



## Teckal and exceptions to mandatory application of public procurement procedures

The law on whether a public authority can award a contract without a tender process to another public authority (the scope of the so-called “Teckal Exemption” to the need for a formal procurement process) is being developed.

In February 2014 we commented on the Advocate-General’s opinion in the case of *Datenlotsen Informationssysteme GmbH v Technische Universität Hamburg-Harburg* (hereinafter the “**Dantenlotsen**” case), which considered the extent to which the application of (1) Teckal and (2) public-public co-operation exemptions applied to otherwise mandatory EU procurement procedures under Directive 2004/18/EC (which is implemented into UK law by the Public Contracts Regulations 2006 (as amended))<sup>1</sup>.

On 8 May 2014 the European Court of Justice (the “**ECJ**”) handed down its judgment in the case. This article considers that judgment and the impact it may have for local authorities that are looking for alternative ways of procuring services. With the impending implementation into UK of Directive 2014/24/EU (the “**New Directive**”, which will replace the existing Directive 2004/18/EC), we also consider how the case may have been decided if the New Directive was already in force in the UK.

### The Teckal exemption

The Teckal exemption (also known as the “in-house” exemption) developed through EU case law to provide that contracting authorities may award a contract to an economic entity (i.e. the supplier), without recourse to a regulated procurement procedure, when:

- the contracting authority exercises control over that economic entity that is similar to that which it exercises over its own departments (known as the “control test”); and
- the economic entity carries out the essential part of its activities with the contracting authority (known as the “function test”).

### ‘Horizontal’ cooperation – Commission v Germany

The case of *Commission v Germany*<sup>2</sup> also established an exemption to the public procurement rules when local authorities seek to use other public resources to meet their requirements. In this case, however, the contracting relationship that was considered was a “horizontal” one, between two (or more) contracting authorities, rather than the “vertical” relationship in *Teckal*.

In *Commission v Germany* the ECJ considered whether an agreement between four districts within the City of Hamburg for waste disposal services was a breach of public procurement law. In the absence of the control necessary for the (vertical) *Teckal* exemption to apply, could an arrangement between two (or more) contracting authorities that genuinely intend to cooperate with one another to perform a public function (i.e. the waste disposal services), be outside the scope of Directive 2004/18/EC? It was decided that such an arrangement could fall outside the Directive if:

- the arrangement involves only contracting authorities and there is no participation of private capital;
- the character of the agreement is that of real cooperation aimed at the joint performance of a common task, rather than a standard public contract; and
- the cooperation is governed only by considerations relating to the public interest.

In *Commission v Germany* (which was decided according to its specific facts) it was decided that the cooperation between the four districts was genuine and did not distort fair competition within the market. The European Commission has since issued guidance (in 2011) on the application of this test, which reinforces the very limited meaning of “cooperation”, so that cooperation is distinct from the relationship between contracting parties in a standard, arms-length public contract. To satisfy the test and fall outside the public procurement rules, the cooperation must have the following features:

<sup>1</sup> See our earlier article: [http://www.localgovernmentlawyer.co.uk/index.php?option=com\\_content&view=article&id=17193%3Ateckal-and-exceptions-to-the-mandatory-application-of-the-procurement-procedures&catid=53%3Aprocurement-and-contracts-articles&Itemid=21](http://www.localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=17193%3Ateckal-and-exceptions-to-the-mandatory-application-of-the-procurement-procedures&catid=53%3Aprocurement-and-contracts-articles&Itemid=21)

<sup>2</sup>(Case C-480/06)

- the cooperation must relate to the execution of a public task that the relevant parties have to perform;
- the parties must have mutual obligations, which may be based on the division of tasks, rather than the performance by one party of a service in consideration for remuneration; and
- the cooperation must not involve financial transfers between the parties other than the reimbursement of actual costs for the performance of certain tasks.

The scope of the public-public cooperation exemption is clearly very narrow.

## Advocate General's opinion in *Dantenlotsen*

The *Dantenlotsen* case is particularly interesting because it develops this strand of case law, at a time when (a) local authorities continue to be under budgetary pressures, causing them to consider new ways of procuring services; and (b) when the New Directive (which codifies the *Teckal and Commission v Germany* case law at Article 12) will soon enter into UK law.

In *Dantenlotsen*, the Technische Universität Hamburg-Harburg (the "TUHH"), a public teaching establishment and therefore a contracting authority, sought to procure a new IT system. The procurement function of the TUHH was controlled by the City of Hamburg.

The TUHH considered two providers to provide this: (1) Hochschul-Informations-Systeme GmbH ("HIS"), and (2) Datenlotsen Informationssysteme GmbH. HIS was a not-for-profit provider of IT services that was controlled by the German State (one-third) and the 16 German Länder (Federal States of Germany) (two-thirds), including the City of Hamburg (4.16%). TUHH entered into the contract with HIS, without following a formal, regulated procurement procedure. *Dantenlotsen* subsequently brought a challenge, claiming that TUHH had directly awarded the contract to HIS. This raised the question whether the *Teckal* exemption applied so that the contract between TUHH and HIS was not a public contract.

The Advocate General's opinion stated that:

- The *Teckal* exemption did not apply because TUHH did not exercise control over HIS; and
- The public-public cooperation exemption did not apply because the contract between TUHH and HIS involved remuneration, rather than merely the reimbursement of costs.

Interestingly, the Advocate General also considered whether a "horizontal" *Teckal* exemption may apply between two contracting parties, controlled by the same contracting authority, where the objective of the contract in question was to carry out the controlling contracting authority's public service.

## ECJ judgment

Whilst the Advocate General's opinion does not bind the ECJ, the ECJ has not chosen to divert far from the opinion. The ECJ reiterated that any exemption to the application of the Directive must be interpreted strictly. The ECJ stated that:

- TUHH did not exercise control over HIS, demonstrated by the fact that it held no share capital in HIS and had no legal representation in its management. Therefore, "Teckal", in that sense, could not apply within the scope of the existing exemption.
- Equally, it agreed that the public-public cooperation exemption did not apply, due to the fact that the provision of the IT service by HIS for TUHH was not the performance of a public task which both of them were obliged to perform. The ECJ did not expressly refer to the existence of remuneration, which the Advocate General had raised.

Crucially, the ECJ stated that there was "no need" to examine the possibility of "horizontal in house transactions" being exempt from the scope of the Directive (i.e. were a contracting authority or authorities exercise "similar control" over two distinct entities who contract with one another) because the City of Hamburg did not have sufficient control over TUHH to satisfy the control test. It only controlled TUHH's procurement function, not its primary functions of education and research.

## Analysis

The *Dantenlotsen* judgment provides some further clarity to the existing law. It is now clear that when applying the control test in *Teckal*, the control exercised by the contracting authority must apply to the whole of the controlled entity, rather than a smaller proportion of it. The case is also a further demonstration by the ECJ of how it narrowly interprets any exemptions to the procurement rules. On one hand, this will act as a cautionary note to local authorities that may seek to stretch the exemptions to their limits. On the other, it may cause private sector suppliers to further scrutinise (and potentially challenge) attempts by local authorities to explore potential exemptions in the markets in which they operate.

The ECJ's judgment is notable for what it does not say, as well as for what it does say. The judgment leaves open the question as to whether a "horizontal in-house exemption" would have applied (as opposed to an exemption for public-public cooperation) if the City of Hamburg controlled TUHH and HIS to the extent necessary to satisfy the control test.

If the City of Hamburg had sufficient control over TUHH and HIS, would this mean that a contract between TUHH and HIS would fall outside the scope of a public contract?

It would seem a natural extension of the standard/vertical *Teckal* exemption for the function test to be required for a "horizontal" exemption to apply. If that is the case, any contract

between TUHH and HIS would only be exempt from the public procurement rules if both TUHH and HIS carried out the essential part of its activities with the City of Hamburg. This further demonstrates the very limited nature of the potential exemption, as had the control test been satisfied, the fact that HIS serviced up to 220 authorities within Germany means that it is unlikely that the function test would have been satisfied.

It may also be possible that elements of the test for the public-public cooperation exemption would be introduced to such a horizontal *Teckal* scenario. For instance, would it be necessary, in addition to satisfying the control test and function test with a common, controlling authority (City of Hamburg in our example) for the contract between the two contracting parties (TUHH and HIS) not to have financial remuneration other than the reimbursement of costs? That would potentially be an incorrect extension of the *Teckal* test, on the basis that the public-public cooperation exemption relies upon a very narrow interpretation of "cooperation", which is distinct from the arms-length contractual relationship that applies in a *Teckal* scenario. Such a convergence between the *Teckal* exemption and the public-public cooperation exemption seems unnecessary and unlikely.

Local authorities are also confronted by an additional question: **would the ECJ judgment in Dantenlotsen have differed if the New Directive applied** rather than Directive 2004/18/EC? Article 12 of the New Directive codifies the *Teckal* exemption. In short, it appears unlikely (on the very specific facts of *Dantenlotsen*) that it would be decided differently under the New Directive. The New Directive elaborates upon existing case law, to the extent that the function test is satisfied if *"more than 80% of the activities of the controlled legal person 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"*. In *Dantenlotsen*, a sizeable proportion of HIS' activities were carried out with other contracting authorities, but the City of Hamburg was one

of those authorities, rather than the contracting authority that controlled all of the other authorities that HIS provided services to.

If the City of Hamburg controlled the authorities that HIS carried out no less than 80% of its activities with and the control and function test was satisfied vis-à-vis TUHH, then it is possible that, had the ECJ pursued a discussion of a horizontal *Teckal* exemption, a contract between TUHH and HIS may be a good test case for a horizontal *Teckal* exemption. Readers will no doubt agree that there are a lot of ifs, buts and maybes in those circumstances.

The ECJ's judgment in *Dantenlotsen* will no doubt be welcomed by local authorities, to the extent that it provides another example of how the *Teckal* exemption should be applied. However, the absence from the judgment of a discussion on the potential application of a horizontal *Teckal* exemption will be seen by some as an opportunity missed at a time when local authorities would benefit from having greater flexibility and certainty when purchasing.

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