its own initiative or at the request of the contracting entity, is entitled to lodge such an application. Since the implementation of 2004/17/EC Directive there has been only one request submitted up until August 2010, concerning the production and wholesale of electricity. However, according to Decision 2008/741/EC the production and sale of electricity in Poland is not directly exposed to competition and is still considered to be one of the utilities activities subject to 2004/17/EC Directive.

What are the main differences between state and utilities public procurement in your country?
Apart from the fact that provisions concerning utilities under PPL are more flexible – which is a direct consequence of 2004/17/EC Directive – there are two particularities of the Polish PP system in respect of utilities procurement.

First of all, provisions of the PPL concerning utilities are applicable if the contract value exceeds the relevant thresholds in accordance with 2004/17/EC, whereas for classical procurement this threshold is set at €14,000.

Additionally, neither state and regional nor local contracting authorities are covered by utilities provisions contained in the PPL. As a consequence, only bodies governed by public law, public undertakings as well as private entities operating on the basis of special or exclusive rights, may be considered as utilities entities under the PPL.

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**Contracts covered**

The Utilities Directive covers procurements made in order to pursue an activity in the utilities sectors. The EU Member States in the text of the Directive have clearly stated what sectors are covered. These sectors are defined as the water, energy, transport and postal sectors. The reason these sectors are called “utilities”, that is, referred to in the plural, is that several sectors are covered, unlike the classical sector which is generally regarded as a single sector. The utilities sectors are related to the national infrastructure and various types of visible and invisible networks. For example, for the rail infrastructure, the network is clearly visible on the surface, compared with bus transportation, where the network is only to be found in the bus schedules.

The EU Court has pointed out that all contracts that contracting entities award in order to pursue an activity in the utilities sectors should follow the provisions in the Utilities Directive. A common misconception has previously been that only goods and services that are directly tied to the supply of the specific service, such as trains or pilotage services, were covered by the Utilities Directive. Other goods and services would be procured under the provisions of the Classical Directive, such as office supplies and cell phones. The EU Court, however, clarified that contracting entities in the utilities sectors are to apply the provisions of the Utilities Directive for all their contracts. Thus even coffee machines, cleaning services and office supplies should be awarded in accordance with the provisions of the Utilities Directive, if they are to be used for a utilities activity.

**Water**

Water utilities are entities working with networks for the production and supply of drinking water. The disposal or treatment of sewage also falls within the water sector, if it is carried out by a contracting entity which also operates in the drinking water sector. Private organisations producing drinking water as a side component of their principal activity need not apply the provisions in the Utilities Directive. There is a special exclusion for the water sector, in that the companies operating in this sector do not have to put the purchase of water out to tender, but can instead buy water from the nearest water source.

**Energy**

Energy utilities are entities running networks for producing and supplying gas, heat and/or electricity. In this sector, private organisations are also excluded if the production is an unavoidable consequence of carrying out another activity. If a private company does not need a special or exclusive right granted by an EU Member State to produce electricity, as in Sweden, these private companies do not have to follow the provisions of the Utilities Directive.

Organisations that pursue activities involving the use of land for the purpose of exploring for or extracting oil, gas, coal or other solid fuels are subject to the Utilities Directive. If an applicant does not need to get a special licence to conduct such activities, then the EU Member States may apply to the Commission for an exemption. Such exemptions, for instance, have been granted to Germany, the Netherlands and Great Britain.

Contracts relating to the purchase of energy or fuel for the production of gas or heat or for the exploration or extraction of gas, oil, coal or other solid fuels are exempt from the provisions of the Utilities Directive.

**Transport**

Transport utilities provide or operate networks for transport by railway, automated systems, tramway, trolley bus, bus or cable. For a transport service to be covered, it must operate under conditions set by a competent authority, such as the routes to be served, the capacity to be made available or the frequency of the service. This means that only passenger transport is covered, not transport of goods, since there are normally no networks for the transport of goods set by a competent authority. On the other hand, bus transport of passengers between different parts of an EU Member State which a bus company organises on its own, is not covered.

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If an organisation provides airports, ports or other terminal facilities to carriers by air, sea or inland waterways, its activities are covered by the Utilities Directive. In Sweden, there are only two commercial privately owned airports, Linköping and Skavsta, and they both use the utilities provisions. There are also a number of commercial ports that are privately owned. They, like the privately owned airports, shall apply the provisions of the Utilities Directives when they buy goods, services or works to pursue their activities.

Postal
The postal utilities collect, sort, transport and deliver postal items and related services. A postal item includes correspondence, books, catalogues, magazines, periodicals and parcel post. The postal sector previously belonged to the classical sector, but was transferred to the utilities sectors under the new directives of 2004. The reason for this move was that it became increasingly competitive, and there were no possible exemptions on the grounds of competition in the Classical Directive.

Purchases for other activities, unrelated to utilities sector business
Purchases made in order to pursue activities that are not covered by the Utilities Directives could either be covered by the Classical Directive, or may even fall outside the EU procurement provisions altogether. It is therefore necessary to examine for what purpose a procurement is conducted, in order to establish what provisions are applicable. It is also necessary, in order for it to be covered by the Utilities Directive, that a pursued activity actually involves offering goods and services to the public.

For example, the Port of Stockholm offers services to all cargo ships to download and unload their cargo at the port and is therefore a contracting entity within the utilities sectors. The local boat club next to it, however, only offers services to its members’ boats; thus its activities fall outside the utilities provisions.

State-owned contracting entities
The organisations covered by the provisions of the Utilities Directive are called contracting entities, compared with contracting authorities in the classical sector. The Utilities Directive states that there is a need to ensure a real opening-up of the market and a fair balance in the application of procurement rules in the utilities sectors. It is therefore required that contracting entities must be identified on an alternative basis rather than by reference to their legal status, as is done in the classical sector. An organisation operating in the utilities sectors usually has some kind of monopoly or oligopoly situation. This means in turn that such an organisation does not have to bother with making good and economical purchases, since it can easily transfer the costs onto the public, who has no alternative sources of supply available. “The public” in these cases includes both private persons and organisations.

For the contracts of an entity to be covered by the Utilities Directive, it is of no importance as to who owns the entity, who supplied its capital or who has the right to appoint members of its board. It is not important whether an entity has an industrial or commercial character. The only issue to be regarded is if the entity pursues an activity covered by the Utilities Directive.

If we first look at the organisations that are contracting authorities in the classical sector, these organisations can become contracting entities if they pursue any of the activities covered by the Utilities Directive. For example, a state-owned company that operates railways will become a contracting entity, the same way as a company owned by a municipality that operates the city’s water supply will be covered by the Utilities Directive. In addition, the Utilities Directive also mentions so-called “public undertakings”, which are companies that in some way are controlled by the EU Member States.
An organisation can become both a contracting authority and a contracting entity. If for example a municipality has a separate division that operates the public bus service, the part of the municipality running the bus service will be covered by the utilities sector, while the rest of the municipality will be covered by the classical sector.

**Private contracting entities in the utilities sector**

If we then go on to examine private organisations, contrary to the classical sector, these organisations can also be covered by the provisions of the Utilities Directive. The condition is that they pursue an activity covered by the utilities sectors under a special or exclusive right granted by a competent authority in the EU Member State. The special or exclusive right must restrict the right to pursue the activity to one or more organisations and place the private companies in a monopoly or oligopoly situation. The special or exclusive rights must also substantially affect the ability of other undertakings to carry out such activity.

It will therefore be difficult for other companies to establish themselves in the same industry in the same field, both de jure (legally) and de facto (actual exclusivity, that is, practically difficult for competitors to pursue similar activities). Only one company can, for example, get permission to build and operate an electricity network in a given geographical area, therefore that company receives special status.

Other examples of private organisations that may become contracting entities are oil exploration companies and companies owning commercial airports and ports, since they have usually found themselves in a monopoly situation. However, if a specific right can be obtained by all or nearly all applicants, companies will not be subject to the provisions of the Utilities Directive. Companies which operate in a competitive market must minimise their costs, at the risk of otherwise being eliminated from the market and going bankrupt. They are therefore not considered to be in need of further pressure to keep their costs low.

Private companies operating in the utilities sectors, having won a contract in a PP process, are not subject to the provisions of the Utilities Directive, even if they end up in a monopolistic or oligopolistic position. Such companies are considered to already have had to streamline their procurement in order to submit a competitive offer. They therefore do not need to comply with the utilities provisions when they buy goods and services to fulfil these contracts.\(^5\)

Because of the possibility of private organisations being covered by the provisions of the Utilities Directive, procurements and contracts in the utilities sectors are not deemed “public”.

**Special exceptions for utilities**

There are some special exemptions from the EU rules on procurement in the utilities sectors that are not applicable in the classical sector. We describe the most important ones here.

**Competitive activities**

It is possible for an EU Member State to apply to the Commission for an exemption from the Utilities Directive for an activity that is directly competitive in a market with free access. The condition for exemption is that the activity is fully competitive, both de jure (the EU Member State has implemented all EU deregulation provisions in the area) and de facto (that even in practice it is possible for competitors to pursue similar activities). The Commission examines if the conditions for an exemption are met. If it finds that a sector is fully competitive, it will declare that the specific activity in the specific geographic area (usually an EU Member State) is exempt from the application of procurement rules.

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5. See the Commissions’ explanatory note on the Utilities Directive – definition of exclusive or special rights, page 6, which can be found at [www.ec.europa.eu/internal_market/publicprocurement/explan-notes_en.htm](http://www.ec.europa.eu/internal_market/publicprocurement/explan-notes_en.htm)
The 80/20 rule for affiliated companies

The 80/20 rule means that purchases of goods, services or works from so-called “affiliated companies” in a corporate group need not comply with the competition requirements of the Utilities Directive. The exemption also covers the situation where companies that are part of a joint venture formed by contracting entities to pursue an activity in the utilities sectors, purchase from each other. The provisions of the 80/20 rule are that not more than 20 per cent of the goods, services or works have been sold on the free market, calculated over an average of the previous three years. Eighty per cent of the products must have been sold within the corporate group or the joint venture. The idea is that goods, services or works produced solely or mainly for the benefit of the group, should not have to be put out to tender.

New companies lacking turnover figures from over three years may instead, by means of business projections and so on, show how they meet the requirements.

Reselling or leasing of goods to third parties

In the utilities sectors, it happens that entities purchase goods to resell them or rent them out, without further processing the goods. If the contracting entity enjoys no special or exclusive right to sell or lease the same kind of goods, that is, other companies have the right to sell or lease the goods under the same conditions, such contracts are exempt from the provisions of the Utilities Directive. Two examples are the purchase of computers for staff leasing or the purchase of containers for leasing to shipping companies at airports and ports.

Non-EU/EEA geographical areas

Contracting entities engaged in activities covered by the utilities, but which are geographically situated outside the European Economic Area (EEA), or without using any physical network or geographical area of any EU/EEA country, are also exempt from the coverage of the Utilities Directive. An example would be if a public power company were to build or operate an electricity network in the Middle East or in India. Contracts for these activities are exempt from the Utilities Directive, since because of cost reasons it is deemed necessary that procurement and advertising must be done in the geographical area where the activity is conducted.

Remedies

The remedies for the utilities sectors are regulated in a special Directive, which in 2007 was amended by a supplementary Directive.6 These amendments for the utilities sectors are more or less the same as those for the classical sector.

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Conclusion

The provisions of the Utilities Directives differ in many ways from the Classical Directive, especially regarding which organisations are covered and the possibility of exclusion.

As mentioned, organisations operating in the utilities sectors usually have some kind of monopoly or oligopoly situation. This means in turn that these organisations do not have to bother with making good and economical purchases, they can simply transfer their extra costs onto the public, who normally has no alternative source of supply available. This is the main reason why it is of great importance to regulate procurement in these areas. If there is no incentive for the utilities to keep their costs down, it could severely affect the competitiveness of other industries which in turn have to raise their prices. The purchasing power of the population would then be affected, to the detriment of a nation’s whole economy.

The fact that the Utilities Directive also covers private organisations is a major difference which still causes some problems in Sweden. Many private organisations have a hard time understanding why they have to follow public rules when they are private, commercial companies. The reason is the same as for regulating the public utilities – they are usually in a monopoly or oligopoly situation, which allows them to ignore their cost levels. It is therefore of major importance to also put extra pressure on these organisations to ensure they do not ignore their costs at the expense of other industries, the consumers and, by extension, the national economy.

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