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Concessions and PPPs

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What are concessions?

Concessions are defined in the public sector procurement Directive 2004/17/EC (“the Directive”) as contracts where the consideration for the works or services to be carried out consists either solely in the right to exploit the work or service, or in this right to exploit together with payment.

Works concessions and services concessions are dealt with differently under the Directive. Works concessions are subject to specific provisions in the Directive covering the way in which they are awarded. Services concessions are excluded from the coverage of the Directive although Treaty principles will apply to the award of service concessions where there is potential cross-border interest in the contract.

In considering whether or not an arrangement falls within the definition of a concession two key factors are of particular relevance:

- **Consideration**¹ - the source of the consideration should not come solely in the form of payments of a price from the contracting authority but partially or exclusively from the right to exploit the works/services. In practice this means that part or all of the consideration comes from a third party source or sources;

and
- **Risk** – the risk in the exploitation of the opportunity should lie with the concessionaire. A concessionaire generally accepts, for example, the operational and/or financial risk of providing a public service or public work in return for the opportunity to generate income through the exploitation of that service or work. The absence of risk transfer to the economic operator will suggest the existence of an ordinary public contract, therefore subject to the full rigour of the Directive, rather than a concession, subject to the Directive’s special provisions on concessions. The requirement for risk to be inherent in the exploitation of the concession opportunity is emphasised by the European Commission as follows:

¹ The term "consideration" can mean financial or monetary payments received by the concessionaire from the contracting authority and/or from other sources, but the term can also cover other benefits or value derived from the work or service which may not be purely financial.

..A key feature of concessions is the right of the concessionaire to exploit the construction or the delivered service granted as a consideration for having erected the construction or delivered the service. The main difference to public procurement is the risk inherent in such exploitation which the concessionaire, usually providing the funding of at least parts of the relevant projects, has to bear.”

Communication on Public-Private Partnerships and Community Law on Public Procurement and Concessions COM (2005) 569 at paragraph 3.1

This is best understood using practical illustrations. The following examples are simplistic and the classification of a concession will depend on the detail of the particular concession proposed.

Works concession: Concessions are often used to deliver major infrastructure projects such as the construction and operation of roads, bridges or tunnels. When the concessionaire receives all of its remuneration by way of tolls directly charged to users, consideration is derived from “exploitation” of the work and not from the contracting authority which awards the concession. The concessionaire takes the financial and operational risk when it funds the construction of the work and operates it without a guarantee that it will be able to recoup its investment and make a profit over the period of the concession. This is an example of a “works concession”.

If the contracting authority agrees to make payments to the concessionaire in the event that the income from third party users is not sufficient to permit the concessionaire to recoup its investment, the possibility arises that insufficient risk is transferred for this to fall within the definition of a works concession. It is more likely to be classified as a works contract.

Services concession: Concessions are also used in projects requiring operation and maintenance but not construction works, for example in the award of a concession to operate an existing railway or port, charging third parties for the use of those facilities, or in the award of a concession to run a government canteen and charging users of the canteen directly for the food and beverages purchased. These types of concession are examples of “services concessions”.

When, in the example of a government canteen, the contracting authority provides the canteen facility for use by the economic operator and also agrees to make payments to

the economic operator to cover basic running costs or to subsidise part of the service, this may mean that the economic operator does not carry sufficient risk for the arrangement to fall within the definition of a services concession. It may then be classified as a services contract.

Important Note – different use of the term “concession” under national laws

The concept of works concessions and services concessions is a concept of EU law and must be interpreted in line with EU law. National laws may define concessions differently. This means that it is possible that some contracts or opportunities which are regarded as concessions under national law will not be concessions for the purposes of the Directive. For example, the grant of a right to exploit natural resources, such the extraction of coal, or the regulation of taxi services by granting of operator licences, may be called “concessions” under national law but will not generally be regarded as concessions for the purposes of the Directive, although Treaty principles will apply where the contract is of potential cross-border interest. Equally, some contracts which are not regarded as concessions under national law may still be classified as concessions under EU law.

It is therefore very important to understand and apply the EU definitions when considering whether or not a proposed arrangement is a concession for the purposes of the Directive.

Does the Directive apply to concessions?

The Directive applies to works concessions but not to services concessions. There are provisions in the Directive covering the award of works concessions but the Directive explicitly excludes coverage of services concessions. The general Treaty principles apply to the award of both works concessions and services concessions.

What is the position where a concession involves a mix of works and services?

When a concession involves a mix of both works and services, it is necessary to decide whether it is classified as a works concession or a services concession. This distinction is particularly important because, as already explained, the Directive includes provi-

sions covering the way in which works concessions are advertised and procured but specifically excludes services concessions from its coverage.

In order to assess how a mixed concession involving both works and services is to be classified, the contracting authority must consider which element represents the principal object of the concession. Where the principal object is the delivery of works, with the services being merely incidental to that purpose, then the contract will be a works concession. A concession whose object is services and with activities within the definition of 'works' that are only incidental to the principal object shall be considered to be a services concession contract.

For example, a local authority decides that it wishes to award a concession contract to an economic operator for the running of an arts centre for a 20 year period. The local authority owns the arts centre building. The consideration which the economic operator receives will be by way of payments from members of the public who use the facilities, such as the café, and who pay to attend events at the arts centre, such as art exhibitions, films and theatrical productions. As part of the concession, the local authority requires the successful economic operator to undertake refurbishment works during the first 5 years of the concession period to create a new restaurant and kitchens, improve access to the building for disabled people, upgrade the elevator and install new toilets. In this case it is legitimate to argue that the principal object of the concession is the long term operation of the arts centre. The refurbishments works, which are part of the overall deal, can be regarded as incidental to the principal object. The concession should be classified as a services concession and not a works concession.

What obligations exist in relation to the award of a services concession?

As already explained, the award of a service concession is specifically excluded from the Directive. EU case law has established that Treaty principles and fundamental rules flowing from those principles do, however, apply where the service concession to be awarded is of cross-border interest. In that case, the fundamental rules of the Treaty in general, the principle of non-discrimination on the grounds of nationality in particular, and the obligation of transparency apply. The obligation of transparency consists in ensuring, for the benefit of any potential tenderer, a degree of advertising sufficient to enable the services market to be opened up to competition and impartiality of procurement procedures to be reviewed. In practice this means that contracting authorities seeking to award a services concession must consider whether the opportunity

is of potential interest to tenderers in other member states. If it is of interest then, the opportunity should be advertised in a manner that potential tenderers from other member states will be aware of the opportunity and that the subsequent process is run in a fair, transparent and non-discriminatory way. In practice, local legislation may go further than this and impose more legal obligations on how service concessions are advertised and awarded.

What obligations exist in relation to the award of a works concession?

The Directive sets out the requirements governing the award of a works concession by a contracting authority.

The contracting authority must advertise the works concession in the Official Journal of the European Union (OJEU) using a standard form concession contract notice. The notice must be dispatched in accordance with the requirements of the Directive and is published in the OJEU. The time limit for presentation of applications by economic operators is a minimum of 52 days from the date of dispatch of the notice (45 days when the notice is dispatched electronically).

There are no detailed requirements on the contracting authority in terms of how it then runs the tender process, giving it freedom to decide on a process which best meets the needs of the particular contract being procured. The contracting authority must, however, ensure that it runs the process in a transparent manner ensuring equal treatment and treating economic operators in a non-discriminatory way.

There are detailed provisions relating to the award of subcontracts by concessionaires. The Directive specifies that the contracting authority may either require the concessionaire to award a minimum of 30% of the total value of the works to third parties (the concessionaire can set the percentage higher) or require candidates for concessions to specify in their tender the total value of the work they intend to assign to third parties.

The Directive also requires that the concessionaire awards contracts to third party subcontractors using competitive processes. In the case of a concessionaire that is a contracting authority (as defined in the Directive – see *Procurement Brief 3 – What Is a Contracting Authority?*), it must use one of the standard competitive processes provided for in the Directive. Where the concessionaire is not a contracting authority then the concessionaire must follow the requirement in the Directive to advertise in the OJEU. There is an exception to this requirement when the award by a concessionaire

is to a third party that is a related undertaking. There are detailed provisions in the Directive defining what constitutes a related undertaking.

What is a PPP?

The acronym PPP refers to “Public-Private Partnership”. There is no single or simple definition of a PPP as the term covers a range of different types of contracts and other delivery models.

A PPP can be described as any form of co-operation between contracting authorities and private sector economic operators, often with the aim of ensuring the funding, construction, renovation, management and maintenance of infrastructure (works) and/or the provision of a service. The participating organisations are often referred to as “partners”, which is a term generally used in a non-legal sense.

A key feature of PPPs tends to be the sharing or transfer of risk to the private sector partner, and PPPs are often, but not always, of long duration.

Payment and funding methods vary under PPPs. Payments may be by the contracting authority or derived from third parties, such as users of the facilities (in which case it may be classified as a concession), or be from a combination of sources. Funding may come from the contracting authority, the private sector party, external funders such as banks or other lenders, or a combination of sources. Due to the nature of PPP projects, the legal documentation tends to be complex and multi-layered.

The structure of a PPP may be contractual or institutional. An institutional PPP (IPPP) is a type of PPP that involves the setting-up of a mixed capital entity delivery vehicle such as a joint venture company or other joint venture organisation, in which both the contracting authority and the private sector party participate. The delivery vehicle is then entrusted with the delivery of the PPP infrastructure or services project, with the ongoing and active participation of the private sector partner together with the public sector partner.

How does the Directive apply to PPPs?

There is no legal definition of a PPP in the Directive and it is not a term which is used in the Directive. The EU legal framework does not contain a PPP law or a specific legal system governing the choice of private partners for PPPs by contracting authorities. Where countries decide to regulate PPPs separately there is no requirement for separate legislation to cover the award procedures for PPP contracts. The public procurement legislation will apply to the procedures for the award of PPPs.

From the perspective of EU procurement rules, PPPs are either public contracts, concession contracts (works or services) or contracts that are excluded from the scope of the Directive. PPPs that are services concessions or that are exempted contracts and are of cross-border interest will be subject to fundamental Treaty principles and the rules derived from those principles will apply, in particular the principles of transparency, equal treatment, non-discrimination, proportionality and mutual recognition.

A PPP that qualifies as a public contract under the Directive must be awarded in using one of the procedures set out in the Directive applying to public contracts. The contracting authority needs to carefully consider the most appropriate award procedure for the award of PPP contracts which are often complex and commonly require negotiation between parties. Where a PPP contract is regarded as sufficiently complex and the member state has adopted the relevant provisions of the Directive, the competitive dialogue may be an appropriate procedure to use. It may also be possible that the conditions are met governing use of the negotiated procedure with prior publication of a contract notice.

When a PPP is a works concession, the specific provisions governing the award, as outlined above, will apply.

When the structure is an IPPP, a single EU process governed by the Directive (for public contracts or works concessions as appropriate) can be used both to appoint the IPPP private sector partner and award the contract to the joint delivery vehicle.

Concessions in the utilities sector

The European Commission in its Interpretative Communication on Concessions under Community Law (OJ 2000/C 121/2) contains the following information in relation to the award of concessions in the utilities sector:

Directive 93/38/EEC on contracts awarded by entities operating in the water, energy, transport and telecommunications sectors (hereafter referred to as the "Utilities Directive") does not have any specific rules either on works concessions or on service concessions.

In deciding which rules apply, the legal personality of the grantor, as well as his activity, are therefore decisive elements. There are several possible situations.

In the first case, the state or other public authority not operating specifically in one of the four sectors governed by the Utilities Directive awards a concession involving an economic activity in one of these four sectors. The rules and principles of the Treaty described above apply to this award, as does the works Directive if it is a works concession.

In the second case, a public authority operating specifically in one of the four sectors governed by the Utilities Directive decides to grant a concession. The rules and principles of the Treaty are therefore applicable insofar as the grantor is a public entity. Even in the case of a works concession, only the rules and principles of the Treaty are applicable, since the works Directive does not cover concessions granted by an entity operating specifically in one of the four sectors governed by Directive 93/38/EEC.

Lastly, if the grantor is a private entity, it is not subject to either the rules or the principles described above.

See *Procurement Brief 16 – Procurement by Utilities* for information on the four sectors governed by the Utilities Directive and the types of contracting entities covered, including a discussion of what constitutes a public entity.

Practical note on scoping, procuring and managing PPPs

PPPs tend to be complex contracts which are often long term. As with all complex or long term contracts, it is very important to ensure that the requirements are carefully considered and scoped in advance so that the specifications and contract terms are comprehensive and thorough, permitting both the contracting authority and the economic operators to fully understand the nature and implications of the project for the duration of the contract.

The procurement process must rigorously test the economic operators' proposals to ensure that they meet and will continue to meet the authority's requirements throughout the contract term. See *Procurement Brief 10 – What Are the Public Procurement procedures and When Can They Be Used?* for further information on the relevant procurement procedures.

Ongoing and proactive contract management throughout the duration of the contract is also critical to the successful delivery and operation of the concession. For further information, see *Procurement Brief 21 - Performance Measurement* and *Procurement Brief 22 - Contract Management*.

Further reading:

- OECD - Principles on Private Sector Involvement in Infrastructure (2007)
- European Commission's web page on PPPs:
http://ec.europa.eu/internal_market/publicprocurement/partnerships/public-private/index_en.htm
- Commission Interpretative Communication on the application of Community Law on Public Procurement and Concessions to IPPP -(C(2007)6661)
- Green Paper on PPP and Community Law on Public Contracts and Concessions (COM (2004) 327 final)
- Communication on PPP and Community Law on Public Procurement and Concessions (COM (2005) 569 final)
- Explanatory note on Competitive Dialogue procedure
- Interpretative Communication on Concessions under Community Law (OJ 2000/C 121/2)

- OECD Public-Private Partnerships – *In Pursuit of Risk Sharing and Value for Money*
- OECD Principles for Private Sector Participation in Infrastructure
- United Nations Economic Commission for Europe – *Guidebook on Promoting Good Governance in Public-Private Partnerships*