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Direction Générale Marché
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1049 Bruxelles
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Paris, 11th May 2010

RE : Fair and open procurement rules for Services of General Interest

Dear Madam,

As a follow up of our discussion in your offices on 3 December 2009, I am pleased to forward you two memos prepared by Suez Environnement.

The first one (appendix 1) focuses on the issue of **fair competition** between management models for Services of General Interest : "in house" provision, and outsourcing to an external operator (PPP).

In the sectors in which Suez Environnement is active (water, wastewater, solid waste management) we can see many cases of economic distortions between these two models, which skew the decisions of the public officials and affect their freedom of choice.

Specific examples are reported in our memo, mostly related to unequal taxation, unfair conditions of access to public subsidies, or abuse of "in house" status.

The second memo deals with the procurement of **concession contracts**.

You invited us to express our views about the appropriateness of the existing awarding procedures for public works or services contracts, in case they should be applied to concessions.

In summary, we think that the contracting public authorities should keep the freedom to choose the procedure they feel most appropriate on a case by case basis, taking into account :

- The nature and level of risk transferred to the private operator,
- The duration of the contract, and the level of uncertainty about the future evolution of its economic drivers (the unpredictability of the economic equilibrium of the contract may more or less significant),
- The level of complexity of the project and the nature of this complexity (projects with high technical complexity may be awarded in a different manner than projects with managerial complexity),
- The existing legal frameworks and practices in Member States.

While the procurement process should be adjusted to the specificity of the projects, it should be described precisely in the tender documents so as to provide full information to the bidders from other member states who may not be familiar with national practices.

In our opinion, in the short term the Commission should take initiative on publicity of tenders. So far, there is a legal vacuum on this matter for service concessions, which creates legal uncertainty. The rules applicable to works concessions (articles 58 of directive 2004/18/EC) should also be suitable for service concessions.

We would be pleased to continue this discussion with you and your team in the upcoming weeks . Our contact persons for this matter are Jacques Labre , vice president European Affairs (jacques.labre@suez-env.com) , and Florence Mourey, our representative in Brussels (florence.mxxxxxx@xxxxxxx.xxx) .

Yours sincerely,

Bernard Guirkingier
Senior Executive Vice President



Appendix 1

Towards a true freedom of choice by public authorities in the way they manage local public services

Analysis and proposals by SUEZ ENVIRONNEMENT

April 2010

EXECUTIVE SUMMARY

In its November 2009 Communication on PPPs and recovery, the European Commission declares that it is « urgent and important to look at new ways to support the development of PPPs ». **SUEZ ENVIRONNEMENT believes that the key to supporting the development of PPPs in Europe is to allow local governments to freely decide which management model** is best suited to the public services for which they are responsible.

Maintaining a fair competition between management models is crucial

- ✓ The benefits of PPPs in “promoting efficiency in public services” have recently been underlined by the Commission¹.
- ✓ Competition between the two models creates a mutual incentive to improving efficiency and service quality, to the benefit of all consumers.
- ✓ Unfair competition between public and private operators of services of general interest means unequal treatment of the users served by different types of operators. For example, all other things being equal, VAT exemptions for public entities lead to a situation where the users of services managed by private operators pay higher tariffs.

Many distortions of competition between public and private operators remain in the current legal framework of Member States

- ✓ Unequal taxation, notably as regards VAT
- ✓ Unfair allocation of national / local subsidies
- ✓ Discriminatory national rules regarding the access to EU funds
- ✓ Lack of knowledge and practice of public procurement procedures
- ✓ Attempts by in-house operators to try and circumvent competition with the private sector

The European Commission should take action to ensure fair competition

- ✓ In the field of VAT, action at the EU level is necessary.
- ✓ In the other areas, the European Commission should encourage Member States towards more fairness in the access of private operators to the market of local public service provision.
- ✓ Direct contract awards should be subject to the scrutiny of competition authorities.

¹ COM(2009) 615 final “Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships”

Maintaining a fair competition between management models is crucial

The European Commission has repeatedly declared its **neutrality with regard to the way national or local public authorities decide to manage services of general interest**, as in its November 2007 Communication², where the Commission states “Public authorities can decide to carry out the services themselves or they can decide to entrust them to other entities, which can be public or private, and can act either for-profit or not for-profit”.

SUEZ ENVIRONNEMENT - a key actor in the water and waste services in Europe - is of the view that it is now time for the Commission to go further than simply declaring its neutrality, and to **ensure that responsible public authorities can actually make a free and non-biased choice regarding the way they manage local public services**.

Imposing open and fair competition between private operators is fine but not enough. **Maintaining a fair competition between management models** is also crucial as:

- ✓ The benefits of PPPs in “promoting efficiency in public services” have recently been underlined by the Commission³.
- ✓ Competition between the two models creates a mutual incentive to improving efficiency and service quality, to the benefit of all consumers.
- ✓ Unfair competition between public and private operators of services of general interest means **unequal treatment of the users served by different types of operators**. For example, all other things being equal, VAT exemptions for public entities lead to a situation where the users of services managed by private operators pay higher tariffs.

Unfortunately, **many distortions of competition between public and private operators remain in the current legal framework of Member States**. They lead to a bias towards direct public management, and thus undermine the efficiency of public services.

Many distortions of competition between public and private operators remain in the current legal framework of Member States

1. Unequal taxation

The main source of unequal treatment between public and private operators as regards taxation lies in the VAT rules applied to the public sector. Pursuant to art. 13 of Directive 1006/223/EC on the common system of value added tax, activities of public bodies are out of the scope of the VAT Directive when public bodies engage in these actions as public authorities, provided that this does not lead to “significant distortions of competition”. For activities not already identified as such in annex I of the Directive, it is the responsibility of the Member States to identify cases where distortions of competition are such that public bodies should be regarded as taxable persons.

While the supply of water is listed in this annex, waste and wastewater management are not. This does not make sense, as the waste sector, just like the water sector, is an area where private undertakings are actively involved, and where the non-taxation of public operators leads to significant distortions of competition. One could even say that distortions of competition through differentiated VAT treatment are even greater in the waste management sector. Indeed, distortions of competition are greater in the case of labor-intensive services, and also in periods without significant investment programmes.

We estimate that distortions of competition through unequal VAT treatment amount to:

- 6% of total service costs in the wastewater sector (labor costs representing about 30% of total costs)
- up to 14% of total service costs in the domestic waste collection sector (labor costs representing about 70% of total costs)

² COM(2007) 725 final “Services of general interest, including social services of general interest: a new European commitment”,

³ COM(2009) 615 final “Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships”

As it was very well explained in the specifications attached to the invitation to tender for the provision of a study on VAT rules applied to the public sector and the exemptions in the public interest⁴, "The exempt and non-taxable status applicable to public bodies creates an incentive to self-supply inputs since, through self-supply, non-deductible VAT can be avoided. This results in a bias towards in-house supplies of goods and services and use of own employee labor. This bias can create **inefficiencies in the production and delivery of services by the public sector**. Spending decisions are often based on VAT rather than on real economic factors."

This has been observed notably in the German waste management sector, where many municipalities have in the recent years decided to establish their own waste management companies, or to switch from private to public law status in order to take advantage of the VAT exemption:

- Bergkamen:

In May 2005, the town council decided to municipalize waste disposal, which had been outsourced to private companies since 1966. This decision followed the results of a study carried out by Ernst & Young, which concluded – among other things- that the VAT exemption would contribute to saving costs.

- Rhein-Hunsrueck district:

In January 2006, it was decided to municipalize waste disposal, which had previously been outsourced to private companies. This decision followed a comparative analysis carried out by the district itself of the fees charged by a private company and by an in-house operator. The costs analysis identified potential costs savings of 1 million euros per year – ascribed to the VAT exemption – if waste disposal services were carried out by a municipal company.

- Lueneburg:

GfA Lueneburg, a publicly owned company operating under private law, currently carries out waste management services. The municipality is considering changing the status of the company to a public law one, notably in order to benefit from the VAT exemption.

- Luebeck:

Waste management services are currently carried out by Stadtreinigung Luebeck GmbH (SRL), a PPP operating under private law, 49 % of the shares being held by a private waste company. The city council decided on April 1, 2010 to transfuse SRL into the public entity Entsorgungsbetriebe Luebeck (EBL) with retrospective effect as of January 1, 2010, as then operating under public law entirely.

While the VAT case is the most emblematic as it is common to several Member States, several other examples of distortions of competition through national taxes exist.

In France for example, public operators will continue to be exempted from the new "Contribution Economique Territoriale" (a local tax, which is to replace the "Taxe Professionnelle"). The burden of this tax for Lyonnaise des Eaux France is estimated at around 15 million euros per year.

2. Unfair allocation of national / local subsidies

In several countries of the EU, national and local authorities favor public operators in the access to public subsidies.

An emblematic example of such distortions of competition in France is the repeated attempt by the Département des Landes - a local authority - to favor direct public management when allocating public subsidies. In 2004, it for example decided to increase by 5% the rate of subsidies allocated to water and wastewater works when municipalities directly managed these services, and to decrease this rate by 5% for the same type of works carried out by municipalities delegating their management.

⁴ Invitation to tender n°TAXUD/2009/AO-03

The 2006 water act offered a welcomed clarification on the allocation of public subsidies, by clearly stating that “public subsidies allocated to local authorities responsible for water and sanitation shall not be adjusted depending on the management model”. The Département des Landes however decided to overlook this piece of regulation and to cut off any subsidies allocated to municipalities having delegated the management of water and wastewater services.

3. Discriminatory national rules on access to EU funds

In the spirit of the general provision on structural funds⁵, no difference is made between public and private operators in the access to EU funding. **What matters is the nature of the project, not the nature of the operator:** the “beneficiary” can be “an operator, body or firm, *whether public or private*, responsible for initiating or initiating and implementing operations”. It is however the responsibility of the Member States to set eligibility rules in their Operational Programmes, and some take advantage of this concern for subsidiarity to introduce **restrictions on the access of Public-Private Partnerships to EU grants such as the ERDF or the cohesion funds**.

The Czech Environmental Operational Programme for 2007-2013 seeks to ensure that existing operational contracts (tendered and negotiated before the accession of the Czech Republic to the EU) achieve a better balance between the interests of the public and consumers and the private interests. The eligibility to Community financial assistance is thus subject to adaptation of the contracts with regards to performance criteria and tariff formula. What is more, the rate of subsidies to which projects can claim decreases with the length of the contract. This concern for an increased competition of existing operational contracts is clearly legitimate. However, it is very unfortunate that this rules should only apply to contractual models where private capital is dominant. There is no reason why joint ventures where public capital is dominant should not abide by the same rules.

The Romanian Environmental Operational Programme for 2007-2013 provides that Regional Operating Companies – newly created public entities, which are to be directly awarded the concession contract from the corresponding intermunicipal authorities – will be the only entities eligible to EU funding in the water sector. This means that EU funding will only benefit to users of water services operated by these public entities.

In this regard, the November 2009 Communication from the Commission on “Mobilising public and private investment for recovery and long-term structural change: developing Public Private Partnerships” has given us hope that this situation could change. It indeed states: “a level playing field between public and private management of public infrastructure and services in the allocation of EU funding to investment projects should be guaranteed. To this end, rules and practices should be reviewed in order to ensure that there is no discrimination in the allocation of funds for investments projects in which the private sector participates.”

4. Lack of knowledge and practice of public procurement procedures

Public procurement rules are often complex and can certainly discourage local authorities, which sometimes **lack the necessary expertise and human resources**, from engaging into outsourcing. Indeed, though PPPs bring many benefits to the delivery of public services, they require significant resources at the bidding stage to design financial and contractual arrangements, as well as long-term political commitment.

We very much welcome the **several actions announced in the November 2009 Communication** in this area of improvement of information, expertise and know-how, and would be happy to contribute to this effort.

⁵ Council Regulation n°1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund.

5. Attempts by in-house operators to try and circumvent competition with the private sector

The above-mentioned distortions of competition are sometimes amplified by attempts to try and circumvent competition with the private sector from the part of in-house operators. These attempts have lately taken the form of:

- ✓ **Abuse of in-house status to avoid tendering:** public authorities sometimes choose an in-house construction while they do not meet the requirements set by the ECJ in order to avoid tendering.

An emblematic example of such an abuse of in-house status to avoid tendering in France is the "Piémont de Barr" case law⁶. The inter-municipal entity "Piémont de Barr" decided in 1997 to award the management of the water and wastewater service on its territory to a public water operator (SDEA) set up by another local authority (département du Bas-Rhin) without any prior tendering. The Piémont de Barr authority did not intend to transfer its competence on water and wastewater to SDEA, but simply decided to outsource the operation to SDEA against payment.

The resolution of this legal argument can be seen as an example of good practice: the highest administrative court ruled that since it involved payment, the contract should be subject to publicity and tender.

- ✓ **Involvement of in-house operators in tenders resulting in economic dumping:** in-house operators bidding for contracts outside of their original territory or mandate and offering prices below the market level thanks to their protected home markets.

In Germany as well as in Sweden, the collection of household waste is qualified as a municipal public service, while the collection of commercial waste is not and should be open to free competition. However, many in-house operators set up for municipal waste management unfairly compete with private operators in the area of commercial waste management. They offer lower prices in a non-transparent way, taking advantage of their monopoly on the municipal waste management segment.

In Sweden, the new Competition Act might help in putting an end to such unfair competition. Its section on *Anti-competitive sales activities by public entities* provides that "a certain conduct by the State, a municipality or a county council (...) may be prohibited through an injunction if such conduct distorts, by object of effect, the conditions for effective competition in the market, or impedes the occurrence or the development of such competition". Several cases are currently being examined.

- ✓ **Qualifying water services as "non economic services of general interest",** which entails the risk of circumventing the guidelines on State aid in favor of public operators.

The European Commission should take action to ensure fair competition

In the field of VAT, action at the EU level is necessary to ensure that not only the supply of water, but also waste and wastewater management are identified as activities where public operators should be subject to VAT since their non-taxation would lead to significant distortions of competition.

In the other areas, the European Commission should encourage Member States towards more fairness in the treatment of public and private operators. The European Commission

⁶ CE, 20 main 1998, « Piémont de Barr »

has already declared its intention to do so as regards the allocation of EU funds⁷. The several actions announced to improve the information, expertise and know-how about PPPs are also an interesting way forward. We however call on the European Commission to be mindful of the increasing attempts by public authorities to try and circumvent competition with the private sector, as explained above.

Direct contract awards should be an exception, but remain the rule in the area of public service in some Member States. We strongly suggest that the Commission undertakes a **close review of these procedures**.

⁷ COM(2009) 615 final “Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships”



APPENDIX 2 : AWARDING CONCESSION CONTRACTS

ASSESSMENT OF EXISTING PROCEDURES DESIGNED FOR PUBLIC CONTRACTS

Awarding procedure	Appropriateness for concession contracts	Possible field of use for concessions
Open procedure	<ul style="list-style-type: none"> ✚ Straightforward procedure - Risk of high economic cost (investment in preparation of numerous unsuccessful bids) - Rigid terms of reference <ul style="list-style-type: none"> ⇒ No room for creative proposals from the bidders 	Not appropriate.
Restricted procedure	<ul style="list-style-type: none"> ✚ Allows for a selection of capable bidders - Little room for creativity : submission of variants may be authorised, but in this case the “most economically advantageous tender” may be difficult to identify - No room for adaptation of the proposals once the bids are open 	Not appropriate (except maybe for small and repetitive contracts with clear risk allocation)
Competitive dialogue	<ul style="list-style-type: none"> ✚ Allows for creative proposals by the bidders - Risk of costly, open ended process for the bidders - Protection of intellectual property of the bidders not fully guaranteed : <ul style="list-style-type: none"> - Risk of leakage from one bidder to another one - Risk of appropriation of the bidders’ ideas by the public client, in the case of abortion of the process and decision to manage the project “in house”. 	<p>Suitable for cases where complexity lies in technological aspects and the public client is unable to express his needs in a detailed manner</p> <p>Inappropriate where complexity lies in management/ operation.</p>
Negotiated procedure (with prior publication of contract notice , and results oriented terms of reference)	<ul style="list-style-type: none"> ✚ Allows for creative proposals by the bidders ✚ Allows for an in depth discussion on organisational matters and their effect on price after the bids are opened. - Risk of open ended process for the bidders - Level of discretion for the decision maker is more important, requiring specific rules to preserve fair and equal treatment of the bidders. 	<p>Suitable when the client is able to express his needs, but complexity lies in operation/management, and/or uncertainty on the future evolution of key drivers .</p> <p>Procedure for concession award should include :</p> <ul style="list-style-type: none"> - Publication of contract notice at EU level above a given threshold. - Prequalification phase: same as restricted procedure - Assessment of bids and recommendations to start negotiation with one or a few bidders by an evaluation committee reporting to the executive of the public authority .