BRIXEN – THE IMPLICATIONS FOR ALMOS

A note for the National Federation of ALMOs

1. BACKGROUND

1.1 *Brixen* case and the ALMO programme

It has been suggested recently (*Inside Housing*, 10th February 2006), that the judgment of the European Court of Justice (the "Court") in the *Brixen* case [Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen v. Stadtwerke Brixen AG* (October 2005)] has adverse implications for the implementation of the ALMO programme. The fundamental question is whether arms length management agreements should be advertised and tendered competitively, as opposed to the current arrangements which do not involve a call for competition.

1.2 Facts of *Brixen*

The *Brixen* case involved the award of a services concession contract by Gemeinde Brixen, an Italian local authority, to Stadtwerke Brixen AG, its subsidiary, for the management of a public car park, without first carrying out an award procedure. The Court considered whether the relationship between the local authority and its subsidiary was sufficiently close for the award of the concession contract to be considered an in-house operation, not subject to a compulsory call for tender, or whether in fact it was an external award and therefore subject to the requirement to be put out to tender.

The Court decided that, despite the fact that the subsidiary car park operator was wholly owned by the Authority, the concession arrangement should have been put out to tender in compliance with the overriding EU principles of transparency, equal treatment and non-discrimination.

1.3 Introduction

This paper explores whether *Brixen* applies to conventional ALMO agreements and the implications for the ALMO programme going forward. It also analyses the possible use of an exemption from the EU regime. It concludes with a brief reference to future ALMO options.

2. ALMOS & THE EUROPEAN PROCUREMENT REGIME: IN-HOUSE

2.1 Introduction: in-house procurement

The prevailing view has been that the implementation of arm's length management organisation arrangements by an Authority falls outside the EU procurement legislation. This is because establishing and letting a contract to an ALMO can be viewed as an "in-house" arrangement, whereby a local authority is using its own administrative, technical or other resources to perform tasks it would otherwise have to enter into contracts with external entities to perform.

In such a situation, a contracting authority may avoid the application of the EU Procurement Directive (2004/18/EC) by awarding the contract to its in-house entity.

To expand on this further, for the Procurement Directive to apply, there must be a public services, works or supply contract. A "public services contract" is defined in the new UK Public Contracts Regulations 2006 (S.I. 2006 No. 5) as "*a contract, in writing, for consideration (whatever the nature of the consideration) under which a contracting authority engages a person to provide services…*"

In the context of a typical "in-house" procurement situation, a contract between two entities within the same organisation will not generally be a binding contract in legal terms. In such a case there is no need to call for external tenders (via the OJEU process or otherwise).

2.2 UK Government guidance: "in-house" provision

In its ALMO Consultation Paper dated December 2000, the then Department of Environment, Transport & Regions advised that "the Government does not regard the implementation of arm's length arrangements as a procurement of those functions, even if evidenced by what appears to be a contract". The Government based its view on the *Teckal* case noted below but concluded that local authorities need to be mindful of the limits to the judgement when implementing ALMO arrangements.

2.3 Case-law: "in-house" provision

It is acknowledged that a local authority and its ALMO is unlikely to fit into the "typical" in-house procurement situation, outlined above, as they are two separate legal entities.

However, the above in-house procurement arrangement may, in certain circumstances, be regarded as extending to a situation where there are two separate legal entities and where, on the face of it, the Procurement Directive, by its wording, does apply. This extension has been the subject of several cases prior to *Brixen*, the initial one being the European case of "*Teckal*" [*Teckal Srl v Commune di Viano,*

Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia (C107/98 [1999] ECR I-8121 (ECJ)].

2.3.1 The *Teckal* case

In the case of *Teckal*, the Court decided that a contract entered into between a public authority and a person legally distinct from that authority, might be regarded as an "internal award" that did not need to be the subject of a regulated procedure where the public authority:

(i) Exercises over the person concerned a control which is similar to that which it exercises over its own departments; and

(ii) At the same time that person carries out the essential part of its activities with the controlling local authority or authorities.

2.3.2 First Criterion – Control

In accordance with (i) above, treatment as an in-house operation is subject to the condition that the contracting authority must exercise over its service provider a control similar to that which it exercises over its own departments.

(a) ***Stadt Halle***

First, it should be noted that, as confirmed by the Court's judgment in *Stadt Halle* [*Stadt Halle, RPL Recyclingpark Lochau GmbH v Arbeitsgemeinschaft Thermische Restabfall und Energieverwertungsanlange TREA Leuna (C-26/03)*], any participation by private undertakings, even as minority shareholders, excludes the possibility of a control similar to that which an authority exercises over its own departments.

This is a far more stringent standard of control than applies in EU competition law (which allows two distinct legal entities in (for example) a corporate group to be regarded as a single undertaking so that, in competition law terms, any agreements between them would not be subject to Article 81(1) of the Treaty of Rome as the agreement would be treated as one undertaking agreeing with itself) and suggests that the introduction of a private body may prevent the public body from fully pursuing its public interests and therefore cannot control semi-public undertakings in the same way that it can its own departments.

In *Brixen*, the service provider (Stadtwerke Brixen AG) was not a semi-public undertaking but a wholly-owned subsidiary of the Italian local authority and the Court did not directly refer to this aspect of the *Stadt Halle* decision in its judgement. However, the local authority was

required, within a maximum of two years following the incorporation of the subsidiary, to surrender its status as sole shareholder to that of mere majority shareholder and the Court appeared to regard this obligation (i.e. to open up the company to private investment) as a contributory factor in rendering the local authority's control tenuous. (This is discussed in greater detail below).

(b) ***Brixen***

Teckal was referred to in the *Brixen* judgment, with the Court taking the view that the particular relationship that existed between the Italian local authority and its subsidiary was not one of "control" as defined in the *Teckal* case. *Brixen* may therefore be significant in providing useful guidance as to how far the Court may be prepared to go in following the control test set out in *Teckal*.

The Court in *Brixen* held that "control" must be "*a case of power of decisive influence over both strategic objectives and significant decisions*". On the facts of the case, it was noted that the Italian local authority laid down the general guidelines, allocated the start-up capital, monitored the operating results and exercised strategic supervision over the service provider.

However, the Court then went on to highlight aspects of the service provider which it described as "*market-oriented*", that would undermine the effectiveness of the local authority's control:-

(i) The conversion of the service provider from a municipal body to a company limited by shares and the nature of that type of company;

(ii) The broadening of its objects and the commencement of work in new fields;

(iii) The expansion of the geographical area of the company's activities;

(iv) The obligatory opening of the company to private investment;

(v) The fact that the board of the service provider had considerable powers conferred to it, which had the effect of diminishing the level of the local authority's management control over the service provider.

The Court concluded that, where a service provider enjoys a degree of independence characterised by elements such as those noted at (i) to (v) above, it would not be possible for the local authority to exercise over it "control similar to that which it exercises over its own departments".

(c) ***Brixen* and ALMOs**

There is therefore merit in examining the "characteristics of independence" noted at (i) to (v) above in order to see how the position of ALMOs can be distinguished from that of the service concessionaire in *Brixen*.

(i) ALMOs are limited by guarantee, not shares. Further, the company is a not-for-profit organisation, controlled by a tightly drafted constitution which focuses on housing management (and related activities) and does not have a general trading power, "catch-all" object within the terms of its constitution;

(ii) Any decision to broaden the ALMOs objectives is usually controlled by the local authority, whose consent is required. An ALMO is therefore unlikely to have the wide range of objects and activities that the concessionaire in *Brixen* enjoyed;

(iii) The ALMO's constitution defines the geographical area within which it is to carry out the majority of its activities. There are two options available to the ALMO in this respect:

(aa) The ODPM-recommended template constitution precludes the ALMO undertaking activities outside the area where the local authority owns or manages houses; or

(bb) The template constitution, with approval from the ODPM, can be amended to incorporate somewhat more flexibility than (aa) above, having the effect of confining the majority of the ALMO's activities to the local authority's area.

Either form of control over geographical activity can be distinguished from the concessionaire in *Brixen*, which could operate across Italy (and indeed abroad).

(iv) Whereas a statutory provision in *Brixen* existed which obliged the local authority to open up the service concessionaire to other capital, there is currently no equivalent in respect of ALMOs under English (and Welsh) law. The simple fact that the ALMO is a company limited by guarantee effectively precludes third party capital. The Council is the sole member. There are no other "shareholders" or investors.

(v) Whilst ALMOs have significant autonomy in respect of their day-to-day activities, those activities are determined by the Delivery Plan, which has to be agreed with the Council each year. The ALMO may be able to determine *how* it delivers the Council's housing service, but *what* it delivers is ultimately a matter for the housing authority. Moreover, as sole shareholder, the Council has the ability to remove/appoint all of the ALMO's Board members. This ability, as a matter of English company law, cannot be formally fettered (even though management agreements usually identify circumstances where the local authority undertakes to fetter its rights to remove/appoint – e.g. non-performance).

Further, it is worth mentioning that the Advocate-General in *Brixen* noted that the mere fact that a company has extensive powers over the day-to-day running of its business does not necessarily mean that it is autonomous from its controlling local authority and that the latter no longer exercises over it a control similar to that which it exercises over its own departments.

2.3.3 Second Criterion – "Essential Part of its Activities"

As the Court in the cases of both *Stadt Halle* and *Brixen* ruled that the local authority did not possess the requisite amount of control over the service provider, it did not consider the second criterion, i.e. whether the relevant service provider carried out the essential part of its activities with the contracting authority.

In his opinion concerning the *Brixen* case, the Advocate-General noted that, when considering whether the service provider carries out the essential part of its activities with the controlling local authority or authorities, it is sufficient to be guided by the actual activities of the undertaking concerned, rather than looking at a service provider's statute (or memorandum and articles under English (and Welsh) law), which tend to be framed in broad terms, often intended to cover not only the activities in which the service provider is engaged at present, but also any others that it may carry out in the future.

Therefore, whilst the Advocate-General considers that the memorandum and articles of a service provider are often framed too broadly to be of any real use, he notes that the activities which an undertaking actually pursues are the best indicator of whether the service provider operates in the same way as others in its market or whether it is so closely connected to the public body that contracts between it and the contracting authority can be treated as in-house operations.

An initial indicator in this regard may be the share of turnover which the service provider derives from the contracts with its controlling authority. If the activities spread over several fields, then turnover in relation to each of those fields must be taken into account.

A further indicator will be the geographical range of activities. Whilst the fact that a service provider performs tasks beyond the boundaries of the controlling authority will not necessarily mean that it does not carry out the essential part of its activities for that authority, a critical examination is required to determine what percentage of the service provider's activities fall outside the relevant boundaries. The higher this is, the less likely the service provider will be able to satisfy the test.

In the context of ALMOs, it is hard to see how the majority of an ALMO's turnover and the location of its activities will not relate to its work for the local authority and/or be within the local authority's control. Therefore, if Criterion 1 is satisfied, then it is likely that Criterion 2 will be also satisfied in the context of ALMOs and their activities.

3. ALMOS & THE EU PROCUREMENT REGIME: EXEMPTION

3.1 Statutory provisions – in-house procurement

In addition to the case-law analysed in Section 2 above, which pre-supposes that the EU procurement regime does not apply <u>because there is no public services, works or supply contract at all,</u> there is statutory provision derived from Article 18 of the Procurement Directive, regarding in-house procurement. This provision applies to public services contracts (i.e. where there is no in-house provision), but it exempts contracting authorities letting contracts described in Article 18 from having to comply with the EU procurement regime. This has been implemented into English law via Regulation 6(2)(l) of the Public Contracts Regulations 2006, which provides:

"These Regulations do not apply to the seeking of offers in relation to a proposed public contract… under which services are to be provided by a contracting authority … because that contracting authority has an exclusive right –

(i) to provide the services; or

(ii) which is necessary for the provision of the services

in accordance with any published law, regulation or administrative provision, which is compatible with the EC Treaty"

The scope of this exemption is thus limited to services contracts awarded by one contracting authority to another contracting authority and is subject to the condition that the company awarded the service contract operates with an exclusive right that is compatible with the Treaty. It therefore does not cover an award to a body that operates on a wholly commercial basis (e.g. a body that is not a contracting authority, which is clearly not currently true of ALMOs).

There is little guidance as to what constitutes a special or exclusive right, either in the context of the European Union or in the UK. Further, there is no definition of "special or exclusive right" under the Consolidated Directive or the Public Contracts Regulations 2006. The only definition can be found in the new Utilities Directive (2004/17/EC). Article 2(3) of the new Utilities Directive defines "special or exclusive rights" as:

"rights granted by a competent authority of a member-state, by way of any legislative, regulatory or administrative provision, the effect of which is to limit the exercise of activities … to one or more entities and which substantially affects the ability of other entities to carry out such activity"

These provisions have obvious application to utilities that are susceptible to government pressure and where operation in that market is controlled by the government.

We should add that the new definition (quoted above) slightly altered the previous Directive in order to clarify that the types of licences which grant special or exclusive rights are those which are not generally open to competition.

We also note, for the sake of completeness, that the *Brixen* judgement states that a statutory provision should not allow the award of a concession contract without a call for competition, but we believe that this relates specifically to concession contracts rather than contracts let pursuant to the specific rights exclusion generally.

3.2 ALMOs and Exclusive Rights

Clearly, the utilities sector in England and Wales is very different from the housing management sector and arguably the Government does not impose such tight controls over the housing management sector as it does for various utilities.

However, the UK Government does require each local authority to seek consent from the ODPM if it wants to outsource its housing management function, whether to another contracting authority or a private entity. These "Section 27 consents" are made pursuant to the section of the Housing Act 1985 that deals with outsourcing of housing management functions.

It is our view that Section 27 could give rise to an exclusive right, for two reasons:

- The local authority cannot outsource its service without the consent; and
- The ALMO is given an exclusive right to manage the stock in accordance with and subject to the terms of the Management Agreement.

If we are right then ALMOs could rely on this exemption from the EU tendering regime and not have to rely on the in-house rule explored in *Teckal* and *Brixen*.

4. CONCLUSION

4.1 Does this "torpedo" the ALMO programme?

In our view, it is wrong to conclude that *Brixen* has dealt a fatal or indeed a significant blow to the ALMO programme. Whilst it provides useful guidance as to when the requisite amount of control will not be present, there is insufficient common ground between the findings of the Court and the position of ALMOs to give rise to real concern. The *Brixen* case simply serves as a reminder of the need (expressed by the DETR back in December 2000) for local authorities to be mindful of the limitations of the *Teckal* decision when implementing ALMO arrangements which depart from the conventions.

4.2 Future options for ALMOs

In the report commissioned by the National Federation of ALMOs and others, published in April 2005 (to which we contributed), various options were identified as to how the role of ALMOs could be extended in the future.

Option 3 suggested that there may be an opportunity for creating a 30+ year management agreement between the ALMO and the Council under which the housing revenue account of the Council was transferred out of the public domain and into the private sector.

Option 3 is, currently, the only situation where private sector finance is envisaged for ALMOs. As this Option is still under discussion, it is clear that the circumstances in *Stadt Halle* are not relevant to current ALMO constitutional arrangements (save perhaps for the unique circumstances of the Kensington & Chelsea ALMO).

As Option 3 develops in the future, the implications of *Brixen* will need to be borne in mind. Option 3 certainly envisages that the Council's sole membership will be relinquished in favour of 'community ownership' of some kind (not least to ensure that the private finance is "off balance sheet" so far as the public sector is concerned). In these instances the in-house criteria (Section 2 above) will not be satisfied and the exemption in Regulation 6 (Section 3) will need to be explored. We have already been doing so in our work on Option 3.

4.3 Actions?

There is, in our view, unlikely to be any need to revisit previous decisions or procedures. *Teckal* principles were understood at the outset of the ALMO initiative and *Brixen* merely clarifies (rather than undermines) them. Nor is there any reason why *Brixen* should adversely affect any current negotiations or plans to renew or extend existing Management Agreements. *Brixen's* impact will be confined to any proposals significantly to expand an ALMO's activities into 'non-core' areas and when, in due course, private finance becomes a factor to be considered, the dilution of the Council's former control and the introduction of funders' control will need to be borne in mind. It may, for example, encourage the use of the Council's own Prudential Borrowing powers.

4.4 Final Comment

All in all, *Brixen* is no 'torpedo', not even a shot across the bows – more a reminder not to venture too far from port without an expert pilot.

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