Direct awards to private non-profit organisations

The Court of Justice of the EU ("**CJEU**") is currently considering a number of cases which concern when a public authority can legitimately procure services without a competition from other public sector entities (including under the so-called "Teckal" exemption). In this forthcoming case, the Court will be asked to consider whether the Teckal exemption can apply in respect of a contractor which is in part owned by a private sector non-profit organisation.

Background

On 27 February, Advocate General Mengozzi published his Opinion on the legal arguments submitted in Case C-574/12 *Centro Hospitalar v Eurest Portugal*, which is the latest in a series of cases dealing with the public sector "in-house" exemption under public procurement law.

By way of background, the CJEU has held (Case C-107/98 *Teckal Srl v Comune de Viano* [1999] ECR I-8121) that there is no requirement to carry out a regulated procurement exercise when a contracting authority awards a public contract to an entity:

- over which it exercises *"a control which is similar to that which it exercises over its own departments"*, and there is no private sector ownership or control involved in the controlled entity; and
- which carries out "the essential part" of its activities with the contracting authority.

The Control Test has since been interpreted (Case C-458/03 *Parking Brixen v Gemeinde Brixen* [2005] ECR I-8612) to equate to *"a power of decisive influence over both strategic objectives and significant decisions"* of the body awarded the contract. Any private sector participation in the ownership of the captive contractor is considered fatal to the possible application of the Teckal derogation owing to the advantage which such arrangements would confer on the private owner vis-à-vis its competitors.

Facts

In this case, Centro Hospitalier, a publicly-owned hospital, awarded a public services catering contract to Le Serviço de Utilização Comum dos Hospitais ("**SUCH**") without having carried out a competitive award procedure. SUCH is a non-profit private law entity incorporated under Portuguese law, which is entrusted with public service missions including the promotion of efficiency and sustainability in the national health service. Whilst there were no shareholdings in SUCH, its constitutional documents provided that its membership was to be confined to entities in the public sector or "social sector" which are engaged in healthcare activities. A majority of its voting rights are held by the government department responsible for healthcare. Whilst SUCH is permitted to engage in limited service provision on the open market, at least 80% of its activities must be performed with its members and its "private" activities cannot prejudice the interests of its membership.

The public hospital unsuccessfully argued at first instance before the Portuguese courts that the Teckal exemption took the contract outside the Portuguese public procurement code which implements Directive 2004/18/EC. The Portuguese Supreme Administrative Tribunal then referred a number of questions concerning direct awards to the CJEU for consideration. The Advocate General has now given his opinion on these questions. This opinion is a preliminary step which does not bind the CJEU when it renders its final judgment, although it may be of persuasive influence.

Three key matters concerning the Teckal exemption emerge from the six questions referred by the Tribunal:

- Does the participation of private non-profit organisations in the "ownership" of SUCH prevent the public hospital or government department exercising the control needed for a direct award?
- Does the government department exercise control over SUCH "similar" to that which it exercises over its own departments if (i) the contractor's constitutional documents provide that the responsible government department will hold at least half of the voting rights, and (ii) the controlling authority (i.e. the public hospital) exercises supervisory authority over the captive entity (i.e. SUCH) including the power to appoint the chairperson and vice-chairperson of the board?
- Does a provision in SUCH's statute allowing for up to 20% of its activities to be carried out on the open market mean that the essential part of its services cannot be said to be public services?

Advocate General Mengozzi's Opinion

The Control Test: effect of participation by private non-profit organisations

The Advocate General ("**AG**") recited the now well-established rule that even a minority shareholding in a contractor by a private sector entity will prevent a contracting authority exercising the requisite control for a direct award (Case C-26/03 *Stadt Halle v TREA Leuna* [2002] ECR I-5553). However, the CJEU had not previously considered if participation by non-profit or social sector organisations governed by private law would have the same effect.

Nonetheless, AG Mengozzi's view is that even participation by such "non-private" entities does prevent the necessary control from

being exercised, including for the following reasons:

- The contracting authority's control would not be sufficient as its public interest objectives could not be coincidental to the private participants' general interest objectives. The AG referenced *Stadt Halle* in which it was held that any private participation "follows considerations proper to private interests and pursues objectives of a different kind". Whilst non-profit entities might pursue laudable general interest objectives, those objectives do not necessarily coincide the public interest even though there might be a degree of complementary overlap (for example, if a private non-profit entity was engaged in the promotion of religion, which appears to have been the case in relation to one of the members of SUCH).
- Given that private sector non-profit entities are entitled to compete with commercial entities for public contracts, their participation in a "semi-public" entity which is awarded an exempt public contract would be tantamount to their being placed in a position of advantage vis-à-vis their competitors.

The Advocate General determined that although the responsible government department held majority voting rights in SUCH (and enjoyed other special powers, rights in respect of reserved matters, etc.), that could not give it the required control due to the participation of a private entity in the contractor's ownership.

The Essential Part Test: up to 20% participation on the open market

The Advocate General noted that it is now well-established that the captive entity can provide some of its activities to third parties (either to non-controlling contracting authorities or to private sector bodies) provided the "essential" part of its activities are carried out with the controlling contracting authority or authorities. In particular, the Advocate General noted that in *Case C-295/05 Asemfo v Tragsa* ECR I-2999, the fact that the captive entity performed at least 90% of its activities with the controlling entity was sufficient to fulfil the Essential Part.

However, AG Mengozzi states that SUCH's provision of up to 20% of its activities with entities other than the "controlling" contracting authority was in excess of what was permissible under the Teckal conditions. He suggests that the essential part of SUCH's business could not be said to be carried out with the "controlling" contracting authority.

Commentary

The Advocate General's Opinion is consistent with the CJEU's usual practice of opposing attempts to make the Teckal exemption conditions easier for contracting entities to satisfy. In his opinion, the Advocate General states that the exemption represents a qualification of the EU "fundamental freedom" of the free movement of services, and accordingly it was deserving of a narrow interpretation.

It might be argued that a refusal by the CJEU to recognise a distinction between profit-making entities and strictly non-profit organisations is an unduly narrow reading of the Teckal exemption. Whilst it is certainly the case that the "public interest" objectives of a non-profit organisation will often not coincide with those of a contracting authority, this does not exclude the possibility that in some instances such interests would align. Arguably, it should be within the gift of a contracting authority to determine it the parties' interests are sufficiently aligned, especially is the non-profit's "control" over the captive entity is nominal. Perhaps more convincing is the Advocate General's view that there is potential for competition to be distorted, as non-profit organisations are entitled to compete with private sector (commercial) undertakings for public contracts. Therefore, participation in an "in-house" arrangement might advantage the non-profit organisation at the expense of its competitors.

In relation to the essential part of the services, the Advocate General's opinion is in line with earlier authorities which suggested that the Teckal exemption might not apply where the captive entity carries out more than 10% of its activities with undertakings other than its controlling entities (e.g. *TRAGSA*). Whilst the facts giving rise to this case arose in 2012, it is notable that the new public procurement directive (approved by the EU Council on 11 February) has taken a less restrictive approach in its codification of the Teckal exemption. Article 11(1)(b) of the new "classical" public procurement directive provides that the exemption can be fulfilled where *"more than 80% of the activities of [the captive entity] are carried out in the performance of tasks entrusted to it by the controlling contracting authority or by other legal persons controlled by that contracting authority."*

If the CJEU applies the AG's reasoning in its judgment, contracting authorities will be prevented from applying the Teckal exemption where there is any private non-profit organisation participation in the ownership of the contractor. In relation to the second limb of the Teckal exemption, the AG's opinion will come as less of a surprise to those familiar with this area of law. Procurement practitioners often use a "less than 10%" rule of thumb in dealing with circumstances involving third party participation and there is little likelihood of the judgment affecting that axiom before it is superseded by the new directive.

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