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Public Procurement and State Aid: Reopening the Debate?

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Abstract

The relationship between public procurement and State aid control rules had been controversial for a long time. However, a growing academic consensus and, more significantly, the official position of the European Commission, ruled out that the award of a public contract can amount to the grant of State aid—as long as it is in compliance with the current EU public procurement Directives. The underlying idea is that compliance with procurement rules ‘objectivises’ the award of the contract and, hence, excludes the element of ‘undue economic advantage’ (or, even further, the prerequisite of ‘selectivity’)—consequently eliminating all risks of disguised granting of State aid by means of public contracts. However, this blunt exclusion of State aid control in the field of public procurement (which has not been free from criticism) may be about to require re-examination if the push for more flexibility and increased scope for negotiations in the 2011 Commission’s proposal for new procurement Directives gets approved. This paper aims to contribute to this ‘new wave’ of debate regarding the interplay of State aid control and public procurement rules, and advocates for stronger and more effective controls of the State aid implications of public procurement.

Keywords: Public procurement, State aid, modernisation.

JEL Codes: H25, H57, K21, K23.

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1. Introduction

The 2011 European Commission Proposal for new EU public procurement Directives strongly relies on three principles: simplification, modernisation and increased flexibility of the public procurement rules with the fundamental goal of promoting increased efficiency of the procurement system and, ultimately, economic growth—as part of the Europe 2020 Growth Strategy.\(^2\) Throughout the process of modernisation and simplification of the procurement Directives, the European Commission stresses the relevance of preventing distortions of competition. Given that public procurement strongly relies on competitive markets, there is a strong need to ensure that the design of public procurement rules and administrative practices, while fit and appropriate to promote competition in a narrow sense (ie competition within the specific tender or procurement process), do not generate unnecessary distortions to competition in its broader sense (ie competition in the market where public procurement activities take place). This has been recently emphasized in the framework of the revision of the current EU public procurement rules, which stresses that:

“[t]he first objective […] is to increase the efficiency of public spending. This includes on the one hand, the search for best possible procurement outcomes (best value for money). To reach this aim, it is vital to generate the strongest possible competition for public contracts awarded in the internal market. Bidders must be given the opportunity to compete on a level-playing field and distortions of competition must be avoided. At the same time, it is crucial to increase the efficiency of procurement procedures as such”.\(^3\)


\(^3\) European Commission, Green Paper on the modernization of EU public procurement policy—Towards a more efficient European Procurement Market. COM(2011) 15 final, http://eur-
Therefore, making procurement’s competition implications explicit and exploring the ways in which market distortions generated by (streamlined) procurement rules and administrative practices can be avoided or minimized—ie how public procurement can be designed in a more pro-competitive fashion—is clearly relevant and might result in a significant improvement of this body of regulation.

Indeed, this seems to be significantly in line with the general trend underlying the current revision of the EU procurement Directives (together with modernization and procedural simplification). Article 15 of the proposed new Directive on Procurement,\(^4\) entitled “Principles of procurement” consolidates the relevance of undistorted competition (or competitive neutrality) by clearly emphasizing that: “The design of the procurement shall not be made with the objective [...] of artificially narrowing competition”. A twin provision is found in Article 29 of the proposed new Directive on procurement in the excluded sectors.\(^5\) In my view, these provisions agglutinate the pro-competitive orientation present in the EU procurement Directives from their initial design in the 1970s, and bring to light the underlying principle of competition embedded in their current version—which could be defined or phrased in these terms:


“public procurement rules have to be interpreted and applied in a pro-competitive way, so that they do not hinder, limit, or distort competition. Contracting entities must refrain from implementing any procurement practices that prevent, restrict or distort competition”.

Therefore, it seems clear to me that the revision of the current EU public procurement rules have a clear orientation towards safeguarding (or, at least, promoting) competitive neutrality as a booster for enhanced competition and, in the end, achieve value for money through increased procurement efficiency. In this regard, it is interesting to stress that the European Commission has itself identified (new) competition risks associated with the simplification of the procurement rules and the increased room they aim to create for negotiations between contracting authorities or entities and tenderers. More specifically, the European Commission has acknowledged the risks that increased flexibility in the choice of procedures, the possibility to conduct negotiations in almost all procurements, and the possibility to introduce (or give greater importance) to considerations unrelated or only tenuously connected with the subject matter of the contract (to name only a few of the relevant proposals) can generate in terms of State aid control—which, in the other hand, “may present certain opportunities to increase convergence between the application of the EU public procurement and State aid rules”.


7 Green Paper on the modernization of EU public procurement policy (above n 3) p. 5. See also Communication from the Commission on the Application of the EU State aid rules to compensation granted for the provision of services of general economic interest [2012] C8/4, paras. 63-68.
In view of such potential for increased convergence, this paper revisits the current situation regarding the liaison between public procurement and State aid (§2), discusses the impact that some of the changes in EU public procurement rules proposed by the Commission may have on the risks of granting disguised State aid by means of public contracts (§3), and concludes with a call for further developments to promote the control of State aid in the field of public procurement (§4).

2. Current Situation: Compliant Public Procurement Cannot Imply State Aid

Art. 107(1) TFEU proscribes as incompatible with the common market any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, in so far as it affects trade between Member States. The exception to this general prohibition of State aid is contained in paragraphs 107(2) and 107(3) TFEU—which respectively establish automatic exemptions to certain types of aid and possible justifications to otherwise incompatible State aid—subject to the authorisation procedure before the Commission set up by art. 108 TFEU and its implementing regulations. It follows that, in order to qualify as State aid and be subject to the general prohibition and to the authorisation procedure, four cumulative conditions have to be met: i) the measure has to be granted out of State resources, ii) it has to confer an

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economic advantage to undertakings, iii) the advantage has to be selective and distort or threaten to distort competition, and iv) the measure has to affect intra-EU trade.9

The possibility of treating the award of public contracts as State aid has been intensely debated, as most of the conditions laid down in article 107(1) TFEU for the prohibition of anti-competitive aid are easily met by certain public procurement activities.10 Public contracts are generally financed, either completely or partially, out of State resources, and most public contracts are directly or indirectly attributable to public bodies included in the broad definition of ‘State’ for the purpose of article 107(1) TFEU.11 Also, the award of public contracts is necessarily selective,12 as it only favours a given tenderer or grouping of tenderers at a time, and might generate competitive distortions. Moreover, given the value of certain public contracts—particularly those covered by EU public

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11 However, the situation might be different in the case of public undertakings autonomously managed; see J. Hillger, “The Award of a Public Contract as State Aid within the Meaning of Article 87(1) EC” (2003) 12 P.P.L.R. 109, pp. 121-125.

procurement directives (ie public procurement above-thresholds), the effect on intra-EU trade will also be usually appreciable. Consequently, in general terms, the most controversial condition will be to determine whether the award of a public contract confers an (undue) economic advantage which the public contractor would not receive under normal market conditions. In other words, it must be analysed whether the procurement activities of the State result in normal commercial transactions—ie

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whether the same decision would have been made by a ‘disinterested buyer’ or a ‘market economy buyer’.15

In this sense, it is noteworthy that, based on the case law of the Court of Justice, the practice of the European Commission has established a presumption that no State aid incompatible with the Treaty on the Functioning of the European Union exists where the award of the contract: i) is a pure procurement transaction, and ii) the procurement procedure is compliant with the EU public procurement directives and suitable for achieving best value for money—inasmuch as no economic advantage which would go beyond normal market conditions will usually arise under these circumstances.16 In the case of contracts not covered by the EU public procurement rules, the second condition would probably need to be rephrased to mandate compliance with the applicable


(domestic) public procurement regulations in a way suitable to achieving best value for money, or at least to following objective, transparent and non-discriminatory rules.17

Hence, according to the Commission’s practice, compliance with the EU public procurement directives in the tendering of a contract that would otherwise raise prima facie concerns about its compatibility with the State aid rules establishes a rebuttable presumption of compliance with the State aid regime (rectius, of the inexistence of illegal State aid). Such an approach is consistent with the understanding that these rules hold a common control device, ie that competition for a public contract is an indication of fair and equal market access in accordance with the procurement rules and, likewise, as regards State aid, of a fair balance of the obligations imposed and the economic advantages granted to the public contractor.18

To rebut such a presumption, it would be necessary to determine that, despite having complied with procurement rules, the public contractor actually received an (undue) economic advantage because the terms of the contract did not reflect normal market conditions.19 As was properly stressed by Advocate General Jacobs,

17 Heuninckx, “Defence Procurement” (above n 14) p. 199; but see Doern “Interaction between EC Rules” (above n 14) p. 124.


19 As regards the importance of the analysis of ‘consideration’ in public contracts to exclude the existence of a gratuitous advantage to the government contractor, see J. A. Winter, “Re(de)fining the Notion of State Aid in Article 87(1) of the EC Treaty” (2004) 41 C.M.L.R. 475, pp. 487-501.
“bilateral arrangements or more complex transactions involving mutual rights and obligations are to be analysed as a whole. Where for example the State purchases goods or services from an undertaking, there will be aid only if and to the extent that the price paid exceeds the market price”.20

It follows that, in the absence of a clear disproportion between the obligations imposed on the public contractor and the consideration paid by the public buyer (which needs to be assessed in light of such complex criteria as the risks assumed by the contractor, technical difficulty, delay for implementation, prevailing market conditions, etc.),21 State aid rules currently (and under this interpretation) impose a very limited constraint on the use of public procurement as a means to grant disguised State aid. That is, determining whether an award was properly made according to the public procurement rules will generally be the acid test to decide whether State aid has been granted, which results in a circular test to establish in the first place whether the award of the public contract constitutes State aid in and by itself. This limited scope for joint enforcement of State aid and public procurement rules rests in a very formalistic approach that relies on the apparent ‘rigidity’ and ‘objectivity’ created by public procurement rules—but does not actually prevent the granting of economic advantages in a significant number of cases. Its only advantage derives from legal certainty (for the awardee of the contract, even in very favourable economic terms), but excludes the economic gains derived from a stricter control of State aid implications of public procurement decisions. However, the issue has been considered settled for some time and there were no indications of a

20 Opinion of AG Jacobs in GEMO (C-126/01) ¶122. See also Opinion of AG Fennelly in France v. Commission (C-251/97) ¶19.

21 In similar terms, Doern “Interaction between EC Rules” (above n 14) p. 117; and Arrowsmith, Law of Public and Utilities Procurement (above n 10) pp. 224-227.
policy change in this area before the recent proposal for the reform of the EU public procurement Directives.

3. Reopening the Debate in Light of the 2011 Commission’s Proposal

Indeed, the situation described in the prior section may change in the future due to the alleviation of the ‘rigidity’ of the public procurement rules that stems from some of the changes included in the proposal for new Directives—which, in turn, would require a more intense scrutiny of the (undue) economic advantages obtained by public contractors in procurement procedures where competitive tensions are alleviated by means of a reduced number of participants, significant negotiations with the public buyer, the use of public funds to develop proprietary technology, or the use of non-economic award criteria with a tenuous connection with the object of the contract.

On the one hand, as stressed in the Green Paper on modernisation, the increased flexibility for contracting authorities to use the competitive procedure with negotiations generates significant (new) risks:

“The possible advantages of more flexibility and potential simplification must be weighed against the increased risks of favouritism and, more generally, of overly subjective decisions arising from the greater discretion enjoyed by contracting authorities in the negotiated procedure. Such subjectivity would in turn make it harder to show that the resulting contract did not involve State aid”.

Along the same lines, but in relation with the integration of environmental and social considerations in the array of award criteria, the Green Paper also emphasised that:

“public procurement policy must ensure the most efficient use of public funds. At the same time, this guarantee of purchases at the best price ensures a measure of consistency between EU public procurement policy and the rules in the field of State aid, as it makes sure that no undue economic advantage is conferred on

22 Ibid, p. 15.
economic operators through the award of public contracts. Loosening the link with the subject-matter of the contract might therefore entail a risk of distancing the application of EU public procurement rules from that of the State aid rules, and may eventually run counter to the objective of more convergence between State aid rules and public procurement rules”.23

Finally, the Green Paper identified concerns about the use of State aid in innovation-promoting mechanisms; although the approach has been rather optimistic and the European Commission has indicated that the use of “pre-commercial” procurement:

“enables public authorities to share the risks and benefits of designing, prototyping and testing a limited volume of new products and services with suppliers, without involving State aid”.24

In my opinion, and substantially in line with the European Commission’s except in relation with pre-commercial and innovative procurement, the main sources of increased risks in connection with State aid are: (A) increased scope for negotiations that increase the discretion of the contracting authority or entity, and (B) the public finance of R&D projects by means of the new “innovative partnership”. This section focuses on each of these sources of (increased) State aid risk as a justification for reopening the debate regarding public procurement and State aid coordination.

A. Increased possibilities for negotiations prior to contract award

The proposal for a new general Directive (replacing Directive 2004/18, hereinafter propDir) introduces significant flexibility in the choice of procurement procedures that imply direct negotiations with tenderers prior to the award of the contract. This is a significant policy shift that departs from the very restrictive approach to negotiations that has dominated the EU public procurement rules from their inception, under the

24 Ibid, pp. 45-46.
restrictive approach imposed by the European Council and the Commission—which clearly established that:

“in open and restricted procedures all negotiations with candidates or tenderers on fundamental aspects of contracts, variations in which are likely to distort competition, and in particular on prices, shall be ruled out; however, discussions with candidates or tenderers may be held but only for the purpose of clarifying or supplementing the content of their tenders of the requirements of the contracting authorities and provided this does not involve discrimination”25.

Under the rules envisaged in Article 24(1)(e) propDir, contracting authorities and entities would be fundamentally free to choose the competitive procedure with negotiation (or the competitive dialogue, which would now be regulated jointly for these purposes) in cases where due to specific circumstances related to the nature or the complexity of the works, supplies or services or the risks attaching thereto, the contract cannot be awarded without prior negotiations. It must be stressed that the general orientation of the propDir towards increased flexibility (which is imported from the WTO GPA) indicates a likely broad interpretation of this provision. This seems particularly clear from recital (15) of the propDir, which indicates that

“[t]here is a widespread need for additional flexibility and in particular for wider access to a procurement procedure providing for negotiations, as is explicitly foreseen in the [WTO Government Procurement Agreement], where negotiation is allowed in all procedures. Contracting authorities should, unless otherwise provided in the legislation of the Member State concerned, be able to use a competitive procedure with negotiation as provided for in this Directive, in various situations where open or restricted procedures without negotiations are not likely to lead to satisfactory procurement outcomes”.

Therefore, rather than limiting the use of competitive procedures with negotiation (or competitive dialogue) to those cases where it is not possible to award the contract under open or restricted procedures (ie the current default solution), art 24(1)(e) propDir seems aimed at giving almost unlimited discretion to contracting authorities to choose this procedure, as long as they offer some motivation for such choice [subject always to transposition by Member States that “may decide not to transpose into their national law the competitive procedure with negotiation, the competitive dialogue and the innovation partnership procedures”, art 24(1) in fine].

This development had been strongly pushed for by practitioners and seems to make procurement rules easier to adjust to the particular needs of each contracting authority or entity, in each procurement process. However, it would generate significant risks of coordination of public procurement and competition law in view of the increased discretion involved in the negotiations (particularly, regarding the control of State aid, see above §2). Moreover, it would render useless (or at least, would leave in dear need for reinterpretation) a significant volume of case law of the Court of Justice regarding changes and clarifications in tenders and their impact on the obligation to retender, which is also significantly altered with the introduction of a specific regime for modifications of contracts during their term in Art. 72 propDir, as well as the provisions on termination in Art. 73 propDir. In this regard, this seems a field where more detailed analysis will be required in the future to ensure that choice of procedure does not artificially narrow competition—as mandated by Art. 15 propDir (see above §1).

B. New tools for innovative procurement

A second relevant novelty is the creation of the “innovation partnership” as a procedure that goes beyond the current configuration of the competitive dialogue and mixed contracts (services + supply) for pre-commercial procurement, and allows the
“development and subsequent purchase of new, innovative products, works and services, provided they can be delivered to agreed performance levels and costs”, in the terms of Article 29 (which refers back to Article 24 on competitive procedure with competition in many significant aspects). In its basic configuration, the innovation partnership is a mixed instrument for R&D funding and subsequent procurement that generates significant (contractual) difficulties (such as the assignment of IP rights, the regulation of commercial uses of the technology developed during the partnership, etc). It is conceived to serve as an instrument to foster innovation. According to recital (17) propDir,

“[t]he partnership should be structured in such a way that it can provide the necessary ‘market-pull’, incentivising the development of an innovative solution without foreclosing the market”.26

However, this is an instrument that seems highly likely to generate (potential) distortions of competition and to be the perfect cover to circumvent rules controlling R&D related State aid and, in that regard, it must be welcome that the final restriction contained in Article 29(4) propDir clearly mandates that “[c]ontracting authorities shall not use innovation partnerships in such a way as to prevent, restrict or distort competition”.

Even if the innovation partnership is a new instrument in the EU procurement toolkit, the competition risks it generates are not unknown. As stressed elsewhere, where public

procurement activities refer to future goods (or services or works, but primarily goods) and the contracting authority funds or sponsors the required R&D activities for one or several selected contractors, it generates a potential for deferred anti-competitive effects.²⁷ In these cases, the temporal element can acquire particular significance for the competition analysis of such public procurement activities, since potential anti-competitive effects can be generated in the short term as regards the development of R&D activities themselves, but there is also room for potentially deferred anti-competitive effects in the products or services market. In this regard, the analysis of the procurement rules and practices shall not be restricted to short-term considerations (mainly linked to State aid control), but shall also take into account the effects in the market for the future technology, goods or services, once they are developed.²⁸ These considerations will be particularly relevant if those goods (or services or works) are not for the exclusive use of the public buyer, since the public contractor could find itself in a starting position that prevented the development of effective competition in “private” markets (or tranches of the market) from the outset (that is, an undue first mover advantage). To sum up, the analyses required to rule out competitive distortions derived from the use of the innovation partnership will be particularly complex in connection with State aid rules (although some guidance can be found in the general rules controlling State aid for R&D projects and those applicable to technology transfer agreements and other R&D-related agreements from a competition law perspective).

4. Conclusion

As follows from the prior discussions, the feeble justification for the current position of the European Commission that compliance with EU public procurement rules excludes

²⁷ Sanchez Graells, Public Procurement and the EU Competition Rules, above n 6, pp. 43-44.

the risk of disguised State aid—because current procurement rules prevent the granting of contracts that imply an (undue) economic advantage for the public contractor—is in crisis, particularly in view of the proposal for new EU public procurement Directives. The introduction of increased flexibility and the broadening of the scope for negotiations require guidance as to the limits within which contractual conditions must remain for them to comply with EU State aid law. In this regard, the need to further develop the concept of the ‘market economy buyer’ and to establish general criteria for its application in the public procurement setting is clear and, in my opinion, should accompany any modernisation of the current public procurement rules.