

In-house procurement in Romania from exception to rule: implications for the rule of law (transparency, accountability)

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Abstract:

The article starts with a short analysis on the main conditions for a municipality to set-up companies over they maintain control in order to supply products, services or works under EU public procurement law. Although it is a positive thing having a regulation at EU level concerning the award of public procurement contracts by municipalities (in-house companies), a close look at various existing arrangements referring to the implementation of these companies in several Member States could raise some practical issues concerning transparency, competition and state aid. Thus, this article aims to analyze the rules applicable to contracts passed to public undertakings. Why? As a rule, the public procurement law is not applicable when a municipality builds the works or provides the product and services through such companies. So, it seems obvious that it is easier to limit the application of public procurement rules by setting-up such companies. Thus, the article looks at the concept of in-house procurement and implications deriving from the need to achieve a certain level of transparency in public procurement and to provide a reasoning when favoring the internalization of a public service instead of buying from the market. Furthermore, the article will conduct a scrutiny at the specifics of such in-house companies recently set-up by the municipality in Bucharest, Romania followed by a court's decision conforming their unlawful status in less than two years.

Key words: public procurement, transparency principle, in-house providing, accountability, rule of law.

1. Points for Practitioners

This paper could provide arguments for policy makers (whether at EU level or Member States) in properly regulating the conditions for setting-up in-house companies including reasonable grounds for doing so like: enlarged supervisory and regulating powers for certain specific areas that are not SGEI, procuring cheaper with internal resources based of thorough analysis of the market, promoting certain social public policies including hiring disadvantaged social categories or improving air quality, the nature of activity imposing in-house procurement, market failure or the main needs of the local community and its surroundings like extended public transportation to support local farming and thus supporting sustainable policies for cities. The lack of such reasons could be a starting point for private operators to successfully challenge the setting-up of this sort of companies.

Secondly, this paper shows that courts should consider the above reasons when examining the legality and the opportunity of buying in-house if such conditions are included for example in some special regulations concerning public procurement contract or SGEI. Basically, the contracting authorities should provide objective criteria when buying in-house instead of buying from the open market as part of their general duty to provide reasons. Failure to give reasons should be deemed as breach of rule of law. Consequently, such omission should normally provide a basis for a legal review even if such reasons are not fully regulated like SGEI with the purpose to prevent abuse of in-house procurement. In-house procurement should be seen as both as an exception to procuring from the market and as a right for doing so. However, the duty to provide objective reasons could also limit a possible abuse of dominant power that could in-house companies have on the market in several Member States (Poland or Lithuania).

Thirdly, it seems that due to their behavior on the market and links with the political protegees, additional safeguards should be taken to control such companies like imposing special regulations and lower the thresholds to such companies in order to place them entirely under Transparency Directive. Currently, this enactment includes thresholds that put such companies outside their application.

Fourthly, when setting-up such in-house companies a special attention should be given to the manner in which the decision is taken in the local councils since the breach of such of regulations could lead to the subsequent annulment

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of said decisions (Romania). Consequently, procuring in-house in breach of legal requirements could eventually lead to incompatible state aid with internal market followed by legal actions to recover it. Additionally, such companies are subject to higher rules concerning transparency and corporate governance. Therefore, additional reporting obligation should be envisaged followed by a control by a third party like Competition Council in addition of the European Commission's role on competition matters. Last but not least, additional safeguards should be taken in consideration against abuse of dominant power on the market of such companies.

2. Introduction. Right of EU municipalities to set-up companies to award public procurement contracts: outsourcing or in-house?

The rule of thumb is that a contracting authority belonging to a Member state has to acquire products, services or works directly from the internal market. To such end, a contracting authority concludes with private entities public procurement contracts under fair and open competition across the entire European single market under the TFEU.

In order to unlock the full potential of the single market, public procurement should be carried between public and private sector out with the full compliance of equal treatment, non-discrimination, mutual recognition, proportionality and transparency.

However, as we will outline below in several EU countries like Lithuania (Kanapinskas, Plytnikas, Tvaronavičienė, 2014), Poland (Wojciech Hartung, Katarzyna Kuźma, 2018) and Romania it seems that currently there is a developing tendency to increase the use of in-house procurement as a threat or abuse of this exception.

In our view, as an exception, such option should be treated with more caution by local authorities. Why? In-house procurement is an exception from concluding a public procurement following any of the award procedures. Thus, in-house procurement eliminates competition from the market.

In the absence of a high-level competition and transparency, it is doubtful if a contracting authority can indeed deliver value for money, as normally requested by all the taxpayers (Semple, 2015).

In the legal doctrine, this manner of meeting different governmental objectives is also called *in-house* (with their own resources) as opposed to outsourcing or contracting out (mainly from private companies but also NGOs) the products, works or services to the market (Arrowsmith, 2014).

Interestingly, public procurement regulation details the main steps of the award procedures and little attention is given on *how* it would be best from the point of view of taxpayers to buy products, services or works: internally or externally (Arrowsmith, 2014).

The answer is far from being easy since many elements must be considered like the maturity of the market on a certain sector and public expectations. Typically, education and health sector are provided internally being core activities while for example IT or other areas where innovation is present are externalized. Therefore, internalizing the latter activities could prove to be counter-productive.

In order to remove the legal uncertainty around various in-house arrangements existing in different EU countries, the new package of directives on public procurement (art. 12)¹, concessions (art.17) and utilities sector (art. 28) has regulated the in-house procurement concept allowing "municipalities to provide services to citizens in the form they prefer or traditionally privilege" as predicted by Mario Monti in his report "A New Strategy for the Single Market". Yet, unless effective safeguards are implemented to control the manner in which in-house procurement is implemented in each EU country, in-house procurement can easily distort the procurement efficiency, transparency and ultimately competition on the internal market.

The activities carried in-house might be seen as distorting competition because of the cross-subsidization risk with the revenues generated by in-house operation.

The aim of this article is to present the implications of the new regulations of in-house procurement in Romania, as an exception from carrying out transparent and competitive (Sánchez, 2011) award procedures.

Looking closely at the manner in which the Mayor of Bucharest has put into practice the in-house concept, we can say that similar to other EU countries (*i.e.* Lithuania or Poland) a potential abuse of in-house exception has led to setting-up of more than 20 companies as an employer for political protégées linked with the ruling party. For the purpose of this article, the case study delineates vertical in-house transactions.

We will briefly indicate how in-house procurement has been carried in Bucharest, Romania starting from the setting-up of more than twenty companies in order to carry out most of activities in different sectors ranging from

¹ For the purpose of this paper, we will refer mainly to Public Sector Directive and vertical in-house procurement.

gardening and central heating and ending with recent final court decision ruling out the illegal manner of their setting-up.

In the first part, we briefly present some considerations regarding the EU notion of in-house procurement. Then, in the second part we will continue with the disadvantages and advantages when buying in-house followed by the Bucharest case study. In final section, we are exploring some best practices for in-house procurement.

3. Methodology

In this paper, we used the systematic analysis to obtain information and qualitatively investigate various laws (positivist and normative approach) and legal practice. Document analysis was used to verify the data from different sources like official website of the Mayor of Bucharest, Romanian Competition Council, newspapers, statistical data provided by independent service providers including data about companies in Romania.

The comparative method was used to verify the transposition of article 12 from Public Sector Directive to Finland, Lithuania, Poland, Romania and Slovenia.

4. What is the EU and Romanian *specific* requirements for the municipalities to set-up companies (*vertical in-house*)?

4.1. *Unwritten exceptions vs. legal certainty*

The new public procurement regulations have introduced many changes with the aim of ensuring simplification and flexibilization to create a level playing field for all businesses across Europe. According to the European Commission "Making Public Procurement work in and for Europe": *"They simplify public procurement procedures, improving access of SMEs to procurement. The overall objective is to obtain better value for public money, to deliver better outcomes for societal and other public policy objectives while increasing efficiency of public spending. Finally, the directives' stronger provisions on integrity and transparency target corruption and fraud. Although turning the directives into national law has been slow, this modernized legal framework is now in place in a large majority of Member States. The European semester process however, identified many specific areas where improvements in the national public procurement landscape would contribute decisively to competitiveness and efficiency gains. Also, Member States are not using to their full extent the possibilities of public procurement as a strategic tool to support sustainable, social policy objectives and innovation. The time is therefore right to focus on the smart application of the new rules in practice"*.

Along with the primary objective of the revision of the EU public procurement regime of providing simplification and flexibilization (Steen Treumer, 2014) for a better use of public funds by regulating specific tools such as life-cycle costs and introduction of new award procedures like competitive procedure with negotiation and innovation partnership, another announced objective was also to provide legal certainty in different areas including in-house procurement.

This need to regulate in-house procurement at EU level emerged following the practices of various contracting authorities from different Member States that set-up different companies awarding them directly all sort of contracts and thus potentially circumventing the public procurement regulations. Following such practice, the other aggrieved economic operators on the market challenged the internal award of such contracts complaining basically about the distortion of the market and the failure to comply with the EU public procurement regulation.

Such practice brought to light an impressive number of cases where the ECJ has confirmed that contracts between contracting authorities cannot be automatically presumed to fall outside the application of EU public procurement law. Consequently, for such a presumption to operate, certain strict conditions must be met.

Concurrently, the ECJ's case law also showed that certain forms of cooperation between contracting authorities cannot be regarded as public procurement contracts.

This eventually led to a public consultation launched by the "Green Paper on the modernization of EU public procurement policy - Towards a more efficient European Procurement Market" with the aim to establish how the area of public procurement should be redesigned for the future. To such end, the European Commission raised several questions to find out details concerning the need to regulate in detail the concept of in-house procurement.

The synthesis of replies showed that a majority of respondents favored the development of a single concept with certain common criteria for exempted forms of public-public cooperation. A minority of the respondents preferred the codification of ECJ case-law.

According to the EU doctrine, the revision of article 12 of the Directive 2014/24 referring to the exceptions of the application of public procurement law for vertical and horizontal cooperation has been one of the most intensively debated topics throughout the entire legislative process (Burgi, 2014). The author W.A. Janssen considered this codification a milestone in the history of public procurement “because clearly confirmed the discretionary power of contracting authorities to decide upon the delivery and organization of public services”. Yet, such discretionary power should have its limits.

4.2. Codification of ECJ’s case law: efficiency and flexibility

The new Public Procurement Sector Directive provides the first explicit legislative rules for determining which contracts can be awarded between public sector entities without a call for tender. Thus, the need to provide legal certainty of such contracts was included right in preamble of the proposal for a directive on public procurement. Apparently, many EU contracting authorities were interpreting divergently the relevant case-law concerning the cases when the contracting authorities are not subject to the application of public procurement rules and thus maximizing the exclusions from applying award procedures.

To limit such practices, article 11 (1) b of the Draft Proposal was even more severe than the ECJ’s case law since:

- (i) it envisaged the total elimination of any private participation in the controlled legal person and
- (ii) imposed a percentage of 90% to activity criterion.

However, this draft received a lot of criticism from both the public and private stakeholders since one could easily argue that factual circumstances of particular cases were regulated into mandatory regulations.

Following a strategic lobby campaign arguing that in-house procurement belongs to the sphere of Member State’s internal organization including references to the subsidiarity principle and fear of forced privatization along with best practices examples from France, Austria, Germany and the Netherlands, the Commission’s Draft proposal was amended into the directions of the public side (Verhelst, 2016).

During the legislative process, the initial wording was amended into a more lenient one favorable to overall efficiency of public procurement by providing for exceptions to the principle of a total ban on private participation while insisting on the need to pursue the general interest (Treumer, 2014). This could indicate an intention towards efficiency by strengthening the cooperation between public-private sector to the benefit of general interest.

However, to purpose of this article is to suggest that in our view the need to pursue general interest could also require a regulation providing a clear indication or at least a solid reasoning of the cases/situations that would require in-house procurement as opposed to external procurement due to exceptional nature of in-house procurement. In addition, due to the implications on state aid, a greater role of the European Commission should be also considered in the future.

This is becoming self-evident in some EU countries due to an abuse of vertical in-house procurement (Harthung, Kuźma, 2018) that we will consider in the following sections (Kanapinskas, Plytnikas, Tvaronavičienė, 2014).

However, before we will continue with a presentation of in-house procurement in Romania, we will briefly summarize the provisions laid down by article 12 that regulates public contract contracts between entities within the public sector having as starting point the fact the freedom of organization it is granted by the article 345 of TFUE and art. 1 (4) of the Public Sector Directive.

As Steen Treumer suggested it could be construed that such a wording represents another example of usage of legal technique called „constructive ambiguity” in order to strike compromises between Member States during the EU decision-making process since article 12 contains several elements that are specific for each EU country like: *department, non-controlling and non-blocking form of private capital participation or public interest*. For this reason, the in-house companies seem to be successful story in some EU countries while in others there could be possible serious infringements of state aid rules (Biancardi, 2018) as well as to the rule of law (Lithuania, Poland or Romania) to we will detail in the following sections.

Article 12 (1) of the Public Sector Directive has codified single in-house procurement with some adjustments the two cumulative criteria for the exemption from EU public procurement rules of a relationship between a contracting authority and another legal person which cannot be completely distinct from it, following mainly the cases Case C-360/96 *Arnhem and Reden v BFI Holding* and C-108/98 *R.I.SAN. v Comune di Ischia and Others* and in the famous *Teckal case*² ruled by ECJ³. Article 12 (2) regulates also sole in-house procurement in case of sister companies

² See C-107/98 – *Teckal vs. Comune di Viano and Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia*, ECLI:EU:C:1999:562

while article 12 (3) deals with joint in-house procurement. Article 12 (4) lays down the criteria of horizontal cooperation.

Cumulative conditions. Basically, under the first paragraph of article 12, a public procurement contract awarded by a contracting authority shall fall outside of public procurement award procedures if two cumulative conditions are met:

1. local authority exercises over the person concerned a control which is similar to that which it exercises over its own departments - the so called “**control test**”⁴ and
2. that person carries out the essential part of its activities with the controlling local authority or authorities – the so called “**dedicated activities test** or direct management” and
3. there is no private capital participation in the controlled legal person with the exception of non-controlling and non-blocking form of private capital participation which do not exert a decisive influence on the contracting authority.

Control test. An important number of cases starting from *Teckal* to *Statd Halle*, *Parking Brixen*, *Asemfo*, *Anav*, *Sea* and *Acoset* have analyzed the issue of control test or hierarchical control. Firstly, it is interesting to notice that the use of term “*departments*” derives from the original reason for setting up autonomous bodies, which was to move **particular departments** out of house. We will insist on the notion of “*particular*” since in our view it is highly debatable whether a local municipality could externalize all or a significant part of these services to in-house companies like it happened in Bucharest, Romania.

The control test entails more than a notion of corporate law, public law or even public procurement law since control must be understood from a functional perspective and not a formal one referring for example to a percentage corresponding to the majority shareholder. Basically, it seems that in case of unlimited powers granted to the board of directors in the sense of corporate law, the control test is not fulfilled since the control must include the power to influence both strategic objectives and significant decisions of the controlled entity. This raises the question of limiting the powers of the board of directors in case of the controlled entity is a joint-stock company or a limited liability company.

The notions of “*strategic objectives*” and “*significant decisions*” are not defined in the Public Sector Directive but they originate from *Parking Brixen* case underlining once again the importance of codifying the relevant case-law. Nevertheless, one could argue that these notions are not sufficient clear enough and still legal certainty is not provided in some particular cases. The notions of “*strategic objectives*” and “*significant decisions*” shall be analyzed on a case-by-case basis.

However, a starting point for providing some guidelines in describing the content of such notions could be the fact that the relationship between a public authority which is a contracting authority and its own departments is governed by considerations and requirements proper to the pursuit of objectives in the public interest of the citizens. Therefore, such objectives and decisions should be carefully identified on a case-by-case basis having as starting point the main function of that department or controlled entity under the contracting authority.

In addition to considerations deriving from pursuing public interest, the contracting authority could make use of contractual instruments to limit any possible unclarity or uncertainty regarding the strategic objectives and significant decisions forming the basis of such similar control. The need to take in consideration public interest has also been mentioned in *Parking Brixen* case: “*What matters is rather whether, in practice, the contracting authority is able to attain its public-interest objectives in full at all times*⁵. It is only where an undertaking has been made independent (autonomous) (59) to such an extent that the contracting authority is no longer able to pursue its interests in full within the undertaking that the contracting authority can no longer be said to exercise a control similar to that which it exercises over its own departments.”

In fact, the control test shall be determined according to the regulations of each country in the light of a complex case-law providing some starting guidelines at the crossroads between public and private law.

Giving the importance of pursuing public interest objectives at all times, a question that could be raised is whether the need to follow public interest objectives should be carefully addressed before procuring in-house during *ex-ante* phase. Such control could provide a clear limitation of public interest as well as additional legitimacy. We will further analyze this possibility under section 7 of this contribution.

³C-107/98, point 50.

⁴ See also point 54 of Opinion of Advocate General Cosmas delivered on July 1, 1999 in C-107/98 – *Teckal*.

⁵ See point 72 of the Opinion of Advocate General Kokot delivered on March 1, 2005 in *Parking Brixen*.

Dedicated activities test. Similar to the control test, the dedicated activities test envisages a limitation of in-house procurement and its impact over the internal market. As opposed to the case-law pertaining to the “operational dependency”, ECJ’s case-law on activities-criterion or “dedicated activities test” was far less due to the secondary position of this criterion. Yet, cases like *Arge* followed by *Stad Halle*, *Carbotermo* and *Asemfo* undoubtedly can underpin the complexity and the implications on the market of the activities carried out by a controlled entity.

The European Commission initially proposed a percentage of 90% of activities of the controlled party to be carried out for the controlling party in line with the ECJ’s ruling in *Carbotermo*. During the debates, the private sector went even further and advocated for a percentage of 100% basically suggesting that should be no activity in the market.

Finally, the Council strongly advocated for a lower percentage from 90% to 80% as currently laid down that in the wording of article 12. Indirectly, the percentage from the former Utilities Directive has been extended to the Public Sector Directive although the Court ruled in *Carbotermo* that no analogy is possible due to the different purpose of the two regulations.

The rationale of this percentage is to limit the freedom of the controlled company on the market since the essential part of the activities must be carried out for the benefit of the controlling authority. Consequently, this criterion limits the likelihood of a controlled company receiving preferential contracts having as object different products, services or works with higher prices followed by a decrease of the same prices for products offered while operating freely under the market for the remaining of 20% activities. Eventually such risk of cross-subsidization could prove to be harmful for SME (Ølykke, Fanøe, 2015).

Given the impact that a controlled entity could have on certain market to distort competition, the economic dependence criterion should have been regulated having in mind both qualitative and quantitative elements (as initially suggested in *Carbotermo* at point 64) in order to prevent a possible abuse of in-house procurement.

The use of a quantitative element like the turnover as opposed to also qualitative elements could in the future distort competition on the internal market.

To sum up, the Public Sector Directive shall apply where the contracting authority has recourse to its own resources for the supply of the products it wants if the cumulative conditions above apply. However, the case-law providing the basis for article 12 states clearly that the exception of in-house providing must be read narrowly. In our view, its application should also be treated with caution.

4.3. A critical view of In-house Romanian regulations

Romania has transposed the Public Sector Directive almost in due time. As in most of the cases, the Romanian public procurement law no. 98/2016 has copy-out at article 31 the provisions of article 12 from the Public Procurement Sector Directive (Dragoş, Neamţu, 2018). This is in line with the tendency in Romania to copy-paste the EU regulations. The other opposing tendency is to extend the public procurement provisions through the so-called “gold-plating.”

In-house procurement is transposed identical in the Public procurement law no. 98/2016 while the direct secondary regulations in the form of Government Decisions no. 395/2016 does not regulate in-house procurement.

It is interesting to note that at the Chamber of Deputies of the Romanian Parliament there was a proposal⁶ draft for amending article 31 (1) b) by introducing a lower percentage of the dedicated activity from the current 80% to 30%. According to the explanatory note of this last proposal, the current value of the percentage of 80% is too high for local contracting authorities that do not have enough financing resources for this kind of companies due to underfinancing. Consequently, a local authority cannot finance the other activities if such percentage remains in force.

The Legislative Council has negatively endorsed this proposal since it was obviously contrary to the EU law. Furthermore, the Romanian Government has negatively endorsed such project while warning about the risk of infringement procedures to be initiated by the European Commission due the failure to comply with the article 12 of the Public Sector Directive.

Romanian Competition Council has issued some special guidelines as proposals to be incorporated in the secondary regulations as adopted by the Government Decision no. 395/2016.

Firstly, the Competition Council requested that the regulatory entity to be separated by the controlled entity and thus avoiding the risk of favorable self-regulation.

⁶ The draft is under no. 151/2018 as of March 26, 2018.

Secondly, the Competition Council was very concerned about the control of the contracting authority over the controlled entity suggesting that such control should envisage a limitation of controlling entity becoming too market orientated and too autonomous and thus limiting the control by the controlling entity. For this reason, this regulatory body suggested a wording including initially a 100% control of share capital by the controlling entity. In case of private holding, it would be required the existence of a dominant influence by the contracting authority and an effective control. Such effective control entails the following criteria: a) the degree of representativity by the controlling entity in the decision-making bodies, provision regarding to such representativity in the article of association, b) equity's participation and c) effective influence and control over strategic decisions and individual management decisions.

However, these interesting and market-oriented suggestions have not been incorporated in the secondary norms as approved by Government Decision no. 395/2016.

Considering the increasing number of in-house companies and especially the set-up of more than 20 in-house companies in Bucharest, Romanian National Agency for Public Procurement and Ministry of Public Finance have issued the Instruction no.1/2018 as of October 26, 2018 regarding the manner of interpreting the provisions of article 31 of Law 98/2016 on public procurement.

This instruction is part of a series of instructions issued by Romanian Agency for Public Procurement in order to give clarifications to the provisions in public procurement sector which in some cases seem to be adding to the provisions of the Law 98/2016.

This instruction clarifies only partially the rationale behind setting-up these kind of companies by firstly reaffirming the right of the municipalities to buy products, works or services from the market or to make them internally. Such decision should consider the need of efficiency in performing certain tasks as well as fulfilling certain objectives of public interest. All contracting authorities should include such analysis in the annual strategy for public procurement. The decision to set-up in-house companies must be well grounded.

The instruction includes in article 7 offers explanations concerning the "dominant influence" although both article 31 (2) of the public procurement law as well as article 12 (1) of Public Sector Directive uses the wording "decisive". This confusion could result from the former Utilities Directive including the definition of "public undertaking."

Although it could prove to be useful under certain matter, the instruction fails to indicate some examples or cases that could provide the basis for creating such companies giving a wide discretion to the contracting authorities. In the absence of such guidelines clarifying the conditions for setting-up in-house company, some contracting authorities could abuse of their right to set-up such companies. A starting point in providing some clarifications on this matter could be the provisions of law 51/2006 of SGEI.

Thus, article 22 (3) states that providing SGEI internally or externally must be decided following an opportunity study considering the following elements: **the nature and the status of the SGEI, providing the best price/quality ratio, current and future interest of the local communities as well as the dimensions and complexity of such services** (Report, 2012-2013).

Furthermore, given the implications on the market, it would have useful that such instruction be issued in cooperation with Romanian Competition Council.

5. Pros and cons for setting-up in-house companies

5.1 *Pros of in-house procurement. Enhanced control mechanism and cheaper products?*

As a first argument to favor in-house procurement, we can consider the autonomy of the Member States in deciding to externalize or internalize their procurement activity according to article 345 of TFEU which recognizes the applicability of national law to system of property ownership. In the same line, Public Sector Directive confirm the discretion of Member states to externalize or not. Secondly, the arguments for identifying in-house advantages require a case-by-case analysis. In some cases, such companies can be important local employers. Another argument for favoring in-house procurement could be to shorten the timeline for providing products, works or services due to the lengthy time required to organize the award procedures.

In case of some particular award procedures, one could argue that contracting authorities do not have the most suitable instruments for supervising and regulating some services and this could provide the basis for contract them to local companies like in waste management sector.

In other cases, one could argue that it is cheaper to procure in-house or that local authorities cannot procure on the market the products they really need due to market failure while in other cases a strategic or political could require buying in-house.

5.2 Cons of in-house procurement: competition distortion?

In other cases, the use of extensive in-house procurement with no additional safeguards or control mechanism could lead to providing huge benefits for political proteges of public officials (Romania, Lithuania), possible abuse of dominant position (Poland) or risk of cross-subsidization like in Italy. In the latter case, the case-law indicated that courts have expressly reaffirmed that the lack of a clear separation of accounts between the public and the competitive activities conducted by an in-house company might be considered a valid indicator of a distortion of competition.

Arguably, in-house procurement can influence the market since like it was argued in Finland in-house units are considered to benefit from their status by: (i) stable purchases from the contracting authority, (ii) the reputation gained by working with the contracting entity in comparison to other market operators. For this reason, in Finland the limit for in-house entity sales to entities other than the controlling contracting authorities is set to 5% as opposed to 20% in the Public Procurement Sector Directive. In case there is no activity or operator on the market, the threshold of 5% can be raised to 10%.

It is interesting to note that in Finland the lack of operators on a certain market shall be established following the publicity by a specific transparency notice resembling to the voluntary ex-ante notice on direct award (VEAT).

6. Case study of municipal companies set-up in Bucharest: from full externalization to court annulment

We will further discuss the in-house concept as put into practice by the Mayor of Bucharest to procure in-house.

According to the public information available on the website of Bucharest's City Hall, in 2017 the General Council of Bucharest voted separately to set up 22 companies as joint-stock companies for providing different services to the citizens at reasonable costs and for a higher quality.

All the companies were part of the holding called "Bucharest, European capital". Shortly, an important part of the internal departments of the City-Hall were transformed into joint-stock-companies operating into various areas including heating, construction, IT services, sports, parking, security, gardening, social services, public lightening and traffic management. Most of these companies have two shareholders: Bucharest City represented by the General Council of Bucharest holding 99,9% of the share capital and Ciclop S.A. holding 0,1% of the share capital, a local company owned by General Council of Bucharest in charge of car repairs set-up following the reorganization of the former public transportation company.

An interesting case of is that of the company called "Compania de dezvoltare durabila S.A." providing feasibility studies for all the investments to be made in Bucharest in a shorter time period than the private operators. According to the public officials, all the companies are fully transparent and audited by the Romanian Court of Accounts. Yet, no such report has been made publicly available so far. However, when making a scrutiny over the websites of these companies, we can easily notice a lack of transparency in the sense of Emergency Government Ordinance no. 109/2011 concerning the corporate governance of public enterprises. For example, regarding Touristic Municipal Company there are no information available concerning the board of director's decisions or new audit report.

According to the public information available on this holding website, all the companies have short-term credits from the Mayor of Bucharest that have not been yet reimbursed although are due. Thus, many of the companies have financial losses but this is somehow a normal business practice in the first years of activity for many companies whether public or private.

In what concerns the quality of the services provided by these the companies, there are no public information regarding key performance indicators or other objective indicators to be taken in consideration. On the contrary, if we consider external indicator like the one provided Mercer for 2019, Bucharest has dropped two more places on the quality of living.

An objective factor to be considered when analyzing the opportunity of such companies could refer to the savings made to the local budget. However, there is no independent data conforming such savings except for the official's statements claiming a 25% reduction of the effort on the local budget. Basically, the Mayor declared that a lot of savings have been made into IT sector where a municipal company both a new IT license for € 2,000 while the former private company requested € 50,000.

The General Council of Bucharest or the Mayor of Bucharest has not publicly made available studies regarding the opportunity of setting-up these companies analyzing in depth the market and the priorities of the city. The decision for the setting-up these companies mentions some internal reports issued by several internal departments. Yet, the said reports were not made publicly available.

Some entities have suggested that the prices offered by these local companies are even higher than the market prices like for example in case of security services. This could also be due to the lack of information about the market since in many cases it seems that there are enough competitors to provide the needed products, services or works. To this end, we identified randomly with the assistance of the private company aggregating big data on each market that there are a number of important competitors to compete for ten out of the 22 companies. The remaining companies were not subject to this kind of checking. As shown in Appendix 1 there are between 4-8 private competitors on each market.

Consequently, a simple random analysis shows that there are an important number of competitors on different areas of the market. Therefore, at least for those companies one cannot argue that market failure could be the rationale behind setting-up these companies. On the contrary, buying through internal companies instead from the free market could actually distort the market. As other authors already pointed out (Sánchez, 2015), it seems that in Romania also there is high risk of competition distortion if local authorities choose to fully externalize most of the internal departments with no market research. For the purpose of this article, we also sent a letter to the Romanian Competition Council to verify if the Mayor of Bucharest is under any investigation. Furthermore, we asked some clarifications regarding the conditions for setting-up local companies and buying in-house. As probably expected, this authority emphasized the fact that the state can indeed involve in market activities in case of market failure or in other words when the market cannot meet a certain need. Furthermore, the Romanian Competition Council underlined the obligation of the contracting authority to provide reasons for buying in-house like market failure or reasons involving economic efficiency.

Hence, from the perspective of Competition Council reaching for in-house should entail a reduction of costs and consequently the level of the costs should be at market level to avoid state aid implications. A similar approach was regulated in Slovenia (Ferk Petra, Ferk Boštjan, 2018). Thus, the Slovenian legislator regulated a fourth criterion requiring that the value of the subject-matter of the procurement is equal or lower than the price of such subject-matter on the market. This led to a peculiar practice where contracting authorities occasionally published procurement procedures for services and influence their in-house companies to bid in order to prove that in-house companies provide services at the market level.

Coming back to point of view expressed by the Romanian Competition Council⁷, an interesting remark was that there is a lower risk for breaching the competition rules when the activities performed by the controlling companies are referring to **additional or residual activities** that were not actually covered by the market. As the above analysis showed, in Bucharest most of the activities are covered by the market as indicated by the number of competitors. In fact, after the Court's decision to cancel the decision pertaining to the setting-up of these companies, the Mayor of Bucharest also declared that in many cases the tender books for certain award procedures in fact were favoring certain economic operators. So, it seems that instead of dealing with this issue procuring in-house was preferred.

Unfortunately, the Competition Council has not issued a special instruction for in-house companies although there seems to be an increasing tendency for many municipalities in Romania to set-up this kind of local companies.

In order to procure in-house, the General Council of Bucharest has approved a simplified internal procedure to be followed by these companies to procure in-house including an invitation notice and a tender book drafted by the contracting authority. In Poland, the contracting authorities have the obligation to apply so-called single source procurement procedure that is not required under article 12 of Public Sector Directive. According to article 66 (1) of the public procurement Polish law, single source procurement means contract award procedures in which the contracting authority awards the contract after the negotiations with only one economic operator.

As expected, the use of this award procedure led to scrutiny by the National Chamber of Appeal. Although it could be useful to obtain some advantages like a price reduction, the rationale behind in-house procurement was to exclude the application of an award procedure and it seems that including such an award procedure it is another example of gold-plating.

Nevertheless, the reduction in prices could also be reached through an informal negotiation without follow a certain procedure since the success of a certain procurement could also depend on the flexibility and the negotiations skills of the person in charge of the entire process.

⁷ Letter no. 15288 as of January 19, 2019 available upon request.

It is important to stress that in Romania these companies follow public procurement award procedures when procuring from the market.

On November 22, 2018, Bucharest Court of Appeal decided that all 22 companies were unlawfully set-up⁸. The Court argued that there is no real intention for association between the two founding entities acting as shareholders of these companies. The main reason for doing so is that Ciclop S.A., the second shareholder holding only 0.1% of the share capital in all these companies is entirely controlled by the Mayor of Bucharest and its share capital contribution was very low or practically insignificant.

Moreover, the Court also took in consideration that Ciclop S.A. has a very narrow object of activity while the companies set up were having a quite diverse object of activity ranging from electricity to security services.

This means that the Mayor of Bucharest was in fact controlling all these companies since there was no real association or intention to procure.

Apart from the lack of *affectio societatis*, the Court also held that the majority of vote was breached since the legal majority to pass all the approving decisions was of two thirds for a lawful approval due to the implications over the patrimony of the municipality.

Following the annulment of all the decisions issued by General Council of Bucharest for setting-up these companies, a new action was brought in Bucharest Tribunal for the annulment of each company following the definitive annulment of a document requested in the incorporation process. This court case is still pending⁹.

Having in view the use of in-house procurement in Romania, we will further discuss some good practices when buying in-house.

7. Good practices when buying in-house: ex-ante phase or pre-procurement phase, special award procedure, separations of accounts, costs allocations and benchmarking?

The current situation of in-house procurement in countries like Lithuania, Poland and Romania could represent a starting at EU level of regulating a special regulation concerning in-house procurement from both a procurement perspective and competition and state aid perspective aiming at better describing the circumstances for buying in-house right from the moment of setting-up of these companies, the manner in which the procurement takes place, the period of time for their existence and the impact on the market including the risk of limiting the existence of SME on the market.

An alternative could be also an instrument of soft law providing guidance to in-house procurement from a competition and state-aid perspective addressing the current situation in several Member States.

We will further discuss some useful tools to be considered as best practices for buying in-house as revealed by several authors as follows: pre-procurement phase, a special award procedure to be considered by contracting authority before procuring in-house, separation of accounts and benchmarking.

7.1. Ex-ante or pre-procurement phase

Given the impact of procuring in-house over the market and especially the SMEs from the local markets, we consider that an in-depth analysis should determine upfront the main arguments for favoring in-house procurement including at least: enlarged supervisory and regulating powers for certain specific areas like waste management, procuring cheaper with internal resources based of thorough analysis of the market, promoting certain social public policies including hiring disadvantaged social categories or improving the air quality, the nature of activity imposing in-house procurement, market failure or the main needs of the local community and its surroundings like extended public transportation to support local farming and thus supporting sustainable policies for cities etc.

Thus, a pre-procurement phase should improve the quality of decision-making in public sector. As in the case of Romania, we could argue that the decision the set-up 22 companies and consequently to limit access to the market should have been grounded on objective factors since as an exception to buying from the market should be treated with caution. Actually, the internal reports grounding such decision to procure in-house were not made publicly available contrary to the good administration principle and the duty to provide reasoned decisions. On the contrary,

⁸ The Court Decision no. 6504 as of November 2018 issued by the Bucharest Court of Appeal is available upon request since such decision was not made publicly available from our knowledge.

⁹ http://portal.just.ro/3/SitePages/Dosar.aspx?id_dosar=300000000853775&id_inst=3

limiting the access to market could be contrary to other principles governing public procurement but mainly proportionality, equal treatment and transparency.

In the Dutch Public Procurement Act, article 1.4 obliges contracting authority to base the choice for the type of procedure, which the contracting authority wishes to use to *objective criteria*. Consequently, an explanation in relation to both of the choices must be available at the request of the market parties. Based on this provision, Willem A. Janssen argues that a market party could **contest the internal performance of a service**.

In a similar manner, in Poland it appears that some contracting authorities are using the benefit of in-house procurement to encroach market share that is not related to a market to their task. This is why we consider that a contracting authority should be allowed to procure in-house only if this is the public interest and excluding competition will bring benefits to public interest.

Basically, the Supreme Court in Poland also indicated that a municipality that intends to confer a contract on its own company on rules relevant for in-house should make a detailed analysis of whether this will constitute an abuse of dominant power.

7.2. Special award procedure

In Poland there is also a special regulation imposing contracting authorities to apply negotiated procedure without publication. This could also be useful indirectly as a tool for better in-house procurement since it could force to controlled company to improve their initial offer. The downside in Poland was that it slowed the entire procurement process due the review in courts (Bogdanowicz, 2018).

The remaining good practices to be further discussed are also valuable tools for enforcement state aid rules.

7.3. Separation of accounts

The obligation to hold separate accounts relating to reserved and competitive activities is included in Transparency Directive as a mean of preventing illegal state aid. However, due to high thresholds (€ 40 of annual turnover) and the special category enterprises covered by this regulation (undertaking with special/exclusive rights or performing SGEI), most of in-house companies are not included under such obligation. Therefore, in-house companies risk distorting the market by cross-subsidizing the market activities with revenues from reserved activities.

7.4. Cost allocation and benchmarking

Cost-allocation methods have as purpose to determine the proper allocation of all the costs for a certain activity based on two test Market Economy Investor Principle (better known as MEIP) or Market Economy Tenderer Principle. In essence, the price charge by an in-house company should be compared with those charged by a hypothetical market operator.

By applying a method of cost allocation, a contracting authority can avoid what is considered in state aid as a payment of high or inefficient costs or paying a higher price.

8. Conclusions

This analysis indicates that in some EU countries, the concept of in-house procurement could still raise some doubtfulness due to the fact that it is a concept existing at the frontiers of EU law and national regulations. Furthermore, the concept of in-house procurement seems to include elements of public and private law. For this reason, it seems that in some countries deviations from carrying out public procurement procedures can create space for violations of transparency, accountability, state aid rules, competition by an abuse of in-house procurement and eventually rule of law. In our view, additional safeguards should be regulated regarding a greater monitoring and control of such in-house procurement companies like the need to provide reasons when procuring in-house.

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