Enriching public procurement regulation through EU state aid law based principles

Tim Bruyninckx

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

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Department of Law

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Examining Board

Professor Giorgio Monti, EUI (Supervisor)
Professor Petros Mavroidis, EUI
Professor Roberto Caranta, Università di Torino
Professor Kris Wauters, Université Catholique de Louvain-la-Neuve

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Department of Law – LL.M. and Ph.D. Programmes

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Summary

The starting point for the thesis is the problem of negative externalities public purchasing gives rise to. We argue that public procurement regulation, having as an objective the structuring of public markets for public contracts, produces the said market failure, which may adversely affect the competitive dynamics in other markets. This may cause a significant loss of social welfare. The reason why public procurement produces such negative externalities is, so we argue, due to the fact that public procurement regulation is foremost concerned with the internal dimension of public purchasing, i.e. the relationship between the public purchaser and actual and potential tenderers. However, public procurement regulation largely omits the external dimension, i.e. the effects public purchasing produces vis-à-vis markets outside the specific market for the public contract at hand.

In our quest for a way to address this problem of negative externalities we argue that these externalities converge to a large extent with an 'advantage', being one of the conditions for the EU state aid prohibition (laid down in article107 (1) TFEU) to apply. Hence, we deem EU state aid law to be a valuable source of inspiration to 'enrich' public procurement regulation. Such 'enriched' public procurement regulation would be able to avoid the occurrence of the negative externalities we identified, or at least to minimise the risk of their occurrence. Examining a number of areas within EU state aid law allowed us to identify a number of principles that ensure absence of an 'advantage'. These principles constitute the basis for our 'standard for enrichment', i.e. a framework for regulatory reform as to public procurement regulation.

We also apply this standard to a number of aspects of public procurement regulation. More specifically, we clarify how 'enriched' public procurement regulation would materialise as to the following aspects of public purchasing: (i) the disclosure obligation as to award criteria and their belongings, (ii) the pursuit of policy objectives through public purchasing and (iii) modifications to public contracts in the performance phase.

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1. INTRODUCTORY CHAPTER

A. THE SUBJECT

In this thesis, we will deal with one cause for the market to fail: negative externalities arising from public purchasing that distort the well-functioning of markets outside the specific 'public market' for the public contact. The overall starting point is therefore that the activity of public purchasing – i.e. public authorities acquiring goods, services and works on the market – produces effects that are able to harm markets outside the scope of the public purchasing (and the market that is created[1] to this effect) at hand. This thesis aims at describing these negative externalities, identifying the source for the negative externalities and suggesting a solution.

We will argue that public procurement regulation is too much focused on the internal dimension of the specific market the public purchaser creates when purchasing. As a consequence, it overlooks the external effects the provisions of such regulation produce. The ultimate goal we pursue is enhancing social welfare by contributing to the well-functioning of competition on markets in general. To this effect, we will reflect upon solutions which allow at least reducing the adverse effects, caused by public purchasing, to the competitive dynamics in other markets. Hence, this thesis is not so much concerned with public purchasing itself; it is concerned with the negative externalities it produces outside the market that is organised for the award of the specific contract. We will study these negative externalities and suggest a framework for improving the regulation. The idea is to reflect on how public purchasers[2] should behave when awarding and entering into public contracts. We will suggest ways to neutralise the anti-competitive external effects public purchasing produces as a consequence of the regulation it is subject to.

[1] We assume that for a given public purchase contract, i.e. a contract entered into by a public authority in the capacity of a purchasing party, such public authority organises competition for the contract, and thus creates a specific market for the award of the contract at hand.

[2] The notion 'public purchaser' is to be understood in the broad sense, i.e. an entity that should comply with the relevant public procurement regulation in a given State. In that sense, the notion is conceptualised in a broad sense and not necessarily confined to a specific definition laid down in a particular public procurement regime.

The overarching problem we intend to tackle here is the following social welfare[3] reducing event: public purchasing may produce an outcome that implies an advantage to the chosen tenderer that allows the latter to cross-subsidise his activities on markets outside the public market for the public contract at hand and thus to build up market power in those markets. Hence, we intend to tackle a market failure (i.e. the negative externality) produced on the specific market for the public contract in order to avoid that another market failure (i.e. market power) affects the well-functioning of markets outside that specific public market. We contend that the cause for the initial market failure (the negative externalities) follows from flaws in the regulation to which public purchasing is subject.

It is relevant to pinpoint the delicacy of this exercise. On the one hand, we will argue in favour of public procurement regulation that takes into account the external effects it produces. Hence, we will point to a number of flaws in this regulation. On the other hand, we must however bear in mind that public procurement regulation as it is today has its merits as well. We will discuss this in section II to follow. Public procurement regulation is in fact an answer to a market failure, i.e. the fact that public purchasing does not yield the same outcome as private purchasing. This is due to a number of reasons, mainly related to the public nature of the purchaser, which we will discuss below. Therefore, when suggesting regulatory reform, we cannot turn a blind eye to the existing public procurement regulation and its rationale. This may imply, at some points, a balancing exercise and therefore impact the purview of our suggestions for regulatory reform.[4]

B. THE RELEVANT CONTEXT: PUBLIC PROCUREMENT REGULATION AS A WAY TO DEAL WITH FAILING PUBLIC MARKETS

This thesis does not focus on public purchasing as regulated by public procurement regulation as such, but deals with its negative external effects. It is however important to see that we deem public procurement regulation to be both the source and the solution to the problem of these

[3]The notion "social welfare" should be understood as: *The economic well-being of a society as a whole*. D Rutherford, *Routledge Dictionary of Economics* (3rd edition), (Routlegde, 2013), 553.

[4] As we will discuss further on, one of the functions of public procurement regulation is addressing the agent principal problem. More specifically, public purchasers usually acquire works, services and goods on behalf of public administrative bodies and agencies. Hence, this activity is not necessarily exposed to market forces. From the perspective of supervision, it may be deemed necessary to set up particular control mechanisms. A private purchaser, however, may deem such mechanisms to obstruct efficiency in the purchasing process. Therefore, we deem merely setting aside public procurement regulation to be utopian, and even inappropriate.

negative external effects. Further on, we will explore what that source is in public procurement regulation and we will elaborate the solution we deem appropriate. First however, we will discuss why there is something like "public procurement regulation". The relevance of this discussion is, on the one hand, to clarify why legislators enact public procurement regulation, and also to clarify that the exercise conducted in this thesis is subject to certain limits. After all, we will discuss further below that public procurement regulation has its merits, and it is not the intention here to contest these merits. Our intention is to elaborate a framework to strengthen public procurement regulation in a way that it interferes to the least possible extent with other markets. On the other hand, the discussion to follow is also relevant to depict the fundamentals that underpin public procurement regulation, and which will be the bedrock to analyse the flaws that produce the negative external effects we intend to deal with.

a. The difference between private markets and public markets

Starting our discussion of the main reasons why public purchasing is subject to a particular body of law – and not just the law which is applicable to market transactions in general (e.g. civil law, including economic and contract law) – we have to identify the main reasons that distinguish private and public markets.

Private markets, allowing for competition, offer the best environment to identify the most efficient supplier, according to Trepte. This is because on competitive markets both the purchaser and the supplier are price takers. They are both informed about the conditions the market produces, and they can enter or leave that market. The clash between demand and supply produces a kind of equilibrium, providing for the proper price for a given product. [5]

Public markets, however, display different features which imply that such markets, in the absence of specific regulation, would not work properly. Hence, the market would not produce the desired outcome. This implies that in absence of regulatory intervention the achievement of efficiency – i.e. a competitive market price – is doubtful to say the least.[6] The following

[5] P Trepte, Understanding the Ends and Means of Public Procurement Regulation, (Oxford University Press, 2004), 112. See also: A Calleja, *Unleashing social justice through EU public procurement*, (Routledge, 2015), 176-177.
[6] Ibid.

elements are deemed to make public markets fail: the nature of public markets, the nature of the public purchaser and the problem of information asymmetry. We will discuss these elements in the sections to follow. These elements, and the way these are addressed in public procurement regulation, thus have to be perceived from the angle that public procurement regulation in essence envisages to bridge the difference between public and private markets, in order to assimilate the working of public markets with the working the of private markets, in order to achieve a similar outcome.[7] This is an essential point to appreciate in view of the discussions to follow.

b. The nature of public markets: the problem of market power

The literature pinpoints a number of issues that relate to the nature of public markets and their actors that require regulatory intervention.[8] First of all, the nature of the products the public purchasers purchase implies that often only a limited number of suppliers are eligible to contract with. Hence, such suppliers have a dominant position vis-à-vis the public purchaser, implying a kind of monopoly. This enables suppliers, in principle, to set prices without being restrained by market forces. The public purchaser is in principle not fully able to verify the correctness of this price anyway as the market fails to provide a yardstick. Suppliers thus become price makers.

However, such limited offer is not always merely due to a supply side market failure. Such failure to ensure appropriate supply can also follow from a 'governmental failure'. After all, efficiency through competition on a properly functioning market requires that both suppliers and buyers can freely enter and leave the market. However, public purchasers tend to create barriers to entry, aiming at favouring national companies.[9] It follows from the foregoing that regulatory intervention, i.e. public procurement regulation, is necessary in order to ensure competition at the supply side in order to guarantee efficient spending of public resources. In

[7] E Iossa and C H Bovis, 'Colloquium' in G Pigai and T Tatrai, *Public Procurement Policy,* (Routledge, 2016), 109.
[8] C H Bovis, 'State Aid and Public Private Partnerships – Containing the Threat to Free Markets and Competition' (2010) 2 *European Procurement and Public Private Partnership Law Review* 167, 171.
[9] P Trepte, *o.c.*, 113-115; See also (although in slightly different wording): C Bovis, *EC Public Procurement: Case Law and Regulation*, (Oxford University Press, 2006), 14-15.

this respect, a system that guarantees that the public purchaser receives as much useful offers as possible is preferable.[10] Furthermore, such an open procedure reduces the risk of collusion between suppliers, since this implies diversity amongst suppliers.[11] After all, Trepte pinpoints the fact that public purchasers can only achieve best value for money if the tenderers actually compete with each other. If they would collude, obviously the procuring process will not lead to an outcome embodying the idea of best value for money.[12]

However, even if such situation (i.e. a situation of monopoly) does not occur, public purchasers often are the only buyer on the market, which endows that market with a monopsony character. Although the public purchaser can act as a price maker – being able to establish the price for the product – this position implies also that public purchasers do not have an incentive to behave efficiently while purchasing such products. After all, being the only possible provider of the final good or service concerned,[13] the procuring entity can pass on the costs related to this inefficiency to the tax payer or the consumer of the goods produced by the public purchaser. Hence, regulation that imposes the organising of competition, in the sense that public purchasers are forced to have suppliers compete with each other, is necessary in order to correct the tendency towards inefficiency on behalf of the public purchaser.[14]

[10] P Trepte, *o.c.*, 121.
[11] P Trepte, *o.c.*, 122. However, Sanchez Graells points to the risk of collusion amongst suppliers due to the mechanisms enshrined in public procurement regulation (*A Sanchez Graells, Public procurement and the EU competition rules*, (Hart, *2015)*, 69-71). Nevertheless, economic literature suggests that if collusion is to be expected in a public procurement procedure, more competition (thus more tenderers) implies that the public purchasers receives lower bids (J Moore, 'Cartels Facing Competition in Public Procurement: An Empirical Analysis', EPPP Discussion Paper No. 2012-09, 4.).
[12] Ibid.
[13] For instance, if a public purchasers purchase "public infrastructure works", such as dredging of rivers or sewerage, at contract terms which do not reflect efficiency (i.e. at a supra-competitive price), he can pass on the costs to the users of the infrastructure. After all, there is no substitute for such infrastructure or for the provider of such infrastructure.
[14]Later on we will discuss the work of Sanchez Graells who studied the anti-competitive effects of public procurement regulation due to the public purchaser's buying power. To put Trepte's point into perspective with Sanchez Graells' analysis, Trepte argues that such situation of inefficiency occurs absent public procurement regulation. Sanchez Graells, however, studies the effects of public procurement regulation once it is put into force. So whereas Trepte argues in favour of the introduction of competition for public contracts, Sanchez Graells in fact points to the flaws in this regulation giving rise to distortions of competition dynamics in the wider market (thus wider than the given public market for a certain product).

c. The nature of the public purchaser: agency problems

Not only the market structure of public markets for a particular public contract implies a need for specific regulation. Also, a number of issues specific to the structure of the public purchaser make public procurement regulation necessary.

This issue was already touched upon in a number of opinions to ECJ cases in the framework of the "private investor test" in EU state aid law. Intuitively, one could argue that a public purchaser and a private purchaser act within a different financial and economic framework. Also, they arguably are not exposed to the same degree of moral hazard. As to the different financial contexts public and private entities are operating in, advocate-general Léger already mentioned in his opinions to the *Meura* and *Bosch* cases that a government has in theory access to unlimited financial resources. Indeed, at least in theory, governments can raise taxes when in need for money. Another possibility is to exploit the strong position they hold and using that position to negotiate loans at favourable terms. Private companies are not able to act accordingly.[15] This point of view should probably be nuanced, but it is true that public and private entities are not subject to the same financial preoccupations. In addition to that, a 2004 report, commissioned by the *Office of Fair Trading*,[16] signalled that even when a public purchaser holds buying power it may not deploy this power due to a lack of a profit maximizing objective.[17] Hence, the OFT seems to recognise that public purchasers are not subject to similar efficiency incentives as private purchasers are when purchasing on the market.

Along these lines, it should be remarked that public purchasers spend public money, i.e. money not directly belonging to them but rather to the community and collected through mechanisms set up by law. Private purchasers on the other hand are spending their very own money, i.e. money they earned on the market or money obtained from third parties (e.g. banks, investors,

[15]Opinion Advocate-General Léger to Case 234/84, Belgium / Commission, [1986] 2263, 14; Opinion Advocate-General Léger to Case 40/85, Belgium / Commission, [1986] 2321, 13. This point of view was subsequently confirmed in jurisprudence of the General Court, see e.g.: Case T-228/99, Westdeutsche Landesbank, [2003], II-435, 272; Case T-156/04, EDF / Commission, [2009] II-4503, 231. See more generally: N Kahn and K-D Borchardt, 'The Private Market Investor Principle: Reality Check or Distorting Mirror?' in X., *EC State Aid Law- Le droit des aides d'Etat dans la CE. Liber Amicorum Francisco Santaolalla Gadea*, (Wolters Kluwer, 2008), 113 and 117.

[16] Office of Fair Trading, Assessing the impact of public sector procurement on competition, September 2004 (hereinafter "OFT Report on Anti-Competitive Effects of Public Procurement").

[17] OFT Report on Anti-Competitive Effects of Public Procurement, par. 3.31-3.34.

…). This means that a cost is involved in the very fact that the private purchaser has this money at his availability. It follows that, in a way, one could say that money is more worth (because more scarce or more difficult to obtain) to private purchasers than to public purchasers.

Also scholars have already pointed to these issues. Nicolaides claimed:

> *"Of course, the state in reality is never just another market participant. Even when it buys for its own needs, it can still artificially boost prices and output by the simple fact that its own internal service may be bloated, wasteful and inefficient. An inefficient company will eventually exit the market. An inefficient state can stay in the market forever because it has the power of taxation".*[18]

In the same vein, Bovis argued that a public purchaser – being part of the government apparatus – cannot be conceived as a normal market participant. This is because the public purchaser's behavior can be affected by economic and social considerations, not to mention the political and personal gains individuals belonging to this entity may derive from public purchasing due to organizational shortcomings in the structures at hand.[19] By the same token, Beckers refers to the less important role public purchasers attach to profit maximisation.[20]

The issue set out in the previous paragraphs can be articulated more formally by approaching public procurement regulation from a principal-agent perspective. A private purchaser is supposed to act in his self-interest, and thus to maximize his profits. However, public purchasers purchase products on behalf of public entities acting in the public interest or even directly on behalf of society.[21] Thus, the purchasing entity is in fact an agent being in a relation with a principal.

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[18] Ph Nicolaides, 'State Aid Advantage and Competitive Selection: What is a Normal Market Transaction?' (2010) 1 *European State Aid Law Quarterly* 65, 66.
[19] C H Bovis, 'State Aid and Public Private Partnerships – Containing the Threat to Free Markets and Competition' (2010) 2 *European Procurement and Public Private Partnership Law Review* 167, 170.
[20] A Beckers, 'Using contracts to further sustainability? A contract law perspective on sustainable public procurement' in B Sjafjell and A Wiesbrouck (eds.), *Sustainable Public Procurement Under EU Law*, (Cambridge University Press, 2015), 223-224.
[21] In the context of public procurement, the roles of the agent and the principal can be fulfilled by various actors. An agent can be the public entity wishing to procure goods and/or services to provide its task to the benefit of the community, the latter being the principal. Also, the agent can be the civil servant that procures the goods and/or services on behalf of the public entity he belongs to. R W Waterman and K J Meier, 'Principal-Agent Models: An Expansion?', (1998) 8 *Journal of Public Administration Research and Theory* 173, 179.

The principal-agent problem envisages the situation in which an agent is potentially driven by other interests than the principal's interests, resulting in a conflict of interests. More in particular, this means as to public purchasing that the agent (i.e. the public purchaser who purchases on behalf of his principal, i.e. the public administrative body he is part of or even (indirectly) society in general) is not necessarily in the first place concerned with addressing the needs in an efficient and/or effective way. In this respect, it is argued that the more discretionary power the agent possesses and the weaker the control exercised over his acts, the more likely that the agent shall act contrarily to the interests of the principal and/or shall abuse this situation to pursue his own interests.[22]

According to Trepte, such misuse on the part of the agent can be attributed to different causes.

First of all, the agent's behaviour can be affected by corruption or fraud.[23] This problem can be addressed, or at least be minimised, by regulating public purchasing. Mechanisms to this end are: publication of the contract and disclosing under which conditions interested parties can obtain this contract (such as the technical specifications and selection and award criteria), a prohibition to negotiate or to have pre-award contacts with individual tenderers, the use of sealed bids, the introduction of suitability requirements as a condition for participation to the tender procedure and the possibility of ex post control (which requires transparency on behalf of the procuring entity when conducting the procedure).[24]

Soudry has further elaborated this question of corruption and fraud. The reason for forcing public entities into a regulatory straitjacket is the absence of control mechanisms vis-à-vis public purchasers. Private purchasers are, contrarily, subject to such control mechanisms since their discretion is restricted through control mechanisms from a legal nature, for instance contractual clauses, as well as through market related control mechanisms, i.e. the so-called "market for corporate control". As to public purchasers, it is held that their behaviour is difficult to monitor, due to their number and diversity. Also, the "market for corporate control"

[22] P Trepte, *o.c.*, 70-71.
[23] P Trepte, *o.c.*, 71.
[24] P Trepte, *o.c.*, 76-77.

mechanism is not applicable to public purchasers.[25] Finally, the public purchaser does not only pursue profits; also other factors determine his behaviour, such as the general interest. Such factor, however, is far more difficult to substantiate and therefore open to various interpretations. These factors imply that control mechanisms should be built in at the input side. This requires the putting into effect of procedures to which public purchasers should comply with while purchasing.[26] Such a procedural framework, to which the public purchasers are subject to, can however itself hinder the achievement of efficiency.[27] Soudry notes nonetheless that this efficiency cost should be balanced with the costs resulting from the principal-agent problem[28].

Secondly, the agent can adopt inefficient behaviour because he does not pursue the best conditions possible. After all, since his behaviour does not affect his own profits or financial situation – only the principal's profits or financial situation are – the agent is not incentivised to act in a way that ensures efficiency. Also, the agent often does not have the necessary market knowledge to assess whether or not contract terms reflect best value for money. In this respect, the nature of public markets – i.e. a limited number of transactions that offer a yardstick – implies that contracting authorities often are not able to measure the contract terms against the terms of a private market transaction.[29] Regulating public procurement may offer a solution to this. It subjects public purchasers to monitoring and it limits their discretion. However, instruments available in private markets cannot be transposed to the public markets. This is because undertakings on private markets have more instruments at their disposal to incentivise their employees to act in the interest of the undertaking. The following reasons are mentioned in the literature: (1) a more direct influence on the employees, (2) a more profound control over labor conditions and (3) more flexibility as to incentive mechanisms. Regulating public purchasing obviously does not envisage the introduction of such instruments. Nevertheless,

[25] This point closely relates to the point we made earlier, i.e. that public purchasers are not incentivised to act efficiently in the same way as private purchasers are. Cf. supra.
[26]O. Soudry, 'A principal-agent analysis of accountability in public procurement' in C Piga and K Thai (eds.), *Advancing Public Procurement: Practices, Innovation and knowledge-sharing*, (PRAcademics, 2007), 435-436; See also: G Heijboer and J Telgen, 'Choosing the open or the restricted procedure: a big deal or a big deal' (2002) 2 *Journal of Public Procurement* 2002, 187, 199.
[27] We will elaborate this point further below. A general example of such procedural requirement that may hinder efficiency are the administrative burdens a tenderer may have to comply with. This may deter undertakings from participating in the tender procedure, and therefore result in reduced competition. Cf. infra.
[28]O Soudry, *l.c.*, 437 and 444.
[29] P Trepte, *o.c.*, 77-78.

public procurement regulation aims at the same outcome, i.e. public contracts reflecting efficiency.[30]

Thirdly, also the so-called "interest group capture" can result in an inefficient outcome of the procurement process. After all, the agent is, compared to the principal, much closer located to the source of information relevant for the entering into the public contract. Hence, the agent can withhold or manipulate information in order to have the contract awarded in accordance with the wish of interest groups that have lobbied for a certain outcome of the procurement procedure.[31]

d. The problem of asymmetric information

Discussing the nature of the public purchaser also brings us to another problem: the information asymmetry between the private suppliers and public purchasers. A public purchaser has in general less information – about the price of a given product or, more generally, about the market at hand and its players and the products offered thereon – in comparison to a supplier.[32] This information-asymmetry problem is quite straightforward when the contract is awarded solely on the basis of a price criterion: the procuring authority has difficulties to establish whether the price offered is a fair price. However, public contracts can also be awarded based on other criteria. Also in such event, information problems may occur. More in particular, the moral hazard problem and the issue of adverse selection may arise.

The moral hazard problem refers to the situation in which a tenderer holds information about how a contract can be performed in the most efficient way. The problem occurs when the tenderer has no interest in communicating this information to the contracting authority. Keeping this information private increases his chances to obtain additional rents, i.e. to make more profits out of the contract. As this information remains private, the public purchaser assumes, due to a lack of information, that the tenderer performs the contract efficiently.[33] The contrary

[30] P Trepte, *o.c.*, 81-82.
[31] P Trepte, *o.c.*, 82-83.
[32] P Trepte, *o.c.*, 86.
[33] P Trepte, *o.c.*, 88.

being true, it follows that the supplier does not carry the cost of his inefficient behaviour but he passes these costs on to the public purchaser.

The issue of adverse selection relates to the situation in which a public purchaser does not possess the information necessary to identify the most suitable tenderer to perform adequately the contract. For instance, procuring authorities are not aware of the state of the art technology which would render performing a public contract drastically more efficient.[34] This could, for instance, imply that public purchaser drafts the tender documents based on information which does not allow to enter into a contract that addresses his needs in the most efficient way. Hence, chances are that the public purchaser will not be able- to choose the most suitable tenderer, due to his lack of information.

It is suggested that the problems as to adverse selection and moral hazard can be dealt with – or at least can be minimised – by regulating a number of aspects of public purchasing. These issues relate for the bigger part to the organisation of competition for the public contract, with a special focus on guaranteeing behaviour on behalf of the public purchaser that indeed enables adequate competition for the contract. Trepte sees competition as the best way to gather information; competition enables the public purchaser to explore the market and extract information out of it.[35] Therefore, Trepte considers competition to be a "discovery procedure".[36] Henceforth, competition imposed by public procurement regulation converges with Hayek's conception of competition, i.e. a tool to discover 'particular temporary circumstances'.[37] This 'discovery feature' follows from the fact that competition is believed to force the tenderer to reveal private information.[38] In this respect, the broader the discovery (thus the more competition), the larger the public purchaser's advantage.[39] This has also been discussed in the

[34] P Trepte, *o.c.*, 89.
[35] P Trepte, *o.c.*, 86-87.
[36] P Trepte, *o.c.*, 86. See also: C Guccio, G Pignataro and I Rizzo, 'Adaptation costs in public works procurement in Italy' (2008) 3rd International Public Procurement Conference Proceedings, 900, <http://www.ippa.org/IPPC3/Proceedings/Chaper%2048.pdf> accessed February 2016.
[37] F A Hayek, Competition as a Discovery Procedure, *The Quarterly Journal of Austrian Economics* 2002, 9-23, 11.
[38] And thus it avoids profit-maximising behaviour on behalf of the counterparty; see A Benassy-Quere, B Coeure, P Jacquet and J Pisani-Ferry, *Economic Policy: Theory and Practice* (Oxford Uni, versity Press 2010), 91-92.
[39]However also drafting an offer and its assessment involves a cost. On the other hand, Trepte pinpoints that a wide notification of the intention to enter into a contract through publication does not only result in the availability of better information for the public entity, but also that costs related to the purchasing process are reduced since the purchasing entity does not have to approach individually potential suppliers (P Trepte, *o.c.*, 88).

literature dealing with the question how to avoid an advantage that qualifies as state aid within the meaning of article 107 (1) TFEU when public purchasers enter into public contracts. If the public purchaser has no knowledge about the costs of performing the contract, he can deploy competitive selection in order identify the least costly supplier.[40]

In order to organize such a discovery procedure, the public purchaser should notify his intention to award a contract pursuant to a public procurement procedure. The aim of this is to reach as many potential tenderers as possible and enabling them to participate in the award procedure. A wide participation provides the information the public purchaser needs to adopt an informed decision. However, merely publishing a contract notice to inform the market is not sufficient. The information problems require a much broader regulatory intervention.

Apart from publishing a notice, such intervention should also introduce mechanisms that foster the tenderers' trust in public purchasers and in the award procedure. Such trust encourages tenderers to communicate the information procuring entities need. For example, when a contract is awarded solely on the basis of a price criterion, trust in the fact that the public purchaser shall effectively award the contract to the tenderer offering the lowest price will encourage the tenderers submit a bid that approximates the equilibrium price.

Also, the public purchaser should stick to his commitments made in the beginning of the award procedure. Once the public purchaser communicates that he shall only apply the price criterion in the course of a procurement procedure, he should maintain this position throughout the whole of the procedure[41]. Obviously, this applies as well when the public purchaser awards the contract on the basis of another award criterion. In case the public purchaser applies other award criteria than the price criterion, the public purchaser should indicate in the tender documents how he will apply those criteria. For instance, whereas the price criterion is rather straightforward, an award criterion relating to qualitative considerations (e.g. the quality of the products supplied or the delivery delays) may leave room for interpretation. Therefore, the public purchaser should already in the tender documents provide for guidance on how such criteria are to be substantiated. This limits discretion and guarantees transparency with respect

[40] Ph Nicolaides and E Rusu, Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?, (2012) 1 European Procurement and Public Private Partnership 5, 7.
[41] P Trepte, *o.c.*, 94-95.

to the assessment of the bids. Furthermore, this also enables ex post verification whether the procurement procedure was conducted properly.[42]

Enhancing trust also requires that the bid assessment method, which was communicated, is applied without modification during the procurement procedure. The aim envisaged here is to create incentives for the potential suppliers to behave like "honest brokers", and therefore to communicate to the public purchaser full and adequate information. Trepte says:

> "*The suppliers need confidence in the system and in the strength of the buyer's commitment to that process before they have a sufficient incentive to act as 'honest brokers' and thus act in a way which benefits the government buyer*"[43].

As a complement to this, also the discretion a public purchaser holds should likewise be subject to a procedural framework that allows verifying whether the public purchaser has actually complied with these procedures.[44] We already elaborated this issue in our discussion above.

In addition to the foregoing, in order to deal with the adverse effects related to adverse selection, public procurement regulation should also aim at avoiding that unsuitable suppliers are admitted to the procurement procedure. Suppliers can be unsuitable because they are unreliable, financially or economically unstable or technically unequipped. Henceforth, public procurement regulation should provide for the possibility that such tenderers cannot participate in the procedure. To this end, generally public procurement regulation provides for the possibility to apply objective selection criteria.[45]

Obviously, adverse selection and moral hazard will occur mostly – and will produce the most detrimental effect – in case the public purchaser grounds his award decision to a large extent on the particular features of a product and thus not only on the price criterion. If that situation applies, the public purchaser starts from its own preferences, but also from the solutions and

[42] P Trepte, *o.c.*, 95. On the importance of transparency to foster trust amongst tenderers, see also J Forssbaeck and L Oxelheim, 'The Multifaced Concept of Transparaency' in J Forssbaeck and L Oxelheim (eds.), *The Oxford Handbook of Economic and Institutional Transparency*, (Oxford University Press, 2014), 11
[43] P Trepte, *o.c.*, 95.
[44] P Trepte, *o.c.*, 96-97.
[45] P Trepte, *o.c.*, 99.

possibilities the market is seemingly offering. Hence, the public purchasers adopts a decision as to how its needs should be addressed based on the information available to him. The problem that arises is the one of making an "informed choice". Adopting such a decision requires information gathering. Obviously, it is important to obtain useful information on the market, but another important issue is the effective processing of this information. This is where the discretion that public purchasers hold, turns into a problem.[46] Public purchasers can abuse the fact that they are close to the source of information in order to deceive the principal by manipulating the incoming information in order to produce a certain outcome.[47] Public procurement regulation should avoid this.

Also in this respect, regulation should introduce objectivity into the public purchasing process, as well as a means to verify later on whether the public purchasing entity actually behaved objectively. This does not only suppose that the procuring entity determines his purchasing behaviour on the basis of the information available; this information should be accurate as well. This requires the procuring entity to clearly set out his needs in the tender documents, which allows the creation of a yardstick for the assessment of the tenders filed. Setting out those needs has to be done though elaborating in the tender documents the technical standards the product should comply with.[48] Public purchasing regulation offers the framework to make sure that the public purchaser drafts these technical specifications in an objective manner, as well as that he evaluates objectively whether the product indeed addresses the needs enshrined in those specifications.[49]

e. The relevance for defining our subject-matter

It follows from the previous sections that public procurement regulation in itself is not to be considered to be the problem we want to address. Public procurement regulation is envisaged

[46] This problem is closely related to the principal agent problem (cf. supra).
[47] P Trepte, *o.c.*, 93. We discussed this issue at length when discussing the principal-agent problem in view of the negative external effects vis-à-vis other markets, and that arise due to the nature of the public purchaser. Cf. supra.
[48] P Trepte, *o.c.*, 92.
[49] P Trepte, *o.c.*, 93. Admittedly, Trepte pinpoints the fact that when a purchasing public entity formulates its needs in technical specifications, it may have too little information about the opportunities and stance of technology in the market, which results then in the purchase of outdate material (P Trepte, *o.c.*, 93).

to address issues that make public markets vulnerable to failures, giving rise to inefficient outcomes. Therefore, public procurement regulation is indispensable as, absent such regulation, public markets would fail. However, as we will discuss further on, the way public procurement regulation addresses these failures are believed to produce the negative externalities.

To be sure, we believe that the answer to the issues we envisage to address – i.e. how to avoid the negative externalities public purchasing produces – cannot entail the elimination of public procurement regulation. Public procurement regulation should remain the starting point when formulating suggestions. Our intention is to provide for a framework for regulatory reform that addresses the negative external effects we see. In the next section we will further discuss the negative externalities we deem problematic and which we aim to address.

C. NEGATIVE EXTERNALITIES RESULTING FROM PUBLIC PROCUREMENT

It follows from the previous section that public procurement regulation has its origins in tackling market failures. However, we believe that public purchasing – as regulated by public procurement regulation – can give rise to a market failure as well, i.e. negative externalities that affect the well-functioning of markets outside the specific public market for the public contract at hand. We will argue that competition – and more in particular defects in the competitive process for the award of the public contract – is a key factor in the analysis when discussing these negative externalities.

The element of competition in public procurement regulation has been discussed widely in the literature. This is hardly surprising. One of the goals underpinning public procurement regulation is the creation of best value for money by organising competition among tenderers. Nevertheless, also other considerations may emerge when organising an award procedure to enter into a public contract. Protectionism and favouritism are such considerations. A vast strand of scholarship has dealt with this issue.[50] Other scholarship has focussed on the role of

[50] See e.g.: S Vagstad, 'Promoting fair competition in public procurement' (1995) 58 *Journal of Public Economics* 283; R P McAfee and J McMillan, 'Government procurement and international trade' (1989) 26 *Journal of International Economics* 291–308; F Branco, 'Favoring domestic firms in procurement contracts' (1994) 37 *Journal of International Economics* 65–80; F Naegelen and M Mougeot, 'Discriminatory public procurement policy and cost reduction incentives' (1998) 67 *Journal of Public Economics* 349–367.

competition in public procurement to ensure best value for money.[51] In the framework of EU law, special attention was dedicated to the issue of equality amongst tenderers so as to ensure genuine competition. Indeed many commentators have engaged in discussions about the principle of competition, in the sense of equality amongst tenderers, within the framework of EU public procurement law.[52]

This scholarship is, however, foremost concerned with competition for the public contract. Yet, the effects of public purchasing (as regulated by public procurement regulation) on competition outside the realm of a given public contract and its specific public market were not addressed in this scholarship. The scope of the principle of 'competition' within EU public procurement law – and thus in some way also the question whether or not this principle covers the problem of anti-competitive external effects of public purchasing – has recently been the subject of a debate between Sanchez Graells, Arrowsmith and Kunzlik. Sanchez Graells argued in favour of a pro-competitive approach towards public procurement regulation, including EU public procurement law. In that respect, he argued that 'competition' should not only be conceived as an internal goal; it also has to be conceived as an external goal, i.e. public procurement should interfere to the least extent possible with competition in general.[53] Arrowsmith argued that the EU public procurement directives do not entail a general principle of 'competition', but that 'competition' should be understood in view of the objective of the directives, i.e. the removal of barriers to the establishing of an internal market for public contracts.[54] Kunzlik correspondingly rejects the claim that 'competition' in EU public procurement law is about

[51] K Goeree and T Offerman, 'Competitive Bidding in Auctions with Private and Common Values', Tinbergen Institute Discussion Paper, TI 2000-044/1, November 1999, 1-30; O Compte and P Jehiel, 'On the Value of Competition in Procurement Auction' (2002) 1 *Econometrica,* 343-355.

[52] E.g. Arrowsmith discussed the relationship between 'competition for the contract' in relation to modifications to specifications. S Arrowsmith, 'Amendments to specifications under the European public procurement Directives' (1997) 3 *Public Procurement Law Review,* 128-137. Treumer took stock of the problem of equality amongst tenderers in case of pre-award contacts with potential or actual tenderers. S Treumer, 'Technical Dialogue Prior to Submission of Tenders and the Principle of Equal Treatment of Tenderers' (1999) 3, *Public Procurement Law Review,* 147. Dekel examined how allowing tenderers to correct defective offers in the course of the procurement procedure can intensify competition without affecting equality amongst tenderers. O Dekel, 'Improving public procurement efficiency - applying a compliance criterion', (2015) 2 *Public Procurement Law Review,* 63-77. Raymant discussed case law dealing with tenderers holding a dominant position in the procurement procedure for the award of a concession contract. B Raymant, 'Abuse of a dominant position in tendering situations: Arriva the Shires Limited v London' (2014) 3 *Public Procurement Law Review* NA187-NA191.

[53] A Sanchez Graells, *Public procurement and the EU competition rules,* (Hart, 2011), 101.

[54] S Arrowsmith, 'The Purpose of the EU Procurement Directives: Ends, Means and the Implications for National Regulatory Space for Commercial and Horizontal Procurement Policies' (2011-2012) 14 *Cambridge Yearbook of European legal studies* 1, 25-34.

efficiency, but argues that it aims at providing *a structure of competition for public contracts to be opened up to EU-wide competition on the basis of equality of competitive opportunity*.[55] Sanchez Graells rejected both points of criticism on his earlier work, the former by referring to the economic rationale underpinning the creation of the internal market and to article 18(1) Directive 2014/14, the latter by interpreting the argument made as actually confirming his point of view as they both seem to achieve the outcome of efficiency.[56]

This discussion brings the question to the table whether 'competition' in public procurement regulation also envisages the effects public purchasing produces vis-à-vis competition in other markets. However, negative external effects produced by public purchasing affecting the well-functioning of other markets have not been the subject yet of extensive scholarly attention.[57] Insofar negative externalities arising from public procurement have been studied, authors mainly focussed on the adverse effects vis-à-vis society (or taxpayers) because of inefficient spending of public money. In that vein, the party suffering from the negative externalities produced by public purchasing are taxpayers. For instance, Ohasi showed that transparency in public procurement procedures may imply savings up to 8% of the contract price.[58] Other authors have looked into the consequences of bribing vis-à-vis the contract value.[59] However, our focus here is not with efficient spending of public money – even though this closely relates to our concern as to the said negative externalities – but it is with the adverse effects public purchasing may produce vis-à-vis the well-functioning of competition outside the market for the specific public contract.

Even though we argued that the problem we address has not yet been the subject of extensive scholarly attention, we nevertheless point to some important contributions to this debate so far. In the 2004 OFT report, the anti-competitive effects as a result of public purchasing were mapped. The report lists three categories of effects in this regard. The first category comprises the short term effects, relating to competition between the tenderers for a specific contract. An

[55] P Kunzlik, 'Neoliberalism and the European Public Procurement Regime' (2012-2013) 15 *Cambridge yearbook of European legal studies* 312, 340.
[56] *A Sanchez Graells, (2015), o.c., xv and xvii.*
[57] A Sanchez Graells (2015), *o.c.*, 61.
[58] H Ohasi, 'Effects of Transparency in Procurement Practices on Government Expenditure: A Case Study of Municipal Public Works' (2009) 3 Review of Industrial Organisation 267.
[59] O Compte, A Lambert-Mogiliansky and T Verdier, 'Corruption and Competition in Procurement Auctions' (2005) 1 The RAND Journal of Economics 1, 10-11.

example is the public purchaser's behaviour that facilitates collusion (e.g. though transparency measures) thereby negatively affecting competition for the contract. The second refers to long term effects that influence competition for future contracts. An example would be a market player's exit due to entry barriers obstructing access to competition for the public contract while this contract is crucial for the viability of this market player. The third contains knock-on effects, i.e. effects working vis-à-vis co-buyers. An example is the fact that private buyers obtain less favourable terms if their suppliers are subject to public purchasers' buying power.[60] The report discusses how certain procurement practices give rise to these effects and how they affect tenderers and influence the achievement of value for money. These effects can result from either exercising buying power or omitting to exercise buying power. It was the purpose of the report to identify the anti-competitive effects and their origins as well as to examine what the indicators are of (potential) existence of anti-competitive effects.

Even though the report does not explicitly deal with negative external effects vis-à-vis other markets, this matter is touched upon implicitly. More in particular, the second category (i.e. long term effects that influence competition for future contracts) we referred to above is relevant to our analysis. This category in fact envisages negative externalities arising from public purchasing. In that respect, the report opens the section on these long term effects as follows:

> *"Where the public sector is a major buyer, winning public contacts can be crucial for the commercial viability of firms. Not being selected as a public contractor might mean that a firm has to leave the market, or that at the very least it is severely handicapped in its commercial activities".*[61]

Such long-term effects can also arise because short-term effects affecting the market structure cannot be remedied by the market itself.[62] These events can be considered to qualify as negative externalities, as such effects arising from public purchasing affect the competitive dynamics in the broader market. The 2004 report is, however, not only concerned with negative externalities as the authors also note that public purchasing can also produce long term effects that entail

[60] Further on, we will refer to this effect as "waterbed effects". We will rely on the work of Sanchez Graells who has studied, in the context of public procurement regulation, the detrimental consequences these effects produce vis-à-vis competition (cf. infra).
[61] OFT Report on Anti-Competitive Effects of Public Procurement, par. 4.12.
[62] OFT Report on Anti-Competitive Effects of Public Procurement, par. 4.17.

positive externalities, e.g. by breaking a monopoly through awarding the contract to a new entrant.[63] Nevertheless, the 2004 report implicitly acknowledges the potential for public purchasing to produce negative externalities, however without further developing the problem we are concerned with in this thesis.

The work conducted by Sanchez Graells is even more relevant to our thesis. This author was among the first authors to approach public purchasing as an activity that has both an internal and an external dimension. Sanchez Graells raised the point that, as a consequence, competition should not only to be an 'internal goal' of public procurement regulation; competition should also be an 'external goal'. More in particular, public procurement regulation should also aim at ensuring that public purchasing interferes to the least extent possible with the normal working of competition.[64] He reasons along the same lines in the context of EU public procurement law. Maintaining and protecting competition on the internal market, i.e. in the broader sense, is also an objective of EU public procurement law. This, he argues, is the 'negative dimension' of competition as a principle within public procurement regulation: public procurement regulation should not produce anti-competitive effects.[65]

In that respect, Sanchez Graells argues that a public purchaser does not merely act within the framework of a "public market". Often also private parties purchase these goods, services and works. Hence, the public purchaser is considered to be just one of the buyers on a given market. It follows from this that the public purchaser's behaviour produces effects as to the market dynamics. Sanchez Graells identified this as a gap in the literature:

> *"All efficiency and cost-benefit analyses exclusively focus on the public buyer (…) and largely omit the effects on suppliers and, especially, on the rest of the purchasers of the same goods and services".*[66]

[63] OFT Report on Anti-Competitive Effects of Public Procurement, par. 4.15.
[64] A Sanchez Graells (2015), *o.c.*, 108-109.
[65] A Sanchez Graells, Truly competitive public procurement as a *Europe 2020* lever: what role for the principle of competition in the moderating horizontal policies?, *Paper presented at UACES 47th Annual Conference*, 2015.
[66] A Sanchez Graells (2015), *o.c.*, 41.

Hence, Sanchez Graells deals with the third category of anti-competitive effects we referred to above when discussing the 2004 OFT report.[67]

Sanchez Graells focusses on the adverse effects resulting from the buying power that public purchasers possess and which affects co-buyers. To see his scope of research clearly, it is important to see which kind of markets Sanchez Graells envisages. He identifies four types of markets. But first, for the sake of clarity: these markets are to be considered as general markets on which at least potentially both public purchasers and private purchasers enter into purchase transactions. Hence, 'public markets' are only a small part of a given market. In fact, a proper way to describe such 'public market' is to depict them as a 'transaction' on the more general market. For instance, there is a market for pens. Both private and public purchasers buy pens. Hence, if a public purchaser organises a public procurement procedure to purchase pens, the 'public market' the public purchaser creates, should not be conceived as a standalone market. It is rather a 'transaction' the public purchaser carries out on the broader market for pens, where private and public purchasers buy side-by-side.

Now, which are the markets that Sanchez Graells identifies? The first type of market consists of the 'exclusive markets'. These are markets where only public purchasers purchase. Such markets are therefore monopsonist markets. The second type includes 'dependent markets'. This type of markets is characterized by the public purchaser being the main purchaser on this market alongside a limited number of private purchasers. The public purchaser's behaviour defines the market dynamics. After all, it is economically rational for suppliers to adapt to the public purchaser's desires and requirements. As the private purchasers hold a relatively weak position, they are bound to follow the dynamics set by the public purchaser.[68] The third type of markets comprises "commercial markets". On such markets, the public purchaser is just one purchaser amongst many others. Hence, a public purchaser does not significantly affect the market dynamics on this market. After all, his buying power equals the other private purchasers' buying power. Lastly, the fourth type of markets consists of private markets. On such markets, the public purchaser is barely active.[69] The negative external effects resulting from public

[67] However, Sanchez Graells also discusses the adverse effects of procurement regulation that facilitates collusion. Hence, he also addresses the first type anti-competitive effects.
[68] Sanchez Graells sees here a problem of welfare loss, especially if the requirements and desires on behalf of the private purchasers are heterogeneous vis-à-vis the ones of the public purchaser.
[69] A Sanchez Graells (2015), *o.c.*, 43-46.

purchasing that Sanchez Graells wishes to tackle arise on the exclusive markets and the dependent markets. These types are both together referred to as "publicly dominated markets".[70]

Sanchez Graells contends that in publicly dominated markets public purchasers cause effects – willingly or unwillingly – that affect the competitive dynamics in those markets. These effects are believed to jeopardize the outcome that would have been achieved in a properly functioning market. The reason for these effects to happen is that the dominant public purchaser is believed to have the power to act as a price setter. The procurement process thus results in a lower contract price in comparison to the normal market equilibrium price. The reason for this is that purchasing activities are subject to public procurement regulation, according to Sanchez Graells. This regulation often forces the public purchaser to behave in a different way than the way a private purchaser would behave. Hence, public procurement regulation gives rise to market imperfections and market failures. The author points, apart from a number of smaller issues, to direct as well indirect economic effects.

First, there are some direct economic effects. Public procurement regulation implying the effects we described above negatively impacts market competition dynamics as it causes 'waterbed effects', i.e. some buyers benefit from an advantage to the detriment of other buyers. Hence, the market power exercised by the public purchasers (implying a price below the equilibrium price) obliges the supplier to recover the difference between the price agreed upon and the equilibrium price from other purchasers. Also, society gets adversely affected. Such 'waterbed effects' may imply an efficiency loss to the detriment of society as they induce price and non-price distortions. In the first place, a net loss of social welfare will occur because of limited exchanges in the market, due to foreclosure of markets for suppliers and/or worse purchase conditions for private purchasers (because of diminished variety and higher prices). Secondly, redistributive effects will occur. After all, value is taken from suppliers and buyers of similar products and is transferred to the public purchaser.[71] Thirdly, welfare losses in the long term may emerge because of reduced economic viability of suppliers and private buyers.[72]

Secondly, as to indirect economic effects, public procurement regulation gives rise to the

[70] A Sanchez Graells (2015), *o.c.*, 46.
[71] Sanchez Graells adds however that such operations may be neutral in terms of overall efficiency or utility.
[72] A Sanchez Graells (2015), *o.c.*, 69-73.

construction of a market structure that facilitates collusion – both on the part of the suppliers and on the part of the public authorities (through entering into a buying cartel). Moreover, such market structure further reduces the level of competition in the market by diminishing the long-term incentives for potential tenderers to compete.[73] As to the latter, one could think of the transparency requirement that is at the core of public procurement regulation. The need for purchasing authorities to disclose information on the procurement process may de-incentivize undertakings from taking part in the procedure. This might particularly be a problem on markets where market participants hold sensitive information.[74]

According to Sanchez Graells these problems originate from the fact that when introducing public procurement regulation, this regulation was meant to introduce market-like instruments in public purchasing in order to introduce actual competition between tenderers.[75] However, when doing so, the regulator failed to take into consideration the fact that such regulation works within a broader market; it does not constitute a substitute for the market.[76] This oversight, or misconception, results in distortive effects, leaving considerable scope for improvement as to public procurement regulation.[77]

It stems from the foregoing that Sanchez Graells already touched upon the issue of negative externalities within the context of public purchasing – particularly where the author discusses the waterbed effects arising from public procurement activity.[78] These negative externalities originate from the buying power public purchasers hold in some markets as a result of public procurement regulation. This buying power negatively affects the well-functioning of the market – to be understood as the market place where both public and private purchasers buy – resulting in a welfare loss.

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[73] A Sanchez Graells (2015), *o.c.*, 73-75.
[74] A Sanchez Graells (2015), *o.c.*, 76.
[75] This point corresponds with our earlier discussion of the rationale underpinning public procurement regulation. Cf. supra.
[76]More in particular, public contracts and the procurement procedure organized for the entering into such contracts do not constitute a market of its own. They are part of a broader product market. For instance, if a public purchaser buys pens, Sanchez Graells does not think in terms of a particular public market for the purchase of pens. He sees the public purchaser as a buyer just like any other buyer on the market for the given product – at least in terms of consequences arising from its behaviour on that broader product market.
[77] A Sanchez Graells (2015), *o.c.* 63.
[78] From the discussion it follows that Sanchez Graells also discussed distortions as to competition for the contract, i.e. because of buyer and/or supplier cartels when competing for the contract. While we do not contradict that supplier cartels may give rise to supra-competitive prices as well, this is not the subject of this research. Below, we will further discuss this limitation of the thesis.

Our focus differs nonetheless from Sanchez Graells' research. We look at the negative externalities public purchasing produces vis-à-vis other markets than the specific public market for the contract at hand. Hence, in view of the perspective adopted in this thesis, we do not adhere to Sanchez Graells' conception that 'public markets' in fact do not exist but that a public contract merely constitutes one transaction on broader market. We will hold on to the terminology of 'public market' to identify the market that has to be distinguished from both the private market for the same product and markets (both private and public) for other products. We believe that the negative externalities we envisage potentially produce adverse effects vis-à-vis both latter markets.

Our concern is with the possibility for the chosen tenderer to use the advantage he receives from the public contract to strengthen his competitive position vis-à-vis a competitor on a market outside the specific market for the public contract at hand. Hence, our analysis envisages in fact a situation of cross-subsidisation.[79] Sanchez Graells looks at negative externalities affecting other purchasers in that market. His analysis requires for his negative externalities to occur that the public purchaser and the parties harmed are 'co-buyers' of the product. Hence, the negative externalities we look at differ. Nevertheless, the effect both externalities produce converge. They are both welfare-reducing since they deprive competition in the respective markets from their competitive dynamics.

Furthermore, we believe that our respective research efforts do not only converge in terms of the outcome we pursue, we also believe that the foregoing indicates that our approaches are complementary. A rough and oversimplified sketch may demonstrate this. When the public purchaser is vested with buying power (thus in 'publicly dominated markets'), he can potentially force a sub-competitive price implying a negative externality for his co-buyers. When the public purchaser has no buying power (thus in 'commercial' or 'private markets'), he

[79] It is however not required that the chosen tenderer conducts other activities than the one that is the subject of the public contract. Suppose an undertaking has only one activity and it only contracts with other public purchasers, it can still use the advantage obtained under one contract to win future contracts. This implies that the negative externalities we envisage are not only problematic in commercial (and maybe private) markets. Also in the extreme case that for a product no private buyer exists the possibility remains that the chosen tenderer uses the advantage obtained under a public contract to win future public contracts thought exercising market power in future public procurement procedures.

potentially contracts at a supra-competitive price implying a negative externality for the chosen tenderer's competitors. In the event of the former, Sanchez Graells' analysis is relevant; in the latter case, ours.[80] However, we should not overgeneralize. We should not assume that public purchasers are always able to force prices below equilibrium in publicly dominated markets or that they always have an incentive to do so. For instance, the public purchaser may not be able to do so because he suffers from a severe asymmetric information problem. The supplier is thus in a position to exploit his favourable position and to proceed to opportunism and rent-seeking. Another point in this respect was raised in the 2004 OFT report. There it was held that public purchasers may not exercise their buying power because they are not driven by profit-maximisation.[81]

D. THE ARGUMENT

The negative externalities we wish to address in this thesis result from the inability of public procurement regulation to provide an environment that guarantees that public purchasers enter into public contracts at market terms. Obviously, our concern lies with those cases where the contract terms are supra-competitive (or above the equilibrium price).

The advantage affiliated to this supra-competitive price enables the chosen tenderer to leverage his position on other markets, i.e. markets outside the specific market for the public contract at hand. Note in this respect that it is not necessary for the chosen tenderer to contract with private purchasers as well. If the tenderer solely contracts with public purchasers for a certain product, he can still strengthen his position in that product market and use this advantage in future public procurement procedures.

The source of this competition distortion lies within public procurement regulation, so we argue. To demonstrate this, we will examine the fundamentals underpinning public procurement regulation in general. This will allow us to point the finger to the flaw in the conception of public procurement regulation that is the source of the negative externalities we

[80] Nevertheless, although Sanchez Graells focusses on 'publicly dominated' markets and our research will mainly be concerned with 'commercial' and 'private markets', we do not fully exclude that our analysis is also valid for 'publicly dominated markets', that is when the public contract reflects supra-competitive terms after all.
[81] OFT Report on Anti-Competitive Effects of Public Procurement, par. 3.31-3.32.

intend to deal with. These fundamentals are ambiguous. One strand of scholarship sees public procurement as a means to deal with principal-agent problems by providing for structures and institutions. A second strand deems public procurement to be a neoliberalist tool to achieve efficiency in public purchasing. Another strand considers public procurement regulation as a body of law to set the boundaries within which the public purchaser can use public procurement as a policy tool albeit while also taking into account efficiency considerations, i.e. the ordo-liberal strand of thought. What these conceptions have in common though, is that they cannot prevent the negative externalities from occurring. All these conceptions are focused on the relationship between the public purchaser and the potential and actual tenderers. However, they overlook the external effects the outcome of the procurement process produces. Hence, it must be concluded that neutrality vis-à-vis competition outside the specific market for the public contract is not a *rationale* that underpins public procurement regulation, no matter which conception is envisaged.

Summarising the problem we discussed above, public procurement regulation is not able to guarantee that the procurement process produce a neutral outcome vis-à-vis markets outside the specific public market for the public contract at hand. Such neutrality is achieved when the contract is entered into at equilibrium price. This statement is valid, so we argue, even though the said conceptions are concerned with efficiency considerations at least to a certain extent. We submit that this is the result of a trade-off. Both in the strand which considers public procurement regulation to provide for structures and institutions as in the neoliberal and ordoliberal conceptions, public procurement regulation is the result of a trade-off between competition and another element – accountability and integrity in the principal agent-conception, avoiding public purchaser's discretion supported by oversight and enforcement mechanisms in the neoliberal conception and pursuing of policy objectives in the ordo-liberal conception.

This trade-off is believed to imply that competition cannot fully fulfil the role it is in principle endowed with in the context of public purchasing, i.e. ensuring that the public purchaser identifies the terms that a contract would reflect in a perfectly competitive environment. Hence, the adverse effects vis-à-vis the other markets are caused by the fact that public procurement regulation itself constraints the role of competition as an information gathering tool on the

market for the public contract. Therefore, we believe that it is justified to search for a response that deals with the adverse effects of this situation. We qualify this effort as 'enriching public procurement regulation'.

In search for foundations for 'enriched' public procurement regulation, it is first important to recall the *rationale* underpinning our 'enriching' effort. The outcome we want to achieve is, in the first place, avoiding competition distortions on other markets on which the chosen tenderer competes with other undertakings. Such distortions are due to overcompensation received under the public contract which can be used to cross-subsidise the chosen tenderer's activities on those other markets. To that end we endeavour to shield the public purchaser from acting in a way that undermines his quest for contract terms that reflect competitive terms and conditions. Even though closely related to these ends, ensuring efficient public spending is not our first concern. Of course, both ends are intertwined, and therefore we believe that our 'enriching' effort also contributes to the objective of rendering public purchasing more efficient from the perspective of the public budget. Even more, one could argue that for the purpose of our analysis, efficient public spending (thus achieving best value for money) serves as a device to avoid the occurrence of the negative externalities we envisage to tackle.

Our mission involves the development of a standard[82] to 'enrich' public procurement regulation so as to avoid the occurrence of the negative externalities (or at least to minimise their effects). We believe that the *rationale* underpinning our effort – i.e. safeguarding competition on the market by avoiding that chosen tenderers receive an economic advantage that harms competition on other markets – converges to a large extent with the *rationale* underpinning EU state aid law. Therefore, in order to construct our 'standard for enriching' we will examine how EU state aid law can help us in constructing our 'standard for enriching'.

E. THE STRUCTURE OF THE THESIS

[82] The notion 'standard' refers to a number of principles we will draw from EU state aid law which, we believe, can contribute (if complied with) to public procurement regulation that is (more) neutral in terms of the interference in other markets, and thus regulation that does not give rise (or at least to a lesser extent) to the negative externalities we address in this thesis.

The thesis is divided into two parts. Part I is of a theoretical nature whereas part II is dedicated to concretising the findings we elaborate in the first part. In the latter part we will sketch how certain issues of public purchasing would be regulated under a regime of 'enriched public procurement regulation'. To do so, we will start from EU public procurement law for the reasons we will discuss further below.

Part I will be structured as follows.

Chapter one is dedicated to a closer examination of the negative externalities that are central to our thesis. Here we will sketch the problem we see and what harm it brings along.

In chapter two we will examine the conceptions that exist in the literature as to public procurement regulation in order to locate the source of this negative externality. We will look into the neoliberal and ordoliberal conceptions as well as into the conception that sees public procurement regulation as regulation that provides structures and institutions. We will establish that the said conceptions are solely concerned with the internal dimension of public procurement regulation, but not so much with the external dimension (i.e. the effect on markets outside the public market for the specific contract). This would not be problematic as long as within this 'internal dimension' competition would be perfect. However, public procurement regulation seems to be the result of a trade-off between competition and other considerations. This trade-off obstructs the well-functioning of competition, so we will argue. It follows that we will submit that imperfect competition as a result of this trade-off is the source of the negative externalities we envisage to address here.

Chapter three embodies the 'how question': how will we 'enrich' public procurement regulation? The idea is that such 'enrichment' should contribute to achieving the outcome competition for the contract would achieve if it were perfect. Perfect competition would have resulted in the public purchaser being able to identify the equilibrium price for the performance of the public contract. We should thus construct our standard with the underpinning idea that it should contribute to the establishing of the equilibrium price. Here, EU state aid law will be pivotal in the analysis. First, we will argue that EU state aid law provides for a useful source of inspiration. This not only because we believe that the negative externalities we address here

match with the notion of 'advantage', being one of the cumulative conditions for EU State Aid law to apply. We also deem the *rationale* underpinning this body of law, as well as the ends EU State Aid law pursues to converge considerably with the ends we pursue here and the *rationale* underpinning our 'enriching' effort. Next, we will look deeper into the relevant areas of EU State Aid law, i.e. areas where EU state aid law is applied to various kinds of public contracts, to identify principles that will allow us to develop our 'standard for enriching'.

Chapter four addresses the 'why question'. We will argue in favour of a regulatory response based upon our 'standard for enrichment'. In that respect, first we will argue that it is, from a law and economics perspective, unfeasible to rely upon the market to deal with the negative externalities we envisage here. Hence, a regulatory response is desirable. To that end, we will refer to Coase's work suggesting that regulation (or regulatory reform) is desirable when the market cannot resolve the problem of the negative externalities. Secondly, we will argue in favour of the specific regulatory response, based upon an *ex ante* regime and not an *ex post* regime, which we advocate. In this respect, we will submit that our suggested regulatory response is to be preferred in terms of enforcement costs, in terms of the effectiveness of the legal rules and in view of a cost-benefit approach. We will also point to a practical element that advocates our approach, i.e. the efficient administration of EU State Aid law.

Once we constructed and justified our 'standard for enriching', we will apply this standard to a number of aspects of public purchasing. This discussion will constitute part II of this thesis. More in particular, we will discuss how these aspects would be regulated under 'enriched' public procurement regulation. As we deem competition for the contract to be an essential element to avoid the negative externalities we address in this thesis, we will focus on three domains of public purchasing where competition plays a significant role. After all, we intend to remedy flaws in the competitive process that arise due to trade-offs with other considerations. It is therefore justified that we concentrate on those aspects that have a prominent role when it comes to competition for the contract.

The first aspect concerns the disclosure obligation as to award criteria and their belongings (i.e. weighting coefficients, sub-criteria and their weighting coefficients and the quotation method). These elements are in fact the scoring rules in an award procedure. Based on these criteria, the

public purchaser assesses which bid is the best in view of his needs. Disclosing them in the tender documents, thus before the assessment of bids so that tenderers can draft a relevant bid, is a prerequisite for competition. After all, these criteria contain specific information the tenderers use to compete effectively and efficiently. However, to what extent should the public purchaser disclose the scoring rules? Should he disclose the scoring mechanism in its entirety, so when assessing the bids the quotation happens almost mechanically? Even though in all three conceptions of public procurement regulation – providing for structures and institution, the neoliberal conception and the ordoliberal conception – competition and transparency are elements that favour a full disclosure obligation, also other considerations are relevant. The transaction cost involved is such a relevant consideration. Transaction costs in this respect do not only refer to the costs related to the drafting of a scoring mechanism *ex ante*. They also refer to information costs the public purchaser incurs when exactly defining his needs. With a flexible scoring mechanism he can explore the market, establish how his needs can be addressed and give substance to the details of the scoring mechanisms accordingly –all this in one procurement procedure. However, we will revisit these considerations in the light of the problem we see in terms of negative externalities and, subsequently, we will apply our 'standard for enriching' to this issue.

The second aspect concerns the pursuing of secondary (or horizontal) policies through public purchasing. The public purchaser can deem it desirable to pursue policy objectives while spending public money. After all, when purchasing, the public purchaser may hold buying power which it can valorise through the procurement process. However, this may affect competition as not all potential tenderers who are able to address the initial needs are also capable to contribute to the policy aspect embodied in the public contract. Here the reason for the trade-off is clearly of an ordo-liberal nature: competition considerations are balanced with policy considerations. We will discuss how this aspect of public purchasing would be regulated under 'enriched public procurement regulation'.

The last aspect we will discuss in part II is the modification of public contracts in the course of their performance. The question here arises whether or not such modifications are allowed without organising a new procurement procedure. Depending on the nature of the contract, the

entire contract would have to be put out for tender again or, if possible, only the additional part would have to be the subject of a new procurement procedure. Also here the question of transaction costs arises: do the competition benefits outweigh the transaction costs? However, also another consideration is put into balance with competition. Assuming that the public purchaser is to be considered as a contract partner just like any other party on the market, the neoliberals and ordoliberals would argue that the regulator should not (or only to the least extent possible) intervene in the performance of the contract. The performance is, after the contract has been awarded, subject to market forces and may require flexibility for the sake of efficiency. Hence, only when the contract displays such far-reaching modifications or new features that it differs from the initial contracts – thus for which no competition has been taken place – retendering is efficient. We will discuss this issue from our perspective of 'enriched public purchasing regulation'.

F. RESERVATIONS AND PRELIMINARY CLARIFICATIONS

The negative externalities we deal with in this thesis stem from the supra-competitive price public contracts potentially display. Hence, the actual externalities equal the difference between the equilibrium price the public purchaser would have paid under perfect competition and the price that is above the equilibrium price. Hence, 'supra-competitive price' should for the purpose of this thesis be understood as an above-equilibrium price.

Also, the negative externalities are, for the purpose of this thesis, only concerned with the financial advantage the chosen tenderer derives from the supra-competitive price. Hence, e.g. reputational advantages are not considered here. We however do not argue that these immaterial advantages are not able to distort competition in other markets as well. For instance, public purchasers often apply the selection criterion of 'references', i.e. evidence of prior adequate performance of similar contracts, when selecting tenderers in the course of a public procurement procedure. We deem this however to be a secondary problem to ours. Our aim is to avoid that public purchasers enter into inefficient public contracts. To the extent that our suggestions contribute to the identification of the tenderer who offers the most efficient terms, the public purchaser will choose the tenderer on his merits. Hence, also the reputational advantage – which

will in principle always be present – is awarded to the tenderer meriting this additional advantage.[83] It follows that dealing with the negative externalities following from the supra-competitive price will indirectly also deal with the negative externalities arising from other advantages for the chosen tenderer – at least, the distribution of such advantage will be social welfare enhancing (as they are awarded on the merits).

Furthermore, for the purpose of this thesis, the negative externalities dealt with here will only comprise the anti-competitive effects resulting from the supra-competitive price. Our focus is with avoiding competition distortive effects of public purchasing vis-à-vis markets outside the specific public market for the contract at hand. Therefore, efficient spending of public money is not our main concern. Nevertheless, as our focus lies with minimising the negative externalities public purchasing gives rise to and as these negative externalities result from contracting at supra-competitive prices, taxpayers are secondarily envisaged as beneficiaries of our suggestions. Their interests are however not the primary focus of our research.

Our focus here lies with the imperfections public procurement regulation is subject to and which give rise to the said negative externalities; our efforts are thus focussed on remedying these imperfections. Our focus lies therefore not with imperfections that are the result of anti-competitive behaviour on the part of tenderers. Obviously, also such conduct gives rise to supra-competitive prices. However, we focus on the role of public procurement regulation that gives rise to the occurrence of these negative externalities. Collusion amongst tenderers, possibly supported by anti-competitive public procurement regulation or practice, goes beyond the scope of our analysis.

Another reservation concerns the relativity of the points we will make in this thesis. The response to the problem we see here, i.e. the negative externalities resulting from public purchasing, may come along as quite strong. For instance, further on, when we develop our suggestion as to how to resolve the problem of these negative externalities, we will conclude that one of the elements of the solution is an obligation for the public purchaser to inform the

[83] We assume for the sake of our argument that the reputational advantage is reflected in the price offered. Hence, if a tenderer deems the monetary value of the reputational advantage to be 100, we assume that this 100 will be reflected in the equation, and more in particular at the "benefits" side, so that it will be put into balance with the expected costs.

market, to greatest extent possible, about the upcoming public procurement procedure. Obviously, in some cases publication is unfeasible or inefficient, e.g. when this may imply unreasonable transaction costs or when the public interest is negatively affected (e.g. in case of urgency). As to this example we however argue that the starting point should be 'publication', and that public purchasers only can derogate from this obligation insofar they can demonstrate that the disadvantages outweigh the benefits. Therefore, the 'standard for enriching' we will suggest is a tool to 'enrich' public procurement regulation, but it is not the sole standard that should be taken into account when substantiating public procurement regulation.

We should also clarify the position of EU public procurement law (to be understood as the EU directives[84] on public procurement)[85] in the context of this thesis. After all, in part II we will explicitly refer to provisions of the relevant directives. The ideas that will be developed in the first part of the thesis aim at contributing to public procurement regulation in general, and thus they are not confined to EU public procurement law. In the second part, however, we attempt to concretise our theoretical findings of the first part by exploring how 'enriched' public procurement regulation would look like as to a number of aspects of public purchasing. In that respect, we will rely upon the regulation in the EU directives as a reference point.

[84] We will here only consider the EU public procurement directives as to the classical sectors. The currently applicable directive is Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC Text with EEA relevance, *OJ* L 94, 28 March 2014, 65 (hereinafter 'Directive 2014/24'). This directive replaces Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, *OJ* L 134, 30 April 2004, 114 (hereinafter 'Directive 2004/18').

[85] These directives apply to contract which's value reaches a certain threshold. Contracts with a value beneath this threshold are not subject to the directives but still EU primary law (and more in particular the free movement provisions) is still relevant in case of a cross-border interest (for a discussion, see C R Hamer, 'Treaty Requirements for Contracts 'Outside' the Procurement Directives' in M Trybus, R Caranta and G Edelstam, *EU Public Contract Law. Public Procurement and Beyond*, (Bruylant, 2014), 191-219). The same applies to contracts that are not covered by the EU public procurement directives, such as concessions (even though it must be noted that a separate directive as to the award of concession was issued and should have been implemented by 18 April 2016). As our thesis is concerned with public procurement regulation in general, also the award procedures as to contracts not envisaged by the EU public procurement directives are in principle the subject of our analysis. However, discussion has emerged in how far principles drawn from the EU public procurement directives are transposable to contracts outside their scope. Arrowsmith, Treumer and Werlauf and Brown (S Arrowsmith, 'Public procurement and horizontal policies in EC law: general principles' in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law*, (Cambridge University Press, 2009), 52-53; S Treumer and E Werlauff, 'The leverage principle: secondary Community law as a lever for the development of primary Community law' (2003) 1 *European Law Review*, 124; A Brown, 'EU primary law requirements in practice: advertising, procedures and remedies for public contracts outside the procurement directives' (2010) 5, *Public Procurement Law Review* 169, 170) establish a tendency of convergence, but point to the legal pitfalls in this respect. This discussion, however, does not affect the fact that our suggestions are also relevant outside the scope of the said directives; the provisions in the EU public procurement directives are after all merely a reference point to demonstrate how 'enriched' public procurement would be substantiated.

Reliance upon the provisions in the EU public procurement directives may strike as odd, as this thesis is not concerned with EU public procurement law as such. This thesis is concerned with public procurement regulation in general, being a body of law that aims at subjecting purchasing activities to a legal framework to achieve the ends the regulator deems appropriate, such as best value for money or the realisation of secondary policy objectives. EU public procurement law is not so much a regulatory instrument to regulate the public purchaser's behaviour, but it aims at harmonising the national laws of the Member States to give effect to the free movement provisions. Advocate-general Jacobs drew a clear distinction between both.[86] Also Arrowsmith contended that EU public procurement law does not prescribe to Member States which ends public procurement law should achieve – i.e. choosing between best value for money and policy objectives. Competition is, in the EU context, not a means to achieve best value for money; it merely intends to give effect to the free movement provisions by lifting barriers that obstruct competition for a public contract throughout the EU.[87] To the possible criticism that EU public procurement law is not the appropriate body of law to build on in our more practical part of the thesis, we can in the first place reply that it is not our intention to re-write EU public procurement law to make it more competition-friendly. We only intend to demonstrate how, in general, 'enriched' public procurement would look like. We take, as a matter of convenience, and because this regime is well-known throughout the EU, provisions of EU public procurement law as a reference point. However, the foregoing does not deprive the second part of this thesis from its relevance for EU public procurement law. Sanchez Graells has convincingly argued, thereby contradicting Arrowsmith, that EU public procurement is not only concerned with competition as an exponent of the intention to open up markets. It also aims at achieving efficiency and best value for money. To that end Sanchez Graells refers to the *rationale*

[86] Opinion of AG Jacobs of 10 May 2001 in Case C-19/00, SIAC Construction, ECLI:EU:C:2001:266, 33: *The main purpose of regulating the award of public contracts in general is to ensure that public funds are spent honestly and efficiently, on the basis of a serious assessment and without any kind of favouritism or quid pro quo whether financial or political. The main purpose of Community harmonisation is to ensure in addition abolition of barriers and a level playing-field by, inter alia, requirements of transparency and objectivity*.

[87] S Arrowsmith, 'Public procurement and horizontal policies in EC law: general principles' in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law*, (Cambridge University Press, 2009), 31; S Arrowsmith, 'Modernising the European Union's public procurement regime: a blueprint for real simplicity and flexibility' (2012) 2 *Public Procurement Law Review* 71, 72.

underpinning the free movement provisions and the establishing of the internal market.[88] In our view, this standpoint is convincing. In that respect, we refer to the Spaak Report.[89]

The Spaak Report reveals the idea behind the free movement provisions aiming at creating an internal market. It is mentioned that merging national markets into a common market results in a more efficient allocation of resources, an increased security of supply and more cost aware production.[90] Also, enlarging the market and eliminating natural monopolies would render it possible to develop modern techniques and efficient production processes because of the economies of scale.[91] It also would stimulate undertakings to invest in efficient production and quality of their products, because of an increase in the degree of competition.[92] In order to achieve this "common market", the Spaak Report mentions the elimination of all barriers to trade and to achieve economic integration as the way forward. Thus, the free movement provisions and the internal market as a concept aim at creating efficiency in the European economy. Therefore, as to public purchasing, the 'deserving undertakings' – i.e. undertakings that can produce in the most efficient way – are entitled to get the contract awarded. In that respect, public procurement procedures should be accessible for all potential tenderers and they should be treated equally, thereby avoiding favouritism, corruption and protectionism. Hence, it may be that EU public procurement law is in the first place considered with ensuring competition and the opening up of market for public contracts and not so much with ensuring the purchasing authorities enter into public contracts under conditions that reflect best value for money and efficiency. However, the economic outcome that is pursued in the end is that public contracts are awarded to efficient undertakings; hence, undertakings that offer best value for money and display efficiency.

Furthermore, Sanchez Graells refers to article 18 (1) of Directive 2014/14 that reads as follows:

> '*The design of the procurement shall not be made with the intention … of artificially narrowing competition* [and that]*competition shall be considered to be artificially*

[88] A Sanchez Graells (2015), *o.c.*, xv.
[89] Comité Intergouvernemental créé par la conférence de Messine – Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères (the "Spaak Report"), Brussels 21 April 1956, 10.
[90] Spaak Report, 13.
[91] Spaak Report, 13.
[92] Spaak Report, 14.

narrowed where the design of the procurement is made with the intention of unduly favouring or disadvantaging certain economic operators'.

Sanchez Graells sees in this article the foundations for a pro-competitive conception of EU public procurement law, aiming at the creation of efficiency through competition.[93] This 'principle of competition' does not only shape the public purchaser's behaviour vis-à-vis actors within the specific public market, it also provides that public purchasing should not interfere with competition outside this specific public market.

It follows from the above that, even though merely intended to be a reference point, the point we intend to make in this thesis, and which we will concretise in part II, may also be beneficial to EU public procurement law.

Another issue that should be clarified, is the role of EU state aid law in this thesis. The first role this body of law is endowed with is that of a source of inspiration for the 'standard for enriching'. Making public procurement regulation 'state aid proof' is however not our first concern. It is because we believe that the concept of an 'advantage' in EU state aid law matches to a large extent the negative externalities we envisage and because we think that the ends pursued by EU state aid law as well as its underlying rationale converge to a large extent with the ends and economic *rationale* of 'enriched public procurement regulation' that we refer to this body of law as a source of inspiration.

Next to this role, EU state aid law is also an important aspect in the fourth chapter to our thesis, where we will justify our approach of 'enriching' public procurement regulation to remedy the problem of negative externalities we see. Whereas we will use the EU State Aid regime at first as an illustration for the purpose of our arguments, we will also argue that 'enriched' public procurement regulation can contribute to a better administration of these provisions of law. This might give the impression that this thesis is EU law focussed. After all, EU State Aid law is specific to the EU context. The fact the we submit that 'enriched' public procurement regulation can contribute to the administration of EU state aid law does however not mean that we will contribute to the debate regarding the question whether public procurement regulation should

[93] A Sanchez Graells (2015), *o.c.*, xvii.

be complied with in order to ensure state aid compliance and which ‘quality requirements’ have to be fulfilled in order for public procurement regulation to be state aid proof. The only question we will touch upon is how we think our ‘enriching’ effort can be valuable for the administration of EU state aid law.

PART I

2. CHAPTER 1. NEGATIVE EXTERNALITIES RESULTING FROM PUBLIC PURCHASING

In the introduction to this thesis above, we briefly outlined the problem we see. Public purchasing may give rise to negative externalities. These negative external effects distort the well-functioning of other markets. The negative externalities we envisage here follow from the supra-competitive nature of the price public contracts potentially reflect. The chosen tenderer can subsequently deploy such economic advantage to strengthen his position in markets outside the specific market for the public contract. In the next chapter, we will examine what the source is that gives rise to these negative externalities. In this chapter, however, we will first elaborate the nature of the negative externalities (section 1) and why these negative externalities merit special regulatory attention (section 2).

A. THE NEGATIVE EXTERNALITIES RESULTING FROM PUBLIC PURCHASING

The negative externalities we address here follow from the fact that in the course of public purchasing, public purchasers do not always enter into public contracts at market price. As public procurement procedures do not warrant an outcome similar to the one that would have been achieved in a competitive private market, this activity may give rise to distortions in other markets as a consequence of cross-subsidisation. This allows the chosen tenderer to build up market power in such markets.

Essential to our point is that the foregoing claim, regarding the existence of non-market prices, is valid. One could argue that compliance with public procurement regulation ensures that public purchasers pay a market price. After all, such public procurement procedure induces competition and thus allows to achieve a competitive price.

Nonetheless, literature confirms that public contracts do not necessarily reflect market prices in spite of the competition organized in line with public procurement regulation. Interested tenderers are sometimes banned from a public procurement procedure because of formal issues which do not directly relate to an economic rationale, but rather to non-observance of formalistic requirements. An example is the requirement that the offer is signed by a person

who is not entitled to represent the tenderer.[94] In that respect, Prieβ notes that public procurement regulation introduces "rigorous formal standards". Such standards imply that many suitable tenderers are eliminated even before they can start competing for the public contract. This results in a negative impact on competition. This puts competitiveness of the price the public contract reflects, into doubt.[95]

Also Sanchez Graells has flagged this issue, discussing the anti-competitive effect of too strict grounds for exclusion.[96] Indeed, the selection stage in a public procurement procedure can be conceived as the 'gateway' to the award stage, i.e. the stage where tenderers actually compete for the public contract based on the merits of their bid. If standards are too strict in the selection phase, without any objective reason for such strictness, competition for the contract is already diluted from the start. Sanchez Graells identifies also other aspects of public procurement regulation that significantly adversely affect the level of competition for a public contract. One example taken from his analysis is the compensation public purchasers ask for obtaining tender documents. Sanchez Graells contends that this is a barrier to entry, especially when such price is high (and thus not reflects the actual costs incurred by the public purchaser when reproducing the tender documents).[97] Another example taken from Sanchez Graells' analysis is the requirement to provide excessive performance guarantees. If the performance guarantee does not match the actual risk, potential tenderers are likely to refrain from participating in the public procurement procedure.[98] In general, it seems safe to conclude that public procurement regulation introduces a number of barriers to entry. At least such regulation provides public purchasers with the discretionary power to introduce such barriers. This obviously hinders tenderers to participate in the procurement procedure. This results in suboptimal competition. The reduced degree of competition obviously implies that the price, being the outcome of the procurement process, cannot be deemed to be an equilibrium price.

[94]For example, Belgian public procurement law provides that when an offer is not signed by the person entitled to legally commit the tenderer, that offer is null and void (art. 95 (2) Royal Decree of 15 July 2011 re the Award of Public Contracts, *Belgian State Gazette* 9 August 2011).
[95]H-J Prieβ and S Saussier, 'Dialogue' in G Piga and S Treumer (eds.), *The Applied Law and Economics of Public Procurement*, (Routledge, 2013), 156.
[96]A Sanchez Graells (2015), *o.c.*, 301.
[97]A Sanchez Graells (2015), *o.c.*, 280-281.
[98]A Sanchez Graells (2015), *o.c.*, 326-327.

By the same token, Dekel points to the fact that only in perfect markets contracts will display complete efficiency. He argues that transaction costs and information asymmetry or information imperfection reduces such efficiency.[99] Not only public purchasers suffer from such costs and problems. Also participation by the potentially interested tenderers can be hindered, as also they incur costs and meet information problems. The problem Dekel identifies is that due to these problems, the two major conceptions of economic efficiency in public procurement, i.e. awarding the contract to the tenderer with the best bid and awarding the public contractor to the most efficient tenderer, do not always match. Dekel uses the example of a sale. A farmer submits an offer of 90 to purchase a field which he deems to be able to exploit in such a way that it produces an outcome of 100. Another farmer, however, deems to realise an outcome of 92 but is willing to pay 91. Hence, overall, the desired amount of efficiency (or welfare) is not reached.[100] Dekel points to information problems as the cause of the market failure.

Translated to public procurement: suppose tenderer A submits a bid of 100 while tenderer B submits a bid of 98 with a dead loss profit margin[101] of 5; tenderer B will get the contract awarded even though he is not the most efficient tenderer in the procedure. Hence, he obtains a supra-competitive advantage of 5 which the public purchaser may not have paid if he had the information that tenderer B's price under perfect competition would have been 93.

Also literature in relation to EU State Aid law has stressed that public procurement procedures do not always enable the public purchaser to identify the most efficient supplier. Nicolaides and Rusu summarise that a competitive public procurement procedure only enables the public purchaser to contract with the most efficient supplier at the lowest profit margin for the latter if three conditions are fulfilled: (i) the tenderers do not know each others costs, (ii) it concerns a one-time procurement procedure (so tenderers cannot learn about each others costs) and (iii) companies set their prices according to their own costs. If conditions (i) or (ii) are not fulfilled,

[99] O Dekel, 'Legal Theory of Competitive Bidding' (2007-2008) 2 *Public Contract Law Journal* 237, 244-245.
[100] *Ibid*, 245.
[101] 'Dead loss profit margin' should be understood as a supra-competitive profit margin that the tenderer draws from strategic behaviour in de procurement game. To illustrate this, it is helpful to point to the distinction between tenderer specific costs and contract specific costs. For example, a tenderer may incur more costs because he is located far away from a construction site. In our example, tenderer A is more expensive, but this can be due to tenderer specific costs. Tenderer B can be aware of this and inflate his price to a level which is still beneath tenderer A's aforementioned costs.

the most efficient tenderer will win, but this tenderer will not necessary forego excessive profits. It suffices to set his price below the costs of the other tenderers but this does not necessarily mean his profits will be limited. If condition (iii) is not fulfilled, it is uncertain whether the chosen tenderer is the most efficient one. After all, if a tenderer does not price in accordance with his costs, but if he prices based on expectations about the other tenderers' costs, this may result in contracting with an inefficient tenderer or at least at a price which exceeds normal profits. After all, if the most efficient tenderer assumes the second-best bid's price will be 10% more, he may decide to increase his price by 8%. Either this tenderer was right and his profits exceed the profits he would make absent this profit-maximising strategy, either he was wrong as the second-best bid was only 6% more resulting in a contract with second-most efficient tenderer.[102]

Furthermore, economic literature points out that public purchasers indeed run an actual risk of entering into contracts containing supra-competitive prices. Bandiera, Prat and Valletti examined purchase practices of standardized goods by a range of public and semi-autonomous bodies in Italy.

One of the aspects of their research related to the difference between active waste and passive waste in Italian public procurement practice. The first kind of waste is to be best explained as waste of public resources due to supra-competitive prices because the public purchaser or one of his agents obtains a benefit. The most obvious example is corruption and bribery. Passive waste on the other hand refers to the unintentional waste of public money through the entering into contracts at supra-competitive prices because of incompetence, lack of incentives to minimise costs, transaction costs, and so on.[103]

For the purpose of their research, the authors distinguished three types of procuring bodies. The first are the 'Napoleonic bodies'. These bodies belong in essence to the central administration (e.g. a ministry) characterized by a classical top-down civil service model. The second type are the 'US style local bodies' (e.g. municipalities, regions, …). They have a directly chosen 'CEO'

[102] Ph Nicolaides and E Rusu, 'Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?', (2012) 1 European Procurement and Public Private Partnership 5, 7-8.
[103] O Bandiera, A Prat and T Valletti, 'Active and Passive Waste in Government Spending: Evidence from a Policy Experiment' (2009) 4 *American Economic Review* 2009 1278, 1278-1279.

(mayor, governor, …) who is elected based on his responses to practical issues and on his personality. Hence, he is not elected on the basis of ideology. Thirdly, the authors distinguish the semi-autonomous bodies. These bodies are publicly funded but nevertheless they display features of private bodies. In that respect, the 'CEO' is put in charge through a private law contract and he receives incentives to act efficiently, e.g. through performance related compensations.[104]

The authors found that bodies belonging to the third category (semi-autonomous bodies) pay less than the US style local bodies when procuring the same goods. The latter bodies in turn pay less than the 'Napoleontic bodies'.[105] These differences are however not in the first place attributable to active waste (bribery and corruption), according to the authors. They found passive waste to be a more significant driver of the price differences.[106]

Even though the research discussed in the previous paragraphs merely relates to standard goods, the findings confirm the claim above, i.e. that public contracts do not necessarily reflect a competitive market price. In that respect, it should also be noted that the authors argue that the risk for active and passive waste increases when procuring complex goods.[107] Apart from that, the findings discussed show that public procurement regulation does not offer a guarantee for best value for money. The authors refer in general terms to the mode of governance as being the key driver of passive waste.[108] The authors seem to argue between the lines that it all comes down to the question of incentives and autonomy. We will address this issue further on in this thesis. For now, it suffices to note that there is a clear risk that public contracts are indeed entered into at supra-competitive prices.

It follows from the foregoing that the problem we identified and that we envisage to tackle is not a virtual nor a theoretical one. Admittedly, demonstrating that the price paid does not reflect the market price as well as the extent of the deviation of the market price, may prove difficult (and costly) in practice. However, we deem this to be non-material as to the relevance of our analysis. Above, we discussed the views in the literature indicating the likelihood that

[104] O Bandiera, A Prat and T Valletti, *l.c.*, 1282.
[105] O Bandiera, A Prat and T Valletti, *l.c.*, 1298.
[106] O Bandiera, A Prat and T Valletti, *l.c.*, 1300.
[107] O Bandiera, A Prat and T Valletti, *l.c.*, 1306.
[108] O Bandiera, A Prat and T Valletti, *l.c.*, 1304.

overpayment occurs in public purchasing. As we can assume that such overpayment occurs in practice, we deem regulation that anticipates on the said likelihood the most efficient response. For this, we rely on cost-benefits analysis, and more specifically on the 'liability for harm vs. regulation for safety debate'. We will further discuss this in chapter 4.[109]

B. THE NEGATIVE EXTERNALITY'S HARMFUL EFFECT

Having discussed that the negative externalities we envisage to address here are far from a merely virtual or theoretical issue, we will now discuss why these negative externalities should be dealt with. After all, we argue that these negative externalities can produce harm that adversely affects social welfare. More in particular, the harmful effect of the negative externalities has the potential to distort the well-functioning of other markets which results in a loss of social welfare.

The specific harm we envisage is the ability the negative externalities give rises to for the chosen tenderer to strengthen his position on other markets than the specific market for the public contract at hand. Hence, the problem we see is one of cross-subsidisation. The advantage obtained through the public contract allows the chosen tender to set prices in other markets below cost (or at least below the equilibrium price). Rents from public purchasing may thus enable the chosen tenderer to build up market power in other markets, including public markets for future contracts.[110]

This harm is not exclusive to the area of public purchasing. The harm we see resembles to a large extent the harm state aid control envisages to address. As has been pointed out in the literature, one of the problems granting state aid implies is that the beneficiary is able to build up market power. As has been noted by Friederiszick, Röller and Verouden, this results in

[109] Another point one could make is that it is not for the legislator to establish whether or not a price converges with a market price. A market price is the result of a competitive process, which counts numerous variables. It seems safe to say that most of these variables are beyond the legislator's control (or at least very costly to control). Therefore, the role of the legislator should be limited to providing for a legislative framework that allows for competition to work properly and to produce a market-like outcome.

[110] Also Yukins and Cora hinted at the risk of leveraging. They note, albeit without a reference to supra-competitive prices, that barriers to public markets can cripple those barred undertakings when competing with chosen tenderers in other markets. C R Yukins and J A Cora, 'Feature Comment: Considering The Effects of Public Procurement Regulations on Competitive Markets' (2013) 9 *The Government Contractor* 1, 2.

higher prices, entry barriers and exclusion of competitors.[111] Furthermore, this harm also extends to the creation of allocative inefficiencies. In this respect, such negative externalities may also distort the so-called 'churn process'. This process refers to the market mechanism whereby efficient entrants drive existing inefficient undertakings out of the market.[112]

To some extent, the harm we distinguish is also dealt with by Sokol. Sokol examined 'public restraints', i.e. government actions (such as regulation or judicial decisions) that exempt undertakings from competition law.[113] We submit that if it is accepted that public procurement regulation does not create an environment that avoids chosen tenderers to obtain an advantage which allows them to exercise market power on other markets, such public procurement regulation could be conceived as a 'public restraint'.[114] As we discussed before, public procurement regulation introduces a number of regulatory provisions that limit competition for the contract.[115] Hence, such provisions allow the chosen tenderer to obtain supra-competitive income through reduced competition.

The rents the chosen tenderer obtains are a *de facto* subsidy that can be used, *inter alia*, to cross-subsidise other activities on competitive markets. Also Sokol mentions, along with other adverse effects of 'public restraints' (such as raising the cost of capital and installing barriers to entry), the risk of cross-subsidising activities on another market as a competition distorting effect of a 'public restraint'. Admittedly, Sokol deems the adverse effects vis-à-vis consumers, as a consequence of distorted competition, more significant when the undertaking concerned

[111] H W Friederiszick, L-H Röller and V Verouden, 'EC State Aid Control: An Economic Perspective' in M Sanchez Rydelski (ed.), *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade*, (Cameron May, 2006), 170.
[112] H W Friederiszick, L-H Röller and V Verouden, 'EC State Aid Control: An Economic Framework' in P Buccirossi (ed.), *Handbook of Antitrust Economics*, (MIT Press 2008), 648. See also: European Commission, New rules on rescue and restructuring aid for industry: the right incentives for innovation and growth, Competition Policy Brief, issue 9, June 2014, 1. We also refer to the presentation "Theories of harm in EU state aid law control" delivered by Verouden at the occasion of the conference "State Aid Control: Where Law and Economics Meet" (Brussels, 30 September 2016).
[113] D D Sokol, 'Limiting Anticompetitive Government Interventions That Benefit Special Interests', (2009-2010) 1 *George Mason Law Review* 191, 127.
[114] Above we mentioned already that collusive bidding is not the subject of our thesis. Hence, provisions of public procurement regulations facilitating collusion are not considered to be 'public restraints' for the purpose of our research.
[115] Cf. supra.

already possesses substantial market power. The cross-subsidisation strengthens the effects of the abuse on the market.[116]

However, it must be made clear that we do not envisage the specific situation of abuse of a dominant position, which is generally prohibited under competition law. Our analysis is not concerned with combatting abuse of a dominant position, e.g. by conducting predatory pricing practices which is dealt with under article 102 TFEU and other competition regulations. As is the case under EU competition law, such practices involve an analysis of the relevant market as well as of the position of the undertaking concerned on that market. If a dominant position is to be established, it remains to be seen whether the undertaking's behaviour constitutes an abuse of such market power.[117] Our aim is avoiding that the rents obtained under a public contract are used to distort competition by exercising market power which is 'subsidised' by the supra-competitive price in the public contract. In that vein, our suggestions in this thesis are aimed to intervene in the market *ex ante* in order to correct a market failure (which occurs on the market for a specific public contract) so as to avoid a forthcoming loss of social welfare (i.e. by giving rise to a market failure on markets outside such market for a particular public contract).

As to the magnitude of the loss of social welfare, we recognize that it is hard to quantify such loss. This was also recognized by Sokol in his paper on 'public restraints' but he noted that research points out that such restraints affecting the normal working of competition lead to a loss of economic growth.[118]

Nonetheless, the alleged harm to markets outside the specific market for the public contract at hand is not merely theoretical. Empirical research in the field of state aid has confirmed that state aid grants entail a clear risk for the receiving undertaking to build up market power. Furthermore, and related thereto, state aid can have an impact on market shares. Buts and Jegers examined a sample of 13,000 Belgian undertakings that received a direct state aid grant, without however differentiating as to the type of government granting the state aid or as to the objective

[116] D D Sokol, *l.c.*, 122-123.
[117] Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, *OJ* C 45, 24 February 2009, 7–20, par. 9 and 19-20.
[118] D D Sokol, *l.c.*, 125-126.

of the state aid measure. It was empirically established that two years after the state aid grant the beneficiaries' market share was increased. This increase correlated positively with the state aid received.[119] In a subsequent paper, Coppens, Hilken and Buts demonstrated that these effects also materialise in the long run. They established that the effect of state aid on market shares does not decline over years. Quite the contrary seemed to be true. Also 6 years after the state aid conferral, authors distinguished an impact on the beneficiaries' market share.[120]

Obviously, the foregoing empirical conclusions only back our point insofar the supra-competitive price can be deemed to constitute state aid. This issue will be discussed more deeply in chapter 3. For now, we only want to point out that, in the first place, it is generally accepted that state aid can be granted through public contracts.[121] This will be the case if a private purchaser would not have accepted the price paid in the framework of the performing of the contract or the terms and conditions at which the contract is entered into. Secondly, we admit that merely entering into a public contract not reflecting market terms does not suffice to establish the existence of a state aid conferral in the sense of article 107 (1) TFEU. Indeed, also other conditions should be fulfilled. However, in this thesis we do not argue that our negative externalities qualify as state aid as such. As we will argue further on, the negative externalities we wish to avoid converge merely with the notion of 'advantage' within EU state aid law. The presence of an 'advantage' is however solely one of the five cumulatively applicable conditions for article 107 (1) TFEU to apply. Hence, we do not argue that every public contract entered into at a supra-competitive price constitutes state aid; we do argue however that such a supra-competitive price resembles the notion of advantage in EU State Aid law. As Buts and Jegers are primarily concerned with sketching the 'advantage' state aid brings along – i.e. strengthening the market position of the beneficiary – we believe that this literature shows that insofar public procurement is not performed in a manner which ensures a competitive price, there is indeed a clear risk that such public contracts, and more in particular the financial advantage it brings along, strengthen the position of the chosen tenderer on other markets than the specific public market for the public contract at hand.

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[119] C Buts and M Jegers, 'The Effect of 'State Aid' on Market Shares: An Empirical Investigation in an EU Member State' (2013) 1 *Journal of Industry, Competition and Trade* 89, 97.
[120] P Coppens, K Hilken and C Buts, 'On the Longer-Term Effects of State Aid on Market Shares' (2015) 1 *European State Aid Law Review* 271, 276-277.
[121] J Hillger, 'The award of a public contract as state aid within the meaning of Article 87 (1) EC' (2003) 3 *Public Procurement Law Review* 109, 122.

This being said, it should be made clear that the response to the negative externalities we favour should not be considered from a 'legalistic' point of view (i.e. providing for legal instruments to combat such negative externalities). Our suggestions are rather motived by an economic concern. We are not concerned with undoing the harm the negative externalities we distinguished produces. We are concerned with avoiding the negative externalities from occurring so that the harm is avoided in the first place. Thus, our intention is to develop incentives in order to avoid the negative externality from occurring.[122] This is because we believe that an *ex ante* regime that allows to avoid the occurrence of the negative externalities is more desirable than an *ex post* regime that provides for remedies to undo the harm. We will further discuss this in chapter 4.

C. CONCLUSION

In this chapter we argued that the negative externalities we intend to address are not of a merely theoretic nature. Public purchasing, as subject to public procurement regulation, does not necessarily yield public contracts that display efficiency. Indeed, public contracts are possibly entered into at a supra-competitive price, which gives rise to negative externalities which are capable of distorting other markets outside the specific market for the public contract at hand.

Next, we elaborated the harm we see to which these negative externalities may give rise. The chosen tenderer is able to cross-subsidise his activities on other markets because of the supra-competitive price he obtains under the public contract. This allows him to exercise market power by setting his prices below the market equilibrium price in those other markets. Hence, a clear risk exists that competition on this market is distorted, implying a loss of social welfare.

As we intend to address the negative externalities public purchasing gives rise to, it is important to identify what the cause is for these negative externalities to occur. We will examine and elaborate this in the next chapter.

[122] Cf. C Veljanovski, *The Economics of Law*, (The Institute of Economic Affairs, 2006), 44-46.

3. CHAPTER 2. THE SOURCE OF THE NEGATIVE EXTERNALITIES ARISING FROM PUBLIC PURCHASING

As we mentioned in the previous section, our concern lies with the existence of negative externalities emerging from the act of public purchasing. These negative external effects affect markets outside the public market for the public contract at hand. In this section we will identify the source of this market failure. This will allow us to reveal the flaw in current regulation which we envisage to remedy.

In order to identify the source of the negative externalities we will first discuss the prevailing strands of thought as to the conception of public procurement regulation. As a starting point for this discussion, we rely on the notion of 'economic constitution'. After all, little discussion can arise regarding the statement that purchasing on the market is in essence an economic activity and that public procurement regulation sets the legal boundaries within which public purchasers conduct this economic activity.[123] In this respect, 'economic constitution' is understood the way Tuori suggested: 'economic constitution' is about the relation of law to the fundamentals of the economic system.[124] Public procurement regulation provides for a legal framework to which public purchasers adhere when conducting an essentially economic activity. Hence, public procurement regulation is considered to constitute the 'economic constitution' as to public purchasing.

The different views in the literature as to the nature of public procurement regulation match to a certain extent with the different views that exist as to the notion of 'economic constitution'. As Prosser described, the notion 'economic constitution' can be substantiated in different ways. The author gives an account of the several conceptions of 'economic constitution'. To our analysis, three conceptions are relevant: (i) the idea that the 'economic constitution' provides for structures and institutions that govern an activity, (ii) the neoliberal conception and (iii) the interpretation based on the ordo-liberal line of thought.[125]

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[123] J M Fernández Martín, *The EC Public Procurement Rules, A Critical Analysis*, (Clarendon Press, 1996), 41; C H Bovis, 'State Aid and Public Private Partnerships – Containing the Threat to Free Markets and Competition' (2010) 2 *European Procurement and Public Private Partnership Law Review* 167, 171-172.

[124] K Tuori, 'The Economic Constitution among European Constitutions', Legal Studies Research Paper No 6, 2001, 3,

[125] T Prosser, *The Economic Constitution*, (Oxford University Press, 2014), 7-11. Also from an economic perspective this distinction was made. Schapper, Veiga Malta and Gilbert make a distinction between public procurement regimes that are focused on safeguarding best value for money, transparency and/or minimising

A. PUBLIC PROCUREMENT REGULATION AS AN 'ECONOMIC CONSTITUTION'

a. Public procurement regulation as an 'economic constitution providing for structures and institutions'

In this part we will discuss the different views as to the nature of public procurement regulation in order to identify the source of the negative externalities we envisage to address. In doing so, in first instance, we apply the concept of 'economic constitution' in the meaning of provisions providing for an institutional framework. This framework structures the activity of public purchasing. The idea that the 'economic constitution' as to public purchasing – i.e. public procurement regulation – provides for structures and institutions that govern this activity is helpful when analysing the existence of public procurement regulation from a principal-agent perspective.[126]

More in general, when discussing the relevance of administrative law[127] (assuming public procurement regulation is part of administrative law), Bishop argues that this body of regulation aims at minimising agency costs. Bishop sees three elements which give rise to agency costs in the absence of administrative law. The first is that the government is actually a network of monopolies for which there is no alternative. Henceforth, competition cannot intervene to ensure efficiency. The second element is that politicians and their agents have different interests than the citizens, who are their principals. The third is that monitoring by the citizens (the principals) or by supervisor-agents is imperfect.[128] Therefore, public procurement regulation, being part of administrative law, reduces agency costs to the benefit of society. It is indeed submitted that the principal-agent problem is in the first place an issue of information-

transaction costs on the one hand and public procurement regimes that also contribute to policy implementation on the other hand. D R Schapper, J N Veiga Malta and D L Gilbert, 'An Analytical Framework for the Management and Reform of Public Procurement' (2006) 1 *Journal of Public Procurement* 1, 10-11.

[126] We discussed the principal-agent problem already in more general terms in the introductory part to this thesis. Cf. supra.

[127] We consider 'administrative law' to be the body of law that governs public administration.

[128] W Bishop, 'Theory of Administrative Law' (1990) 2 *The Journal of Legal Studies* 1990 489, 504.

asymmetry which the agent can use to behave opportunistically.[129] Public procurement regulation deals with this problem.[130] In that respect, agency theory has proven helpful to explain public procurement regulation, and the procedural framework it imposes, to ensure accountability in public purchasing.[131] This is because public procurement regulation subjects public purchasers to procedures which constrain their discretion and align their interests with their principals' interests.[132] Such principals can be society, the legislator or hierarchical public entities.

Accordingly, Greenstein referred to public procurement regulation as a means to align the agencies' behaviour with the ends pursued by the legislator (in this case the Congress in the USA), i.e. accountability, efficiency and equal access for all potential tenderers. This is achieved through limiting the public purchasers' discretion. Obviously, the accountability and efficiency considerations are not limited to the mere decision to spend public money (i.e. the award decision). Also, when conducting a public procurement procedure, the public purchaser should act in the interest of the principal. This implies that also when conducting the procedure the public purchaser should act efficiently, and not engage in unnecessary costs.

In sum, public procurement regulation can thus be conceived as an 'economic constitution' that provides for an institutional framework governing the relationships between actors in the purchasing process: the agencies that perform the purchasing behaviour, the central legislator being elected to pursue the interests of society and society on behalf of who and with whose money the purchasing is performed.

However, not all authors analysing public procurement regulation from the perspective of 'public procurement regulation as an economic constitution providing for structures and institutions' deem overcoming the principal-agent problem as the exclusive goal of public procurement regulation. Indeed, some literature defines public procurement regulation as a

[129]S A Ross, 'The Theory of Agency: The Principal's problem' (1973) 2 *Amercian Economic Review* 134, 138; N Mercuro and S G Medina, *Economics and the Law. From Posner to Post-Modernism and Beyond* (2nd edition), (Princeton University Press, 2006), 264.
[130] We have discussed the problems arising in this respect at length in our introductory part.
[131] O Soudry, *l.c.*, 435 et subs.
[132] S Greenstein, 'Procedural Rules and Procurement Regulations: Complexity Creates Trade-offs' (1993) 1 *Journal of Law, Economics, and Organization* 159, 165.

means to deal with the principal-agent problem because of the need to avoid favouritism and fraud. Equality amongst tenderers and achieving best value for money are believed to be separate goals, which do not relate to the principal-agent problem.[133] This approach would imply that public procurement regulation as an 'economic constitution providing for structures and institutions' exists together with public procurement regulation in its neoliberal conception (which we will discuss further below).

It is not our purpose to refute such a point of view but we do want to clarify that this is believed to be not an established fact. We assert that public procurement regulation as an instrument to deal with the principal-agent problem is not exclusively concerned with maintaining the integrity of the process. It is believed to be also a mechanism that imposes economic rationale upon public purchasers. After all, such *rationale* is serving the interests of the principal (be it the hierarchical higher public entity or society). This is necessary because public purchasers are not exposed to the same incentives as private buyers.[134] Hence, we believe that also ensuring equality amongst tenderers and achieving value for money fit within the conception of public procurement regulation as an 'economic constitution that provides for structures and institutions'. In favour to our point, Dekel identifies the need to ensure integrity as the first ranked goal of public procurement regulation, and adds that equality and ensuring efficiency are closely linked thereto.[135] Hence, insofar our views contradict Dekel's, we want to clarify that for the purpose of our analysis here, we deem public procurement regulation to constitute an instrument to overcome the principal-agent problem to ensure integrity and accountability as well as to ensure equality and efficiency.

b. Public procurement regulation as a neoliberal 'economic constitution'

Public procurement regulation in its neoliberal conception aims at creating a market-place that allows for competition, achieving best value for money and efficiency. Kunzlik has discussed this conception at length. He argues that public procurement in its neoliberal conception aims at addressing three issues. The first is that it should be assured that the public purchaser acts as

[133]O Dekel, 'Legal Theory of Competitive Bidding' (2007-2008) 2 *Public Contract Law Journal* 237, 241.
[134] O Soudry, *l.c.*, 435-436.
[135] O Dekel, *l.c.*, 258.

a market participant. The second is overcoming the fact that public purchasers do not compete with each other. The third is avoiding that public purchasers – as part of a state – proceed to protectionist purchasing.[136] Public procurement regulation should thus not just favour access to public markets by removing barriers that are economically irrational, it should also *require public authorities to conduct themselves in ways that will maximize competition for public contracts so that the market can achieve a degree of 'efficiency' approximating to that in private markets*.[137]

Sanchez Graells, to whose work we referred in the introductory part, has been mentioned as a neoliberal protagonist.[138] This is because he identified public procurement regulation as an instrument that foremost aims at ensuring that public purchasers adopt market behaviour to establish best value for money.[139] Also other authors have referred to achieving best value for money and efficiency as objectives of public procurement regulation – be it not the exclusive objective.[140]

In addition, it must be noted that this strand of thought also reflects some features which are present in the conception of public procurement regulation as an 'economic constitution providing for structures and institutions'. Also here, public procurement regulation provides for a procedural framework to ensure that public purchasers adopt the desired behaviour, i.e. efficiency oriented behaviour. The latter seems to distinguish the two conceptions. In the conception of public procurement regulation as an 'economic constitution providing for structures and institutions', the aim of public procurement regulation is to avoid agency costs. In the neo-liberalist conception, this regulation is explicitly aimed at yielding efficiency.

This neoliberal approach has been distinguished as the prevailing conception in early EU public procurement law. Bovis, using the term neo-classical though, argues that initially the European

[136] P Kunzlik, 'Neoliberalism and the European Public Procurement Regime' (2012-2013) 15 *Cambridge yearbook of European legal studies* 312, 297-300 and 310-311.
[137] P Kunzlik, 'Neoliberalism and the European Public Procurement Regime' (2012-2013) 15 *Cambridge yearbook of European legal studies* 312, 311.
[138] P Kunzlik, 'Neoliberalism and the European Public Procurement Regime' (2012-2013) 15 *Cambridge yearbook of European legal studies* 312, 310.
[139] A Sanchez Graells (2015), *o.c.*, 105-109.
[140] S Arrowsmith, J Linarelli and D Wallace, *Regulating Public Procurement. National and International Perspectives*, (Kluwer Law International, 2000), 28.

Commission conceived public procurement as an economic process based on price competition. The underpinning idea was that through focusing on price competition, with transparency as a means to achieve as much participation as possible and to avoid protectionism, efficiency and an optimal allocation of resources would be achieved. This, in turn, would produce social welfare gains.[141]

Such system, based on price competition, is believed to be desirable to achieve integration of national markets in order to create an internal market for public contracts. Such price oriented system avoids important barriers to entry for potential participants in other Member States. In addition, such a system may attract additional undertakings to public markets. Also, this system guarantees predictability as to accessibility to the relevant product or geographical markets. Hence, undertakings are likely to orient their activities to the public sector, leading to a widening of the pool of private suppliers throughout the whole of the internal market.[142]

c. Public procurement regulation as an ordo-liberal 'economic constitution'

Another way to look at public procurement regulation is to conceive it as an 'economic constitution' that provides for a legal context that allows for 'interventionist' public purchasing practices – albeit subject to limits. The regulation itself, as enacted by the legislator, sets the limits within which public purchasers can pursue certain policy oriented outcomes. Public procurement thus becomes a policy instrument that is deployed within the limits public procurement regulation prescribes.

This idea of an 'interventionist' conception of public procurement is closely related to the idea of 'regulation through contract'.[143] Through entering into public contracts, public purchasers can implement economic policy considerations. Daintith defined "economic policy" as *all purposeful governmental action whose actual or professed primary objective is the*

[141]C H Bovis, 'Public Procurement and the Internal Market of the Twenty-first Century: Economic Exercise versus Policy Choice' in T. Tridimas and P. Nebbia (eds.), *European Union law for the twenty-first century. Rethinking the new legal order* (volume 2), (Hart, 2004), 294-295. See also: C H Bovis, 'Public Procurement in the European Union: Lessons from the Past and Insights to the Future', (2005-2006) 1 *Columbia Journal of European Law* 53, 109-117.
[142] C H Bovis (2004), *o.c.*, 296.
[143] T Daintith, 'Regulation by Contract: The New Prerogative' (1979) 1 *Current Legal Problems* 41, 42 et subs.

improvement of the economic welfare of the whole population for which the government is responsible or of segment of that population.[144] In this respect, public purchasing has been identified in the literature as an instrument to regulate, and thus to pursue policy objectives. To clarify this, one can point to the difference made by Daintith between "dominium" (the use of force to implement policy) and "imperium" (the use of financial resources to implement a policy).[145]

Prosser identifies public purchasing as one of the instruments to regulate through economic management, thus belonging to the category "imperium".[146] While spending public money in the framework of a public contract, policy objectives can be pursued at the same time. It follows that, given the particular nature of public purchasing activities, this activity finds itself at the crossroad of economic activities and the pursuance of policy objectives. However, while 'regulating through contract', the public purchaser is subject to provisions of law. After all, when regulating through contract, the public purchaser should have the legitimacy to do so.[147] The public purchaser can derive this legitimacy from the 'economic constitution', i.e. public procurement regulation.[148]

Now, what are the principles that underpin this conception of the 'economic constitution as to public procurement'? The literature allows to distinguish two sets of principles. The first set of principles is the one that is defined by efficiency considerations. Three main principles can be distinguished. The first is that competition for public contracts amongst tenderers should be created in order to achieve best value for money.[149] A second principle relates to accountability. Public procurement regulation should provide for transparency in the public procurement process to prevent fraud, corruption or nepotism by ensuring oversight and monitoring.[150] A third principle concerns the efficiency of the procurement process. Procurement procedures should be cost-effective and not burden the public purchaser without an economic reason for

[144] T Daintith, 'Law as a Policy Instrument: Comparative Perspective' in T Daintith (ed.), *Law as an Instrument of Economic Policy: Comparative and Critical Approaches*, (Walter de Gruyter & Co, 1987), 6.
[145] T Daintith, 'Legal Analysis of Economic Policy' (1982) 2 *Journal of Law and Society* 191, 215.
[146] T. Prosser, *The Economic Constitution*, (Oxford University Press, 2014), 4.
[147] T Prosser, *o.c.*, 7.
[148] T Prosser, *o.c.*, 7.
[149] A Sanchez Graells, *Public procurement and the EU competition rules*, (Hart, 2011), 101-103; S Arrowsmith, J Linarelli and D Wallace, *o.c.*, 28.
[150] A Sanchez Graells, *o.c.*, 111-112. See also: S Arrowsmith, J Linarelli and D Wallace, *o.c.*, 38.

doing so.[151] This set of principles closely adhere to the 'neo-liberalist' strand of thought, which in itself carries some features that are present in the strand of thought which conceives public procurement regulation as an 'economic constitution providing for structures and institutions'.

The second set of principles is oriented towards achieving policy goals. A first principle would be that the public purchaser has buying power and that he should deploy this power to achieve policy goals. An example is reserving contracts for certain categories of employees (e.g. disabled employees). Another principle relates to the spending decision: public resources should be deployed in such a way that they contribute to the achievement of policy objectives. An example here would be purchasing products that are produced in an environmentally friendly way. This category of principles is thus not in the first place concerned with efficiency but rather with redistribution.[152] After all, the government to which the public purchaser belongs extracts 'wealth' from society (e.g. through taxes and other contributions) and deploys the resources obtained to achieve policy outcomes (such as social justice or green environment).

There is an inevitable tension between both sets of principles. A number of authors have argued that a public purchaser should be entitled to pursue policy objectives[153] – even though other authors argued that this often contradicts with the basic goals of public procurement regulation.[154] This also became apparent at the level of what is now the EU. As discussed by Fernandez Martin, whereas the Commission (at the time backed by the ECJ) initially favoured an efficiency oriented conception of EU public procurement regulation, scholars and Member States (later on backed by the ECJ) conceived public purchasing not only as an instrument to yield efficiency. This purchasing activity is also considered to be an instrument to achieve social and economic policy goals.[155] Reconciling these functions public procurement should perform, requires a balancing exercise. Therefore, public procurement regulation, being the economic

[151] A Sanchez Graells (2015), *o.c.*, 109-110. An example of this is the possibility for public purchasers not to organize a procedure that allows for full competition when it is clear that such degree of competition will not be attained anyway – because e.g. the market only provides for a limited number of potential suppliers (G Heijboer and J Telgen, *l.c.*, 202).
[152] Ph Bolton, 'Government Procurement as a Policy Tool in South Africa' (2006) 3 *Journal of Public Procurement* 2006 193, 194.
[153] S Arrowsmith, 'Public procurement as an instrument of policy and the impact of market liberalisation' (1995) 2 *Law Quarterly Review* 235, 247; C McCrudden, 'International economic law and the pursuit of human rights: A framework for discussion of the legality of 'selective purchasing' laws under the WTO Government' (1999) 1 *Journal of International Economic Law* 3, 11.
[154] A Sanchez Graells (2015), *o.c.*, 104.
[155] J M Fernández Martin, *o.c.*, 41-52.

constitution as to this economic activity, lays down the boundaries within which the public purchaser can act. In defining those boundaries, the legislator has to balance the first set of principles with the second.

This point has also been discussed by Bovis. Above, we mentioned that this author argues that initially EU public procurement law was considered to be a tool to open up markets and to ensure best value for money through competition. Along the way, in the EU context, public procurement became also an instrument to pursue policy objectives. In that respect, public purchasers went on not merely to apply the lowest price criterion. Emphasis shifted to applying qualitative criteria, along with the lowest price criterion. Hence, public procurement became to be more than merely a 'buying tool'. It also became a 'policy tool'. According to Bovis, this approach added another dimension to public procurement (at the EU level) in three ways: (i) public procurement as contributing to European integration, (ii) public procurement as a 'contract compliance' instrument and (iii) public procurement as an instrument to develop and implement policy objectives through the idea of the rule of reason.[156]

Public procurement as a tool to foster European integration relates to public contracts as a subsidy tool. Whereas preferential treatment of national undertakings causes welfare losses, such preferential treatment may also be conceived as an 'investment tool', either to harvest welfare gains in the future (e.g. when protected infant industries become mature) or to ensure equity through redistribution.[157]

Public procurement also can be conceived as a tool to ensure 'contract compliance'. Bovis thus sees public procurement as a tool to ensure compliance with "the range of secondary policies relevant to public procurement, which aim at combating discrimination on grounds of sex, race, religion or disability".[158] Non-compliance would result in a ban from the public procurement process. Also, such concept can be framed positively in order to promote policies. In such case, public procurement is a tool to rectify social disequilibria. Bovis, however, points to the fact that pursuing such policies may undermine the aims and objectives of the opening up of public markets. After all, public purchasers are ought to pay more when pursuing such policy

[156] C Bovis (2004), 300-301.
[157] C Bovis (2004), 302-303.
[158] C Bovis (2004), 304.

objectives.[159]

Public procurement may also foster public purchasers' policies through the use of other award criteria than merely the price criterion. After all, the free movement provisions can be deviated from through the application of qualitative criteria on the basis of a rule of reason reasoning. Hence, public purchasers can use public procurement as a tool to pursue policy objectives through applying policy oriented award criteria. Such practice ensures that policy objectives are carried out throughout the whole of the EU, creating a foundation of harmonization or standardization.[160]

The aforementioned principles lying at the heart of public procurement regulation indicate an 'ordo-liberal' conception of public procurement regulation. This school of thought was concerned with the consequences a 'dictatorship of pure economic rationale' would imply. Ordo-liberalists agreed that the market should operate freely from political and governmental influence and that competition is the driver of societal and economic well-being.[161] However, concentration of economic power should be avoided. Such concentration of economic power would have the mere cosmetic effect of replacing undesired political power that was banned from the marketplace. Together with the desire to keep economic power dispersed (e.g. by avoiding monopolies and supporting the creation of SMEs), there was also an intention to structure economic life in such a way that it allowed achievement of social goals. Here, also a desire to avoid "economic dictatorship" lies at the heart of the reasoning: allowing creating economic power without counterbalancing this to ensure fairness would not have societal support. This is because holding economic power would imply the ability to oppress the weak. Hence, ordoliberals considered there to be a need for redistribution mechanisms in economic regulation.[162]

The fact that, according to this conception of public procurement regulation, also redistribution goals are believed to underpin public procurement regulation, confirms the ordoliberalist

[159] C Bovis (2004), 305-307.
[160] C Bovis (2004), 307-309.
[161] This matches the first category of principles: the public purchaser is subject to rules that constrain their discretionary power when purchasing and their ability to favour certain undertakings over others.
[162] D J Gerber, 'Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New" Europe' (1994) 1 *The American Journal of Comparative Law* 25, 35-38.

approach of this conception. Kingston made a similar reasoning in the framework of the intention to introduce environmental concerns to EU competition law. According to her, if environmental policy can be seen as a policy objective that fits within economic policy (i.e. the idea that when pursuing an economic policy also environmental concerns are to be considered), the economic constitution as to 'preserving competition' should reflect such environmental policy. Hence, from an ordoliberal perspective, competition policy can pursue environmental objectives.[163] This implies for our analysis that if society believes that redistribution objectives in public purchasing are an essential element within public purchasing, also the economic constitution related to public purchasing should take this into account.

B. IDENTIFYING OUR WHARF

In the previous section we discussed the different conceptions as to public procurement regulation – i.e. an 'economic constitution' that provides for structures and institutions, an 'economic constitution' that pursues neoliberalist outcomes and an 'economic constitution' that provides for a framework which draws the boundaries within which public purchasers can pursue policy objectives while purchasing. Having discussed these different conceptions to approach public procurement regulation, we will now establish the source that gives rise to the negative externalities we wish to address.

One may perceive these conceptions as irreconcilable as the first conception (providing for structures and institutions) envisages the procedure pursuant to which a public purchaser enters into public contracts and the two others (the neoliberal and ordoliberal conceptions) are concerned with the outcome that can be achieved via public purchasing.[164] However, we believe these conceptions share a common element, i.e. public procurement regulation aims at regulating the establishing of a particular public market and organising the relationship between the public purchaser and the actual and potential tenderers thereon. Hence, this regulation is

[163] S Kingston, *Greening EU Competition Law and Policy*, (Cambridge University Press, 2012), 17-19.
[164] It must however be noted that an overlap exists. Public procurement regulation as an instrument to overcome the principal-agent problem also produces indirectly a certain outcome (efficiency and integrity) which can also be distinguished in the neoliberal and ordo-liberal approach. On the other hand, also aligning the interests of the public purchaser with the ones of his principal (e.g. society or the legislator) is an element that contributes to achieve policy related outcomes.

concerned with the 'internal dimension' of public purchasing. In view of this, we submit that all conceptions share one same flaw: they all ignore the 'external dimension' to public purchasing. After all, none of the conceptions considers the effects vis-à-vis the competitive dynamics of markets outside that specific public market.[165] We will further elaborate our point in the paragraphs to come.

As we already mentioned before, public procurement regulation as an 'economic constitution' that provides for structures and institutions intends to provide for provisions that ensure accountability, efficiency and equality amongst tenderers. In this conception, public procurement regulation provides for rules defining the behaviour the public purchaser should adopt when organising a public market. It shapes the behaviour vis-à-vis actual and potential tenderers in a way that the principal's interests are safeguarded, the principal being either society (being the 'final customer'), or a hierarchical up-ranking public entity. Therefore, such regulation neutralizes the principal-agent problem. In this respect, public procurement regulation provides that the public purchaser should advertise his intention to enter into a public contract and it elaborates how such publication should be done. It provides also the limits public purchasers are subject to when assessing the bids, i.e. by providing that award criteria should be communicated and applied rigorously in the course of the procurement process. Furthermore, it forbids public purchasers to collude with a particular tenderer to manipulate the outcome of the procurement process. These are just a few examples of how public procurement regulation, being an economic constitution providing for structures and institution, gives substance to the question of the public purchaser's behaviour when purchasing. It follows that public procurement regulation is focused on how a public purchaser should behave when creating the public market as well as how to behave within the public market he creates.

Obviously, in this respect, public procurement regulation is principally aimed at ensuring that a competitive environment is created free from corruption and favouritism. In this environment tenderers are able to compete enabling the public purchaser to identify the most advantageous bid. This may induce the reaction that even though competition may not be the exclusive goal,

[165] In this respect, Sanchez Graells notes that *"(…) public procurement is not designed to prevent distortions of competition between undertakings"*. A Sanchez Graells, "Public Procurement and Competition: Some Challenges Arising from Recent Developments in EU Public Procurement Law" in C Bovis, *Research Handbook on EU Public Procurement Law*, (Edward Elgar 2016), 425.

and even if it were only a secondary goal, still such regulation results in a contract at competitive conditions. However, as has been argued in the literature, regulating the public purchaser's behaviour to avoid 'agency costs' comes with a price as well. This 'price' follows from strict procedural provisions that may hinder de desired outcome of the procurement process.[166] An example is a provision that a public purchaser has to reject a bid if not signed by a competent representative. Another example concerns the application of srict selection criteria. It follows that even if public procurement regulation providing for institutions and structures at least indirectly pursues the idea of honest and free competition, it is not able to achieve perfect competition nor full competition.[167] Hence, the negative externalities we discussed above may occur.

The neoliberal conception, being concerned with profit-maximisation through competition, is internally focused as well. Public procurement regulation inspired by this neoliberal approach provides that the public purchaser should create a market on which eligible undertakings can compete. Moreover, the public purchaser should act as if he was a profit-maximising economic actor. In that respect, the public purchaser should apply mechanisms that allow for the creation of a market that resembles to the largest extent possible a 'private market situation'. To that end, public procurement regulation provides for provisions that substantiate the public purchaser's behaviour vis-à-vis actual and potential tenderers. These are deemed necessary because the outcome pursued requires that the public purchaser's discretion is mitigated and that oversight and enforcement mechanisms are put in place.

The aim here is not so much to structure the relationship between an agent (the public purchaser) and a principal (society, the legislator, …), as is the case in the conception of 'structures and institutions'. The aim here is to impose to the public purchaser to deploy market-like instruments while purchasing.[168] Hence, the outcome sought here is best value for money and efficiency (in terms of procedural efficiency), whereas in the previous conception the outcome

[166] S Arrowsmith, 'The EC Procurement Directives, national procurement policies and better governance: the case for a new approach' (2002) 1 *European Law Review* 3, 8-9; O Soudry, *l.c.*, 444. We also discussed this at length in chapter 1.
[167] This reasoning applies regardless whether 'equality amongst tenderers' and 'achieving best value for money' are conceived as separate goals or as goals that are interrelated with the goal of 'ensuring integrity'. As we argued above, we advocate the latter conception.
[168] See also A Sanchez Graells (2015), *o.c.*, 62-63.

sought was ensuring that the public purchaser behaves in line with the interests of his principal(s). Admittedly, the means to achieve those outcomes converge to a certain extent. For instance, imposing procedural mechanisms to ensure the integrity of the purchasing process is closely related to the intention to achieve a competitive outcome that is not blurred by favouritism or corruption.

However, the fact remains that also in the neoliberal conception, public procurement regulation is focussed on the internal dimension of the public market for the public contract at hand. It requires from the public purchaser to comply with provisions that have as an underpinning rationale to impose market-like behaviour on the public purchaser. An example could be the requirement to exclude undertakings which are not suitable to perform the contract, e.g. because of a lack of experience. After all, it can be assumed that a private purchaser would not contract with an undertaking which is without a proven track record. Such inexperience may jeopardise the apt performance of the contract and give rise to additional costs (in addition to the price) when performing the contract. However, such rigidity may also backfire. If applied mechanically, a public purchaser may miss out on a tenderer who would, even though not able to provide the necessary references, duly perform the contract. If so, there was no need to exclude him from the competition for the contract, so competition is imperfect. This provision, which concerns the 'internal dimension' (the relationship between the public purchaser and the tenderer concerned), produces effects vis-à-vis markets outside this particular market for the public contract. These effects remain unaddressed in public procurement regulation as conceptualised in the neoliberal approach.

Also in the ordoliberal conception public procurement regulation is concerned with the internal dimension of the market for the public contract, i.e. with the relationship between the public purchaser and the actual and potential tenderers. The fact that policy objectives are pursued does not alter this. Also here, public procurement regulation provides how the public purchaser should behave vis-à-vis actual and potential tenderers while pursuing policy objectives and the other objectives that relate to efficiency. Suppose a public purchaser wishes to deploy his buying power to stimulate innovation. To do so, he requires tenderers, in order to be successful, to deliver a highly innovative solution for the public purchaser's need. Public procurement regulation may provide that the public purchaser may do so by applying particular award criteria

to this effect or by inserting the appropriate technical requirements in the contract. The provisions of public procurement regulation allowing this still govern the relationship between the public purchaser and the tenderers. The same goes in the absence of any provisions in this respect. In such event, the rule is that the public purchaser is not subject to any rule in this respect when organising competition for the public contract. Still, this concerns the 'internal dimension'.

The essential difference with the conception of public procurement regulation as an 'economic constitution providing for structures and institution' is that here public procurement regulation provides for the limits within which public purchasers can pursue policy objectives. Hence, whereas the former is 'procedurally oriented', the ordoliberal conception is (just like the neoliberalist conception) 'outcome oriented'. This however does not put into question our point that they share one common flaw. We already discussed that public procurement regulation in its ordoliberal conception is the outcome of a balance exercise between the need to ensure efficiency and integrity on the one hand and policy objectives on the other hand. Also here, the provisions of public procurement regulation which pursue efficiency may not deliver the outcome desired. We refer to our discussion in this regard of public procurement regulation as an 'economic constitution providing for structures and institution'[169] and public procurement in its neoliberalist conception.[170]

In the ordloliberal conception, there is even an additional element that gives rise to the negative externalities we envisage. Here, competition is put into balance with policy objectives. We referred above to the example of fostering innovation. Suppose public procurement regulation allows to conduct a public procurement procedure which does not only focus on competition for the contract but also on the value the chosen tenderer can add to the broader policy goal of innovation. In such case, competition is likely to be limited. After all, it is conceivable that the innovative nature of the solution required to address the public purchaser's needs will be an obstacle to enter the market for the public contract at hand.

This example demonstrates that the ordoliberal conception embodies a trade-off between

[169] Cf. supra.
[170] Cf. supra.

competition, efficiency consideration and policy objectives. This does not necessarily provide for problems in the 'internal dimension': given the definition of the product tendered for, the public purchaser can still treat eligible tenderers equally. Also, the award procedure applied may still guarantee absence of corruption and favouritism, and thus guarantee the public purchaser's integrity. Nevertheless, even though competition between the tenderers may still reflect equal treatment of the tenderers involved, the full and perfect competition pursued by one set of principles embodying this ordoliberal conception (which is already rather virtual due to the inability of public procurement regulation to provide for provisions which guarantee perfect competition) is not the exclusive objective and will most likely not be realized.

The foregoing discussion shows that no matter which conception of public procurement regulation is applied, efficient competition is never achieved. This is because of a trade-off with other concerns. We believe that this is the flaw embedded in public procurement regulation that gives rise to the negative externalities we discussed in chapter 1. This is also the reason why we believe that public procurement regulation does not even address the problem of negative externalities indirectly.[171] After all, one could argue that even though public procurement regulation is concerned with the internal dimension to public purchasing, it still addresses the external dimension indirectly. This would however only be the case absent the said trade-off. After all, we consider this trade-off, efficient competition for the public contact being at best only one element in this respect, to be the source of the negative externalities.

Henceforth, our view is that the negative externalities – giving rise to a market failure that is to be situated on markets outside the given public market – result from imperfect competition in public purchasing. In essence, our point is the following: because of imperfect competition, public markets do not function perfectly. Reduced competition in public markets implies that no equilibrium price can be established, giving rise to prices above equilibrium price. The foregoing also coincides with the element of 'competition as an information discovery tool'. Public purchasers suffer from imperfect information when entering the market in search of a party which is able to address his needs. This situation puts the potential contract-partner in a favourable position as it allows him to extract rents. Public procurement regulation aims at

[171] In any event, it does not do so directly. A Sanchez Graells, 'Public Procurement and Competition: Some Challenges Arising from Recent Developments in EU Public Procurement Law' in C. Bovis, *Research Handbook on EU Public Procurement Law*, (Edward Elgar 2016), 425.

solving this issue: organising competition allows the public purchaser to extract information out of the market, e.g. about which solutions are available to properly address the public purchaser's needs and which price is fair in this respect. Competition for a public contract is considered to be a 'discovery tool' for public purchasers. However, if competition on public markets works imperfectly, also the ends it pursues are achieved imperfectly. It follows that public procurement regulation does not guarantee that the public purchaser extracts all necessary information out of the market in order to identify the best bid in terms of efficiency. The public purchaser may therefore not be able to determine whether the conditions in a public contract are competitive.

Here we arrive at the omission as to public procurement regulation we intend to rectify: public procurement regulation envisages the 'internal dimension' of public purchasing, but is not concerned with the 'external dimension' to it. When discussing the various aims and ends of public procurement regulation, the aim of 'minimising external effects of public purchasing' was never mentioned. We, however, will endeavour to 'enrich' public procurement regulation in a way that allows for neutralising – or at least minimising – the negative externalities public purchasing produces vis-à-vis other markets outside the specific public market for the contract at hand.

Our purpose is thus to introduce mechanisms into public procurement regulation that ensure that this regulation is not merely 'internally focused'. The aim is provide for a framework for regulatory reform, or for interpretation of existing regulation, which allows public procurement regulation to also envisage the 'external dimension' of public purchasing. Hence, we will endeavour to formulate suggestions to compensate for the reduction of competition in order to limit the negative externalities public purchasing, as subject to public procurement regulation, gives rise to.

C. CONCLUSION

In this chapter we identified the source of the negative externalities we discussed in chapter 1. Using the notion of 'economic constitution' to characterise public procurement regulation, we discussed the different conceptions of 'public procurement as an economic constitution'. In that

respect, we discussed public procurement regulation as a 'constitution that provides for structures and institutions' as well as public procurement regulation in its neoliberal and ordoliberal conception.

We concluded that in all three conceptions public procurement regulation is internally focused. It regulates the public purchaser's behaviour vis-à-vis actual or potential tenderers. At the same time, these conceptions also represent a trade-off between competition for the contract and other considerations. Hence, competition for the public contract is, by nature, never perfect. This is problematic as imperfect competition implies an imperfectly functioning of the market. Hence, the market for the public contract at hand is likely to fail as it will not be able to establish an equilibrium price. As the trade-off affects competition at the supply-side, prices tend in theory to exceed the equilibrium price. The consequence is that the public purchaser enters into public contracts at supra-competitive prices. By the same token, competition serves as a tool to gather market information. If competition is imperfect, the information gathering will be imperfect too. The public purchaser will thus be poorly armed against rent seeking and opportunism on the part of the tenderers, but above all he will not be able to identify market-like contract conditions. Hence, he will enter into a public contract at terms that do not reflect the equilibrium price (i.e. the price as established under perfect competition).

We established that public procurement regulation is focused on the 'internal dimension' to public purchasing, i.e. the relationship between the public purchaser and the actual and potential tenderers. It does not take the 'external dimension', i.e. the external effects vis-à-vis third parties and markets, into consideration. This is the objective pursued in this thesis: developing a framework for regulatory reform which allows to further public procurement regulation to compensate the loss of 'competitive capacity' in the internal dimension. In the next chapter we will discuss our suggested framework, and its underpinning *rationale*.

4. CHAPTER 3. DEALING WITH THE NEGATIVE EXTERNALITIES

In the previous two chapters we discussed the negative externalities arising from public purchasing. We deem these problematic because of their ability to distort competition in other markets. We also elaborated what we believe to be the source for these negative externalities. To recall, the negative externalities we envisage follow from the inability of public procurement regulation to ensure that public contracts are entered into at a competitive price, i.e. the equilibrium price. In essence, we argued that public procurement regulation itself produces a failure that distorts the well-functioning of the market for a public contract. Hence, competition in such markets is imperfect. This implies the risk that chosen tenderers will use the financial advantage, which they are able to obtain due to this market failure, to distort competition on other markets to their benefit, i.e. by cross-subsidising activities on those markets resulting in prices below the market equilibrium price. Thus, we argued that the source for these negative externalities lies within public procurement regulation: no matter what conception of public procurement regulation one relies on, such regulation is based upon a trade-off between competition and other considerations. This results in imperfect competition, producing the risk of entering into public contracts at supra-competitive prices. As public procurement regulation essentially is concerned with the 'internal dimension' of public purchasing, it leaves these negative externalities unaddressed.

The foregoing was elaborated in the previous chapters. It is relevant to recall this here for two reasons.

First, it allows us to clearly formulate the goal of our research: avoiding that public purchasing implies supra-competitive prices which give rise to competition distortions on other markets. This distortion follows from the possibility for the chosen tenderers to leverage their position on other markets through cross-subsidisation. After all, they can deploy the financial advantage they obtained under a public contract to set prices below the equilibrium price. The underpinning intention would be building up market power on such market.

Secondly, it allows us to revisit the cause for the negative externalities we envisage. Generally put, we established that public procurement regulation is the result of a trade-off between, on the one hand, establishing 'best value for money' through competition and, on the other hand,

various other considerations which depend on the conception of public procurement regulation that is applied. Hence, such trade-off jeopardises the role of competition in the purchasing process. Consequently, the market cannot produce an equilibrium price and the public purchaser extracts insufficient information from the market to establish competitive terms and conditions in view of the needs that are to be addressed.

The means to tackle the negative externalities is, so we will argue in this chapter, 'enriching' public procurement regulation. We will develop a 'standard for enriching'. This standard is to be conceived as a framework for regulatory reform. More in particular, the reformed regulation should be apt to at least minimise the occurrence of the negative externalities we identified before. However, the notion 'framework for regulatory reform' should not be interpreted too strictly. Such framework may also be relevant, insofar feasible, for the judiciary and public purchaser when interpreting and applying public procurement regulation.

Constructing the 'standard for enrichment' can be divided into two parts. In the first part, we will discuss the actual ends and *rationale* underpinning our 'enriching' effort and, subsequently, examine whether these ends and *rationale* converge with the ends and *rationale* which underpin another body of law. We will conclude that EU state aid law shares to a large extent the ends and *rationale* underpinning our 'enriching' effort. Therefore, EU state aid law provides for such convergence. Hence, we will submit that EU state aid law provides for a valuable source of inspiration for the construction of our 'standard for enrichment'. In the second part we will examine relevant domains of EU state aid law in order to give substance to the 'standard for enrichment'.

A. EU STATE AID LAW AND NEGATIVE EXTERNALITIES ARISING FROM PUBLIC PURCHASING

In this first part of this chapter, we will examine whether there is a body of law that provides us with inspiration to suggest a solution for the problem of negative externalities we described in chapter 1. In this respect, it is important to keep the ends and the *rationale* underpinning our 'enriching' effort in mind.

Our research is concerned with dealing with the negative externalities public purchasing produces. The negative externalities we envisage stem from the supra-competitive price public contracts may reflect. The chosen tenderer can use this financial advantage to strengthen his position on another market. More in particular, cross-subsidisation funded by such advantage enables him to set his prices below the equilibrium price resulting in the acquisition of additional market share. Thus, this market may fail as a consequence of the market power the chosen tenderer can exercise on that market.

The reason for this is that public procurement regulation is not solely concerned with creating competition for the public contract. Also other considerations give substance to public procurement regulation.[172] If public procurement regulation is to be classified as a body of institutions and structures to overcome the principal-agent problem, not only achieving best value for money is pursued merely indirectly. It pursues in the first place the aligning of the agent's (the public purchaser) interests with the interests of the principal (society or the hierarchically up-ranking public entity), e.g. through assuring monitoring and oversight in order to guarantee the integrity of the process.[173] In the neoliberal conception, public procurement regulation is also concerned with limiting the discretion of public purchasers and with oversight and monitoring but here with the primary objective of ensuring efficiency and best value for money. If public procurement regulation is conceived from an ordoliberal point of view, the objective of achieving best value for money, efficiency and accountability is flanked by the pursuance of policy considerations. It follows that due to the situation of imperfect competition, the public market is unable to produce an equilibrium price. In this vein, the reduced competition on the supply side may give rise to the entering into public contracts at supra-competitive prices.

Addressing the problem we discussed could involve overcoming the information asymmetry between the public purchaser and the tenderers. This would allow the public purchaser to identify the best offers on the market. Competition is considered to be an instrument for the public purchaser to extract information out of the market, as we discussed before. As we

[172] Cf. supra.
[173] Obviously, maintaining the integrity of the process can also contribute to the goal of best value for money. Nevertheless, we believe that this is neither the primary nor the exclusive goal of ensuring the integrity of the purchasing process. For instance, maintaining this integrity also contributes to political goals, such as 'trust in the state'.

however noted previously, competition is not the sole objective which public procurement regulation pursues and therefore it may not deliver this outcome. This situation leaves the public purchaser in a weaker position vis-à-vis the tenderers. They can exploit this information-asymmetry and behave opportunistically. But also without there being an intention to seek rents, still the public purchaser may lack the information needed to identify the terms and conditions of what would be an efficient contract in view of his needs that should be addressed.

The foregoing discussion indicates that overcoming the problem of the negative externalities is closely related to improving, where possible, competition for the public contract. To that end, we will construct a 'standard for enriching'. This standard will be developed in section 2. In this section we will examine whether a body of law exists which provides a source of inspiration for our standard. We argue that EU state aid law is highly helpful in this respect. To substantiate this claim, we will argue that is true because of three reasons. First, public contracts entered into at a supra-competitive price contain an 'advantage' as envisaged by article 107 (1) TFEU. Secondly, the ends pursued by EU state aid law converge with the ends we pursue when developing a 'standard for enriching'. Thirdly, the economic *rationale* underpinning our 'stand for enrichment' matches to a large extent the economic *rationale* that underpins the state aid prohibition.

a. Supra-competitive prices as an advantage

Above we argued that EU state aid law, and more specifically the state aid prohibition laid down in article 107 (1) TFEU, is a valuable source of inspiration for the construction of our 'standard for enrichment'. This is because the negative externalities we intend to tackle are to be qualified as an 'advantage' in the meaning of article 107 (1) TFEU. We are, however, not so much concerned with the question whether the 'advantage' resulting from the supra-competitive price actually qualifies as state aid. To this end, also other conditions have to be fulfilled.[174] We will not further engage in this question. The essential element for our analysis

[174] Nevertheless, it has been argued that the other conditions are easily fulfilled in case of state aid though public contracts. A Sanchez Graells, 'Distortions of Competition Generated by the Public (Power) Buyer: A Perceived Gap in EC Competition Law and Proposals to Bridge It', Working Paper CCLP (L), 2009, 20-21.

is that a public contract entered into at supra-competitive terms gives rise to a distortive competitive advantage which EU state aid law wishes to avoid.

For our argument, we have to clarify the notion of 'advantage'. More in particular, the question arises when a public contract involves an advantage in the meaning of article 107 (1) TFEU. In the first place, In EU state aid law, an undertaking receives an advantage when entering into a public contract if such contract is entered into at supra-competitive terms. This follows from the 'private purchaser test' (itself being based on the 'market investor test'). This test provides that if a Member State acts in its capacity of an economic operator, it should also act in an economically rational way, just like a private operator would do. If not, and such economically irrational behaviour results in a transaction at a supra-competitive price, the Member State grants an advantage. If next to the conferral of such advantage, also the other conditions enshrined in article 107 (1) TFEU are met, such transaction constitutes state aid. Hence, if the undertaking performing the public contract benefits from supra-competitive terms, it receives an advantage which potentially distorts competition. This advantage converges with the negative externalities we identified in chapter 1.

Case law dealing with the relationship between EU state aid law and public contracts points out that public contracts at supra-competitive terms endow the contract performer with an advantage. This advantage improves the beneficiary's competitive position, and thus results in a competition distortion. In the BAI judgment, the GC formulated the principle that state aid cannot be ruled out merely because the public entity and its supplier commit themselves to mutually perform contractual obligations.[175] More in particular, the GC established that the number of voucher purchased did not reflect the public entity's needs.[176] Hence, the contract was not the result of economically rational behaviour. Another issue touched upon in the judgment was the favouring of the competitive position of the ferryboat company through the purchase. The vouchers could only be used in the low season. Such limits the risks the ferry boat company would have incurred under normal market conditions.[177] Consequently, the GC deemed the contract not to reflect market like terms.

[175]Case T-14/96, BAI, [1999] II-139, 71.
[176]*Ibid.*, 76.
[177]*Ibid.*, 76.

Another case in which the issue of state aid conferrals through public contracts emerged, was the P&O case (in fact dealing with the same transaction as in the BAI case). Referring to the BAI jurisprudence, the GC stated that a contract implying mutual commitments does not rule out a state aid grant. After all, the public entity may have no actual need for the goods and/or services purchased.[178] The P&O case was also important in another respect. It opened the door for public procurement regulation to step in as an important tool to avoid the granting of an advantage. Although the GC was asked to verify whether an actual need for the vouchers existed, and thus to establish whether a normal commercial transaction was at hand, it nevertheless stated the following:

> *"It is all the more necessary for a Member State to demonstrate that its purchase of goods or services constitutes a normal commercial transaction where, as in the present instance, selection of the operator has not been preceded by a sufficiently advertised open tender procedure. In accordance with the Commission's settled practice, the fact that such a tender procedure is conducted before a Member State makes a purchase is normally considered sufficient for the possibility that the Member State is seeking to grant an advantage to a given undertaking to be ruled out"*[179].

Based upon this paragraph, the Commission has accepted in a vast number of decisions that a public contract did not entail an advantage because the contract was entered into pursuant to a public procurement procedure.[180]

In addition to the aforementioned case law, confirming that state aid can be granted through a public contract, also advocate-general Fenelly[181] and advocate-general Jacobs[182] joined this point of view. They stressed that a public contract that displays overcompensation entails an advantage as envisaged in article 107 (1) TFEU.

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[178] Joined cases T-116/01 and T-118/01, P & O European Ferries and others / Commission, [2003] II-2957, 114-117.
[179] *Ibid*., 118.
[180] We will discuss the problem of the interplay between public procurement regulation and EU state aid law further on in this chapter.
[181] Opinion AG Fenelly of 26 November 1998 in Case C-251/97, France / Commission, ECLI:EU:C:1998:572, 19.
[182] Opinion AG Jacobs of 30 April 2002 in Case C-126/01, GEMO, ECLI:EU:C:2002:273, 122.

It follows from the above that for a public contract to be in compliance with EU state aid law, the public contract should display market terms – and thus economical rationality on the part of the public purchaser. As confirmed in the BAI and P&O judgments, problems in this respect occur not only in case of supra-competitive prices, but also if the contract does not match an actual need. For our analysis we will only focus on the first hypothesis: distortions following from advantages due to supra-competitive prices.[183] So we can conclude that the negative externalities we envisage match with the notion of 'advantage' in EU state aid law as to public contracts.

However, there is also another, more intuitive justification for arguing that our negative externalities converge with the notion of 'advantage'. Also an 'advantage' is in fact a negative externality. It originates from the relationship between the grantor of state aid and its beneficiary. That relationship produces distortive effects vis-à-vis third parties, i.e. the competitors to the beneficiary. Their competitive position on the market gets harmed, and consequently competition on that market is harmed as well. Henceforth, insofar we consider state aid granted through a public contract, the contract itself may not be problematic from a contract law point of view. It is the advantage granted to the public purchaser's counterparty under the contract, producing negative external effects, which is problematic. Accordingly, we submit that the notion 'advantage' actually converges with our concept of 'negative externalities'.

It follows from the foregoing that, contrarily to Sanchez Graells' problem, EU state aid law is able to help us to address our problem. The reason why this was not possible in Sanchez Graells' analysis, was that he focused on the public purchaser's buying power leading to public contracts at prices below the equilibrium price. This does not give rise to overcompensation.[184] Hence, in principle, the condition of there to be an 'advantage' for the party performing the contract would not be fulfilled – insofar no elements point at a non-market like transaction.[185]

[183] This encompasses also situations in which the contract price is at first sight compliant to the requirement of a market price but where a closer look to the contract terms reveals other provisions which, would they have been taken into account when establishing the price, would have led to a lower price. An example is the situation where the public purchaser assumes more risks than what would have been acceptable to a private purchaser given that price.
[184] A Sanchez Graells (2015), *o.c.*, 65-66.
[185] One could think of the situation in the *BAI* and *P & O* cases where the public purchaser bought products without an actual need in that respect.

The following point could however be put forward. Accepting that a public contract can be entered into at a supra-competitive price after organising a public procurement procedure sits uneasily with the GC's statement that such a procedure gives rise to the assumption that EU state aid law is complied with. Such compliance ensures absence of an advantage after all. Indeed, our reasoning in the previous paragraphs indicates that we deem our negative externalities to be present even when the public contract was award pursuant to a procedure provided for by public procurement regulation. Nevertheless, apart from the fact that this is a rebuttable presumption,[186] we believe that this does not affect our claim that EU state aid law can be a source of inspiration for our 'standard for enriching'. As we already demonstrated above, public procurement regulation does not guarantee that the public contract is entered into pursuant to a procedure reflecting perfect competition. Even more, as we will discuss later on, invoking the GC's case law (and the Commission decisions as to state aid granting through public contracts) to claim that compliance with public procurement regulation equals EU state aid law compliance because of a lack of an advantage, may put the robustness of that case law and decision practice into doubt.

As we discussed in chapter 1, our claim that public contracts may display a supra-competitive price is not a virtual one. Hence, because of public procurement regulation's features – designed to organize public purchasing and to deal thereby with various concerns, not only efficiency concerns, without however addressing the external dimension to public procurement – the public purchaser runs the risk to enter into contracts at a supra-competitive price. As EU state aid law does not see to the cause of or reason for the aid but only to its effects,[187] such supra-competitive prices should qualify as an 'advantage' in the sense of article 107 (1) TFEU. Hence, if the other conditions laid down in article 107, lid 1 TFEU are fulfilled, such supra-competitive price may qualify as state aid. In that vein, public procurement regulation cannot serve as a trustworthy instrument to guarantee the entering into contracts at market price.

[186] A Sanchez Graells, 'The Commission's Modernisation Agenda for Procurement' in E Szyszczak and J W van de Gronden (eds.), *Financing Services of General Economic Interest: Reform and Modernization and SGEI*, (Asser, 2013), 171.

[187] See e.g. case C-56/93, Belgium v Commission [1996] ECR I723, 79. Hence, as Heuninckx already pointed out as to defence procurement, the fact that the public purchaser does not have the intention to grant state aid is irrelevant (B Heuninckx, 'Defence Procurement: the Most Effective Way to Grant Illegal State Aid and to Get Away with it … Or is it?' (2009) 1 *Common Market Law Review* 191, 198).

b. The ends pursued by EU state aid law

We established in the previous paragraphs that the supra-competitive price public contracts may display, converge with the notion of 'advantage' in EU state aid law. The problem we mentioned earlier in this respect is that this 'advantage', i.e. our negative externalities, may distort competition in other markets. Thus, EU state aid law envisages the same problem as the one we outlined in chapter 1: state aid is problematic as it distorts competition.

As a principle, EU state aid law provides that Member States should refrain from granting financial benefits to specific undertakings or sectors insofar such benefits distort or are capable of distorting competition and insofar they negatively affect trade between Member States. This principle is enshrined in article 107(1) TFEU.[188] This article does not clearly articulate a particular objective, but it can be drawn from its wording that the state aid prohibition aims at preserving competition. This is also how the GC and the ECJ have explained the existence of the EU state aid prohibition. The ECJ and GC refer to the objective of preserving free competition[189] and free trade[190] on the common/internal market as being the main objective of EU state aid law. Based on the foregoing, one could conclude that the objective of the EU state aid prohibition is avoiding that competition and interstate trade are adversely affected. To do so, it avoids that specific undertakings receive an advantage reducing the costs they would incur while performing their economic activities, this advantage being funded through public resources.

In that respect Piernas Lopez made an interesting observation. He divides the life of EU state aid law so far, into four periods. He notes that as from the start of the third period (i.e. mid 1980s) the Commission is using EU state aid law as a 'competition tool'. EU state aid control

[188] In order to preventively avoid such behaviour, article 108 (3) provides for a notification obligation for Member States which intend to confer state aid, which is combined with a standstill obligation (Member States cannot confer the state aid until the European Commission agrees).
[189] See e.g.: Case C-225/91, Matra, [1993] I-3203, 42; Case T-358/94, Air France, [1996] II-2109, 56; Case T-16/96, Cityflyer Express, [1998] II-757, 50; Case C-209/00, Commission v Germany, [2002] I-11695, 29; Case C-404/00, Commission v Spain, [2003] I-6695, 19.
[190] See e.g. Case 148/77, Hansen and Balle, [1978] 1787, 14; Case C-387/92, Banco Exterior de España, [1994] I-877, 12; Case T-46/97, SIC, [2000] II-2125, 77; Joined Cases C-393/04 and C-41/05, Air Liquide, [2006] I-5293, 27.

was from then on no longer so much a tool to preserve competition amongst economies of the EU. It rather became a tool to ensure undistorted competition amongst undertakings.[191] Our suggestion to 'enrich' public procurement regulation is closely related hereto.

Also the Commission has shed in various documents some more light on the ends EU state aid control pursues.[192]

The 2005 State Aid Action Plan reveals that the role of the EU state aid prohibition is closely related to the idea that competition should be protected. More in particular, market-economy based markets with a high degree of competition are considered to produce, on the one hand, a high standard of living for EU citizens and, on the other hand, a competitive European economy.

In that respect, the EU state aid rules aim at establishing and maintaining a level playing field for all firms on the relevant European-wide market. After all, conferring aid can falsify the competition game as it produces situations where the most efficient firm does not receive the rewards (or profits) it merits on the basis of its economic performance. This would result in de-incentivising further investments in economically efficient behaviour. Also, aid can improve the market position of the aid beneficiary, inducing other firms to decrease their activities on that market. This would allow the aid beneficiary to enhance his market position – albeit not merited on the basis of efficient performance. A last possible negative effect related to the conferral of state aid concerns the creation of barriers to entry for new or foreign undertakings.

Also the ECJ case law reflects this stance, although less explicitly. This is for instance the case in judgments where the ECJ stated that even though the beneficiary of state aid does not participate in interstate trade, competition can still be distorted. This is because the aid precludes undertakings in other Member States from entering the market on which the state aid beneficiary performs activities (thus referring to barriers to entry). Furthermore, such state aid

[191] J J Piernas López, *The Concept of State Aid under EU Law: From internal market to competition and beyond*, thesis defended at the EUI, March 2013, 257.
[192] A caveat is necessary here as the Commission documents that will be discussed, and especially the 2005 State Aid Action Plan, dealt with the Commission approach towards article 107 (3) TFEU, dealing with state aid the Commission can declare compatible with the internal market. We, however, are foremost interested in the ends enshrined in article 107 (1) TFEU, i.e. the actual state aid prohibition.

may incite the beneficiary to engage in intrastate trade in the future (thus hinting at the risk that the beneficiary will deploy the advantage to conquer market share on other markets).[193]

All these adverse effects result in higher prices, lower product quality and less innovation. Another rationale underpinning EU state aid law which the European Commission touches upon in the State Aid Action Plan is the fact that state aid is funded through public money. This creates concerns at two levels: not only are national governments dealing with taxpayers' money, they also drive public money away from a possibly more efficient allocation.[194] However, the efficient spending of public money is not of direct concern to us in this thesis.[195]

This role for EU state aid law is also emphasized in the 2012 Communication on the modernization of EU state aid policy. EU state aid law, as part of the competition policy, should ensure the well-functioning of the market.

Also, the Commission recognizes that EU state aid law – as it contributes to a competitive environment in which investments, efficiency and innovation are rewarded – enhances the competitiveness of Europe's economic sectors when competing at the level of the world economy as well. In this communication, the Commission also emphasized that it deems EU state aid law to be important in combating the adverse consequences resulting from the financial and economic crisis and, more in particular, to achieve the Europe 2020 Strategy.[196] The European Parliament resolution on state aid modernisation refers to creating a level playing field in the internal market as being the primary objective of EU state aid law.[197]

Whereas this last end pursued by EU state aid law, or more precisely by EU state aid policy, is not of direct relevance to our analysis,[198] the ends mentioned earlier (i.e. preserving the

[193] See e.g. Case C-148/04, Unicredito, [2005], I-11137, 58.
[194] State Aid Action Plan - Less and better targeted state aid: a roadmap for state aid reform 2005–2009, 7 June 2005, COM(2005) 107 final , par. 6-8.
[195] Cf. supra.
[196] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - EU State Aid Modernisation (SAM), 8 May 2005, COM(2012) 209 final, par. 2-5.
[197] European Parliament resolution of 17 January 2013 on state aid modernisation (2012/2920(RSP)), 4.
[198] Nevertheless, public procurement regulation that minimises the chances for the negative externalities we discussed in chapter 1 to occur, and thus that contributes to the well-functioning of other markets, promotes also these policy goals which are to be achieved through well-functioning markets.

competitive dynamics on markets) are. After all, these ends can also be distinguished in the framework of our 'enrichment' effort. In essence, the state aid prohibition in article 107 (1) TFEU aims at avoiding a market failure, i.e. market power. State aid blurs the distribution of incentives. Therefore, EU state aid law intends avoiding that the market rewards undeserving undertakings. Even more, it undermines competitive dynamics in markets as it gives rise to barriers to entry and endows beneficiaries with market power. Also this is an element EU state aid law intends to prevent. These ends pursued by EU state aid law were also mentioned when discussing the ends our 'standard for enrichment' pursues. After all, the ends pursued when 'enriching' public procurement regulation concern avoiding that public purchasing endows a chosen tenderer with an advantage that allows him to exercise market power on another market and to expand undeservedly his market share.

c. The economic rationale underpinning the state aid prohibition

The literature discusses a number of economic *rationale* underpinning the state aid prohibition laid down in article 107 (1) TFEU.

The first *rationale* concerns the intention to avoid 'cross-border externalities'. The literature mentions *grosso modo* two kinds of such externalities.

First, Member States may wish to help national firms to increase the market share of their national undertakings. To that effect, the Member States grant financial aid improving those undertakings' competitiveness vis-à-vis firms established in other Member States. If successful, such aid damages the interests of these other Member States and their undertakings. Therefore, such other Member States may deem themselves forced to support their national undertakings as well. In the end, all Member States end up granting subsidies or other kinds of support without there to be a beneficial economic effect for any of the Member States involved. The subsidy turns out to be a waste of public money. The aid granting thus goes against the public interest.[199]

[199] H W Friederiszick, L-H Röller and V Verouden, *l.c.*, 161-162. See however the observation made by Piernas Lopez, i.e. that EU state aid law has become a tool to preserve competition amongst undertakings instead of between the economies of the Member States. Cf. supra.

Even though we do not explicitly consider the problem of protectionist purchasing here, this rationale can in theory also underpin our 'standard for enriching'.[200] If competitors to the chosen tenderer lose market share because of public purchasing at supra-competitive prices in a Member State, they have an incentive to request compensatory measures from their government to defend their market position. Governments, in turn, may have incentives (such as political rents) to concede to such requests. Hence, also as to public purchasing at a supra-competitive price the risk occurs that governments get involved in an inefficient subsidy race.

Even more, in the context of protectionist purchasing Mougeot and Naegelen argued that when one government favours national tenderers over foreign tenderers because of reasons of political economy (such as interest group capture or maximizing chances for re-election), other governments have an incentive to proceed to protectionist purchasing as well.[201] This reasoning is also relevant to our problem. If public procurement regulation leaves room for pursuing the interests of the public purchaser (e.g. to obtain political rents trough favouring local industry which maximises chances for re-election) or for lobbying, such discretion can result in an inefficient outcome. In turn, this would strengthen the competitive position of the chosen tenderer and imply a strong incentive for his competitors to request 'compensatory measures' from their government. Even more, it is not necessary for the public purchaser to award the contract intentionally at a supra-competitive price. As we already contended, for the negative externality to occur, it is not necessary that the public purchaser infringes the law. Such an outcome may also be the result of a public procurement procedure conducted in compliance with the relevant provisions. After all, public procurement regulation may be contaminated by a 'regulatory failure' which gives rise to such an undesired outcome. Nevertheless, competitors to the chosen tenderer may have a strong incentive to lobby with the government to obtain financial means to protect their business. In turn, depending on the circumstances, such government may have a strong incentive to adhere to this request.

[200] However, protectionist purchasing may contribute to the negative externalities we envisage to address here. Therefore, our 'standard for enrichment' also serves as a device to counter protectionist purchasing. The standard is, however, not in the first place directed against protectionist purchasing itself but rather to the negative impact vis-à-vis competition it potentially produces.

[201] M Mougeot and F Naegelen, 'A political economy analysis of preferential public procurement policies' (2005) 2 European Journal of Political Economy 483, 495.

Secondly, Spector points to the negative cross-country externalities that state aid may produce in oligopolistic markets (thus markets with imperfect competition). He notes that in oligopolistic markets, where market players make profits in accordance to their market power, which in turn is determined by their investments, states can induce a decrease of investments of foreign market players by granting aid to the national undertaking. This national undertaking has the means to invest and thus to increase its market share. Consequently he can also increase its profits. Foreign undertakings do not have an incentive anymore to invest in increasing or maintaining their market share. This leads to an even stronger market position for the national undertaking. However, such market distortions do not merely occur on oligopolistic markets. State aid may also affect competition in general, e.g. by enabling firms to apply predatory pricing policies or to take over other firms to increase their (dominant) position on the market.[202] Also, in more general terms, authors have noted that state aid granting (insofar economically justified) should be balanced with the negative economic consequences it produces, as the granting of state aid implies a cost. One of these costs can be found in the anti-competitive side effects that may hurt competitors and, in the end, consumers.[203]

This line of reasoning matches our concern that supra-competitive prices in public purchasing potentially endows the chosen tenderer with market power which he can use to his advantage on other markets. This jeopardises competitive dynamics on such markets and reduces social welfare. In the specific case of an oligopolistic market, this holds true as well. Suppose the public purchaser contracts with an undertaking in a market that is oligopolistic at the supply side. The chosen tenderer can use the advantage obtained under the public contract to win future contracts in public markets as well as in private markets. To do so, he can set his prices below the equilibrium price. Other undertakings on that oligopolistic supply market may see no other option than leaving the market.

Secondly, a number of "paternalistic" justifications are referred to in the literature. The most important one appears to be "national commitment problems". Member States may find it hard to stick to their budget when undertakings are in need for financial support on behalf of the

[202] D Spector, 'State Aids: Economic Analysis and Practice in the European Union' in X Vives, *Competition Policy in the EU*, (Oxford University Press, 2012), 181-184.
[203] H W Friederiszick, L-H Röller and V Verouden, *l.c.*, 160; See also: Ph Nicolaides and I E Rusu, 'The "Binary" Nature of the Economics of State Aid' ' (2010) 1 *Legal Issues of Economic Integration* 25, 28.

government. Undertakings which are aware of this do not have an incentive to operate efficiently. They know they can rely upon intervention by the Member State in case of financial hardship. After all, as Spector notes, governments have "short horizons". Governments prefer the short-term benefit resulting from an aid conferral over avoiding the long-term budgetary disadvantages and disadvantages following from the decreased competitiveness of the firms involved.[204] This results in a efficiency and welfare loss.[205] Such a commitment problem may also arise when interest groups lobby for financial intervention by the state. Governments may be in need for an instrument to protect them against the influence exercised by interest groups, who are driven by their self-interest and not so much by efficient spending of public money or by preserving competition. EU state aid law is believed to provide for such a commitment device.[206]

Another paternalistic justification concerns dealing with the potential incompetence of national officials – which relates to a certain extent to the question dealt with in the previous paragraph.[207] Also, the intention to avoid rent-seeking on the part of the undertakings eligible to receive aid is a justification that is tought to be paternalistic. EU state aid law avoids undertakings getting involved in unproductive or economically unprofitable but subsidized activities to the detriment of conducting productive activities.[208]

These paternalistic justifications refer to the procedural aspects of public purchasing, rather than to its outcome. In that sense, they reflect traces of the principal-agent problem: the conduct of the Member State has to be aligned with the interests of the EU, i.e. ensuring undistorted competition on the internal market. The economic justification of providing a 'commitment device' is particularly relevant to our analysis. Public procurement regulation should not leave room for pursuance of other interests than the ones that are related to the act of public purchasing. Public procurement regulation should offer a 'commitment device' to which the

[204] D Spector, *l.c.*, 180.
[205] H W Friederiszick, L-H Röller and V Verouden, *l.c.*, 162-164.
[206] M Dewatripont and P Seabright, ' "Wasteful" Public Spending and State Aid Control' (2006) 2/3 *Journal of the European Economic Association 513, 5*20.
[207]However, as Spector notes it should not be taken for granted that the supranational body's officials are more competent and if this were the case, why are other areas not brought under the supervision of a supranational body as well? See: D Spector, *l.c.*, 177-178.
[208]D Spector, *l.c.*, 180-181. See also: D. Spector, 'L'économie politique des aides d'État et le choix du critère d'appréciation' (2006) 2 *Concurrences* 34, 35-40.

public purchaser should adhere. This would address the risk that other (political) interests or lobbying provide for an incentive to manipulate the outcome of the public purchasing process. This is what our 'enriching' exercise envisages: assuring that the negative externalities do not occur even though other forces, having an interest in the emergence of the negative externalities, may insist on their occurrence. Such occurrence does not necessarily follow from lobbying by tenderers. It may also follow from tenderers using their information advantages, allowing them to act opportunistically. Hence, 'enriched' public purchasing regulation intends to immunize the public purchaser against rent-seeking and opportunism. After all, such behaviour gives rise to supra-competitive prices and thus to our negative externalities. As a consequence, immunising public purchasing for rent-seeking behaviour also achieves that undertakings will not participate to public markets solely because of the prospect of rents as a result of opportunism.

Lastly, literature mentions the 'internal market rationale' as an economic rationale underpinning EU state aid law. On the integrated European market, economic growth can be achieved if companies behave efficiently and create economies of scale. Competition creates the incentives to this effect. In that respect, aid by national authorities does not only harm the other Member States, it also damages the well-functioning of the internal market since it de-incentivizes achieving economies of scale and it undermines competition.[209]

Insofar EU public purchasing law is considered, maintaining the internal market can also be considered to be a *rationale* underpinning the 'enriching' exercise.[210] After all, the EU directives on public procurement provide how the Member States should regulate public procurement. In doing so, the EU legislator drafted the provisions with the intention to create an internal market for public contracts. 'Enriching' EU public procurement law would imply that the EU directives are also based upon considerations regarding the maintaining of undistorted competition in other markets (thus avoiding the negative externalities we envisage here). The rationale underpinning 'enriched' EU public procurement law would thus converge with the 'internal market *rationale*' which underpins EU state aid law.

[209] H W Friederiszick, L-H Röller and V Verouden, *l.c.*, 164.
[210] However, we do not specifically focus on EU public procurement law in this part of the thesis. Cf. supra.

Some literature also mentions other *rationale* for EU state aid control. Nicolaidis and Bilal put forward that EU state aid control introduces enhanced transparency and predictability as to the partner countries' policy-making. In this respect, authors submit that such increase in transparency and predictability makes it easier for companies to plan their investments and for other governments to formulate and implement their own policies.[211] We consider this rationale to be irrelevant for our thesis here.

B. THE 'STANDARD FOR ENRICHING'

We established in the previous section that EU state aid law is a valuable source of inspiration for our 'enriching' exercise. This is in the first place because the negative externalities we envisage converge with the notion of 'advantage'. This notion is an essential element for the state aid prohibition in EU law to apply. Another reason is that our 'standard for enriching' pursues the same ends as the ones EU state aid law pursues. Lastly, we believe that the economic *rationale* underpinning our 'standard for enriching' converges to a large extent with the economic *rationale* underpinning EU state aid law.

Next, we will examine EU state aid law as to a number of activities in order to construct our 'standard for enriching'. This examination allows us to distinguish the principles which ensure that EU state aid law achieves the ends it envisages. Apart from the EU state aid regime as to public purchase contracts in general, which we already discussed briefly in the previous section, we will also examine the regimes as to the financing of SGEIs and as to privatisations. In both regimes, competitive bidding procedures are an important tool so as to avoiding the granting of an advantage in the meaning of article 107 (1) TFEU.

When distinguishing the principles which will inspire our 'standard for enrichment', we will use three notions. These will allow us to provide some structure. The first is 'competition'. It refers to the mere act of organising a market place. The second is 'genuine competition'. This notion refers to the relationship between the participants to this market. The idea is that merely creating a market is insufficient. The public purchaser organising such market should also create

[211] P Nicolaides and S Bilal, 'An Appraisal of the State Aid Rules of the European Community — Do they Promote Efficiency?' (1999) 2 *Journal of World Trade* 97, 100-101.

conditions which allow undertakings to actually compete with each other. For instance, genuine competition will be impossible if the participants possess different information or if uncertainty about the public purchaser's needs prevents the tenderers from effectively competing for the contract. Here, both a problem of horizontal information asymmetry (amongst the tenderers, e.g. because one tenderer has better knowledge about the public purchaser's preferences) and a problem of vertical information asymmetry (because the public purchaser does not fully communicate his preferences to the actual and potential tenderers) emerge. The third is 'fair competition'. This relates to the behaviour of the organizer of the market on that same market. For instance, competition will not be considered to be 'fair' when, even though a market is created and all participants have equal information, the public purchaser engages in behaviour which affects the outcome of that competitive process (e.g. collusion with one participant).

a. Compensations for the provision of SGEI's

It has been argued in the literature that public procurement regulation should comply with 'quality standards' in order to constitute an apt instrument to avoid that the public contract implies the conferral of an advantage.[212] This became particularly clear in the field of compensations for the provision of services of general economic interest ("SGEIs"). Especially in the wake of the *Ferring*[213] and *Altmark*[214] judgments, the question when a compensation for the provision of SGEIs constitutes an 'advantage' as envisaged in article 107 (1) TFEU and the role of public procurement regulation to this effect, was a major point of debate, both among scholars and in the field of EU state aid policy.[215]

Even though we will argue in chapter 7 of part II of this thesis that the financing of SGEIs is not about purchasing but rather about administering subsidies, we believe this discussion nonetheless to be instructive in view of the construction of our 'standard for enriching'. After

[212] A Sanchez Graells, 'Distortions of Competition Generated by the Public (Power) Buyer: A Perceived Gap in EC Competition Law and Proposals to Bridge It', Working Paper CCLP (L), 2009, 21.
[213] Case C-53/00, Ferring, [2001] I-9067.
[214] Case C-208/00, Altmark, [2003] I-7747.
[215] For an account of the evolutions in this area of EU state aid law, see C Quigley, *European State Aid Law and* Policy (Hart, 2015) 231.

all, the Commission relied in the Draft Notice on the Notion of State Aid[216] on the SGEIs regime when dealing with state aid granting through public purchasing. [217] This SGEIs regime is articulated in the *Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest*. Admittedly, in the actual Notice on the Notion of State Aid[218] the Commission did not refer explicitly to this Altmark Communication. Nevertheless, it seems safe to say that the Commission indicated the approach set out in the Altmark Communication to be also valid when substantiating the notion of 'advantage'. In any event, the Altmark Communication is relevant for our analysis, as it establishes the conditions to be met assure the entering into a contract at market terms.

Discussing this area of EU state aid law demonstrates two things. First, compliance with public procurement regulation is a suitable method to determine the compensation a chosen tenderer receives. However, and secondly, merely applying public procurement regulation is not sufficient. The procedure public procurement regulation provides also has to meet certain requirements which ensure that the procurement procedure is apt to establish a competitive price, and thus to avoid an 'advantage'.

As to the first point, it follows from the 4th *Altmark* condition that contracting with a SGEI provider pursuant to a procedure in compliance with public procurement regulation, results in the absence of an advantage.[219] According to Buendia Sierra,[220] an award procedure is a well suited method to guarantee efficiency in such service providing. After all, the competition the

[216] Communication from the Commission. Draft Notice on the Notion of State Aid pursuant to article 107 (1) TFEU, http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf (hereinafter "Draft Notice on the Notion of State Aid) , par. 91-99.
[217] Cf. infra.
[218] Communication from the Commission. Notice on the Notion of State Aid pursuant to article 107 (1) TFEU, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719(05)&from=EN (hereinafter "Notice on the Notion of State Aid).
[219] More in particular, this fourth condition entails that in order for the compensation not to constitute state aid the SGEI provider has to be chosen in a public procurement procedure. Alternatively, the level of compensation has to have been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.
[220] J L Buendia Sierra, 'Finding the Right Balance: State Aid and Services of General Economic Interest' in X, *EC State Aid Law- Le droit des aides d'Etat dans la CE. Liber Amicorum Francisco Santoalla Gadea*, (Wolters Kluwer, 2008), 210-214.

public procurement procedure generates, induces tenderers to offer efficient contract performance. This creates contract terms that comparable to the terms which would have been achieved in a normal market situation.[221] Apart from this, the author notes that this idea of efficiency can also be identified in the Commission's decision practice at hand and the *P & O* judgment.[222]

Secondly, and still in the field of the financing of SGEI, award procedures as such should also comply with 'quality standards'. In the Altmark Communication, the Commission discusses the requirements an award procedure should comply with to produce the most efficient outcome. The open tender procedure, an award procedure which allows every interested tenderer to submit an offer, is deemed apt for this purpose. The restricted procedure, i.e. a procedure whereby every interested tenderer can submit his candidacy to submit an offer but only a limited number of them is actually invited to submit an offer, may be acceptable. This would only be the case if such procedure is applied for a valid reason. On the other hand, the competitive dialogue procedure and the negotiated procedure with prior publication are deemed problematic as they confer a large degree of discretion to the public purchaser. Hence, only in exceptional cases these procedures are satisfactory from a state aid law point of view. The negotiated procedure without prior publication is deemed to be inappropriate to ensure best value for money.[223]

In that same Communication, the Commission also clarifies how a public purchaser can deploy award criteria[224] without impeding the efficiency of the contract. When "lowest price" is the only award criterion, no problems arise. When also other criteria are applied, those criteria should be closely linked to the subject-matter of the contract. In that, they should assure competition to minimise the advantage for the chosen tenderer. It is also mentioned that the risk of overcompensation can be minimised through claw-back mechanisms.[225]

Lastly, if it is not feasible to assure sufficiently open and genuine competition (e.g. because of intellectual property rights or property rights as to infrastructure) or when the public purchaser

[221] J L Buendia Sierra, *l.c.*, 210.
[222] Cf. supra.
[223] Altmark Communication, par. 66.
[224] These are in fact the 'scoring rules'.
[225] Altmark Communication, par. 67.

receives only one bid, organising an award procedure, no matter what type, does not assure absence of an advantage.[226]

It follows from the foregoing that a procurement procedure should comply with certain 'quality requirements'. If not, the compensation for providing a SGEIs may entail an advantage as envisaged in article 107 (1) TFEU when. Also previous Commission decision practice goes along these lines. An example of how the Commission applied these principles in a state aid investigation, even before the Altmark Communication, is a decision regarding the compensation for an obligation to secure electricity supply. This was deemed to constitute a SGEI. The Commission sketched its mission in this respect as follows:

> "*In the present context the Commission has to verify whether the characteristics of the procurement procedure at stake are such as to actually "allow for the selection of the tenderer capable of providing those services at the least cost to the community". This is a material analysis which is different and goes beyond the mere respect of the applicable public procurement rules*[227].

Hence, also this Commission decision indicates that in order to assure state aid compliance, merely conducting a public procurement procedure is not sufficient. Such procedure should be able to guarantee efficiency, and thus meet certain 'quality requirements'.[228] It follows that, for instance, even if public procurement regulation allows applying a negotiated procedure without prior advertisement, the public contract which was the subject of this procedure does not automatically lack an advantage in the meaning of article 107 (1) TFEU.[229] Quite the contrary, in the framework of the financing of SGEIs EU state aid law seems to have a standard of its own to which award procedures have to comply. Three considerations, which give substance to

[226]Altmark Communication, par. 68.
[227]State aid N 475/2003 – Ireland. Public Service Obligation in respect of new electricity generation capacity for security of supply, C(2003)4488fin, 16 December 2003, par. 58.
[228]M Klasse, 'The Impact of Altmark: the European Commission Case Law Response' in E Szyszczak and J W. van de Gronden (eds.), *Financing Services of General Economic Interest: Reform and Modernization and SGEI*, (Asser, 2013), 47; T M Rusche and S Schmidt, 'The post Altmark Era Has Started: 15 Months of Application of Regulation (EC) No. 1370/2007 to Public Transport Services' (2011) 2 *European State Aid Law Quarterly* 249, 257.
[229] This issue was also raised by Baistrocchi, albeit in a slightly different context. P A Baistrocchi, 'Can the award of a public contract be deemed to constitute state aid?' (2003) 24 *European Competition Law Review* 510, 517.

such state aid law standard as to award procedures, were decisive in the Commission's reasoning when establishing that no state aid was present:[230] (1) the public entity did not have a margin of discretion when deciding which supplier could perform the service[231], (2) the notice was widely published, both at a national and at a European level, so that all possibly interested undertakings were informed and were able to participate in the procedure[232] and (3) both the selection phase as the award phase were conducted on the basis of transparent, objective and ex ante established criteria, without a possibility for the public entity to negotiate and without leaving it any margin of discretion.[233]

Based on the previous discussion, we can establish a number of EU state aid law requirements vis-à-vis procurement procedures for the public contract as to the provision of SGEIs not to entail an 'advantage'. We distinguish the following requirements: (i) ensuring the widest possible participation, (ii) applying award criteria that are relevant in view of the subject-matter of the contract, (iii) not leaving discretion for the public purchaser, (iv) publishing the intention to award a public contract so as to inform the market about the procurement procedure, (v) informing actual and potential participants so they can participate effectively and (vi) assuring an objective and transparent procedure.

Obviously, as these requirements are put to public procurement procedures, public procurement regulation should reflect them. Therefore we suggest regrouping these requirements in a set of principles public procurement regulation should comply with in order to rule out an 'advantage'. We already discussed the structure we suggest in this respect.[234] Our suggestion is to regroup these requirements based on three categories: (i) requirements to create 'competition', (ii) requirements to create 'genuine competition' and (iii) requirements to create 'fair competition'.

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[230] Admittedly, in the literature it has been noted that the Commision's approach changed over time, tending towards a more flexible approach implying that merely complying with EU public procurement law equaled EU state aid law compliance. A Sanchez Graells, 'The Commission's Modernisation Agenda for Procurement' in E Szyszczak and J W van de Gronden (eds.), *Financing Services of General Economic Interest: Reform and Modernization and SGEI*, (Asser, 2013), 166. Nevertheless, the approach discussed is currently reflected in the Altmark Communication, thus suggesting a return to the more strict approach.

[231] State aid N 475/2003 – Ireland. Public Service Obligation in respect of new electricity generation capacity for security of supply, C(2003)4488fin, 16 December 2003, par. 59.

[232] *Ibid.*, par. 60. The European Commission also indicated that the fact that bidders from other countries were attracted, was to be considered as being a positive element.

[233] *Ibid.*, 61-62.

[234] Cf. supra.

First, in order to create 'competition', public procurement regulation should provide that the public purchaser informs the market about the organizing of the procurement procedure and its modalities and specificities. Secondly, in order to create 'genuine competition', public purchasers should disclose all the information necessary for tenderers to prepare and submit a competitive bid (and thus to participate effectively). Thirdly, in order to create 'fair competition', the public purchaser should apply relevant award criteria, conduct the procedure objectively and transparently and hold no discretion when assessing the bid and awarding the public contract.

b. EU state aid law compliant privatisations

The second area of EU state aid law we deem instructive concerns the treatment of privatisations under this body of law. More in particular, it is important for our analysis to examine how to avoid state aid when entering into such transactions. This regime is all the more relevant because in the *PPP London Underground* decision, which related to a public purchasing contract, the Commission referred to this regime when analysing whether or not the PPP contract entailed state aid.

In principle, a privatisation should take place at a market price. The GC defined 'market price' in the context of a privatisation as follows: "the market price of an undertaking, which generally depends on the interplay of supply and demand, corresponds to the highest price that a private investor operating in normal competitive conditions would be prepared to pay for that undertaking".[235] The Commission has set out the principles to establish such a market price in the Commission's XXIII Report on Competition Policy,[236] accompanied by a Commission Staff Working Paper.[237] Instructive for our analysis is that the Commission deems no advantage to

[235]Joined Cases T-268/08 and T-281/08, Bank Burgenland, ECLI:EU:T:2012:90, 69 (this was not contradicted by the ECJ on appeal, Joined Case C-214/12 P, C-215/12 P and C-223/12 P, Land Burgenland, ECLI:EU:C:2013:682, 64).
[236]XXIIIrd Report on Competition Policy. 1993, Office for Official Publications of the European Communities, 1994.
[237]Commission Staff Working Paper. Guidance Paper on state aid-compliant financing, restructuring and privatisation of State-owned enterprises, 10 February 2012, SWD(2012) 14 final (hereinafter the "Working Paper").

be present if the privatisation contract is entered into pursuant to a competitive bidding procedure. However, this bidding procedure should comply with a number of requirements.

First, the procedure must be competitive and open to all interested parties. Commission decision practice demonstrates that competition may not be rendered merely virtual because of contacts with potential bidders before the actual initiation of the bidding procedure. This would impede the equality amongst the bidders, which is (as we will discuss further on) a general requirement in case of such a procedure.[238]

Also, this procedure must be conducted transparently and unconditionally. According to the Working Paper, the former requires in essence that all interested parties must be aware (at least potentially) about the intended sale, so they are able to participate in the bidding procedure.[239] The latter means that the sale should not be subject to conditions alien to the sale. Examples are the requirement to acquire assets other than the ones involved or to continue the operation of certain businesses. The Working Paper clarifies that this also implies that every interested buyer must have the chance to participate in the procedure and have a fair chance of winning, regardless of his activities or intentions. The underpinning idea is that participation to the bidding procedure should not be artificially restricted.[240]

In addition to that, those bidders must be awarded sufficient time and information to carry out a proper valuation of the assets which is the basis for their bid. Furthermore, the public seller should sell to the highest bidder.

These guidelines mention also two events[241] that render notification in the framework of EU state aid law necessary. This is because the behaviour on the part of the public seller concerned may imply an advantage. The first event concerns privatisations pursuant to negotiations either with one single prospective purchaser or with a number of selected bidders. We already

[238]Commission Decision 2008/717/EC of 27 February 2008 on State aid C 46/07 (ex NN 59/07) implemented by Romania for Automobile Craiova, *OJ* L 239, 6 September 2008, 12-25, para. 69.
[239]Working Paper, p. 11-12.
[240]Working Paper, p. 11.
[241]We deem the two other situations mentioned not relevant for our analysis. They are the following: (i) a privatisation preceded by the writing-off of debt by the Member State, other public enterprises or any public body and (ii) a privatisation preceded by the conversion of debt into equity or capital increases.

mentioned that participation should be as wide as possible in order to create a genuine competition amongst bidders for the risk of an 'advantage' to be absent. Conducting such negotiations do not fit within this requirement. The second event concerns a privatisation at conditions that are not customary in comparable transactions between private parties. This relates to the requirement of an unconditional procedure which we discussed above. Such conditions which are alien to normal market transactions put the market-like character of the transaction into question. However, the Commission can still establish that no advantage as envisaged in article 107 (1) TFEU is present if these events occur. The *Centrale del Latte* decision illustrates this.[242] Here, the bidding procedure did not meet the standards of an open, unconditional and transparent bidding procedure. Yet, the Commission established that the price paid was sufficiently high to establish that the price was not below the market price, even though the sale was not unconditional.[243] The same could be argued to be true vis-à-vis public contracts. If public procurement regulation was not complied with but the price the public purchaser paid still reflects a market price or it is below a normal market price, no advantage is present.[244] Another example, is a decision in which the Commission established that a special condition which required the seller to lease out part of the assets purchased did not affect the market-like character of the price.[245] [246]

Also, the Commission stated that a selling Member State may not discriminate on the basis of nationality.[247] The idea underpinning this requirement is that the Member State may not exclude

[242]Also Commission practice as to state aid through privatisation transaction was relied upon to assess whether the PPP arrangement in the London Underground project implied state aid. State aid No N 264/2002 – United Kingdom. London Underground Public Private Partnership, C(2002)3578fin , 2 October 2002, par. 78.
[243]Commission Decision 2000/628/EC of 11 April 2000 on the aid granted by Italy to Centrale del Latte di Roma, OJ L 265, 19 October 2000, 1-28, par. 91.
[244]This also is in line with the point we made earlier as the 'external dimension' of relationships EU state aid law is concerned with. EU state aid law is only concerned with the avoidance of the negative externality it wishes to tackle while being indifferent as to the 'internal dimension' of a transaction. In the examples, the 'internal dimension' would be the relationship between the selling Member States and the interested buyers.
[245]Staatliche Beihilfe N 804/2000 – Deutschland. Veräußerung von Geschäftsanteilen des Landes Berlin an der GSG, 20 June 2001, SG(2001) D/ 289319, p. 4
[246] Based upon these decisions, one may argue that even though public procurement regulation does not take into account the negative externalities it produces (thus possibly resulting in the conferral of an advantage in the meaning of article 107 (1) TFEU), further examination may point out that the negative externalities we envisage do not occur. Even if this were true, still there is a problem of enforcement costs. If public procurement regulation is not able to assure *ex ante* absence of the negative externality, this has to be examined in the framework of EU state aid control. This implies costs, which could be avoided though ensuring that public procurement regulation rules out the existence of state aid in the first place. We will further elaborate this point below (cf. infra).
[247] Working Paper, p. 12.

potential buyers from the bidding procedure. This would impede the establishing of the market value because this distorts the competitive process.[248]

Based on the foregoing, we can establish absence of an advantage when the following requirements are met: (i) the public seller does not engage in anti-competitive behaviour which would jeopardise competitive dynamics, (ii) the procedure is unconditional (iii) the intended sale is published widely so as to attract as much potential buyers as possible, (iv) the potential and actual candidates have the necessary information to prepare and submit a competitive bid and (v) the public seller refrains from behaviour which would restrict participation.

As we did when discussing compensations for SGEIs, also here we suggest to regroup these requirement based on the three notions we already discussed.[249] First, in order to create 'competition', privatisation regulation should compel the public seller to inform the market about the intended sale. Secondly, in order to create 'genuine competition', privatisation regulation should ensure that the actual and potential bidders have all the information necessary to prepare and submit a competitive bid. Thirdly, in order to create 'fair competition', participation to the procedure should be unconditional, the sale conditions should not be comparable to the ones in a similar transaction in the market and the public seller should refrain both from behaviour which restricts participation and from anti-competitive behaviour.

The foregoing conclusion is also confirmed by the fact that the XXIII Report on Competition Policy mentions another preferred method to conduct a privatisation transaction, i.e. a sale through the stock exchange. The idea behind this is that the stock-exchange market ensures openness, transparency and objectivity. This is because the stock market is subject to specific regulation and control mechanisms to that effect.[250]

c. EU state aid law compliant public purchase contracts

[248]D Grespan and S Santamato, 'Favouring certain undertakings or the production of certain goods: Advantage' in W Mederer, N Pesaresi and M Van Hoof, *Volume VI – State Aid (Book I)*, (Claeys & Casteels 2008), 336.
[249] Cf. supra.
[250] D Grespan and S Santamato, *l.c.*, 336.

As we will discuss further on, most Commission decisions merely refer to the need to conduct an open, transparent and objective award procedure so as to avoid the conferral of an advantage as envisaged in article 107 (1) TFEU through a public contract. EU public procurement law compliance is thus often considered to be sufficient in this respect. Hence, it seems safe to say that a public purchaser is assumed to purchase works, goods and/or services at a market price if to that end it organizes an award procedure compliant to public procurement regulation.[251] The Commission indeed developed such reasoning in its decision practice. For instance, in the *Welsh Public Sector Network Scheme* decision, the Commission stated that a service supplier did not benefit from an economic advantage he would not have obtained under normal market conditions since the supplier was chosen pursuant to a public procurement procedure.[252] The *Prague Municipal Wireless Network*-decision reflects a similar reasoning.[253]

The GC's ruling in *P & O* seems to go along the same lines. The GC held that organising a sufficiently advertised open tender procedure is, normally, sufficient to rule out the presence of an advantage.[254] The GC referred to two Commission documents. The first is the *Community framework for state aid for research and development*.[255] Here, the Commission held that when contracts regarding the commissioning of R&D "are awarded according to market conditions, in particular after an open tender procedure in accordance with Council Directive 92/50/EEC" absence of an advantage can be presumed.[256] Another document the GC referred to was the *Community guidelines on State aid to maritime transport*.[257] According to this document, providers of public service obligations should be appointed pursuant to an open tender procedure which allows for genuine competition. To this effect, the call for tenders should be

[251] See also P A Baistrocchi, *l.c.*, 517.
[252] State Aid N 46/2007 – United Kingdom. Welsh Public Sector Network Scheme, C(2007) 2212 final, 30 May 2007. It must be remarked that this decision concerned a competitive dialogue procedure. Pursuant to the draft notice on the notion of "state aid", such procedure cannot be deemed to guarantee a market price without more. This is because of the large degree of discretion on behalf of the public purchaser. See: Communication from the Commission. Draft Notice on the Notion of State Aid pursuant to article 107 (1) TFEU, http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf (hereinafter "Draft Notice on the Notion of State Aid) , par. 91-99.
[253] State Aid NN 24/2007 – Czech Republic. Prague Municipal Wireless Network, 30 May 2007, C(2007)2200, par. 29.
[254] Joined cases T-116/01 and T-118/01, P & O European Ferries and others / Commission, [2003] II-2957, 112.
[255] *OJ* C 45, 17 February 1996, 5-16.
[256] *Ibid.*, point. 2.5.
[257] *OJ* C 205, 5 July 1997, 5-15.

adequately advertised and all relevant elements should be disclosed in order to provide potentially interested undertakings with an equal chance to win the contract.[258]

In the *PPP London Underground* decision, the Commission made a more elaborate assessment. It examined whether the public procurement regime applied – which was in line with EU public procurement law – was apt to ensure that no advantage was granted. The public purchaser applied a negotiated procedure, based upon the directive on utilities procurement (which is in general more lenient compared to the directives as to procurement in the classical sectors).[259] The public purchaser selected a number of bidders based on a tender procedure. Subsequently, the public purchaser negotiated with the selected bidders. In the course of the negotiations, the public purchaser modified the tender documents. The question arose whether this behaviour gave rise to a possible state aid grant. The Commission examined both the selection of the bidder and the impact of the modifications in the course of the award procedure in view of the question whether this procedure gave rise to an advantage of the chosen tenderer.

As to the choice of the bidders, the Commission established three facts which resulted in the finding that the public purchaser conducted an EU state aid law compliant selection procedure. First, the choice for a negotiated procedure was in line with EU public procurement law. Secondly, before actually inviting interested tenderers to submit an offer, the public purchaser published several 'indicative notices', thereby (i) informing potentially interested undertakings that a call for tenders was about to be issued and (ii) communicating particularities of the project as well as requirements to which potential partners would be subject. The purpose of these 'indicative notices' was ensuring that the market players had as much time as possible at their disposal to prepare for participation. Thirdly, the selection methodology allowed for a fair and consistent appraisal of the bids and guaranteed that the best bidders were chosen to conduct negotiations with.[260]

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[258] *Ibid.*, title 9. The fact that the GC linked the EU state aid regime as to the financing of public services with the regime as to public contracts confirms that our discussion above of the regime as to SGEIs is relevant for our analysis.

[259] Currently, utilities procurement is covered by Directive 2014/25/EU of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC, *OJ* L 94, 28 March 2014, 243.

[260] State aid No N 264/2002 – United Kingdom. London Underground Public Private Partnership, C(2002)3578fin , 2 October 2002, par. 82-85.

Next, the Commission looked into the impact of the modifications of the tender documents applied in the course of the procurement process. For four reasons, the Commission deemed the modifications not to give rise to an advantage to the benefit of the chosen tenderer. In the first place, the Commission did not identify an issue as to non-discrimination and equal treatment. It noted that such modifications were applied pursuant to provisions in the tender documents. These provisions allowed for modifications of the tender documents if such would become necessary due to external circumstances or changed views as to technical aspects. The possibility of applying modifications was communicated in advance to the tenderers and was applied in an objective manner. Furthermore, the Commission established that the modifications did not alter the scope and characteristics of the project. It was rather a logical step in the course of a project like the one at hand. Secondly, the Commission established that the modifications would not have had an impact on the bids of the tenderers which were not selected to conduct negotiations with should they have been selected. Thirdly, no other tenderers would have participated in the tender procedure if the modifications would already have been incorporated in the initial tender documents. Fourthly, the Commission established that even after applying the modifications, the chosen tenderers' bids were still the best ones in terms of best value for money. To establish this, the bids of the non-chosen tenderers were virtually modified, in line with the modifications, and those bids were compared to the bids of the selected tenderers.[261]

Another relevant case in this respect, is the *Antwerp PPP* decision. In this decision, the Commission held that the terms of a public-private partnership could entail an advantage, even though the relevant public procurement regulation was complied with. This was because the private partner was chosen pursuant to procedure that left discretion to the public purchaser. More in particular, the selection criteria were not preliminary established. Nevertheless, the Commission decided that the procedure allowed for sufficient competition and that the most competitive bid was chosen.[262]

[261] State aid No N 264/2002 – United Kingdom. London Underground Public Private Partnership, C(2002)3578fin , 2 October 2002, par. 86-92.
[262] Aide d'État n° N 355/2004 – Belgique. Partenariat public-privé pour la mise sous tunnel de la Krijgsbaan à Deurne et la mise en valeur de terrains industriels et l'exploitation de l'aéroport d'Anvers (projet de PPP – aéroport d'Anvers), C(2005)1157 fin, 20 May 2005, 41-42.

Also other documents prove to be relevant for our analysis, i.e. the Draft Notice on the Notion of State Aid and the subsequent Notice on the Notion of State Aid. Above we discussed the Altmark Communication and other sources in the context of the financing of SGEIs. We deem this document to be relevant as well here. The Commission copied to a large extent the requirements laid down in the Altmark Communication to apply them also to the general notion of "advantage" in its Draft Notice on the Notion of State Aid. This draft notice provides that a tender procedure should comply with the following requirements: (i) open[263], (ii) transparent, (iii) sufficiently well-published, (iv) non-discriminatory and (v) unconditional.[264] Even though the Commission did not withhold in the final Notice on the Notion of State Aid all considerations formulated in the Draft Notice on the Notion of State Aid, we nonetheless deem both documents relevant to provide guidance as to the views the Commission retains in this respect.

A procedure is 'open' (or 'competitive') if all interested parties are allowed to participate. In that respect, an open tender procedure is apt to produce a market price. A restricted procedure can be allowed, but only if that procedure is applied for valid reasons. As to the competitive dialogue and the negotiated procedures, the Commission adopts the same position in the Draft Notice on the Notion of State Aid as in the Altmark Communication.[265] Admittedly, the Notice on the Notion of State Aid formulates this less strictly.[266] Nevertheless, given the previous Commission's decision practice[267] and the stance adopted in the Altmark Communication,[268] we still believe the Draft Notice on the Notion of State Aid to provide for a relevant indication of the Commission's point of view in this respect.

The transparency requirement refers to the prerequisite that all interested tenderers are equally and adequately informed at each stage of the tender procedure. This involves that they can access the relevant information, have sufficient time and that selection and award criteria are

[263] In the Notice, the Commission employs the notion 'competitive'. However, the Commission clarified in footnote 146 that this notion has the same meaning as 'open'.
[264] Draft Notice on the Notion of State Aid, para. 91; Notice on the Notion of State Aid, par. 89
[265] Draft Notice on the Notion of State Aid, par. 93, Notice on the Notion of State Aid, par. 90.
[266] Notice on the Notion of State Aid, par. 93.
[267] Cf. supra.
[268] Cf. supra.

clear.[269] Also, all potentially interested tenderers should be informed about the tender procedure. Therefore, a contract notice should be widely published.[270]

Furthermore, tenderers should be treated equally and non-discriminatorily. Likewise, the contract should be awarded on the basis of objective selection and award criteria. Those criteria should be disclosed in advance.[271] This avoids discretion on the part of the public purchaser. Also, the award criteria should allow for an objective comparison and assessment of the bids submitted.[272]

Lastly, the requirement that the purchase[273] is unconditional intends to avoid exclusion of a potential tenderer based on his particular features. 'Unconditionally' requires that no special obligations to the benefit of the public purchaser or in the general public interest, i.e. other obligations than those that result from national law, interfere in the procurement process and the award of the public contract.[274]

The previous discussion allows us to conclude that when awarding public contracts, the regulation the public purchaser is subject to while purchasing, should comply with the following requirements in order to avoid the conferral of an advantage: (i) ensuring the widest participation possible, (ii) providing the actual and potential tenderers with the information to prepare and submit a competitive bid, (iii) inform the market about the intention to organise a public procurement procedure, (iv) ensuring objectivity as to the participation by interested parties as well as to the assessment of the offers, (v) abstaining from introducing conditions which are irrelevant in view of the subject-matter are applied and (vi) avoiding discretion on behalf of the public purchaser.

[269] Notice on the Notion of State Aid, par. 91.
[270] Draft Notice on the Notion of State Aid, par. 94; Notice on the Notion of State Aid 91.
[271] This also follows from the discussion of the Commission approach in the framework of the financing of SGEIs (cf. supra).
[272] Draft Notice on the Notion of State Aid, par. 95; Notice on the Notion of State Aid, par. 92.
[273] The relevant paragraph mentions only sale transactions. However, as this paragraph is inserted in the part dealing with both sale and purchase contracts, we deem this to apply also to purchase contracts.
[274] Draft Notice, para. 96; Notice on the Notion of State Aid, par. 94.

We can map these requirements as well on the basis of the structure we discussed earlier.[275] First, in order to create 'competition', public procurement regulation should provide that the public purchaser has to inform the market about the upcoming procurement procedure and its modalities and specificities.

Secondly, in order to create 'genuine competition', public procurement regulation should subject the public purchaser to an obligation to fully inform the potential and actual tenderers. This is to enable them to compete effectively and thus to prepare and submit a competitive bid.

Thirdly, in order to create 'fair competition', public procurement regulation should provide that the public purchaser may not restrict participation. By the same token, such regulation should ensure that, as to participation by tenderers and assessment of the offers, the public purchaser should act objectively. Also, public procurement regulation should guarantee that the tender documents do not contain conditions that are alien to the conditions an economically rational private purchaser would have applied and that the public purchaser does not hold discretionary power when assessing the bids and deciding upon the award of the public contract.

d. The standards for 'enriching' EU public procurement regulations

Having established what the criteria are, according to EU state aid law, a tender or bidding procedure should comply with in order to avoid the conferral of an advantage, we can now construct our 'standard for enriching'.

This standard is thus based on the principles that ensure that the negative externalities EU state aid law wishes to avoid, do not occur. These negative externalities, so we argued, are not addressed in public procurement regulation. We already argued that such negative externalities, in fact converging with the 'advantage' in the meaning of article 107 (1) TFEU, of no direct concern in public procurement regulation.

[275] Cf. supra.

We submit that the following principles should be the bedrock of our 'enriching' effort. First, public procurement regulation should ensure ‘competition’. To this end, this body of regulation should assure that the intention to award a public contract, and to organize a public procurement procedure to that effect, is adequately published. This is to inform the market about the organisation of the procurement procedure to the maximal extent. Obviously, merely informing the market about the upcoming purchasing procedure is not sufficient. The information should also be ‘useful’. More in particular, it should allow potential tenderers to assess whether or not to participate in the procurement procedure and to preliminary assess their chances to win. Unsatisfactory information dispersion is to be perceived as a barrier to entry, and therefore to be avoided.

Secondly, public procurement regulation should ensure ‘genuine competition’ on the public market which is created, i.e. by ensuring that competition is of high quality. To that end, the participants have to have full and equal knowledge about the public purchaser’s needs. Equal and full information tackles two problems of information asymmetry. In the first place, there is an issue of ‘vertical’ information asymmetry, i.e. between the tenderers on the one hand and the public purchaser on the other hand. Tenderers should have full information about the public purchaser’s needs so they can allocate their resources optimally in view of the subject-matter of the public contract to be awarded. This allows for competition on the merits.[276] Moreover, such equal and full information allows comparability of the bids submitted. Therefore, such information dispersion contributes to the quality of the assessment the public purchaser makes when evaluating the bids.

[276] Goeree and Offerman discuss the importance of information distribution by an auctioneer in order for him to decrease uncertainty among the bidders, which in turn increases his revenues. Authors argue that in auctions with both a private value component (the value of this component is individual to each bidder) and a common value component (this component has the same value to all bidders), uncertainty about the common value component implies inefficiencies which will increase in correlation with the extent of the uncertainty. The authors explain this by referring to the bidders’ intention to avoid the ‘winner’s curse’: in case of uncertainty about the common value, bidders are bidding more cautiously and thus less aggressively. It follows that with a minimal degree of uncertainty bidders bid aggressively implying higher revenue for the auctioneer. (K Goeree and T Offerman, ‘Competitive Bidding in Auctions with Private and Common Values’, Tinbergen Institute Discussion Paper, TI 2000-044/1, 1999, 2-3). This discussion is also relevant to our analysis. In a public procurement procedure, the public purchaser wishes to award a contract which has a certain value for the party performing the contract. Hence, even though the tenderers have their own expectations about the costs they will incur (a private value component), they should in theory share the same expectations about the contract value (a common value component). However, if the public purchaser does not reveal all information about the contract’s subject-matter, tenderers are confronted with uncertainty about this common value component. They will bid less aggressively, and the chosen tenderer will submit a bid with a higher price than in the event of full information disclosure.

The second issue concerns 'horizontal' information asymmetry, i.e. information asymmetry among the tenderers. If the knowledge about the public purchaser's needs is not 'equal', and tenderers compete based upon different information or different interpretations of the available information, the bids are not comparable. Hence, the bids of the tenderers do not actually compete. Even more concerns arise if one or more tenderers hold specific information while this information is decisive to win the contract (e.g. because of previous contractual relationships). The tenderer holding this information can use this information strategically and act opportunistically. This requirement of 'equal information' relates closely to the requirement of 'full information'. After all, incomplete information puts comparability of the bids and the equality amongst tenderers into jeopardy.[277]

Thirdly, public procurement should ensure 'fair competition'. This requires the public purchaser to abstain from behaviour which undermines the competitive dynamics on the public market that has been created. Hence, the public purchaser should not engage in anti-competitive behaviour (such as collusion with one tenderer) nor in discriminatory behaviour. Also, the conditions in the tender documents, and eventually the public contract, should not go against economic rationality (i.e. containing provisions or requirements that are alien to the subject of the contract or which are not market-like). In addition, when conducting the procurement procedure and awarding the contract, the public purchaser should act objectively and without exercising discretion. As to the latter, we argued in the previous paragraph that such discretion is limited if the public purchaser is under an obligation to provide the actual and potential tenderers with full information. This in essence implies the following: the information in the tender documents or the notice should be of such nature that the tenderers can assess which conditions they should fulfil to win the contract.

Now, why is this standard helpful? As we mentioned before, we believe that the negative externalities we intend to address converge with the notion of 'advantage' in EU state aid law. Compliance with the above-mentioned principles ensures that a contract entered into by a

[277] The issue of 'full information', even though initially affecting competition between the tenderers, also closely relates to the problem of 'fair competition'. Full information does not only affect the competition between tenderers, it also implies that the public purchaser's margin of discretion is limited leaving no scope for 'unfair' behaviour on the part of the public purchaser. Hence, 'full information' falls equally within the third category regarding 'fair competition'.

Member State (or: a public purchaser) does not give rise to the granting of an advantage (or: our negative externalities). Hence, compliance with these requirements will neither give rise to our negative externalities.

Earlier we argued that the prevailing conceptions of public procurement regulation are concerned with the internal dimension to public purchasing, i.e. governing the relationship of the public purchaser with the actual and potential tenderers. We argued that guaranteeing competition was an important element in that respect, but not an exclusive one as it is traded off with other concerns. Hence, competition cannot produce fully the outcome it would normally produce. This results in supra-competitive prices. This affects markets outside the public market at hand. The chosen tenderer may be in a position to build up and/or exercise market power on those other markets due to cross-subsidisation. Public procurement regulation does however not take this external dimension into consideration. This is why this 'standard for enrichment' is valuable: it allows public procurement regulation to also take the external effects of the activity it regulates into account.

Obviously there is an overlap in some respects. Public procurement regulation will generally provide for a publication obligation,[278] for an obligation to treat tenderers equally and objectively,[279] for a prohibition to collude with tenderers,[280] and so on. Nevertheless, we believe that our 'standard for enriching' – to be applied when drafting or interpreting public procurement regulation – can contribute to avoid the negative externalities the act of public purchasing may produce and which we discussed in chapter 1. In part II of this thesis we demonstrate this by means of applying our standard to a number of specific topics within public procurement regulation. We will apply this 'standard for enriching' to three important aspects of public procurement regulation which we deem to be 'vulnerable'. By this, we mean that they are likely to be a source of the negative externalities we envisage to tackle. This is because they have an important impact on both the degree and the quality of the competition for the public contract. These three aspects are the following: (i) the disclosure obligation as to award criteria, (ii) modifications to the public contract in the course of its performance and (iii) pursuing secondary policies through the use of award criteria and technical specifications.

[278] See e.g. art. 35 et subs. of Directive 2004/18 and art. 48 et subs. of Directive 2014/14.
[279] See e.g. art. 2 of Directive 2004/18 and art. 18 of Directive 2014/14.
[280] See e.g. par. 8 of the preamble to Directive 2004/18 and art. 40 of Directive 2014/14.

Admittedly, also other elements of public procurement regulation are able to affect competition. For instance, failure to publish a notice,[281] applying too strict selection criteria and imposing too short deadlines for submitting a bid or candidacy may reduce the number of participants to the award procedure. This would be contrary to the first limb of our 'standard for enrichment'. Also, the public purchaser may apply discriminatory requirements as to the contract's subject matter (e.g. a strict certification requirement) or as to contract performance (e.g. discriminatory penalties for late performance). The latter would be contrary to the first and second limb of our 'standard for enrichment'. Of course, our negative externalities may also arise in the context of these aspects of public purchasing. We see however one important difference with the elements we select for further analysis. Contrary to the selected elements, these do not concern the actual competition for the public contract as such. They pave the way to the competition arena. Once in this arena, direct interaction between the public purchaser and the tenderers takes place, and this interaction allows to establish the price. However, as to the other elements mentioned, no direct interaction takes place. These elements are of a regulatory nature: the public purchaser provides for the 'rules of the game', such as: the conditions to participate (selection criteria), the delays to comply with, the limits to comply with when performing the contract. It follows that the 'vulnerability' of the public purchaser is limited (although not absent) here. He is not interacting with another party when establishing these 'rules of the game'. In the competition arena, however, he relies on interaction with the tenderers to establish the contract terms. Without however minimising the importance of these aspects with regard to ensuring competition, in our view, this justifies our selection of aspects of public purchasing to be further examined in part II.

C. CONCLUSION

The purpose of this chapter was twofold. First we intended to identify a body of law that could serve as a source of inspiration for the construction of our 'standard for enriching. We argued that EU state aid law provides for such source of inspiration. This is because of three reasons. First, the negative externalities we envisage, converge with the notion of 'advantage'. This

[281] However, the publication requirement is an element which will be further addressed in part II, i.e. when discussing the disclosure obligation as to award criteria and their belongings.

notion is central to the state aid prohibition in EU law. Another reason is that our 'standard for enriching' pursues the same ends as the ones EU state aid law pursues. Lastly, we believe that the economic *rationale* underpinning our 'standard for enriching' converges to a large extent with the economic *rationale* underpinning EU state aid law.

Secondly we constructed our 'standard for enriching'. This standard constitutes the basis to strengthen public procurement regulation so as to avoid its tendency to produce the negative externalities we identified in chapter 1. To that end, we examined a number of areas where EU state aid law is applied to an economic transaction involving competitive bidding. Next to the EU state aid law regime as to public purchase contracts, we also looked into its regime as to the appointment of SGEIs providers and as to privatization transactions. We identified a three layered requirement of competition for such transactions not to be in breach with the state aid prohibition. Applied to public purchasing, these requirements can be formulated as follows. First, the public purchaser should organize 'competition' by adequately informing the market about the intention to award a contract and about the modalities and specificities of the public market. Secondly, the public purchaser should organize 'genuine competition' by providing equal and full information to the tenderers. This should allow them to compete on an equal footing while having a clear idea about the needs the public purchaser wants to have addressed. This allows the tenderers to allocate their resources efficiently, resulting in high quality competition. Also, this should improve the quality of the public purchaser's assessment when scoring the bids, as this favours comparability of the bids. Thirdly, the public purchaser should ensure 'fair competition'. He should abstain from discriminating behaviour and anti-competitive behaviour. This undermines the competitive dynamics between the tenderers. He should also assess the bids and award the contract in an objective and transparent manner. In this respect, the public purchaser's discretion should be curtailed. Moreover, he should not base his purchasing decision on considerations which are alien to the contract and that runs counter to economic rational behaviour.

5. CHAPTER 4. WHY THE REGULATORY RESPONSE OF 'ENRICHING'?

So far, we discussed the negative externalities we wish to tackle, why we should tackle them and how we should tackle them. The question in this chapter is: why should we tackle these negative externalities the way we suggest? *Pro memoria*: we suggested to apply a 'standard for enriching', based upon principles inspired by EU state aid law, when enacting (or interpreting or applying) public procurement regulation. But why such 'standard for enriching', which is in essence a regulatory response?

Indeed, what we suggest is a regulatory response, i.e. amending public procurement regulation in order for it to be apt to deal with the negative externalities we identified earlier. Hence, we adopt a normative (economic) approach.[282] Our aim in this thesis is to develop a 'standard for enriching' to which public procurement regulation should adhere. On the basis of this standard, we can suggest a way to amend public procurement regulation in such a way that the negative externalities will not occur anymore, or at least that the chance of occurring and their effects are minimised.

But what are the arguments to justify a regulatory response to the problem of negative externalities in public purchasing as subject to public procurement regulation? And what are the arguments for suggesting our 'standard for enriching', which is essentially an *ex ante* regulatory intervention, as a solution? These questions are dealt with in this chapter.

A. THE SUGGESTION OF A REGULATORY RESPONSE

The basic idea underpinning our quest for 'enriched public procurement regulation' is to remedy a market failure: the way public procurement regulation is conceived may give rise to a negative externality which distorts the well-functioning of the markets outside the specific market for the public contract at hand. After all, the negative externalities potentially give rise

[282] Cf. C Veljanovski, 'Chapter 2. Economic Approaches to Regulation' in R Baldwin, M Cave and M Lodge, *The Oxford Handbook of Regulation*, (Oxford University Press, 2010), 19-21.

to the building up of market power, or exercise of such market power, through cross-subsidisation.

But why do we need such a regulatory response? Why is it unfeasible to leave it to the market to take care of this negative externality? We argue that Coase's work on the problem of negative externalities is helpful here. Coase's work provides for a basis to argue that a regulatory response is desirable and justified. Simply put, the argument goes as follows: public purchasing produces negative externalities vis-à-vis other markets, thus affecting competitors to the chosen tenderer; under zero transaction costs, the chosen tenderer and the aggrieved competitors would negotiate an efficient outcome (irrespective of the distribution of entitlements); this is however impossible due to transaction costs, so regulatory intervention aiming at neutralizing those negative externalities is required. In the next paragraphs, we will articulate this argument in a more formal way.

Coase developed his views as to negative externalities, and how to deal with them, in the framework of the allocation of radio frequency rights. The then relevant American regulation provided that licenses for the use of radio frequencies were allocated based upon an application by an interested party. A commission would decide whether or not to grant the frequency applied for. Such licenses were granted free of charge. Coase criticised this practice. Such allocation system implied that a successful applicant would obtain a licence which has a value to him and for which he would be willing to pay a price. In the absence of the requirement to pay for the licence, the successful applicant obtained an advantage he would not have obtained under normal market conditions.[283] A competitive bidding procedure would entice the applicant to offer a price which is equal to the value he attaches to it.

This reasoning also applies to public purchasing. Instead of merely awarding a contract to parties who express their interest to perform it, public procurement regulation compels the public purchaser to organize a competitive bidding procedure. This forces the interested parties to 'pay a price', in the sense that given the competitive environment they will have to let go of the rents they might have obtained in the absence of competition. After all, there is a lot of 'hidden information' in the market, including the amount of the rents the interested party would

[283]R H Coase, 'The Federal Communications Commission', (1959) 2 *Journal of Law* & Economics 1, 22.

obtain. A competitive process overcomes this issue of 'hidden information' as it reveals the actual market value of the contract.[284]

However, such relationship may produce negative external effects. Coase noted this as well in the context of the allocation of radio frequency rights. Establishing such rights may interfere with the interests of other parties. Suppose the radio frequency rights are assigned to one party. The use a party can make thereof may interfere with the activity of another party, e.g. by bothering the user of the adjacent radio frequency.[285] Coase's answer to this is that once the property rights are established, parties can negotiate. Through these negotiations, parties achieve an optimal use of the rights (and thus efficiency).[286] Hence, if the owner of a radio frequency licence can obtain more profit from operating that right compared to the harm inflicted on the party harmed, the owner of the licence will be willing to pay the party harmed. The amount will be somewhere between the amount of his profit and the amount of the harm. Conversely, if the harm outweighs the profits, the party harmed will have an incentive to pay the owner of the right an amount between the harm and the benefit in order to incite the owner to stop exercising his licence. This is also the message conveyed in Coase's paper "The Problem of Social Cost": forbidding party A to cause harm to party B will cause harm to party A; which party should be allowed to cause harm?[287]

Here we arrive at the externalities issue. Party A has a right to operate but when doing so he will inflict harm on party B. Hence, party A's behaviour will produce a negative externality. However, if parties negotiate and re-allocate their rights and achieve a situation which maximises the value of production – no matter whether one party is liable for the damages and no matter which party is liable, albeit that this might affect the reallocation of the rights – they will achieve an efficient outcome.[288]

This, however, presupposes that the pricing mechanism operates without costs. This is

[284]As we discussed earlier, Trepte considers a public procurement procedure to be a discovery procedure which allows the public purchaser to obtain the necessary information to enter into an efficient contract. P. Trepte, *o.c.*, 86.
[285]R H Coase (1959), *l.c.*, 26.
[286]R H Coase (1959), *l.c.*, 27.
[287]R H Coase, 'The Problem of Social Cost' (1960) 1 *Journal of Law & Economics* 1, 2.
[288] R H Coase (1960), *l.c.*, 2-15.

obviously often not the case. Correction of the allocation of rights through negotiations may not always be feasible (e.g. in case of a large number of affected parties). Also, negotiations may turn out to be very costly (e.g. because of information costs, contract drafting costs, monitoring and enforcement costs, …). The market may thus become too costly to operate.[289] This is where special regulation provides a solution.[290] Such regulation prescribes the desired behaviour, i.e. the behaviour that would have been adopted if the market would have operated properly.[291]

An example may clarify the foregoing discussion. Applying Coase's views as to negative externalities to a public procurement setting, one could bring up the point that the tenderer can negotiate with his competitor and "bribe" him. This would be feasible if the gains the successful tenderer receives are higher than the adverse competitive effects the competitor incurs. For instance, the contract was entered into at a price of 1,000,000 EUR whereas the market value would be 800,000 EUR. The 'gains' for the tenderer are thus 200,000 EUR. If the loss on behalf of the competitor, because the chosen tenderer uses these gains to build up or to exercise market power, would be less than 200,000, the tenderer would pay him an amount between 1 and 199,999 EUR. However, if the loss incurred by the competitor would exceed 200,000 EUR (let us assume 300,000 EUR), than the competitor would pay an amount between 200,001 EUR and 299,999 EUR to convince the tenderer to perform the contract at the market price.

Obviously, things are not as straightforward as that. Apart from legal concerns (as such behaviour is likely to qualify as collusion among tenderers) the negative externalities following from such a public contract may affect a huge number of players on various markets; the losses incurred by those competitors are very difficult (or even impossible) to compute; the competitors will need to monitor the commitments made by the tenderer. Hence, the transaction costs in the form of searching costs, information costs, drafting costs and enforcement costs would be enormous and negotiations would be practically impossible. All this advocates an intervention by the regulator.

[289] R H Coase (1959), *l.c.*, 29.
[290] R H Coase (1960), *l.c.*, 16.
[291] R H Coase (1959), *l.c.*, 29; R H Coase (1960), *l.c.*, 17.

How does the foregoing fit into the point we would like to make here? Public procurement regulation is a body of law which introduces an allocation mechanism as to public contracts. Hence, it structures the act of public purchasing. In doing so it ensures that a public purchaser enters into a contract with the party who turns out to be the most suitable candidate to perform the contact. However, the transaction also produces effects outside this circle of parties. We discussed this in chapter 1. There we demonstrated the feasibility that public contracts are entered into at supra-competitive prices. Such supra-competitive price represents negative externalities which affect markets outside the specific market for the public contract. After all, they allow the chosen tenderer to build up or exercise market power on those markets. This undermines the competitive dynamics on such other markets and thus implies a loss of social welfare. Still in accordance with Coase's reasoning, we believe that regulation has to remedy this situation as the market cannot produce an efficient (welfare maximising) outcome. As the negative externalities we envisage are the result of public procurement regulation, we argue regulatory intervention is necessary to remedy the flaws that exist in the current conceptions of public procurement regulation. We discussed these flaws in chapter 2. There we argued that public procurement regulation – no matter which conception is envisaged – is focused on the internal dimension of the purchasing process. This internal dimension is an arena where different concerns are balanced with each other. The balancing exercise has as a consequence that competition is not the exclusive objective. Henceforth, public procurement regulation cannot guarantee – neither directly, nor indirectly – that the contract is entered into at a competitive price (or: market equilibrium price). Hence, compliance with public procurement regulation does not assure absence of the negative externalities we identified – quite the contrary. Our 'standard for enriching' is intended to remedy this, or at least to contribute to remedying this. Hence, our 'standard for enriching' represents the 'special regulation' envisaged in Coase's analysis.

Which kind of regulatory intervention would be adequate to remedy the harm caused by the externality? According to Coase, the outcome should reflect what parties would have agreed upon in case negotiations would have been feasible.[292] One possibility is that the aggrieved competitors are compensated for their losses. Arguably, this solution gives rise to a number of problems: losses will probably only occur in the long run, the losses for the competitor can be

[292]R H Coase (1959), *l.c.*, 29.

enormous and difficult to compute (as the losses will go beyond the advantage embedded in the public contract), competitors are faced with problems when providing evidence, courts have to examine the claims and the evidence, and so on. Another possibility is that the contract is put out for tender again. Also here problems arise: parties incur additional transaction costs, the transaction is delayed giving rise to additional costs, and so on. It follows that *ex post* solutions are undesirable as they involve huge costs and practical issues. This advocates regulation that is able to deal with the negative externality *ex ante*.

The foregoing theoretical considerations favour the existence of public procurement regulation that is able to deal preventively with the negative externalities public purchasing is capable of producing. This supports our argument that an *ex ante* regime of 'enriched' public procurement regulation is the preferred way to deal with the negative externalities we identified.[293] We will further substantiate this claim in the sections to come.

B. THE SUGGESTION OF 'ENRICHING'

In the previous section we advocated a regulatory response in order to remedy a failure public markets produce because the market cannot solve this issue itself. The regulatory response we suggest consists of 'enriching' public procurement regulation through our 'standard for enriching'. This standard aims at remedying the consequences resulting from the imperfect competition for a public contract within a market for a public contract. Hence, by putting forward this standard, we envisage to bring in, into public procurement regulation, the concern to avoid the negative externalities affecting markets outside the specific market for the public contract.

In this section we will argue that this enriching exercise is to be preferred above other regulatory responses, such as regulation that works independently from public procurement regulation or *ex post* remedies to restore the market. We see three reasons for this. The first, tackling the counterargument that a regime working independently would suffice, is that 'enriching' public procurement allows for cost-efficient monitoring and enforcement. The second, concerned with

[293] Further on in this chapter, we will indeed argue that an *ex ante* remedy system is preferable over an *ex post* remedy system. In this respect, we will rely on scholarship on the "liability for harm versus regulation for safety debate".

the position in favour of *ex post* remedies, is that 'enriching' is to be preferred as 'enriched' public procurement regulation is more suitable to ensure effectiveness if compared to an *ex post* regime. Thirdly, we argue that from a cost-benefit perspective, a clear prohibition (introduced by the 'standard for enrichment') is to be preferred over a more general principle prohibiting behaviour which gives rise to the negative externalities. In addition, we also argue – and this is specific to the EU law context – that such response could improve the administration of EU state aid law.

a. Procedural efficiency: reducing monitoring and enforcement costs

The first reason why we deem 'enriching' public procurement regulation pursuant to our 'standard for enrichment' to be justified is that this allows for cost-efficient monitoring and enforcement.

As we argued in chapter 1, public purchasing produces negative externalities that may affect other markets. The chosen tenderer may build up or exercise market power on those other markets 'subsidised' through the advantage he obtains under a public contract. We argued in the previous section that a regulatory response is necessary in order to avoid these market failures. The regulator can choose to intervene by enacting a new body of law, aiming at tackling this market failure.

To make this more tangible, let us take the example of taxing away the advantage the chosen tenderer receives: the regulator may provide that when a public contract is entered into at a supra-competitive price, the difference between the equilibrium price and the supra-competitive price will be taxed away. Hence, such regulation removes the advantage the chosen tenderer receives. As a consequence, he cannot use this advantage to build up or exercise market power. However, applying this tax regulation implies a cost. The tax authority has to establish when a public contract displays a supra-competitive price and what the magnitude of the advantage is. The authority also has to collect the tax, maybe enforce the tax regulation concerned and so on. At the same time, the public purchaser still has to comply with public procurement regulation. Whether this regulation is actually complied with, has to be monitored and possibly enforced

as well. Both regimes, the tax regulation and the public procurement regulation, thus work in parallel, each giving rise to its own operating, monitoring and enforcement costs.

Integrating both regulatory regimes into one can avoid this duplication of costs. Applying our 'standard for enrichment' to public procurement regulation achieves this. It introduces the preservation of the well-functioning of other markets in public procurement regulation, rendering parallel regulation superfluous. Indeed, such integration allows that there is only one regulatory regime which has to be applied and whose compliance has to be monitored and enforced. Taking our exampling of introducing a tax system to neutralise the advantage, such would involve the application of two regimes (the tax regime being expensive to operate itself) to achieve the result that 'enriched' public procurement regulation can achieve by itself.

To illustrate the foregoing, we can – by way of an example – refer to the relationship between EU state aid law and public procurement regulation in the context of EU law.[294] For the sake of the argument, we assume that entering into a public contract at a supra-competitive price potentially entails a state aid grant.[295] When a public purchaser enters into a contract at a supra-competitive price, in principle two bodies of law are triggered (though not necessarily infringed): public procurement regulation and EU state aid law. Whereas both bodies of law embody the interests of society by ensuring efficient public spending, the former protects the interests of actual and potential tenderers (i.e. participants to that public market) and the latter the interests of competitors of the chosen tenderer (i.e. parties outside that public market).

The organising of the public market and the award of the contract gives rise to a double set of enforcement measures. As to public procurement regulation, the participants to the procedure will monitor whether the public purchaser conducts the procedure in compliance with public procurement regulation. If appropriate, they will start litigating to safeguard their interests. Also public enforcers may take action, even if the regulation does not provide for a specific enforcement agency. More in particular, the public procurement procedure may be the subject of criminal investigations, e.g. in case of collusion with a tenderer. In addition to that, in the EU context, the Commission also monitors compliance with the EU directives on public

[294] See also: J Mehta, 'State aid and Procurement in PPPs – Two Faces of a Single Coin?' (2007) 3 *European Procurement and Public Private Partnership Law Review*, 141, 152.
[295] Literature confirms that this assumption is a realistic one. See e.g. J. Hillger, *l.c.*, 122.

procurement. The Commission can subsequently initiate proceedings with the ECJ for an infringement of EU law.[296]

At the same time, EU state aid law is triggered.[297] The public contract, if implying state aid, should in principle be preliminarily notified with the Commission.[298] If so, the Commission incurs monitoring costs as it will have to examine the public contract. If the public purchaser does not notify the public contract, both the Commission and the competitors to the chosen tenderer can take action. The Commission can investigate the contract *ex officio* in view of compliance with EU state aid law.[299] The competitor (or more broadly, any interested party)[300] can proceed to two enforcement actions. First, he can submit a complaint with the Commission.[301] Secondly, as the notification obligation, accompanied by the standstill obligation, produces direct effect vis-à-vis such a competitor, he can bring an action before the national courts in order to have his interests safeguarded.[302]

It follows that the entering into a public contract gives rise to parallel monitoring and enforcement, each concerned with the interests the relevant regulation pursues. However, suppose public procurement regulation already achieves the objective EU state aid law envisages. This would imply that notification in the context of EU state aid law control is no longer necessary. After all, the public contract does not entail an advantage and, accordingly, a state aid grant can be ruled out. Also, the Commission nor competitors would have to monitor EU state aid law compliance as public procurement regulation guarantees that the public purchasing does not produce the negative externalities we envisage here and which converge with the notion of 'advantage' enshrined in article 107 (1) TFEU. Hence, it is no longer necessary to monitor and enforce compliance with the two fields of law independently and in parallel. The objective pursued in the latter is, because of the application of our 'standard for

[296] Cf. art. 260(1) TFEU.
[297] G Skovgaard Ølykke, "Commission Notice on the notion of state aid as referred to in article 107(1) TFEU - is the conduct of a public procurement procedure sufficient to eliminate the risk of granting state aid?" (2016) 5 Public Procurement Law Review 197, 205; Ph Nicolaides and E Rusu, Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?' (2012) 1 *European Procurement and Public Private Partnership Law Review* 5, 14.
[298] Art. 108(3) TFEU.
[299] Art. 10 Regulation 659/1999.
[300] Art. 1 (h) Regulation 659/1999.
[301] Art. 20(2) Regulation 659/1999.
[302] Case C-354/90, Saumon, [1991] I-5505, 14-16.

enriching', integrated in the former. Therefore, at least in theory, applying 'enriched' public procurement regulation would result in a state aid free public purchase contract.

A practical example can be drawn from the *Antwerp Airport PPP* decision. In order to select a private partner to establish a joint venture in a PPP project, the public partner organized a public procurement procedure (i.e. a negotiated procedure) in accordance with the then applicable public procurement directive. In the decision, the Commission established that the type of procurement procedure applied provided for a large margin of discretion on behalf of the public authority involved. The selection criteria and their relative weightings were not preliminarily established. Hence, notwithstanding compliance with the applicable provisions of EU public procurement law, the Commission deemed it necessary to examine whether the procedure applied produced the outcome desired from an EU state aid law perspective. In that respect, the Commission was of the opinion that the discretion the procedure allowed, could have implied the granting of an advantage as envisaged in article 107 (1) TFEU. However, the Commission established absence of an economic advantage as the procedure that was applied guaranteed sufficient competition after all and resulted in the choice of the most advantageous bid.[303] It follows that even though the relevant public procurement rules were complied with – which was already the subject of monitoring – still EU state aid law monitoring was considered to be necessary.

Another example can be drawn from the *London Underground* decision. Also this decision dealt with a PPP project. After submission of the bids and after certain tenderers were chosen to conduct negotiations with, the public purchaser modified the tender documents. The Commission examined whether the public purchaser had complied with the then applicable directive to verify whether or not the public purchaser's behaviour constituted an advantage as envisaged in article 107 (1) TFEU. The particularity here was that the public purchaser deployed a negotiated procedure, which entails a flexible regime. Nevertheless, such procedure has to comply with elementary EU public procurement principles, such as transparency and non-discrimination.[304] Hence, in order to perform state aid control, the Commission had to

[303]Aide d'État n° N 355/2004 – Belgique. Partenariat public-privé pour la mise sous tunnel de la Krijgsbaan à Deurne et la mise en valeur de terrains industriels et l'exploitation de l'aéroport d'Anvers (projet de PPP – aéroport d'Anvers), C(2005)1157 fin, 20 May 2005, 41-42.
[304]In addition to that, another particularity was that this case concerned utilities procurement, and thus not classical procurement. This however does not change our analysis.

assess whether the modification of the tender documents in the course of the procedure was acceptable in the light of the public procurement directive and the principles enshrined in it[305] so that the procedure produced a market price that ruled out an advantage.[306]

A last example concerns the *Leidschendam* decision. In this decision, the Commission reviewed the specifics of a PPP project in the light of the EU state aid rules. In this decision, the Commission expressly stated that the analysis made from the perspective of EU state aid law did in no way prejudice the analysis the Commission could subsequently make in the framework of EU public procurement law. Hence, the Commission expressly confirmed that such a transaction is governed by both fields of law, which is monitored and enforced separately.[307]

Also another, more indirect cost arising from monitoring and enforcement is relevant. Even if public procurement regulation is complied with, an action can be brought under EU state aid law. No matter how much effort the public purchaser has put into ensuring public procurement regulation compliance and no matter which safeguards public procurement regulation provides in this respect, the risk remains that sensitive information goes public in the course of enforcement. This may in turn harm the chosen tenderer. After all, the risk involved in litigation leading to disclosure of sensitive information may imply that fewer undertakings are inclined to take part in the competition for the contract.

Sanchez Graells touched upon this issue when dealing with the adverse consequences following from transparency in the purchasing process. The author contends that such transparency may de-incentivize potential tenderers from taking part in a public procurement procedure. This may be the case when the costs they incur due to such transparency outweigh the benefits they can obtain from taking part in such procedure.[308] Hence, the threat of having to disclose sensitive

[305] At the time, this issue was an element of debate in the field of public procurement regulation. A Brown, 'The permissibility of post selection modifications in a tendering procedure: decision by the European Commission that the London Underground Public Private Partnership does not involve state aid' (2003) 3 *Public Procurement Law Review,* NA 47, NA54.

[306] State aid No N 264/2002 – United Kingdom. London Underground Public Private Partnership, C(2002)3578fin , 2 October 2002, par. 77-103.

[307] SA.24123 – The Netherlands. Alleged sale of land below market price by the Municipality of Leidschendam-Voorburg, C(2013) 87, 23 January 2013 footnote 8. The GC later on annulled this decision. However, this annulment does not affect the point we draw from this decision.

[308] A Sanchez Graells, *o.c.* (2015), 76.

and/or confidential information for the purpose of enforcement of the other regulation[309] – also in the event of public procurement regulation compliance – may deter potential tenderers from taking part in the public procurement procedure. In addition to this, also the threat of facing enforcement measures long after the contract was entered into,[310] may produce such an effect. Another impediment to participation in the tender procedure in this respect, could be the mere fact of an increase of the likelihood of litigation. This may produce adverse reputational consequences or simply prevent the tenderer from planning ahead. All these elements may imply less competition in the award phase and thus an increased chance that the public contract is entered into at a supra-competitive price.

b. The preference for an ex ante regime and the unsatisfactory nature of an ex post remedy scheme

Next to the desirability of an integrated regulation, able to address the negative externalities we envisage here, we also argue that the *ex ante* nature of our solution- implying that a regulator enacts 'enriched public procurement law to which the public purchaser and tenderers are subject – is to be preferred over an *ex post* remedy scheme. Indeed, one could argue that also an *ex post* remedy scheme can achieve the objective our 'standard for enrichment' pursues. The argument that not all public contracts are entered into at a supra-competitive price, implying over-inclusion, might come across as valid to dispute the usefulness or desirability of our 'enriching' effort. Nonetheless, in this section we will argue that our 'standard for enrichment', embodying *ex ante* regulation, is to be favoured.

The situation is thus as follows. Public markets, organised in accordance with public procurement regulation, may give rise to a market failure affecting the well-functioning of other markets outside the one for the public contract at hand. The essential problem is that the chosen tenderer can build up or exercise market power on other markets through transferring the

[309] Taking the example of EU state aid law, we argue that this threat is not merely theoretic. We refer to the ECJ's *Boiron* jurisprudence. In this case, the ECJ held that to ensure the effectiveness of EU state aid law the beneficiary of the alleged state aid can be compelled to transfer information – such as the contract terms for the provision of a SGEI, as was the case in the *Boiron* case – to the complainant or the court. Case C-526/04, Boiron, [2006] I-7529, 55.

[310] Referring to the example of EU state aid law, article 15 (1) Regulation 659/1999 states as a principle that the delay for the Commission to order state aid recovery is 10 years as from the date of the aid granting.

advantage obtained in the public market to support his activities on other markets. The well-functioning of those other markets, and at the same time the interests of competitors on those markets, could be safeguarded through an *ex post* remedy scheme. For instance, regulation can provide that if the chosen tenderer indeed receives an advantage under the public contract due to a supra-competitive price, and if he uses this advantage to build up or exercise market power, the regulator intervenes by taking away the advantage from the chosen tenderer. Another possibility is to apply a liability regime. Then, the chosen tenderer can be held liable for the damage he committed when using the advantage to build up or exercise market power. Alternatively, also the public purchaser could be held liable for awarding such a contract to a tenderer.

We believe that such *ex post* regulatory regime is unsatisfactory. In that respect, we rely on the work of Shavell on the 'liability for harm vs. regulation for safety' debate.[311] The discussion to come thus embodies a law and economics approach. Liability is necessarily an *ex post* method, as the deterrent effect of incurring liability incites parties to act in accordance with the socially desirable behaviour.[312] The liability regime and regulation that provides for 'claw back' mechanisms are considered to be *ex post* regimes. Such regimes deal with the negative externalities after the public contract is entered into. 'Regulation for safety' is more of an *ex ante* regime. It explicitly prohibits certain behaviour in order to prevent harmful behaviour from occurring. For the purpose of our analysis, we consider 'enriched' public procurement regulation to be an *ex ante* regime, as it provides for a regulatory regime that avoids the negative externalities from occurring.

Now, what are the criteria for the choice between an *ex ante* regime and an *ex post* regime? Four elements can be distinguished.

[311] S Shavell, 'Liability for Harm versus Regulation of Safety' (1984) 2 *Journal of Legal Studies* 357.
[312] Public procurement regulation usually provides for an *ex post* remedy scheme itself. For instance, within EU public procurement law, Directive 89/665/EEC of 21 December 1989 as amended by Directive 2007/66/EC of 11 December 2007 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts (*OJ* L 395, 30 December 1989, 33) provides for remedies (such as ineffectiveness of a public contract). However, theses remedies only apply in case of infringement of the relevant public procurement regulation. This is, however, not the subject of our analysis, as the negative externalities we envisage are not the result of an infringement of public procurement regulation but of its sheer application. Therefore such remedies are not material for the purpose of our point here.

The first element concerns the fact the regulator and the persons subject to the regulation possibly possess heterogeneous information about the risky activities. If the latter persons have more and/or better knowledge about the risks a certain behaviour implies, it is rational to leave the assessment whether or not to adopt the behaviour with them. An *ex post* regime is to be favoured in such case. In case the regulator has more and/or better information on the consequences the behaviour at hand may produce, an *ex ante* regime is to be preferred.[313]

As to our analysis, who has the best knowledge about the risks, i.e. the negative externalities and its distortive effects? The negative external effects arising from the supra-competitive price under which the contract is entered into do entail a 'risk' for competitors to the chosen tenderer. However, especially as to the position held by competitors to the chosen tenderer, it can be assumed that nor the public purchaser nor the chosen tenderer have a clear view on the magnitude of the risk the entering into the public contract under a supra-competitive price implies. Moreover, it is more likely that the regulator has a better view on this issue. After all, he may have gathered experience from all public purchasers he regulates and/or supervises. Also, the regulator may have a better view on different dynamics that work in markets. In any event, it is less costly to take such risks into account when drafting public procurement regulation than expecting that the public purchaser and tenderers – as a matter of preliminary risk assessment – have to verify for each individual contract what the magnitude of the negative externalities will be. Therefore, we argue that the first criterion provides support for 'enriched' public procurement regulation.

The second element concerns the question whether or not the parties that are likely to behave socially undesirably can fully undo the harm caused. If the damages the party would have to pay when the harm occurs exceeds his financial capacity, he has no incentive to control the risk under an *ex post regime*. After all, the maximum exposure is his financial capacity, even if the harm exceeds this amount.[314]

Arguably a public purchaser has unlimited resources as it is part of the state – at least in principle. However, this point is not convincing. After all, it can be assumed that public

[313] S Shavell, *l.c.*, 359-360.
[314] S Shavell, *l.c.*, 360-362.

purchasers have been allotted a limited budget by a central authority collecting taxes. Also, it can be assumed that public authorities will not be in favour of raising taxes as this will undermine re-election. Even more, the harm suffered by competitors does not directly follow from the supra-competitive price, but from the building up of market power by the chosen tenderer. Hence, it seems plausible that it is the chosen tenderer who will be called upon to undo the harm. Chosen tenderers clearly have financial constraints.

There is also another issue. Not only is the harm the negative externality inflicts difficult to compute. Also the magnitude of the harm is potentially enormous and can keep producing effects for an infinite time.[315] For instance, undertakings can go bankrupt if a chosen tenderer uses the supra-competitive price to strengthen its position on other markets. Also, innovation may be slowed down because of a distorted market, leading to additional social costs. Even if the public purchaser would be the one considered to be liable for the harm and he would theoretically have the financial capacity to undo that harm, such compensation would be unsatisfactory. After all, the harm is difficult to compute and potentially keeps producing effects in the future. This is all the more true for the chosen tenderer. Moreover, it is likely that the harm, if computable, will exceed his financial capacity. This constitutes an argument in favour of 'enriching' public procurement regulation.

The third element relates to the chance that parties causing the harm will not be sued for their undesired behaviour. Shavell distinguishes a few reasons why parties are not sued even though they inflicted harm. One reason is that the consequences of the undesired behaviour are dispersed, so none of the victims considers it worth to bring actions. Secondly, parties causing harm can escape law suits because the consequences only become apparent after a long time. Lastly, failure to bring suits can follow from absence of knowledge that the harm has emerged.

Also, even when a party behaving harmfully is sued under an *ex post* regime, it may be the case that such law suit does not alter his behaviour. This would especially be the case when large firms are involved. The person actually responsible may be immune to the consequences of the law suit, e.g. because he left the firm or it is the firm that actually bears the consequences.

[315] In chapter 1 we already mentioned literature that argues that the effects of state aid vis-à-vis market shares keep producing effects in the long term. Cf. supra.

Hence, it is uncertain that liability will produce the deterrent effect it is envisaged to produce.[316] The foregoing applies when the liability claim is directed against the beneficiary of the advantage (i.e. the chosen tenderer). However, also when the public purchaser is sued, such deficiencies may occur. After all, the same is true for civil servants who are backed by their statutory position, or who are merely a part of an administrative structure.

There is indeed a clear chance that the public purchaser or the chosen tenderer will not be faced with a law suit lodged by a competitor to the chosen tenderer.[317] A first reason for this is that parties harmed may not realise this harm happened or that they are unable to obtain information as to the sources of the harm. Public contracts are mostly not easily accessible because of incentives to maintain confidentiality, e.g. in view of economic considerations, confidentiality clauses or provisions of law that prescribe confidentiality. Also, it is hard to compute the amount of the harm done, and potentially an infinite number of parties can be affected by the negative externalities. Moreover, it is all but certain that all parties whose interests are adversely affected by the negative externalities realize that the negative externalities have happened. Or maybe they only find out after a long time. Moreover, it is probable that the law suit will not affect the behaviour. Civil servants and employees come and go and law suits are directed against the public purchaser. The same applies *mutatis mutandis* to the chosen tenderer. Persons actual responsible for the negative externalities are unlikely to be directly affected by the law suit. Hence, also this third element advocates the *ex ante* 'enriched' public procurement regulation option.

The last criterion is the one based upon administrative costs. An *ex ante* regime implies designing costs and compliance cost. An *ex post* regime involves litigation costs and costs related to its administration through the judiciary.[318] Next to direct costs, arguably also cost as to over-inclusion and under-inclusion should be taken into account.[319]

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[316] S Shavell, *l.c.*, 363.
[317] Taking EU state aid law as an example, it already has been submitted that a large amount of illegal state aid conferrals is never discovered. Cf. A Sinnaeve, 'Chapter 8. Procedures before the Commission, Council Regulation 659/1999' in M Heidenhain (ed.), *European State Aid Law*, (Beck, 2010), 628.
[318] To a certain extent, this point relates to the 'rules versus standards' debate. This debate will be discussed hereinafter.
[319] S Shavell, *l.c.*, 363-364.

Also here, it is argued that from a cost-benefit perspective it is more rational to design adequate rules that prevent the harm from occurring. Litigation costs and information costs in the framework of the administration of the remedy to undo the negative externalities are huge: public contracts have to be examined, the harm has to be computed, performance of the remedy has to be monitored, ... Moreover, as was argued before, the remedies available to deal with the negative externalities may be inadequate to undo the harm inflicted. After all, the harm may be difficult to compute and the remedy itself may not be flawless either. Hence, also the problem of administrative costs pleas in favour of an 'enriched' public procurement regulation.

It follows from the foregoing that an *ex ante* regime, i.e. 'enriched' public procurement regulation, is to be preferred over an *ex post* regime.[320] As was demonstrated in this section (but also in the foregoing sections) this is the most economically rational way of dealing with the issue of negative externalities arising from public purchasing.

To substantiate the previous discussion, let us consider the example of the interaction between EU state aid law and public procurement regulation and assume that occurrence of the negative externalities we envisage, converge with a state aid grant.[321] In such case, EU state aid law is the *ex post* regime. EU state aid law provides in this respect for two remedies: recovery of the state aid from the beneficiary[322] and an action for damages.[323] A discussion of the current stance of these remedies demonstrate that *ex post* remedies to undo the distortive effects of the negative externalities is problematic. This is because the remedies aggrieved parties have to rely upon in

[320]It should however be stressed that the foregoing does not mean that we prefer regulation over an ex post liability regime. Also Shavell noted that it is socially advantageous to have both systems in place (S Shavell, 'A Model of the Optimal Use of Liability and Safety Regulation' (1984) 2 *The RAND Journal of Economics* 271, 271). Hence, our discussion does not imply that competitors whose interests are harmed should not be entitled to claim damages under a liability regime. Our aim was to demonstrate that an 'enriched' public procurement regulation, being a form of *ex ante* regime, is an efficient method to tackle the negative externalities we envisage here, thereby minimising the administration cost and maximising the effectiveness of the relevant regulation.
[321] To be clear, 'enriching' public procurement regulation by applying our 'standard for enriching' does not imply a 'merger' between public purchasing law and EU state aid law. If a public purchaser still, even though public procurement regulation has been 'enriched', grants state aid through a public contract, the competitor or any other interested party can still rely upon EU state aid law remedies. If this would not be the case, a problem of judicial protection of these interested parties would emerge as they may not be considered as an interested party for the purpose of enforcing public procurement regulation.
[322] Art. 14 Regulation 659/1999.
[323] This remedy is not explicitly provided for in EU state aid law, but nevertheless it has been stressed that the general action for damages is a suitable remedy to undo the harm the state aid conferral implied to a competitor. Cf. infra.

the field of EU state aid law are unsatisfactory[324], or – transposed to our analysis – that they do not succeed in swiftly undoing the harm inflicted by the negative externalities. It follows from this unsatisfactory nature that also the effectiveness of substantive EU state aid rules is undermined. [325]

First, the competitor harmed by the state aid conferral (our negative externalities) can file a complaint with the Commission.[326] The Commission may adopt, after a lengthy procedure, a decision ordering the Member State to recover the state aid granted. However, issuing such a recovery order does not mean that the Member State actually complies with this order. In practice performance of such recovery orders is often delayed or even avoided.[327] It follows that a long time lapses between the complaint and the actual recovery. During this period, the negative externalities remain present in the market. Hence, relief for the competitor will arrive very late, if it arrives at all. Another issue concerns the question whether the recovery remedy itself is an appropriate remedy to re-establish the market situation in the condition it was in before the state aid granting.[328] In conclusion, it is submitted that the recovery remedy as administered by the Commission is both untimely and ineffective.

Secondly, and assuming that the contract and the state aid it contains were not notified to the Commission, the competitor can also ask a national judge to adopt appropriate measures to have his interests safeguarded.[329] These interests converge with the right the competitor draws from the obligation for the Member State to notify a state aid measure and to await Commission

[324]This point as to the unsatisfactory nature of the available remedies also relates to the theoretical argument drawn from the *ex ante* vs. *ex post* debate as to enforcement. We argued that an *ex ante* regime is to be preferred over an *ex post* regime.
[325] C A Wright, 'The Law of Remedies as a Social Institution' (1955) 18 *University of Detroit Law Journal* 376, 377.
[326] Article 20 (2) Regulation 659/1999.
[327] Opinion AG Colomer, of 18 May 2006 in Case C-232/05, Commission / France, [2006] I-10071, par. 100 et subs; F-E González Díaz, 'Community Report' in P F Nemitz, *The effective application of EU State Aid Procedures. The Role of National Law and Practice*, (Kluwer Law International, 2007), 59. According to figures on the DG Comp website, over the period 2004-2014, still 36% of the amount to be recovered is not yet reimbursed (http://ec.europa.eu/competition/state_aid/studies_reports/situation_recovery.jpg). As for the year 2013, currently 95% is still to be recovered . (http://ec.europa.eu/competition/state_aid/studies_reports/number_recovered_amounts.jpg).
[328]We discussed this issue at length already at another occasion. We concluded that the recovery remedy cannot be considered to always serve the ends substantive EU state aid law pursues. T. Bruyninckx, 'Recovery as a Multi-dimensional Remedy' (2014) 1 *Competition Law Review* 68.
[329] Case C-354/90, Saumon, [1991] I-5505, 12.

endorsement before actually implementing that aid measure.[330] The national judge has to adopt all necessary measures to safeguard the interests of the adversely affected party.[331] However, also addressing the national judge is not costless. Moreover, the question remains whether the measures the judge orders are adequate and issued in a timely manner.[332]

It is for the national judge to decide upon the nature of the measure, provided that the measure ensures the effectiveness of EU state aid law.[333] In the framework of a guarantee contract, advocate-general Kokott favoured the annulment of such a contract in the event of an illegal state aid grant if such annulment would contribute to restoring the market situation prior to the state aid grant.[334] The ECJ proved to be more cautious though, by stating that the national judge can […] *in the absence of less onerous procedural measures, declare the cancellation of the guarantee […] if it takes the view that, regard being had to the circumstances specific to the present case, that cancellation may lead to or facilitate the restoration of the competitive situation which existed before that guarantee was provided*. Cancellation or declaring the contract null and void is thus not mandatory under EU state aid law when substantiating recovery. Nevertheless, in another case, regarding an illegal state aid grant to a real estate sale contract, the national judge ordered that the illegal state aid should be recovered through the payment of an additional amount to the sale price.[335] Both solutions, i.e. the annulment and the additional payment, can be criticised. If the contract would be annulled, this would imply enormous additional transaction costs. Undoing the illegal state aid by adjusting the price of the purchase contract *ex post*, on the other hand, would be affected by the same deficiencies as to the recovery remedy as we discussed earlier. After all, the beneficiary and, possibly, the Member State have an incentive to delay the payment as long as possible or even to avoid it. During this delay, the negative externalities keep affecting the market.

[330] This obligation is laid down in article 108 (3) last sentence TFEU. This provision has direct effect.
[331] Case C-354/90, Saumon, [1991] I-5505, 12.
[332] See on the problematic character, the 2009 update of the 2006 Study on the enforcement of State Aid rules at national level, published on the DG Comp website, http://ec.europa.eu/competition/state_aid/studies_reports/enforcement_study_2009.pdf, p. 4.
[333] Case C-275/10, Residex, [2011] I-13043, par. 44-46.
[334] Opinion advocate-general Kokott of 26 May 2011 in Case C-275/10, Residex, [2011] I-13043, par. 87.
[335] Rechtbank Noord- Nederland, Afdeling Privaatrecht, Locatie Leeuwarden, 4 June 2014, C/17/110054/HA ZA 11-75, Stichting Accolade, www.rechtspraak.nl, 4.6-4.9.

Another possibility is an action for damages. As pointed out by the Commission notice on the enforcement of State aid law by national courts ('Private Enforcement Notice')[336], it is possible for a third party to claim damages in case the Member State did not comply with the notification and standstill obligation. This possibility is based on the *Francovich* and *Brasserie du Pêcheur* judgments[337], which confirmed Member State liability for breaches of EU law. It is also clarified in the Private Enforcement Notice that, since the failure to comply with these obligations must be considered as being a 'sufficiently serious breach', the main question will in such proceedings relate to the amount corresponding with the damage suffered.[338] Also the causal link might be an issue of debate in such proceedings. This brings along significant costs for the claimant.

Furthermore, without even questioning whether damages claims suffice to undo the harm caused by the breach concerned, one could criticise the practical effectiveness of this remedy. First, a 2006 report regarding the enforcement of the state aid rules before national courts shows that up until the release of the report, no damages claim brought before a national judge because of a failure to perform a recovery obligation appeared to be successful.[339] Secondly, legal scholars express their doubts as to whether *Francovich* and *Brasserie du Pêcheur* are helpful in such a case. Parties might have difficulties to demonstrate the causal link between the breach of EU state aid law and the damage suffered.[340]

c. Cost-benefit justification for the 'over-inclusive standard for enrichment'

In the introduction, we clarified that we accept that the negative externalities we envisage here will not always occur, e.g. because the public purchaser can exercise countervailing buying power or because of sheer luck. Hence, one can put forward the criticism that applying our 'standard for enriching' is over-inclusive: applying our standard, giving rise to a cost, will

[336] *OJ* C 85, 9 April 2009, p. 1.
[337] In essence, these judgments provide that a Member State is liable to compensate individuals for damages they suffered due to an infringement of European Union law if the following conditions are met: (i) the rule of European Union breached intends to confer rights to individuals, (ii) the breach is "sufficiently serious" and (iii) there is a causal link between the damage suffered and the breach of the provision of European law.
[338] Private Enforcement Notice, para. 69.
[339] T Jestaedt, J Derenne and T Ottervanger, 'Study on the Enforcement of State Aid Law at National Level', March 2006, 48.
[340] M. Haidenhain, *o.c.*, 778.

sometimes appear to be unnecessary. Such over-inclusion would imply a loss of welfare. Instead, a regime that only intervenes when the public contract actually involves the negative externalities should be put in place. Also here, we can think of a system whereby the state taxes the advantage away or simply requires to reimburse it to the public purchaser. We however think that the 'rules vs. standards' debate provide for arguments in our favour.

For the purpose of our analysis we consider 'enriched' public procurement regulation a 'rule'; public procurement regulation (merely considered with the 'internal dimension' to public purchasing) flanked by regulatory measures to undo *ex post* the negative externalities when occurring are considered 'standards'.[341] To be sure: the 'standard for enrichment' we suggest, provides for a framework to establish 'rules'. Therefore, the 'standard for enrichment' is not to be confused with the notion of 'standard' in the framework of the discussion to follow.

'Rules' define precisely the behaviour that is expected. 'Standards' on the other hand are more vague, as they require an appraisal of facts when applied. Applied to our analysis, a 'rule' is prescribing the behaviour a public purchaser should adopt in order to avoid that the negative externalities occur. A 'standard' is merely formulating the principle that negative externalities may not occur but without providing for detailed requirements which have to be complied with in that respect. The literature pinpoints that in the real world it is very hard to identify pure rules and pure standards. After all, the former can be subject to exceptions which make its application less predictable. On the other hand, standards may evolve in the direction of rules, as for instance jurisprudence may render their application less unpredictable, thus making them more rule-like.[342] However, for the purpose of the argument here, we will not consider these nuances of the rules vs. standard debate.

Now, what is the criterion to choose between a 'rule' and a 'standard'. Hereinafter a criterion based upon a cost-benefit analysis as developed by Kaplow shall be suggested.[343]Three types of relevant costs are identified in the literature: administrative costs, undesirable behaviour costs and private transaction costs.

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[341] Hence, the standard would constitute an open prohibition that provides that the negative externalities may not occur, and when they do, such should be remedied (e.g. through a liability regime).
[342] R B Korobkin, 'Behavioral Analysis and Legal Form: Rules vs. Standards revisited' (2000) 23 *Oregon Law Review* 23, 28-29.
[343] L Kaplow, 'Rules versus Standards: An Economic Analysis' (1992) 3 *Duke Law Journal* 557.

As to the administrative costs, two costs have to be distinguished, i.e. public costs and private costs. The subcategory of public costs relate to the costs of designing rules and standards (standards are cheaper to design[344]) and their administration costs (standards are more expensive to administer[345]). It follows that in case identical issues arise often, rules are a more cost-efficient option. After all, those disputes can be resolved at a lower price than if the situation would be dealt with by a standard. On the other hand, standards are better suited for sectors characterized by disputes displaying heterogeneous facts or sectors that evolve rapidly. In that case, rules would have to be specifically drafted for an infinite number of possible situations. Also, they would have to be amended constantly, thus giving rise to designing and amending costs. Standards however provide the flexibility necessary to avoid such costs.

We submit that the issue of public costs pleas in favour of a 'rule' based regulatory response, i.e. 'enriched' public procurement regulation. First of all, in terms of public administration costs, drafting and applying the rule is less costly than applying a broadly formulated standard. Public contracts are entered into on a regular basis, and each time the question emerges – at least implicitly – whether this contract implies the negative externalities we discussed above. Enormous administration costs would arise for the regulator who has to enforce the standard flanking public procurement regulation.

Also, applying a standard would be preferable in case of heterogeneous facts. The contract terms and the product purchased change from case to case, indeed. However, the legal question remains the same every time: does the provision of public procurement regulation at hand imply negative externalities? To answer this question in case of the standard, the administrating institution will incur large information costs. It will have to take into account numerous facts. Moreover, it will have to get acquainted with aspects specific to the market it is probably not familiar with. In addition, it was already argued that potentially every time a public contract is awarded this issue arises. This would multiply the information costs. The other argument

[344]After all, in principle it requires much more effort to design a rule as when designing the rule a number of facts has to be taken into account and the situation to be addressed has to analysed thoroughly. This is not true for standards. As to the latter, the appraisal of facts is to a large extent left for the administrator.
[345]In principle, a rule can be applied once a set of facts occur. Hence, these facts do not have to be assessed when the rule is administered. The contrary is true for standards, which require an in depth appraisal of facts in order to administer the standard.

advanced in favour of a standard approach concerns the fact that standards are to be preferred in sectors where technology develops rapidly. This is arguably not the case here. Whereas the subject of the purchasing may be highly innovative, the act of purchasing is not of such a nature. Purchasing is conducted applying the same principles all over again every time.

The other subcategory consists of the private costs. These costs relate to the fact that it is more costly for parties to establish which behaviour will produce a particular legal consequence in the hypothesis of a standard. Rules describe in principle clearly the facts which give rise to a certain consequence. For example, if the traffic code provides that exceeding a speed limit of 100 kilometres/hour will be sanctioned with a fine of EUR 500, the information cost for parties subject to this rule is low. However, suppose the traffic code provides that inappropriate speed will be sanctioned with a fine of EUR 500. A party who wants to know when his driving speed is inappropriate will incur more information costs.

Also this type of costs plea in favour of 'enriched' public procurement regulation. Under the 'enriched' public procurement regulation public purchasers and the chosen tenderer would incur large private administration costs. After all, in case of the standard, they would have to examine every time when they enter into a public contract whether they comply with this standard, i.e. that the public purchasing process is of such a nature that the public contract does not give rise to the negative externalities we discussed. In case of the rule, i.e. applying 'enriched' public procurement regulation, they would only have to apply the provisions provided for. This reduces considerably the information costs on behalf of the parties to the contract.

The second category of costs to be taken into account is the undesired behaviour costs. Also here, a number of subcategories exist, i.e. the costs related to over-inclusion and under-inclusion. It is assumed that regulation drives parties to the socially desired behaviour. However, if this end (adopting the socially desired behaviour) is not achieved, costs arise. Rules, displaying a clear set of facts, are capable of being over-inclusive (desired behaviour is forbidden) or under-inclusive (undesired behaviour is permitted). This risk especially arises if the facts addressed by a rule are heterogeneous. However, the costs will be limited if compliance is not costly or if the forbidden behaviour does not produce large gains.

Hence, one would assume that using standards would avoid the issue of over-inclusion and under-inclusion. However, uncertainty as to the limits behaviour should not trespass, gives rise to costs. These costs arise because some parties will be risk-averse and behave overly prudent, while other parties may go beyond what would be allowed under the standard. Both cases imply a cost because the desired behaviour is not achieved. In addition to this point, costs can also arise because of errors made by institutions administering the standards. If perfection when administering the standards would be the aim, such perfection comes with a cost, information costs being arguably the most important one. Therefore, administrators may decide that the costs of being perfect every time when applying a standard outweigh the costs of an occasional error. Hence, also standards can be over-inclusive or under-inclusive when they are applied. In addition, this may imply that parties learn, on the basis of precedents, that certain behaviour will be punished. If this punished behaviour is actually desired behaviour, parties will adapt to the precedent and act in an undesired way.

We believe that the foregoing allows us to argue in favour of our 'rule', i.e. enriched public purchasing regulation. First, the cost that arises because of over-inclusiveness is not significant. After all, probably the public purchasing would have been subject to an obligation to organize a public procurement procedure anyway. In the EU context, applying national law transposing the public procurement directives is mandatory after all. Moreover, also below the thresholds for application of the directives, still the free movement provisions require public purchasers to adhere to principles that *de facto* prescribe organising an objective and transparent award procedure.[346] Also, suppose no public procurement procedure was organised, the public purchaser would still have to negotiate the public contract. Hence, he would incur transaction costs following from searching the market, drafting the contract, negotiating the contract terms, and so on. Insofar applying the additional requirements following from our 'standard for enriching' the public procurement would imply additional costs, still those additional costs can be expected to be relatively limited. This is even reinforced if we consider that these additional requirements aim at achieving a competitive price, thus implying cost savings for the public purchaser.

Secondly, without the clarity rules provide, public purchasers may trespass the boundaries of

[346] Cf. supra.

socially desired purchasing behaviour and enter into contracts at supra-competitive prices. After all, those boundaries are not clear in case of standards. We already mentioned before that such gives rise to distortions leading to welfare losses, which are nearly impossible to remedy. We argued so when submitting that 'enriching' public purchasing regulation as a way of dealing *ex ante* with the negative externalities is to be preferred over an *ex post* regime whereby public procurement regulation and EU state aid law work independently, the latter dealing with the negative externalities we envisage here.[347]

Thirdly, applying the standard of 'avoiding that the negative externalities occur' gives rise to considerable enforcement costs. The contract will have to be examined thoroughly taking into account the market context that is applicable. Therefore, establishing whether the public contract implies negative externalities and determining their magnitude will prove to be very complex and thus costly. Moreover, the complex economic background that the enforcer has to take into account (and which may not be familiar to him) opens the window for errors which may in turn influence future behaviour. Also this advocates applying the rule of 'enriched' public procurement regulation.

The third category of relevant costs consists of the private transaction costs. In this respect, transactions are believed to be an instrument to achieve allocative efficiency: the party who values an entitlement the most will purchase that entitlement from its possessor. The price will be higher than the value the holder attaches to it, yet it will be lower (or equal) than the value the purchaser attaches to the entitlement. Hence, welfare is maximized. Rules, reflecting a clear set of factual events that give rise to a certain legal treatment, make it easier for parties to negotiate when trading entitlements. This is true when transaction costs are low. After all, when transaction costs are low the parties will negotiate and reach an efficient outcome. The clarity of rules implies that they are preferable in such situation. However, when transaction costs are high – and parties are not likely to negotiate leading to an efficient outcome – standards become more appealing. This is because in case of disputes, it is more likely that the administrating institution allocates the entitlement efficiently – provided that allocative efficiency is an end underpinning the law. For the purpose of the discussion here, this criterion does not seem to be relevant.

It follows from the above that in view of a cost-benefit analysis, the rule that public purchasers have to comply with 'enriched' public procurement regulation is to be preferred over the standard of public procurement regulation flanked by regulation tackling the negative externalities it produces.

d. An additional justification: the contribution to the administration of EU state aid law

Above, we discussed three compelling reasons why we consider our 'enriching' effort valuable. These reasons are of a rather theoretic nature. However, we believe that there is also another, more practical justification that supports our effort – which is however confined to the EU context. We believe that applying our 'standard for enriching' when drafting, applying or interpreting public procurement regulation can contribute to a better administration of EU state aid law, both in terms of efficiency and cost-effectiveness. To see this, we have to consider the 'private purchaser test' in EU state aid law.

The 'private purchaser test' provides in essence that when a Member State engages in the economic activity of purchasing on the market-place, such act does not imply a state aid conferral if the contract resembles a contract a private party would have entered into.[348]

Referring to the general discussion of EU state aid law as to public purchasing in chapter 2, and especially to the *P & O* judgment, it can be advanced that a public purchaser is assumed to purchase works, goods and/or services at a market price if, to that end, he organizes an award procedure compliant to public procurement regulation.[349] The Commission seems to share this analysis in its decision practice. For instance, in the *Welsh Public Sector Network Scheme* decision, it stated that a service supplier did not benefit from an economic advantage it would not have enjoyed under normal market conditions since that supplier would be selected through a public procurement procedure.[350] The same reasoning was applied in the *Prague Municipal*

[348] E Szyszczak, *The Regulation of the State in Competitive Markets in the EU,* (Hart, 2007), 191.
[349] Cf. supra.
[350] Cf. supra.

Wireless Network-decision.[351] Hence, compliance with public procurement regulation – in the EU state aid law context: EU public procurement law – is sufficient to ensure the absence of an advantage.[352] However, it must be noted that in the Draft Notice, as well as the subsequent actual Notice on the Notion of State Aid, the Commission formulated a number of 'quality requirements' to which public procurement procedures should adhere in order to rule out the existence of an advantage.[353] Also, scholars already have shed more light on this issue. [354]

We see however a problem of effectiveness in this way of EU state aid law administration. As we discussed, public procurement regulation, including EU public procurement law, may produce negative external effects that affect the competitive dynamics on other markets. These negative externalities, so we argued in chapter 3, converge with the notion of 'advantage' in EU state aid law. Here is the problem: the Commission, as the EU state aid law authority, accepts that compliance with EU public procurement law rules out the existence of an 'advantage', while nonetheless public procurement regulation itself is capable of producing such an 'advantage' (i.e. the negative externalities we discussed in chapter 1). Consequently, such reasoning implies that EU state aid law, as administered, does not achieve the ends it pursues: avoiding competition distortions.[355] Suppose however that public procurement regulation is able to address these negative externalities. *Ipso facto* it also prevents the conferral of an 'advantage' via the public contract.

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[351] Cf. supra.

[352]The Commission indeed tended to reason in its decisions that when EU public procurement law is complied with – no matter which type of procedure is applied – no advantage is granted. An example is the Welsh Public Sector Network Scheme decision (State Aid N 46/2007 – United Kingdom. Welsh Public Sector Network Scheme, C(2007) 2212 final, 30 May 2007). Here, the Commission decided that even though the competitive dialogue was applied, no advantage was at hand. The Commission decided so regardless the point of view that the competitive dialogue does not guarantee proper competition and, thus, does not provide for a proper safeguard that no advantage is granted.

[353] Cf. supra.

[354] See e.g. Ph Nicolaides, 'State Aid Advantage and Competitive Selection: What is a Normal Market Transaction?' (2010) 1 *European State Aid Law Quartely* 65; Ph Nicolaides and E Rusu, 'Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?' (2012) 1 *European Procurement and Public Private Partnership* 5; Ph Nicolaides and S Schoenmaekers, 'Public Procurement, Public Private Partnerships and State Aid Rules: A symbiotic Relationship' (2014) 1 *European Procurement and Public Private Partnership* 50; P C Gomes, 'The innovative innovation partnership under the 2014 Public Procurement Directive', (2014) 4 *Public Procurement Law Review* 216; A Sanchez Graells, 'Public procurement and state aid: reopening the debate?' (2012) 6 *Public Procurement Law Review* 205.

[355] The fact that the Draft Notice as well as the Notice on the Notion of State Aid formulates 'quality requirements' does not alter this. Also procedures complying with these requirements are capable of producing the negative externalities we discussed in chapter 1. After all, also these procedures suffer from the trade-off between competition and other concerns which depend on the conception of public procurement regulation that is relevant in a particular case (cf. chapter 2).

The alternative to the use of 'enriched' EU public procurement law and still guaranteeing the proper administration of EU state aid law, is that the Commission examines every individual public contract upon notification.[356] Indeed, given the inability of public procurement regulation to deal with the negative externalities we identified, the Commission should in fact examine every public contract in the light of EU state aid law. After all, it cannot be excluded that an advantage as envisaged in article 107 (1) TFEU is granted.[357] Apart from the fact that, currently, such in depth examination is often not conducted, which raises again the problem of ineffective administration of EU state aid law,[358] such examination of each public contract implies huge costs. After all, the Commission has to examine as to every public contract whether it involves a state aid grant, thus including whether it contains an advantage (i.e. our negative externalities). Such costly examination can be avoided if EU public procurement law would be 'enriched' so that the Commission can rest assure that no advantage (i.e. our negative externality) is present. In such case, the mere compliance with 'enriched' public procurement regulation guarantees indeed that the public contract does not imply an 'advantage'.

C. CONCLUSION

In this chapter we demonstrated why our suggestion of 'enriching' public procurement regulation is to be preferred over other possible responses to the problem of negative externalities following from public purchasing which affect other markets outside the specific public market for the contract at hand.

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[356] Obviously, this involves huge costs.

[357] Already in the current stand of EU state aid law, public procurement regulation compliance only gives rise to a rebuttable presumption of absence of an advantage as envisaged in article 107 (1) TFEU in Commission decision practice. A Sanchez Graells, 'The Commission's Modernisation Agenda for Procurement' in E Szyszczak and J W van de Gronden (eds.), *Financing Services of General Economic Interest: Reform and Modernization and SGEI*, (Asser, 2013), 171.

[358] State Aid NN 24/2007 – Czech Republic. Prague Municipal Wireless Network, 30 May 2007, C(2007)2200, par. 29; State Aid N 46/2007 – United Kingdom. Welsh Public Sector Network Scheme, C(2007) 2212 final, 30 May 2007. See also: Communication from the Commission — Framework for State aid for research and development and innovation, *OJ* C 198, 27 June 2014, 1-29, title 2.3; EU Guidelines for the application of state aid rules in relation to the rapid deployment of broadband networks, *OJ* C 25, 26 January 2013, -26, par. 78 (b). This was also remarked in the field of the financing of SGEIs by arguing that the Commission often only verifies whether an EU public procurement law compliant procedure was applied. A Sanchez Graells, 'The Commission's Modernisation Agenda for Procurement' in E Szyszczak and J W van de Gronden (eds.), *Financing Services of General Economic Interest: Reform and Modernization and SGEI*, (Asser, 2013), 166.

In the first place, a regulatory response was considered to be necessary as we deem the market not capable of neutralising the negative externalities that follow from public purchasing. This is because the market is too costly to operate and thus it cannot reach an efficient outcome. Specific regulation is necessary to remedy the market failure.

Secondly, our regulatory suggestion is justified in view of efficiency as to monitoring and enforcement (i.e. it implies reduced enforcement costs in comparison to a regime whereby specific regulation works independently from public procurement regulation), in view of effectiveness (i.e. its *ex ante* nature provides for a better guarantee that the negative externalities will not distort other markets in comparison to *ex post* regimes flanking public procurement regulation) and in view of cost-benefit considerations (i.e. introducing a clear rule that prohibits behaviour giving rise to the negative externalities is less costly than operating an open ended regime that merely indicates that the negative externalities should not occur). Specific to the EU-context, we also argued that 'enriched' public procurement regulation may also contribute to a more effective and efficient administration of EU state aid law.

PART II

6. CHAPTER 5. THE 'ENRICHED' OBLIGATION TO DISCLOSE AWARD CRITERIA

A. INTRODUCTORY REMARKS

Award criteria are the scoring rules in a public procurement procedure. The score a tenderer receives, is obviously linked with the extent to which his bid accommodates the public purchaser's requirements embedded in these criteria. Hence, the award criteria are an important source of information for the tenderers. After all, this information reveals what it takes to win the contract. Thus, disclosing award criteria relates closely to providing the tenderers with information so as to allow for competition. In that respect, we already argued that markets only operate efficiently in case of perfect information.

If the public purchaser applies only the lowest price criterion, his priorities are clear. He wants to purchase at the lowest price available. Applying also other award criteria, such as delivery or quality requirements, renders the scoring mechanism more complex. After all, the public purchaser will have to elaborate these scoring elements. Furthermore, if the public purchaser applies more than one criterion, all the criteria have a weighting of their own. Also, it may occur that the public purchaser applies sub-criteria, having a weighting of their own themselves. Moreover, when scoring the bids, the public purchaser has to allocate the points in view of the award criteria and possibly their sub-criteria based on a quotation method.[359]

The following example may clarify this terminology. Suppose a public purchaser wishes to enter into a contract for the purchase of chairs. The first award criterion is the price and the second is user friendliness. Suppose the public purchaser allots 70% of the points to the price criterion and 30% to the user friendliness criterion. These percentages are the weightings vis-à-vis both award criteria. However, the public purchaser cannot apply these award criteria without more. After all, how will the public purchaser define, for instance, "user friendliness" for the purpose of scoring the bids? Suppose he considers two elements relevant to substantiate the award criterion "user friendliness": (1) ergonomic quality and (2) weight of the chair. Also,

[359] It follows from this discussion that there is more to award criteria than merely a set of qualitative requirements that determine a tenderer's score. The application of these requirements requires a scoring mechanism consisting of the elements we discussed in this paragraph (i.e. weighting, sub-criteria and their weighting and a quotation method). For the purpose of the discussion that follows, we will refer to this scoring mechanism as 'award criteria and their belongings'.

he allots more importance to the ergonomic quality (e.g. 70% of the 30% assigned to the award criterion "user friendliness") than to the weight of the chair (e.g. 30% of the 30% assigned to the award criterion "user friendliness"). These are in fact sub-criteria, accompanied by their weighting factors.

Next to sub-criteria and their weighting, there is also the quotation method. We know now that the public purchaser assigned 21% (70% of 30%) of all points to the sub-criterion "ergonomic quality" and 9% (30% of 30%) of all points to the sub-criterion "weight of the chair". However, it still not clear how these points will be allocated. Suppose the public purchaser awards 6 points to tenderers offering a chair weighting less than 3 kg, whereas a tenderer offering a chair of 3 kg or more gets 3 points awarded. This is the quotation method the public purchaser applies when evaluating the offers.

We argued in chapter 2 that the source of the negative externalities lies within imperfect competition: competition is traded off with other concerns, no matter which conception of public procurement regulation is envisaged. Hence, a public market displays imperfect competition, impairing the achievement of an equilibrium price. Even more, the market may produce a supra-competitive price. This results in the negative externalities we discussed in chapter 1. We will consider here the scope the disclosure obligation as to award criteria and all or some of their belongings should adopt. Public purchasers may prefer to retain as much margin of discretion as possible in this respect. After all, such margin of discretion provides flexibility.[360] Moreover, an obligation to develop *ex ante* an elaborated scoring mechanism may imply considerable transaction costs for the public purchaser. However, we will argue that an incomplete disclosure obligation implies imperfect competition, due to an imperfect distribution of information. After all, award criteria and their belongings contain information that is valuable to tenderers when competing for the contract. Hence, the benefit of increased and enhanced competition should be weighed against the costs related to such information dispersion. Referring to the relevant provision in the EU directives on public procurement law, we will examine the implications of our 'standard for enrichment'. However, in the next section we will first discuss why we deem incomplete disclosure problematic.

[360] S T Poulsen, P S Jakobsen, S E Kalsmose-Hjelmborg, *EU Public Procurement Law*, (Djof Publishing, 2012), 37.

B. THE PROBLEM OF NEGATIVE EXTERNALITIES FOLLOWING FROM UNSATISFACTORY DISCLOSURE OF THE AWARD CRITERIA AND THEIR BELONGINGS

In this section we will discuss that unsatisfactory disclosure of the award criteria and their belongings can give rise to the negative externalities we discussed in chapter 1. We believe such unsatisfactory disclosure obligation to imply the risk for these negative externalities to occur in three ways. In summary, the following problems we identify all relate to the problem that, absent a full disclosure obligation, competition for the public contract is defective.

First, unsatisfactory disclosure may restrict participation to the tender procedure because tenderers are not adequately informed about the public purchaser's needs and about the requirements a bid should meet in order to be chosen. This is in fact a problem of transaction costs (e.g. in the form of information searching costs) reducing competition for the public contract. Transaction costs are a barrier to entry the market for a public contract.[361] At least part of such costs may follow from the information costs a potential tenderer incurs when preparing his offer.[362] If the tender documents do not clearly reveal the public purchaser's preferences, the tenderer has to invest in discovering these preferences. If these costs outweigh the potential gains, such lack of information may dissuade the potential tenderer to participate in the award procedure.

Also, uncertainty about the actual public purchaser's preferences may result in a decision not to participate at all.[363] After all, such uncertainty makes an analysis, when deciding on participation to the procedure, problematic. If such preferences are not clear, it is unlikely that a potential tenderer can make an adequate assessment of its chances to win. Since competition in principle implies better contract conditions, it is actually in the public purchaser's interest to keep transaction costs as low as possible. This is because this allows attracting as many tenderers as possible to the procedure. Another reason why tenderers may refrain from taking

[361] M Hellowell and A M Pollock, 'Non-Profit Distribution: The Scottish Approach to Private Finance in Public Services' (2009) 3 *Social Policy and Society* 405, 411.
[362] N Dimitri, G Piga en G Spagnolo, *Handbook of Procurement*, (Cambridge University Press, 2006), 274.
[363] H Ohasi, 'Effects of Transparency in Procurement Practices on Government Expenditure: A Case Study of Municipal Public Works' (2009) 3 Review of Industrial Organisation 267, 267-268.

part into the procurement procedure is that they are unable to determine the opportunity cost. This is because it is difficult to predict, absent the relevant information, what the chances are to win the contract.

Secondly, unsatisfactory disclosure may also affect the quality of the competition for the public contract. If the tenderers do not have information allowing them to identify the public purchaser's actual needs and the requirements for the bid to be successful, the interpretation of the tender documents may diverge among those tenderers. Hence, competition will be based on different information or different interpretations of the available information among the tenderers. This implies that bids are possibly not comparable. This affects the quality of the competition, and therefore also its capacity to enable the public purchaser to extract information out of the market.

To illustrate this, we refer to the aforementioned example of a contract for the purchase of chairs. The award criteria are price (70%) and user friendliness (30%). Merely disclosing these elements does not provide adequate information to the tenderers. One tenderer may consider that equipping the chairs with wheels accommodates the user friendliness criterion. Another tenderer may consider the adjustable backrest being the decisive element. Hence, tenderers will compete with each a different idea on how to accommodate the public purchaser's needs. The sub-criteria (ergonomic quality) and weight of the chair reveal some more information. If this information is disclosed, the tenderers are more likely to submit comparable offers. If also the quotation method is communicated, tenderers have even more information at their disposal. As to the sub-criterion 'weight of the chair' we said that quotation would be dependent whether or not the chair weighed more than 3 kg.[364]

[364] A similar example can be drawn from *Commission / Ireland*, a case which we will be discussing extensively in the section to follow. For instance, suppose the public purchaser attached more importance to the criterion 'qualifications and relevant experience' than to 'cost'. If the tenderers would have known this beforehand, tenderers could have invested in qualifications and experience and focus less on the costs the services would have brought along. Without disclosing this, the tenderers are not sure what the public purchaser desires. Hence, one tenderer could have drained resources from cost-cutting initiatives to acquiring employees with qualifications and experience, while another tenderer could have acted the other way round. This illustrates how tenderers can have different views as to the needs absent adequate information communicated through the award criteria and their belonging: does the public purchaser wants to purchase cheap but average quality services or expensive but high quality services? Without this knowledge, the tenderers cannot allocate the resources efficiently and their offered products do not actually compete as the features differ.

The foregoing demonstrates that equal (and thus full) information among the tenderers is necessary to create genuine competition between tenderers.[365] If tenderers decide to submit a bid absent full disclosure of the award criteria and their belongings, the quality of the competition may be questionable. Hence, competition may not produce the outcome it is ought to produce. If tenderers are not aware of the actual needs, and tenderers thus have to 'guess' the public purchaser's needs, the risk arises that no genuine competition can be achieved. This would be due to the divergent interpretations of the tender documents and the public purchaser's needs. Bids are thus potentially not comparable because they are based upon different assumptions and interpretations. This is even more problematic if one tenderer has more or better information in comparison to the co-tenderers, e.g. because of previous contractual relationships.[366]

Moreover, not only the quality of the competition may be questionable in case of incomplete disclosure because of the consequential information problem. Also, the public contract entered into may not be apt to address the public purchaser's needs. Cooter and Ulen submit as to the coming into existence of a contract – that is, in general, not only as to public contracts – that parties should exchange the necessary information so as to establish an efficient contractual relationship. They say: "*(...) the presence of asymmetric information can sometimes preclude otherwise mutually beneficial exchanges from taking place*"[367].

Public purchasers should therefore disclose as much information as possible so as to indicate their desires and needs. In this respect, economic literature also points out that when scoring rules are clear and predictable, this allows tenderers to allocate their resources in the most efficient way in order to satisfy the needs to be addressed. This also gives rise to best value for

[365] This of course presupposes the public purchaser is in the position to define his needs, and thus that he is properly informed about the solutions the market provides. Arguably, an open formulation of the award criteria may address the informational problems the public purchaser may encounter here. However, other, less distortive solutions are feasible as well. Apart from acquiring (technical) advice from third parties (which indeed may turn out to be costly), article 40 of Directive 2014/24 enables public purchasers to preliminarily consult the market.
[366] Indeed, such disclosure also mitigates the risk that competition is jeopardised because one tenderer has information about the actual needs of the public tenderer, e.g. because of previous contractual relationships. In the absence of full disclosure, which would have put him on an equal footing, he has an information advantage that enables him to behave opportunistically. He has no incentive to put his price close to his costs and to submit an offer that reflects efficiency.
[367] R Cooter and T Ulen, *Law & Economics*, (Pearson, 2007), 208.

money when performing the contract.[368] It follows that for tenderers to efficiently address the public purchaser's needs, they have to be informed about the award criteria, the sub-criteria, both their weighting factors and the quotation method. In disclosing these elements, public purchasers can avoid or mitigate horizontal and vertical information-asymmetry.[369]

Thirdly, not disclosing the award criteria and their belongings endows the public purchaser with a large degree of discretion.[370] This discretion can be used to grant an advantage to a tenderer by entering into a contract at a supra-competitive price. Moreover, the concern here is not limited to the public purchaser pursuing other interests than entering into a public contract reflecting best value for money. Even if the public purchaser is not pursuing adverse interests, still the problem persists that potential tenderers may conceive the procedure to be prejudiced. They may suspect corruption or favouritism. This is problematic as participating in a public procurement procedure comes with a cost for the tenderer. If the potential tenderer has doubts as to whether his bid will be assessed on its merits, the potential tenderer may refrain from investing in drafting a bid. Hence, tenderers who would normally participate, may decide not to. This resembles the situation Akerlof described in his 'market for lemons' paper. If the potential tenderers do not have trust in the integrity of the public purchaser, they will leave the market.[371] The consequence is not only that high quality and efficient potential tenderers will be de-incentivised to submit a bid. After all, their efficiency will allow them to win other contracts. Also, at the end of the day, competition for the public contract will be reduced. Henceforth, absence of a full disclosure obligation impedes transparency, while such transparency is necessary to strengthen the public purchaser's reliability.

C. 'ENRICHED' PUBLIC PROCUREMENT REGULATION'S REQUIREMENTS

[368] N Dimitri, G Piga and G Spagnolo (eds.), *o.c.*, 296-299; R Mateus, J A Ferreira and J Carreira, 'Full disclosure of tender evaluation models: Background and application in Portuguese public procurement' (2010) 3 *Journal of Purchasing & Supply Management* 206, 214.
[369] See also: J Asker and E Cantillon, 'Properties of scoring auctions' (2008) 1 *RAND Journal of Economics* 69, 79.
[370] As we discuss further on, this may imply the granting of an advantage as envisaged in article 107 (1) TFEU, and which is tantamount to the negative externalities we intend to address. See: Ph Nicolaides and E Rusu, Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?, (2012) 1 *European Procurement and Public Private Partnership Law Review* 5, 20.
[371] G Akerlof, 'The Market for Lemons: Quality Uncertainty and the Market Mechanism' (1970) 3 *The Quarterly Journal of Economics* 1970, 488-500.

The discussion in the previous section indicates that 'enriched' public procurement regulation would provide for an obligation to disclose award criteria and their belongings. From the perspective of avoiding the negative externalities we discussed in chapter 1, we advocate full disclosure of the scoring mechanism, thus involving disclosure of award criteria, sub-criteria, both their weightings and the quotation method, in the tender documents. This is to assure the information these elements contain are known to tenderers when they are assessing whether or not to participate and when preparing the bid. Also, this assures transparency throughout the scoring process. We deem all three aspects of our 'standard for enriching' – i.e. 'competition', 'genuine competition' and 'fair competition' – relevant.

In the first place, the public purchaser should create a 'competitive' public market through announcing his intentions in this respect. This is the first leg of our 'standard for enrichment'. However, merely announcing this intention without also clarifying what the requirements are to win the contract, would not effectively achieve this objective of creating competition. Potential tenderers should indeed be informed about the conditions governing that public market. A lack of information de-incentivises potential tenderers from taking part in the procedure – i.e. because of transaction costs and/or because of doubts about the integrity of the procurement process. This would imply a low degree of competition. A full disclosure obligation is thus, in the first place, necessary to create competition.

Also, a full disclosure obligation is necessary in order to create 'genuine' competition, being the second leg of our 'standard for enriching'. It was held that to ensure genuine competition, competitors need to have similar information at their disposal. This is to enable them to compete on an equal footing. Such allows ensuring the comparability of the bids. Also, this implies that tenderers should have full information about the public purchaser's needs. After all, if certain aspects are not clear, tenderers may have different conceptions or interpretations. This would imply that they hold dissimilar information, which would undermine competition. Furthermore, if one of the tenderers has more information about how to interpret the partially disclosed award criteria, competition would equally be undermined. Such a situation may for instance occur when one tenderer was previously involved in a contractual relationship with the public purchaser. A full disclosure obligation thus ensures that tenderers can compete based on the merits of their bid and this on an equal footing.

The third leg of our 'standard for enrichment' relates to the creation of 'fair' competition. As to the disclosure obligation vis-à-vis award criteria and their belongings, a full disclosure obligation contributes to the 'fairness' in two interrelated ways. The first is the full disclosure obligation's ability to avoid discretion on the part of the public purchaser. The second refers to its contribution to guaranteeing an objective and transparent assessment of the bid. If the public purchaser enjoys a too wide margin of discretion when applying the scoring mechanism, the door is open for corruption and favouritism. Disclosing the complete scoring mechanism in advance, i.e. before the public purchaser has knowledge about the participating tenderers and the conditions they submit, ensures that the tenderer submitting the most advantageous bid, will be chosen. In this respect, Nicolaides and Rusu have submitted that if a public purchaser enjoys a wide margin of discretion when applying award criteria, the procurement process may not guarantee absence of an advantage.[372] Furthermore, such disclosure warrants that achieving such outcome can be monitored. This guarantees the objectivity of the public procurement process.

The foregoing discussion indicates that the 'enriched disclosure obligation' requires a full disclosure obligation. More in particular, it requires disclosing the relevant award criteria, the sub-criteria, both their weightings and the quotation method.

From an efficiency point of view, such full disclosure obligation can be criticised for being over-inclusive. After all, it also requires such disclosure when the costs of developing the scoring mechanism outweigh the gains such full disclosure obligation brings along. However, we believe that the costs related to over-inclusion can be justified from a cost effectiveness perspective. The alternative to the full disclosure obligation is that the public purchaser has to disclose award criteria and their belongings insofar this achieves competition, 'genuine' competition and 'fair' competition. Hence, if disclosure of certain aspects does not affect the creation of competition and the ensuring of 'genuine' and 'fair' competition, the public purchaser should not invest in formulating and disclosing the complete scoring mechanism. Yet, even if it were possible to establish *ex post* that full disclosure produces no competition

[372] Ph Nicolaides and E Rusu, 'Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?' (2012) 1 *European Procurement and Public Private Partnership Law Review* 5, 20.

gains, still a few issues arise. First, how can a public purchaser *ex ante* establish whether or not disclosing an aspect of the scoring mechanism affects competition in one or another way? At least the public purchaser will incur information costs when assessing this risk. Moreover, a risk-averse public purchaser will develop and disclose the scoring mechanism *ex ante* anyway.[373] Also, agency costs may arise. Such implied discretion creates an opportunity for corruption or favouritism. Even if the public purchaser does not intend to adopt such behaviour, the exercise of this discretion still has to be monitored. Also this implies costs, i.e. monitoring costs and, possibly, enforcement costs. Therefore, also not formulating a full disclosure obligation gives rise to costs.

Another issue that can arise, however, is the objective impossibility for public purchasers to formulate a scoring mechanism or the impossibility for public purchasers to develop such a scoring mechanism at a cost below the expected competition gain. This can be due to a lack of information, e.g. as a result of the complexity of the market. However, the public purchaser can obtain expert advice.[374] Of course, obtaining such expert advice implies costs as well. Also here, the criticism can be put forward that, in the absence of competition gains, incurring such costs is economically irrational. However, also here we refer to the costs we discussed above. An alternative, more cost friendly, solution could be formulating these requirements in terms of output-specifications. In any event, the foregoing discussion supports our point of view that a full disclosure obligation should be the rule. In case the said impossibility and/or irrationality occur(s) when a public purchaser is faced with the full disclosure obligation, a deviation from the rule should only be acceptable when such impossibility and/or irrationality occurs. It would be for the public purchaser to adequately prove that a deviation from the full disclosure obligation is required in view of cost-benefit analysis. As we discussed, we however deem it

[373] Here we also refer to our discussion in chapter 4 of Part I dealing with the potential criticism that 'enriched' public procurement regulation may be over-inclusive. We argued that from a cost-benefit point of view, a 'rule' (here: a full disclosure obligation) is to be preferred over a standard (here: disclosing to the extent this contributes to competition).

[374] Article 40 of Directive 2014/24 provides this possibility. This provision reads as follows: "Before launching a procurement procedure, contracting authorities may conduct market consultations with a view to preparing the procurement and informing economic operators of their procurement plans and requirements. For this purpose, contracting authorities may for example seek or accept advice from independent experts or authorities or from market participants. That advice may be used in the planning and conduct of the procurement procedure, provided that such advice does not have the effect of distorting competition and does not result in a violation of the principles of non-discrimination and transparency".

feasible in most cases to adopt measures, flanking the full disclosure, that mitigate the costs related thereto.

D. 'ENRICHED' PUBLIC PROCUREMENT REGULATION AS TO THE DISCLOSURE OBLIGATION

We established in the previous sections that 'enriched' public procurement regulation would provide for an obligation to disclose the complete scoring mechanism, i.e. the award criteria as well as all their belongings. We will now, in order to give substance to the 'enriched' provision as to this disclosure obligation, apply these considerations to our reference point. Hence, we will examine whether the EU public procurement law regime as to award criteria, and their disclosure in case the public purchaser applies award criteria to identify the most economically advantageous tenderer, satisfies our 'standard for enrichment'. The provisions at hand are laid down in article 53 of Directive 2004/18 and in article 67 of Directive 2014/24. The latter article does not alter fundamentally the disclosure regime that was enshrined in its predecessor. As the ECJ case law, which we will discuss below, relates to the provision in Directive 2004/18, we will focus hereinafter on this provision. However, we stress that the disclosure regime enshrined in the provision in Directive 2014/24 is similar to the one in Directive 2014/24.

Article 53 (2) of Directive 2004/18 provides:

> *"(...) the public purchaser shall specify in the contract notice or in the contract documents or, in the case of a competitive dialogue, in the descriptive document, the relative weighting which it gives to each of the criteria chosen to determine the most economically advantageous tender".*

In this respect, recital 46 of the preamble to Directive 2004/18 is relevant as well. After all, it ties the disclosure obligation in article 53 (2) with the principles of equal treatment amongst tenderers and transparency referred to in article 2 of Directive 2004/18:

> *"To ensure compliance with the principle of equal treatment in the award of contracts, it is appropriate to lay down an obligation - established by case-law - to ensure the*

necessary transparency to enable all tenderers to be reasonably informed of the criteria and arrangements which will be applied to identify the most economically advantageous tender. It is therefore the responsibility of contracting authorities to indicate the criteria for the award of the contract and the relative weighting given to each of those criteria in sufficient time for tenderers to be aware of them when preparing their tenders. (…)"

Whilst it is clear from this wording that award criteria and their weighting should be disclosed, the question remains whether similar requirements apply for sub-criteria and their weighting and for the quotation method. Above, we already elaborated an example to clarify this terminology. The example referred to a public purchaser purchasing chairs. The first award criterion was the price and the second user friendliness. Without any doubt, the public purchaser has to disclose these criteria. Also, according to article 53 (2) of Directive 2004/18 and 67 (2) of Directive 2014/24, the public purchaser should indicate how the points are divided among these two criteria.[375] Again, in our example, the public purchaser would have to disclose that the price criterion represents 70% of the points while the user friendliness criterion would cover 30% of the points.

Above we already indicated in the example above that applying these award criteria however requires additional elements. We referred to the need for sub-criteria, including a weighting, and a quotation method. Do these elements have to be disclosed in the tender documents according to the provisions in the directives? This does not stem clearly from the relevant provisions.

Arguing that sub-criteria and their weighting and the quotation method are implicitly mentioned in the article 53 (2) Directive 2004/18 seems problematic. The consideration in the preamble to Directive 2004/18 referred to above, indicates that the disclosure obligation aims at ensuring "*the necessary transparency to enable all tenderers to be reasonably informed of the criteria and arrangements*". This reflects the idea that tenderers must have equal information. However, this does not necessarily that tenderers have full information. Moreover, the transparency sought for relates to the prohibition for the public purchaser to provide one or more specific

[375] The public purchaser can however also meet this requirement by indicating them in a descending order of importance in the tender documents.

tenderers with more or better information than other tenderers. This may suffice from the perspective of ensuring the well-functioning of the market for public contracts. This however conveys also the implicit message that if tenderers are under-informed, they should all be under-informed. Hence, such idea of equality does not necessarily contribute to the achievement of an efficiently working public market. It follows that a provisions such as article 53 (2) of Directive 2004/18 and article 67 (2) of Directive 2014/24, understood in the light of paragraphs 46 resp. 90 of the preambles, do not provide a framework allowing for perfect competition. Henceforth, such provision does not rule out the risk that the negative externalities we discussed in chapter 1 will occur. This is because whereas such provisions may accommodate concerns that arise within the 'internal dimension' of public procurement, i.e. the relationship between the public purchaser and the tenderers, that provision however neglects the 'external dimension' of public purchasing.

However, as the wording of article 53 of Directive 2004/18 and article 67 of Directive 2014/24 is rather broad, it is relevant to examine the question how the ECJ has interpreted these provisions. The ECJ and the GC delivered a number of judgments dealing with the relationship between, on the one hand, transparency and, on the other hand, the disclosure of sub-criteria and their weighting factors and quotation methods. The following cases shall be examined hereinafter: *ATI EAC*, *Lianakis*, *Commission v Ireland*, *Evropaïki Dynamiki* and *TNS Dimarso*.

The facts in the *ATI EAC* case were as follows. In order to award a contract for transport services, the public purchaser applied, among others, the award criterion 'organisational procedures and support structures used in carrying out the service'. This criterion was assigned 25 points, which the public purchaser could allocate at its absolute discretion. The tender documents further specified that, in the framework of this criterion, tenderers should provide an overview of the organization and of the logistical and support structures which would be used to perform the contract. This 'overview' should at least have contained the following information: (1) depots and/or areas where buses can be parked, owned by or available to the undertaking, within the territory of the Provincia di Venezia …; (2) procedures for supervising the service supplied and the number of employees supervising the service itself; (3) number of drivers on the route and the type of license they held; (4) the number of places of business owned by or available to the undertaking (other than depots) within the territory of the Provincia

di Venezia …; (5) number of employees engaged in organising drivers' shifts'. After the tenderers filed their bid but before the bids were opened, the public purchaser allocated the points by dividing them over the elements being part of the 'overview'.

The question the ECJ had to answer following a request for a preliminary ruling was: does the fact that a public purchaser determines the weight of the sub-criteria, being the subheadings of award criteria which were disclosed and defined in the tender documents, after submission of the bids but before the opening of the bids an infringement of EU law? The ECJ answered that such a decision would not imply an infringement of EU law provided that three conditions are met: (i) the decision does not alter the criteria for the award of the contract set out in the tender documents; (ii) the decision does not contain elements which, if they had been known at the time the bids were prepared, could have affected preparation of the bids and (iii) the decision was not adopted on the basis of matters likely to give rise to discrimination against one of the tenderers.[376]

Hence, this 'test' is concerned with ensuring the equality amongst tenderers in the sense that they envisage the relationship between the participating tenderers. This corresponds with our point that article 52 (2) of Directive 2004/18 and 67 (2) of Directive 2014/24, understood in the light of paragraphs 46 resp. 90 of the respective preambles, sees to the 'internal dimension' of public purchasing. Full disclosure is not necessary if the elements that were not disclosed would not have an impact on the equality among tenderers. Thus, if omitting to disclose the weightings does not imply that some tenderers are advantaged vis-à-vis other tenderers, the requirement of equality would be complied with. Questions such as whether the omission to disclose would have attracted more and/or other tenders, or whether providing full information about the preferences would have allowed for more and/or better competition, were however not raised. Such jurisprudence is therefore not in line with our 'standard for enrichment'.

[376] Case C-331/04, ATI EAC, [2005], I-10109, 26-32. In the aftermath, the Italian Council of State took a very strict approach. Although not touched upon by the ECJ, the Italian Council of State noted – as a preliminary remark – that it should be avoided that contracting authorities should have a possibility to further define the elements relevant for the assessment of the bid after the offers were submitted in order to avoid the possibility of favoritism. However, it noted that EU law nevertheless requires the application of the three above-mentioned criteria, and established that both the second and third criteria were not satisfied. Consiglio di Stato 31 March 2006, ATI EAC, N. 5323/06.

The *Lianakis* case concerned a contract for the carrying out of a contract in the area of cadastre management and town planning. The public purchaser informed the tenderers in the contract documents that the contract would be awarded pursuant to the following three award criteria, in descending order of importance: (1) the proven experience of the expert on projects carried out over the last three years; (2) the firm's manpower and equipment; and (3) the ability to complete the project by the anticipated deadline, together with the firm's commitments and its professional potential. The tender documents did not provide for any further information in this respect. It was only while assessing the bids (i.e. after the bids were opened) that the public purchaser established the modalities on how the bids would be evaluated. In this respect, the public purchaser attributed the following weightings to the said award criteria: 60%, 20% and 20%.

In addition to this, the public purchaser established how the award criteria would be evaluated. For instance, as to the second criterion, it stipulated that firm's manpower and equipment should be assessed by reference to the size of the project team whereby a tenderer would receive 2 points for a team of 1 to 5 persons, 4 points for a team of 6 to 10 persons, and so on up to a maximum score of 20 points for a team of more than 45 persons.

The ECJ held that a public purchaser cannot apply weighting rules or sub-criteria which he did not previously bring to the tenderers' attention. Tenderers should be aware of all elements that the public purchaser takes into consideration when assessing offers in the course of an award procedure.[377] However, the ECJ uses the notions 'weighting rules' and 'sub-criteria', whereas this case rather seems to deal with 'weighting rules' and 'quotation methods'. In any event, this approach seems to be a broader one towards the disclosure obligation when compared to the approach adopted in the *ATI EAC* case. However, the ECJ itself points out that the *Lianakis* case does not overrule the *ATI EAC* case. In this respect, the ECJ refers to the factual background of both cases in order to distinguish them. The ECJ states that *Lianakis* is about a situation where the public purchaser determined the weighting factors and the subcriteria (or weighting rules and quotation method) after the opening of the submitted offers. Contrarily, in *ATI EAC* the case concerned the establishing of weighting rules before the bids were opened.

[377] Case C-532/06, Lianakis, [2008] I-251, 37-40.

This may indicate that the appearance of subjectivity – the opening of the offers being the crucial landmark – is the reason for such a strict stance in *Lianakis*.

Although we qualified the strict stance in *Lianakis*, the ECJ nonetheless seems to rule in line, contrarily to *ATI EAC*, with our 'standard for enrichment'. After all, the ECJ held that the disclosure obligation in the relevant directive, read in the light of the principle of equal treatment and transparency, that "*potential tenderers should be aware of all the elements to be taken into account by the contracting authority in identifying the economically most advantageous offer, and their relative importance, when they prepare their tenders"*.[378] Even more: *"Potential tenderers must be in a position to ascertain the existence and scope of those elements when preparing their tenders"*.[379] If not, such would run counter to the rationale underpinning the public procurement directives. They envisage to remove obstacles to the freedom to provide services, but also to the free movement of goods etc. After all, these directive envisage *"to protect the interests of economic operators established in a Member State who wish to offer services to contracting authorities established in another Member State*".[380]

Regardless of the qualification further on in the judgment – i.e. that *Lianakis* does not overrule *ATI EAC*, thus indicating that the *Lianakis* jurisprudence is primarily focussed on avoiding that public purchasers abuse the discretion to assess bids to favour a particular tenderer – the quotes taken from the judgment mirror elements of our 'standard for enriching'. Considering the first leg, the ECJ stated that 'potential' tenderers should be aware of all the relevant elements, both as to their existence and their scope, for the award of the bid. This seems to indicate that the public purchaser has to inform the market. To this effect, the public purchaser does not merely have to give notice of the upcoming public procurement procedure. The public purchaser also has to indicate the modalities that will govern the public market at hand. As to the second leg – equal and full information so as to avoid horizontal and vertical information asymmetry – the ECJ holds that 'all the elements' relevant for the award of the public contract should be known to the tenderers when preparing the bid. Hence, this indicates that the tenderers should be aware of all the elements that relate to the scoring mechanism. After all, the case dealt with weighting

[378] Case C-532/06, Lianakis, [2008] I-251, 36.
[379] Case C-532/06, Lianakis, [2008] I-251, 37.
[380] Case C-532/06, Lianakis, [2008] I-251, 37.

factors and sub-criteria (or actually weighting rules and quotation method). Hence, one could draw from the underlying facts of this case that "all elements" have to be understood broadly. Also as to the third leg, 'fair' competition, this case if important. After all, if all the elements that are relevant for the award of the contract have to be disclosed in advance, the public purchaser does not enjoy discretion.

It follows that *Lianakis* seems to introduce requirements that converge with the requirements stemming from our 'standard for enrichment'. However, the wording the ECJ deployed does not suggest that the ECJ had the 'external dimension' of public purchasing in mind. However not mentioned explicitly, the wording rather refers to the conception of competition in the sense of ensuring the well-functioning of the internal market for public contracts. Moreover, the ECJ does not abandon the stance adopted in *ATI EAC*, suggesting that this rather strict stance is in the first place directed against the introduction of new elements at a stage where tenderers are not anymore able to process such additional information and to modify the bid accordingly. Moreover, insofar "all elements" includes also the quotation method, it must be observed that, for instance, the Belgian Council of State is of the opinion, in the post-*Lianakis* era, that the relevant law (thus including EU public procurement law) does not provide for an obligation to disclose the quotation method.[381] Hereinafter we will discuss that the ECJ has confirmed this position to a certain extent. Moreover, whilst the *Lianakis* case seems to provide for arguments in favour of a broad disclosure obligation, subsequent judgments (albeit not all in the framework of the EU public procurement directives) seems to temper this evolution.

A first case which seems to delimit the broad interpretation the *Lianakis* judgment may provide support for, is the *Commission v Ireland* case. This case concerned a contract as to so-called 'non-priority services', i.e. services which were only partly covered by Directive 2004/18. The disclosure obligation, laid down in article 53, is not applicable to the award of public contracts covering these type of services. Nevertheless, the Commission started an infringement action[382]

[381] Belgian Council of State 23 December 2011, nr 217.012, Schoonmaakbedrijf All Building Services, Belgian Council of State 23 January 2014, nr. 226.180; Gerechtsdeurwaarderskantoor Vergauwen en Avontroodt; Belgian Council of State 14 June 2012, nr. 219.732, CKS.

[382] This is another difference between the *Commission v Ireland* case on the one hand and the *ATI EAC* and *Lianakis* judgments on the other hand. The latter two cases concern preliminary rulings. In an infringement procedure, the Commission has to deliver proof of an infringement so mere presumptions are insufficient. Conversely, in a case pursuant to a reference for a preliminary ruling, the ECJ merely interprets EU law and leaves the judgment upon the facts to the national judge.

against Ireland. This Member State established the weighting factors to the award criteria only after the submission of the bids. In this respect, the Commission referred to the principles of equal treatment and transparency.

The underlying facts were the following. The public purchaser intended to award the contract for interpretation and translation services based on the basis of the following award criteria: (i) completeness of tender documentation; (ii) stated ability to meet requirements; (iii) range of lots, services and languages; (iv) qualifications, relevant experience; (v) cost; (vi) suitability of proposed arrangements and (vii) reference sites. It was made clear that the importance attached to the criteria was not to be inferred from the order of appearance. In order for the members of the evaluation committee to be able to individually assess the offers before the committee would gather, the public purchaser communicated an evaluation matrix to these members, thereby attaching weighting factors to these award criteria.

Having established that article 53 of Directive 2004/18 did not apply to the contract at hand, the ECJ took the view that imposing a disclosure obligation such as laid down in the said article is too far-reaching. Nevertheless, the ECJ considered the general principles of EU law still to be applicable. Next, the ECJ seems to apply the *ATI EAC* criteria to this situation. The ECJ states that the award criteria were such that the subsequent establishing of a weighting could not imply an unequal treatment between Irish service providers and service providers established in other Member States. It concerned merely the establishing of the terms for evaluation of the offers submitted. Moreover, the ECJ seems to indicate that the decision to establish the weighting factors after the submission of the bids, was not intended to discriminate since (i) none of the participating tenderers were provided with this information and (ii) the award criteria did not enable the public purchaser to discriminate. Next, the ECJ also held that if the tenderers would have been informed in advance about such weightings, this would not have had an impact to their offers. Furthermore, the subsequent establishing of the weightings did not alter the award criteria.[383] It seems that the ECJ applies the *ATI EAC* criteria softly, thereby departing from its strict positions in *ATI EAC* and *Lianakis.*[384]

[383] Case C-226/09, Commission / Ireland, [2010] I-11807, 44-48.
[384] This was also mentioned in the literature. Smith notes that the ECJ's finding, that if the weighting factors would have been known in advance by the tenderers, this would not have altered their offer, is peculiar since such information is usually of major importance for the preparation of an offer. S Smith, 'Irish translation

If such interpretation is to be endorsed, this shows the flaw embedded in the application of the 'equality' principle, which we already pinpointed before. Ensuring equality among tenderers is also satisfied when all tenderers are equally under-informed. This may avoid that certain tenderers are favoured above others, but it does not serve the purpose of establishing a competitive price. After all, this affects the organisation of competition as well as the quality of the competition that is achieved. It is however important to stress, as the ECJ also emphasised, that the contract in this case did not trigger the provision of the disclosure obligation as such. Yet, the ECJ examined this behaviour in the light of the principle of equal treatment and transparency. These principles are lying at the heart of the EU public procurement directives.

Another relevant case is the *Evropaïki Dynamiki* case, issued by the GC in the framework of a contract awarded by an EU institution. Therefore, this contract was not subject to Directive 2004/18. The case is nevertheless relevant since EU institutions are subject to procurement rules that are similar to these laid down in Directive 2004/18 and Directive 2014/24. Furthermore, the GC refers to the *ATI EAC* and *Lianakis* case in the judgment.

This case deals with the award of a contract for IT-services. One of the award criteria concerned the technical evaluation. Tenderers should, for 40% of the points, elaborate the methodology to perform the project. This criterion was further defined in the tender documents. Tenderers should include *"detailed proposals of how the project would be carried out"*, including milestones and deliverables. More in particular, tenderers should include in their offer: (i) detailed information regarding the project implementation structure, (ii) a clear description of each work package and (iii) the project implementation structure.

As to this last element, the tender documents further stated that this element encompassed the following aspects: (a) horizontal activities; (b) a description of the project management team and responsibilities (meaning that tenderers were to *"clearly define in the offer the exact services and … provide detailed information in respect of response time [and] provide with*

services: disclosure of and changes to the weighting of award criteria for "Annex II B" (non-priority services)' (2011) 1 *Public Procurement Law Review* NA 9, NA 11.

their offer detailed curriculum vitae of each staff member responsible for carrying out the work, including his or her educational background, degrees and diplomas, professional experience, research work, publications and linguistic skills"), (c) deliverables on project management and (d) work package description and relations (meaning a total overview of the 'man days' and 'man days cost' for each work package).

After the offers were submitted and opened, the evaluation board decided to subdivide the award criterion 'proposed methodology for the project' into two sub-criteria: 'repartition of tasks, manpower offered of quality and man-days (roadmap) – 20%' and 'deliverables – 20%'. The plaintiff put forward that this was contrary to the obligation to disclose sub-criteria in the tender documents. The GC, however, took the view that this did not introduce new sub-criteria, since these sub-criteria *essentially* corresponded to the description of the award criterion 'proposed methodology for the project'. Therefore, the evaluation board did not subdivide that award criterion into sub-criteria which were not previously been brought to the tenderers' attention. It merely divided the points allocated to the overarching award criteria. The GC did not find any proof that the requirements set out in the *ATI EAC* judgment were not met.[385]

Bearing in mind our 'standard for enriching', such purchasing behaviour would not satisfy the second leg, i.e. 'genuine competition'. It does not provide the tenderers with accurate information on what the public purchaser deems relevant to have his needs addressed. For instance, based upon the tender documents, the tenderers were not able to conclude that the public purchasers deem 'deliverables' as important as the 'repartition of tasks, manpower offered and man-days'. Hence, some tenderers might have invested in their workforce because they assumed this would have been the decisive element. Consequently, they may have underinvested in the 'deliverables' requirement. If all tenderers would have known the 20%-20% repartition, competition could have been of a better quality. Furthermore, this does not comply with the third leg neither, as this possibility to rearrange the award criteria and to assign it a weighting after the opening of the bids, endows the public purchaser with a large degree of discretion.

[385] Case T-70/05, Evropaïki Dynamiki, [2010] II-313, 145-155.

The evolution set out in the previous paragraphs culminates in the *TNS Dimarso* case. In this case the ECJ clearly stated, thereby following the advocate-general's opinion, that quotation methods are not subject to the disclosure obligation enshrined in the then applicable Directive 2004/18. Apart from the fact such obligation would lack a legal basis, a disclosure obligation would also contradict the need for some leeway on the part of evaluation committees when carrying out their tasks.[386] Furthermore, the ECJ considers that public purchaser should enjoy the freedom "*to adapt the method of evaluation that it will apply in order to assess and rank the tenders in accordance with the circumstances of the case"*.[387] There is however a limitation. Establishing the quotation method after publishing the tender documents may not alter the award criteria or their relative weighting.[388]

This jurisprudence conflicts with the requirements following from our 'standard for enrichment'. As we already held before, discretion on the part of the public purchaser has to be avoided for the reasons we set out above. Hence, this *TNS Dimarso* jurisprudence does not comply with our third leg. Also Sanchez Graells has flagged this. He argued that this judgment grants too wide discretion to the public purchaser and allows for *ex post* rationalisation of a decision to award the contract to the preferred (but not necessarily best) tenderer.[389] In addition, Nicolaides and Schoenmakers pinpointed the risk following from such discretion that the contract implies the conferment of an advantage.[390] Moreover, also here the problem of incomplete information arises, giving rise to a problem of inadequate competition, both as to the organisation of completion and as to the quality of the competition. This conflicts with the first and second leg of our 'standard for enrichment'.

It follows from the discussion above that the wording of the relevant articles in the EU Directives and the ECJ case law indicate the absence of a full disclosure obligation in EU public procurement law. As we discussed above, this may be justifiable if only the 'internal dimension' to public purchasing is considered. If so, it suffices that the public purchaser ensures

[386] Case C-6/15, TNS Dimarso, [2016] ECLI:EU:C:2016:555, 29.
[387] Case C-6/15, TNS Dimarso, [2016] ECLI:EU:C:2016:555, 30.
[388] Case C-6/15, TNS Dimarso, [2016] ECLI:EU:C:2016:555, 32
[389] A Sanchez Graells, 'CJEU opens door to manipulation of evaluations and fails to provide useful guidance on the use of 'soft quality metrics' in the award of public contracts (C-6/15)', 11 August 2016, http://www.howtocrackanut.com/.
[390] Ph Nicolaides and S Schoenmaekers, 'Public Procurement, Public Private Partnerships and State Aid Rules: A symbiotic Relationship' (2014) 1 *European Procurement and Public Private Partnership Law Review* 50, 54.

competition on an equal footing within the public market for the contract. Henceforth, he should not favour, willingly or unwillingly, certain tenderers over others. However, even though such point of view may assure equality amongst tenderers, it does not assure a perfectly working public market. Hence, the outcome produced by a market subject to the said provisions, as interpreted by the ECJ and GC, does not avoid that our negative externalities may occur. We argued that, in order to assure that these negative externalities do not occur, or at least that the chance their occurrence and their effects are minimised, the complete scoring mechanism (i.e. the award criteria and their weightings, the sub-criteria and their weightings and the quotation method) should be disclosed in the tender notice or tender documents. This allows actual and potential tenderers to process this information, either to decide whether or not to submit a bid, either to submit a bid based on all the relevant and required information.

E. CONCLUSION

In this chapter we discussed the disclosure obligation vis-à-vis award criteria and their weightings, the sub-criteria and their weightings and the quotation method from the perspective of our 'standard for enriching'. We submitted that a full disclosure obligation, thus a disclosure obligation vis-à-vis all the aforementioned elements, is to be favoured. This allows not only for the creation of a market without any barriers to entry. It also assures that competition on that market does not suffer from vertical information asymmetry (i.e. between the public purchaser and the tenderers) nor from horizontal information asymmetry (i.e. among the tenderers). Moreover, such full disclosure obligation avoids discretion when assessing the bids and awarding the contract. This, in turn, avoids that other interests than those related to creating value for money determine the outcome of the procedure. It also reassures potential and actual participants that the procedure will be conducted in an integer manner.

Henceforth, we believe that a full disclosure obligation contributes to the avoidance, or at least the mitigation, of the negative externalities in the following ways: (i) higher degree competition as the informational barrier to entry is removed and as the transparency and absence of discretion assure an integer assessment of the bid, (ii) better competition as it is clear for tenderers which aspects are relevant to compete upon so they can allocate their resources

efficiently, (iii) removal of informational advantages for certain tenderers and (iv) focus on best value for money without interference of interests that jeopardise such outcome.

Situations where such full disclosure obligation is impossible or economically irrational (in terms of cost-benefit anlysis) to comply with, can however not be ruled out. Informational problems may indeed render the application of this obligation inefficient due to the information costs involved. Therefore, if public purchasers deem this rule impossible of economically irrational, they should deliver proof of this prior to deviating from this obligation.

7. CHAPTER 6. 'ENRICHED' PUBLIC PROCUREMENT REGULATION AS TO SOCIAL AND ENVIRONMENTAL AWARD CRITERIA AND TECHNICAL SPECIFICATIONS

A. INTRODUCTORY REMARKS

a. What are 'secondary considerations'?

Member States may deem it appropriate to promote policy objectives when purchasing on the market. To that effect, they integrate 'horizontal policies' or 'secondary policies' into the procedure. Arrowsmith and Kunzlik define this notion as the "phenomenon whereby public procurement is used to promote social, environmental and other social objectives that are not inherently necessary to achieving the fundamental objective of a specific procurement, but which the procuring body chooses, or is required, to advance in the context of its procurement".[391] The authors explain the underpinning idea as follows. A public purchaser, being also part of the government, purchases products on the market to perform the tasks vested in him. Hence, such purchasing behaviour is actually ancillary to the actual mission he has to perform. For instance, in order for the forestry guard agency to protect the woods, the guards need vehicles. Next to this core function, such entity may also have an obligation or intention to pursue other objectives when performing the mission vested in them. Such objectives do not necessarily arise from or relate to such mission. Imagine the forestry guard agency would want to purchase vehicles produced in the local region. Hence, a public purchaser could require that the supplier complies with requirements inspired by industrial, economic or social policies.[392]

Comba favours a more restrictive definition. In essence, the author defines secondary policies as "*everything that is not necessary for the execution of the works, the supply of products or provision of services"*.[393] The author, however, acknowledges that it is for the public purchaser to define what is necessary to have his needs addressed. Hence, if he deems specific features

[391] S Arrowsmith and P Kunzlik, "Public procurement and horizontal policies in EC law: general principles" in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law*, (Cambridge University Press, 2009), 12.
[392] *Ibid.*, 13.
[393] M E Comba, 'Green and Social Considerations in Public Procurement Contracts: A Comparative Approach', in R Caranta and M Trybus (eds.), *The Law of Green and Social Procurement in Europe*, (DJOF Publishing, 2010), 308.

necessary even though such features actually relate to a wider policy objective, such features are part of the subject-matter of the contract. The secondary consideration is then in fact not secondary. It is part of the primary objective. However, Comba pinpoints that it is not easy to objectively determine what the primary objective is.[394]

Comba provides the example of the purchase of coffee. A public purchaser may require that the coffee has been produced and traded in accordance with standards assuring 'fair trade'. Such requirement would in fact implement a secondary policy objective. However, Comba argues that both fair trade and non-fair trade coffee are objectively the same product.[395] Hence, the author seems to rely upon a concept of 'consumer substitutability'. If a public purchaser purchases coffee to offer to his civil servants in the canteen, would they be affected by the choice for one of both types of coffee? This is likely not to be the case. Comba, however, also addresses the issue of legal requirements public purchasers are subject to. Suppose environmental law provides that a product has to meet certain environmental standards, then purchasing authorities are obviously also subject thereto. Hence, Comba suggests the following definition: *(…) something which is required by the procuring entity even if not objectively necessary in order to reach the aim of the public contract, (…), something additional and unnecessary, in respect of the object of the contract (…)*.[396]

Having discussed the concept of 'secondary considerations', we raise two additional preliminary remarks in this respect. First, it follows from the foregoing discussion that in the literature two notions are deployed: 'horizontal objectives' and 'secondary policies'. The former is believed to express a more favourable approach towards their use in public procurement.[397] In this chapter, we will use the more neutral term 'policy objectives', when appropriate.[398] Even though the two descriptions of this concept seem to reveal a different attitude towards their implementation in public procurement, both descriptions fit the concept

[394] McCrudden, on the other hand, argues that defining the subject-matter should in any event be the full prerogative of the public purchaser. Hence, he may decide to purchase also a social policy outcome. C McCrudden, *Buying Social Justice. Equality, Government Procurement, & Legal Change*, (Oxford University Press, 2007), 524. See along the same lines: S Arrowsmith and P Kunzlik, *l.c.*, 12-13.
[395] M E Comba, *l.c.*, 309.
[396] M E Comba, *l.c.*, 309.
[397] S Arrowsmith and P Kunzlik, *l.c.*, 12.
[398] As this chapter is concerned with 'social and environmental policy considerations', we may also use this term occasionally.

we envisage here: the pursuit of policy objectives and using public purchasing as a lever to this effect.

Furthermore, we will only consider social and environmental policy objectives in this chapter. This limitation is due to two reasons. First, social and environmental are currently at the heart of the debate amongst public procurement law scholars.[399] This is amongst other due to the particular role the EU legislator conferred to public procurement regulation in terms of achieving the Europe 2020 objectives. These objectives are tantamount to sustainable and inclusive economic growth.[400] Secondly, considering all the possible policy objectives a public purchaser could possibly pursue through purchasing would go beyond the boundaries of our research. However, we believe that our analysis also holds vis-à-vis other policy considerations, such as ethical considerations (which could be qualified as social considerations as well actually).

b. The instruments to pursue policy objectives

Public purchasers can rely on various instruments to pursue social and environmental objectives in public purchasing, as Arrowsmith notes.[401]

A first instrument is the very decision to purchase or not to purchase. A public purchaser may adopt the decision to purchase not only because of the need for the product but also because of the benefits the purchasing produces. Boosting employment though adopting the decision to purchase is an example. Absent such benefits, the public purchaser might not have decided to purchase. By the same token, public purchasers may decide not to purchase if such purchase

[399] See e.g.: B Sjafjell and A Wiesbrouck, 'Why should public procurement be about sustainability?' in B Sjafjell and A Wiesbrouck (eds.), *Sustainable Public Procurement Under EU Law*, (Cambridge University Press, 2015), 1 et subs; S Morettini, 'Public Procurement and Secondary Policies in EU and Global Administrative Law' in E Chiti and B G Mattarella (eds.), *Global Administrative Law and EU Administrative Law. Relationships, Legal Issues and Comparison*, (Springer 2011), 188.
[400] Communication from the Commission. Europe 2020 - A strategy for smart, sustainable and inclusive growth, 3 March 2010, COM(2010) 2020.
[401] S Arrowsmith, 'A taxonomy of horizontal policies in public procurement' in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law*, (Cambridge University Press, 2009), 130-158.

would be in conflict with his policy objectives. Here, an example could be the decision not to perform a project because this would burden the environment.

Secondly, and closely related to the previous instrument, also the decision on what to purchase can be an instrument. Once the public purchaser has defined his needs, he has to decide how these needs should be addressed. He may consider how and to which extent the possible solutions affect policy objectives. For instance, the public purchaser envisages to assure access to an isolated area. Than the question may arise: which solution is best, building a tunnel or a bridge?

Thirdly, also contractual requirements may be apt to further social and environmental policy objectives through public purchasing. This category is to be further divided into the following categories: (1) technical specifications (i.e. contractual requirements that also may give rise to exclusion in advance), (2) specific conditions (i.e. contractual requirements that cannot give rise to exclusion in advance) and (3) contractual requirements that are not allowed at all.

Packaging and timing orders are a fourth type of suitable instrument. Public purchasers may divide their needs in separate parts or spread contract performance over time. The reason to do so may originate from the intention to attract more undertakings to the procurement procedure and thus to obtain better contract conditions. Another reason may be the intention to support SME's by removing hindrances to their participation – which would rather be an industrial policy objective.[402] Fifthly, set-asides may also prove effective to implement policy objectives. Here, public purchasers reserve participation to the procurement procedure for specific firms or groups in order to pursue a policy objective (e.g. participation of disabled persons to the labour market or encouraging SME participation).

A sixth instrument is the exclusion from participation to procurement procedures because of non-compliance with government policies. Public purchasers can exclude firms (or threating to exclude them) in order to stimulate compliance with the policy objective pursued or for the purpose of sanctioning past non-compliance.

[402] Directive 2014/24 expressly encourages such measures that foster SME participation to public procurement procedures. See e.g. recitals 2 and 78 of the preamble to Directive 2014/24.

Seventhly, also preferences in inviting firms to tender can serve the purpose of pursuing environmental and social considerations in public purchasing. Public purchasers may decide to invite only firms which meet certain standards accommodating the policy objectives. In this vein, the public purchaser may decide to invite only undertakings applying fair recruiting standards or undertakings apt to contribute to the achievement of certain policy objectives (e.g. inviting only undertakings from deprived regions).

Award criteria are an eighth instrument. The purchaser may apply criteria to assess the bids on the basis of their suitability to achieve policy objectives. For instance, tenderers can receive additional points, and thus distinguish themselves positively from other tenderers, if his product is environmental friendly.

Ninthly, also measures aimed at improving access to public contracts can serve as a way to implement social and environmental objectives. The public purchaser may actively stimulate participation by certain undertakings, without however limiting competition or altering the requirements. In this respect, the public purchaser may provide guidance to SMEs on how to successfully participate in tender procedures.[403]

In this chapter we will, however, only consider the implementation of social and environmental policy considerations through award criteria and technical specifications.

Award criteria are criteria in accordance to which public purchasers assess the bids and decide which tenderer deserves to be chosen.[404] Public purchasers can apply solely the lowest price criterion. However, they can also award the contract to the economically most advantageous tender. In case of the latter, also other considerations than only the price submitted are relevant when assessing the tender. The public purchaser can only in case of the latter apply environmental or social award criteria.

[403] S Arrowsmith, 'A taxonomy …' *l.c.*, 127-146.
[404] See e.g. Green paper: public procurement in the European Union: exploring the way forward. Communication adopted by the Commission on 27th November 1996, point 3.21. See also the discussion of the concept of 'award criterion' in the previous chapter.

Contractual requirements in the form of technical requirements are tantamount to the 'technical specifications' as envisaged in Directive 2014/24. The latter provides for a legal framework within which technical specifications can be used to pursue horizontal objectives. The fact that this kind of contractual requirements can be used to this end follows from the wording of the definitions in Directive 2014/24 (previously Directive 2004/18[405]) of this concept. These definitions refer explicitly (amongst others) to environmental and social ends that can be achieved through the use of technical specifications.[406] Without however going too deeply into the complex provisions governing technical specifications, a technical specification can be described as follows: *Technical specifications include all characteristics required by the contracting authority in order to ensure that the product or service fulfils the use for which it is intended*.[407]

c. The taxonomy for the analysis

Hereinafter we will examine the various ways to deploy award criteria and technical specifications to pursue environmental and social policy considerations through public purchasing in the light of our 'enriching' exercise. To structure our analysis we will rely upon the taxonomy Arrowsmith elaborated. This taxonomy maps the various possibilities for public purchasers to pursue policy considerations.

Arrowsmith bases her taxonomy on three key distinctions: (i) the instrument aims at compliance with legal requirements which embody social or environmental policy considerations vs. the instrument aims at implementing a policy that goes beyond legal requirements; (ii) the policy objective pursued is related to contract performance vs. the policy objective pursued entails a general policy that is not related to the contract performance and (iii) the different mechanisms

[405] Directive 2014/24 replaced Directive 2004/18. However, further below we will also rely on the provisions of Directive 2004/18. This is because the vast majority of the relevant jurisprudence concerns provisions of Directive 2004/18.
[406] S Arrowsmith, 'Application of the EC Treaty and directives to horizontal policies: a critical review' in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law*, (Cambridge University Press, 2009),., 202. More in particular, Arrowsmith refers to two definitions. The first is the definition in Annex VI, point 1(a) to Directive 2014/18 and point 1(b) of Annex VI to Directive 2014/18. The definitions can currently be found in annex VII to Directive 2014/24.
[407]Commission interpretative communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement, COM/2001/0274 final, OJ C333, 28 November 2001, p. 10.

for implementing the horizontal objectives.[408] We already discussed the various mechanisms in a previous section. We will not further discuss them in this section, but we reiterate that our analysis will be limited to the use of award criteria and technical specifications. In addition to these criteria to map the options open to public purchasers to pursue policy objectives when purchasing, we will also discuss the regulator vs. purchaser dichotomy that can be drawn from Arrowsmith's, but also from Arrowsmith and Kunzlik's analysis.

(a) Compliance with the law or going beyond the law

The first key distinction entails the question whether the policy consideration aims at compliance with the law or whether the objective envisaged goes beyond merely law compliance. As to policy objectives aiming at compliance with the law, Arrowsmith gives the example of the contractual requirement to comply with health and safety regulations in the course of contract performance.[409] The reasons why a public purchaser would consider to pursue such an objective are, according to Arrowsmith: (i) avoiding that the government gets associated with illegal behaviour, (ii) introducing an additional enforcement tool and/or reducing the risk that the contract performer will violate the law when performing the contract, (iii) avoiding that some tenderers have a competitive advantage due to their illegal behaviour and (iv) avoiding that public money is used to support tenderers developing criminal activities or that the public purchaser choses a tenderer who does not deserve to earn public money.[410]

The public purchaser can introduce such requirement regardless of whether the policy objective pursued relates to contract performance or goes beyond the actual scope of the contract.[411] Conversely, as to the mechanisms to implement the policy consideration, not every mechanism is suited to favour law compliance. The author gives the example of an award criterion which implies additional points in case of compliance with certain legal requirements.[412] Obviously, every tenderer is presumed to comply with the law.

[408] S Arrowsmith 'A taxonomy …', *l.c.*, 109.
[409] S Arrowsmith, 'A taxonomy …', *l.c.*, 110.
[410] S Arrowsmith, 'A taxonomy …', *l.c.*, 112-113.
[411] S Arrowsmith, 'A taxonomy …', *l.c.*, 111.
[412] S Arrowsmith, 'A taxonomy …' *l.c.*, 111-112.

Next to law compliance, the public purchaser may also pursue objectives that go further than what is provided for in existing laws and regulations. These objectives can relate to contract performance or to a more general policy.[413] Pursuing such more general policies often result in the public purchaser taking up the role of a regulator.[414] In this case, the question emerges whether the application of such 'regulation' is justified given its selective nature. After all, undertakings not competing for the public contract are not subject to such 'regulation'. However, Arrowsmith puts forward two justifications. First, pursuing such policies allows the public purchaser to ensure that the government is associated with the highest possible standard. This may be motivated by the intention to set an example, thereby aiming at wider acceptance in the market or to avoid criticism. The second is that public purchasing is a more efficient tool to pursue particular objectives.[415] Arrowsmith, however, lists a number of concerns that emerge here: (i) the question of democratic legitimacy, (ii) the adequacy of procedural safeguards, (iii) lack of legal certainty and (iv) problems as to transparency.[416]

(b) Confined to contract performance or going beyond contract performance

The second key distinction involves the dichotomy between policy objectives closely connected with contract performance and policy objectives going beyond contract performance. This distinction matches broadly the distinction between the public purchaser as a purchaser on the one hand, and a purchaser as a regulator on the other hand, according to Arrowsmith.[417] Arrowsmith and Kunzlik describe the purchaser-regulator dichotomy as follows:

> "*This reflects, broadly, the fact that sometimes the government's concern is not merely to acquire a product, work or service that it needs, but that in other cases it also uses its procurement power to 'regulate' behaviour as a substitute for more traditional regulatory techniques.*"[418]

[413] S Arrowsmith, 'A taxonomy …', *l.c.*, 116.
[414] More in particular, this will be the case when the requirement embodying the policy consideration is not confined to contract performance. Cf. infra.
[415] S Arrowsmith, 'A taxonomy …', *l.c.*, 118-119. Nevertheless, in an earlier paper Arrowsmith discusses the fact that also the costs of doing so should be taken into account when testing the efficiency. S Arrowsmith, 'Public procurement as an instrument of policy and the impact of market liberalisation' (1995) 2 *Law Quarterly Review* 235, 245-246.
[416] S Arrowsmith, 'A taxonomy …', *l.c.*, 119-120.
[417] S Arrowsmith, 'A taxonomy …', *l.c.*, 122.
[418] S Arrowsmith and P. Kunzlik, *l.c.*, 21.

As to policies confined to contract performance, Arrowsmith distinguishes three implementation mechanisms:[419]

(i) Decisions to purchase or not to purchase;

(ii) Decisions on what to purchase and

(iii) Policies relating to the contract that are implemented through other mechanisms (such as the use of environmental award criteria or technical specifications).[420]

As our analysis is confined to award criteria and technical specifications as instruments to pursue social and environmental policy objectives through public purchasing, only the last category is relevant to our analysis.

This last category is subdivided into four categories, based on the effects the instrument concerned is intended to produce. The first category comprises instruments producing consumption effects: the policy objective relates to the effects when the product is consumed. An example is assuring that the food served in a canteen accommodates the desires of all religious groups. The second category includes instruments producing production or delivery effects: the policy objective implemented relates to the effects when the product is produced or delivered. An example is achieving the policy objective that the product is manufactured through an environmental friendly production method or that the products are delivered without an impact on the environment. The third category comprises instruments producing disposal effects. The policy objective implemented relates to the effects when the products, services or works are disposed of. An example here is requiring suppliers to recycle products after the performance of the contract. The fourth category includes instruments implying workforce measures. The policy objective here relates to the workforce the supplier employs when performing the contract. In this regard, the public purchaser may require the contractor to hire long-term unemployed people.[421]

[419]See also the discussion above on the various instruments to pursue social and environmental policy considerations.
[420] S Arrowsmith, 'A taxonomy …', *l.c.*, 122.
[421] S Arrowsmith, 'A taxonomy …', *l.c.*, 123-124.

Hence, for our analysis it is important to note that an award criterion or a technical specification can embody the pursuit of an environmental or social policy objective. In doing so, such instrument can produce consumption effects, production/delivery effects, disposal effects and workforce effects.

Next to policies confined to contract performance, Arrowsmith also distinguishes policies that go beyond contract performance. The author distinguishes three kinds of policies to be pursued: (i) policies regarding the regulation of the behaviour of undertakings across its business activity as a whole (e.g. excluding firms that maintain undesirable business relationships in third countries); (ii) policies aiming at supporting undertakings displaying particular features (e.g. reserving contracts for firms employing disables people) and (iii) policies involving a requirement for undertakings to provide benefits to the community that are not directly connected with the contract (e.g. requiring the firm to build a production plant in the local area without this having a connection with the contract).[422]

(c) The regulator vs. purchaser dichotomy

Based on the analysis by Arrowsmith and Kunzlik[423] and Arrowsmith[424], we can also map the various kinds of measures for implementing social and environmental considerations through public purchasing. The categories that allow mapping are based on the role the public purchaser adopts when applying these measures: the role of a purchaser or the role of a regulator. Arrowsmith and Kunzlik contend that purchasers pursuing policy objectives that are not confined to contract performance act as a regulator. Conversely, a public purchaser pursuing policy objectives that are confined to contract performance acts as a purchaser.

However, a *caveat* is in place here. Even though the regulator-purchaser dichotomy Arrowsmith and Kunzlik[425] suggest is based upon the criterion whether or not the policy consideration relates to the subject-matter of the contract, Arrowsmith seems to suggest that also considerations that go beyond law compliance have a regulatory dimension.[426] It seems safe to

[422] S Arrowsmith, 'A taxonomy …', *l.c.*, 125-126.
[423] S Arrowsmith and P Kunzlik, *l.c.*, 21-22.
[424] S Arrowsmith, 'A taxonomy …', *l.c.*, 109-127.
[425] S Arrowsmith and P Kunzlik, *l.c.*, 22.
[426] S Arrowsmith, *l.c.*, 118.

assume that Arrowsmith addresses the hypothesis of considerations that are confined to contract performance but that go beyond law compliance. However, also a private purchaser may wish to implement considerations that are confined to the subject-matter of the contract but go beyond law compliance. This could be the case for considerations producing consumption effects (e.g. a private purchaser entering into a purchase contract for vehicles requiring those vehicles to meet stricter environmental criteria than the law provides for). On the other hand, it looks highly unlikely that such is the case for a policy objective aimed at producing workforce effects (e.g. a private purchaser requiring that a contractor employs long-term unemployed people for the performance of the contract).

We will discuss this point further below. Hence, for now, we submit that when the policy objective pursued goes beyond what is legally provided for but that is confined to contract performance, the public purchaser can act both in a capacity of regulator and a capacity of purchaser. This point is relevant for our analysis in the next section.

B. THE PROBLEM OF NEGATIVE EXTERNALITIES FOLLOWING FROM PURSUING POLICY OBJECTIVES IN PUBLIC PURCHASING

The problem we see as to the pursuit of policy objectives in public purchasing is that they have the capacity to limit the pool of tenderers competing for the contract. Hence, competition is imperfect, possibly resulting in a supra-competitive price and thus in the negative externalities we envisage to address. The literature already flagged that intergrating such policy considerations in public purchasing may imply an increased price. Sanchez Graells remarks in this respect that using public purchasing to pursue policy objectives undermines achieving the economic goals of public procurement regulation.[427] The author discusses that such policy objectives can be alien to the actual process of awarding a public contract through a public procurement procedure. Hence, in order for a social or environmental consideration to be acceptable it should not merely relate to the subject-matter of the contract. Such consideration should relate 'closely' to the contract's subject-matter.[428] After all, such pursuing of policy objectives is deemed to be alien to the function of public procurement as a 'buying tool'. Hence,

[427] A Sanchez Graells (2015), *o.c.*, 184.
[428] A Sanchez Graells (2015), *o.c.*, 100 and 185.

Sanchez Graells suggests that pursuing policy goals through public purchasing should be abandoned or at least be subject to strict conditions. In this respect, the author also refers to the undervalued significance of the external goal of public procurement regulation, i.e. not affecting competition in the broader market. If advancing social or environmental policy objectives through public purchasing adversely affects market dynamics, such practice should be abandoned.[429]

As we discussed earlier, our angle for approaching public procurement regulation differs from the angle Sanchez Graells adopted. Nevertheless, the point he made is also relevant to our analysis. After all, the author argues that pursuing policy objectives through public purchasing can produce inefficiencies. If a public purchaser fails to achieve efficiency, the risk emerges that the public contract is entered into at a supra-competitive price. Indeed, also economic literature points out that pursuing policy objectives when purchasing, undertakings able to fit the public purchaser's requirements can inflate their bids and still win the contract.[430]

It is generally accepted that public purchasers pay more when policy considerations are pursued.[431] This in turn will give rise to the negative externalities that are at the heart of this thesis. However, we do not argue that pursuing social or environmental policy objectives when purchasing is automatically questionable. Public purchasers may have sound reasons to pursue policy objectives.[432] After all, public purchasing may offer a suitable environment to pursue such objectives. What we argue here is that the public purchasers' discretion to do so should be balanced with the negative externalities this gives rise to. Such discretion should be limited in order to accommodate the concerns resulting from these negative externalities. As mentioned above, implementing such policy considerations may produce an increase in price. This is not only because the additional requirements related to the policy consideration imply more costs.

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[429] A Sanchez Graells (2015), *o.c.*, 101.
[430] T P Hubbard and H J Paarsch, 'Investigating bid preferences at low-price, sealed-bid auctions with endogenous participation' (2009) 1 *International Journal of Industrial Organization* 1, 2.
[431] A Sanchez Graells (2015), *o.c.*, 104-105; C H Bovis, 'Public Procurement, State Aid and Public Services: Between Symbiotic Correlation and Asymmetric Geometry' (2003) 4 *European State Aid Law Quarterly* 553, 557
[432] After all, literature suggests that purchasing economically friendly products may provide cost-efficiencies in the long run. I Rüdenauer, M Dros, U Eberle, C O Gensch, K Graulich, K Hünecke, Y Koch, M Möller, D Quack, D Seebach, W Zimmer, M Hidson, P Defranceschi, and P Tepper, 'Costs and Benefits of Green Public Procurement in Europe - General Recommendations Procurement in Europe', 27 July 2007, http://ec.europa.eu/environment/gpp/pdf/eu_recommendations.pdf, 1-2.

Also, the tenderers able to meet the public purchaser's requirements, have a more favourable position vis-à-vis other tenderers when competing for the contract. This implies that competition is undermined and/or limited.[433] As a consequence, the 'favoured tenderer(s)' can increase the price without running the risk of punishment by the competition mechanism.[434]

The problem we see can however not be simplified to merely the problem of payment of an increased price. As we discussed in chapter 1, our aim is to avoid that negative externalities occur. These negative externalities follow from contracting at a supra-competitive price. Our issue with pursuing policy objectives in public purchasing is that this may, from an economical viewpoint, give rise to a subsidy. This is because actually a public purchaser pays a price for the supplier's contribution to the pursuit of the policy objective. A subsidy is a government intervention that is necessary when the market fails to deliver the desired outcome. We will discuss further below that pursuing policy objectives when purchasing may result in such an intervention.

In fact, here we enter the area of EU state aid law.[435] This body of law sees to the anti-competitive effects such subsidy-granting implies. The beneficiary obtains a subsidy and uses it to expand his market share. This harms his competitors as they do not receive such subsidy. An example may clarify this. Suppose an undertaking can offset his investment in an environmental friendly production process due to a price increase when contracting with a public purchaser. This undertaking receives an advantage to compete with other companies on other markets. The latter do not have the possibility to recoup such investment, leaving them with a competitive disadvantage. After all, the chosen tenderer has now funds available to expand his market share. If he would not have been chosen to perform the public contract, he

[433] C. Weller and J. Meissner Pritchard, 'Evolving CJEU: Balancing Sustainability Considerations with the Requirements of the Internal Market' (2013) 1 *European Procurement and Public Private Partnerships Law Review* 55, 58. The authors however contend that such problem may be solved in the long run because increased demand creates increased supply. Hence, initially the competition for supplying the product with the specific features envisaged may be limited, but the market will react and other suppliers will enter the market for the specific product at hand. This point does however not contradict our position. After all, authors confirm that for the contract at hand, competition may be limited. Furthermore, this point seems only to apply if the requirements aim at fostering innovation. It does not seem to apply for products for which already a market exists.
[434] T P Hubbard and H J Paarsch, *l.c.*, 13.
[435] The reference to EU state aid law is all the more relevant as we argued in chapter 2 that our 'enriching' exercise and EU state aid law share to a large extent the same ends and *rationale*.

would have had to deploy these funds to invest in his production process in order to remain competitive.

Of course, state aid should be allowed under certain conditions, i.e. when it is the appropriate instrument to correct a market failure. However, such a subsidy should be subject to prior state aid control. This follows from article 108 (2) TFEU, which requires the Member States to notify state aid measures with the Commission prior to their conferment. After all, before granting state aid, this aid should have been the subject of a balancing test. This test involves balancing the positive and negative effects the aid measure produces. If pursuing policy objectives would be allowed without more, leaving an open window for subsidizing via public purchasing, the subsidies granted by virtue of the public contract would escape state aid control, including the balancing test. We deem this problematic as we believe that it is doubtful whether such a subsidy would not be allowed in view of state aid law.

We see three issues in this respect.

First, the aid measure should be an appropriate instrument[436] and be proportionate in view of the outcome.[437] Subsidising through public procurement is however not subject to such a test. The amount of the subsidy may well be disproportionate in view of the result. Furthermore, the result aimed for when pursuing the policy objective could possibly be achieved more effectively. For instance, regulation, a specific subsidy mechanism or taxation may prove better suited in view of the proportionality requirement. In this respect, the Environmental State Aid Guidelines provide that state aid should be the ultimate measure to correct the market failure.[438] We can also illustrate this problem by discussing a research project carried out by Cerqua and Pellegrini. These authors have examined the effect of public subsidies for investment in deprived regions. The authors found that the subsidies resulted in an increase of the private capital within the subsidised undertakings and that the subsidies implied firm growth (in terms

[436] Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3 , http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf., (hereinafter "Common Principles"), par. 30.
[437] Common Principles, par. 39.
[438] Communication from the Commission. Guidelines on State aid for environmental protection and energy 2014-2020, 2014/C 200/01, *OJ* C 200, 28 June 2014, 1 (hereinafter "Environmental State Aid Guidelines"), par. 36.

of turnover and employment). However, the authors also pinpoint the inefficiency of this subsidy policy. They state that the average cost per job created was higher in comparison with other instruments more focused on the employment target. Moreover, the output per employee suggested that such a capital increase did not necessarily yield efficiency and productivity. Cerqua and Pellegrini suggest that this was due to the subsidy criteria. These rewarded applicants whose projects ensured a high number of new employees. Hence, applicants had an incentive to hire more employees than economically reasonable. This endangered the efficiency and growth of the undertaking in the long run, the authors contend.[439] In another paper, Bernini and Pellegrini even submit that such subsidy measures may give rise to an increase of employment, but this will probably turn out not to be sustainable. Furthermore, they submit that productivity in non-subsidised undertakings grew faster compared to the productivity of subsidised undertakings.[440] Also Bovis has flagged this problem, albeit in a more general way. He considered the argument that addressing market failures can be a justification for discriminatory public procurement. Bovis argues that such argument is flawed as there is no guarantee that the market failure envisaged is addressed efficiently and successfully.[441]

Secondly, the aid measure must produce a stimulating effect. This requires that the aid should incite the beneficiary to change his behaviour.[442] However, when subsidizing an undertaking through a public contract, this is not verified. Especially if the investment was already done before initiating the award procedure, this is a clear indication that the subsidy does not contribute to a behavioural change. Imagine an undertaking which invested in a more environmentally friendly production process submits a bid in a tender procedure with "environmental friendliness of the production process" as one of the award criteria. This tenderer will obtain additional points when the bids are scored. Being aware of this, he can inflate his bid. The "subsidy" can thus be deemed to lack an incentive effect. After all, the necessary investments were already carried out before receiving the "subsidy". The fact that the tenderer with the most environmental friendly production process is chosen – and thus that

[439] A Cerqua and G Pellegrini, 'Do subsidies to private capital boost firms' growth? A multiple regression discontinuity design approach' (2014) 1 *Journal of Public Economics* 114, 124-125.
[440] C Bernini and G Pellegrini, 'How are growth and productivity in private firms affected by public subsidy? Evidence from a regional policy' (2011) 3 *Regional Science and Urban Economics* 253, 264.
[441] C H Bovis, 'State Aid and Public Private Partnerships – Containing the Threat to Free Markets and Competition' (2010) 2 *European Procurement and Public Private Partnership Law Review,* 167, 174-175.
[442]Common Principles, par. 32; Environmental State Aid Guidelines, par. 68.

the policy objective can be considered to be achieved – does not alter this conclusion. After all, the question is not whether the subsidy results in an environmental friendly production process. The question is whether the tenderer also would have invested in the production process absent the knowledge that he would get awarded this particular contract in the future. It seems safe to assume that the investment in this example would have been carried out anyway, as a part of the undertaking's business strategy.

A third issue follows from the requirement that the subsidy's distortive effect should be limited.[443] Subsidising an undertaking through a public contract grants a competitive advantage to that tenderer while his competitors do not enjoy such an advantage. Even more, if the subsidy is obtained through a public contract, competitors to the chosen tenderers on private markets are not even in the possibility to obtain this subsidy. However, they as well are able to contribute to the pursuit of the policy objective. Hence, the decisive criterion to obtain the subsidy is whether or not the undertaking competes for a public contract and subsequently gets the contract awarded. The pool of undertakings eligible to obtain the subsidy is thus limited. It follows that there is a clear chance that the subsidy is not granted to the undertaking making the most efficient use of it. In the Environmental State Aid Guidelines, the Commission pinpoints this as a source of disproportionate competition distortion. More in particular, the Commission prefers the subsidy to be administered through "a non-discriminatory, transparent and open selection process, without unnecessarily excluding companies that may compete with projects to address the same environmental or energy objective". The underpinning idea is that such process guarantees conferment of the state aid to undertakings that can address the objectives using the least amount of aid or in the most cost-effective way.[444]

When the state aid is administered via a public procurement process there is indeed formally a competitive selection procedure. However, this procedure is not (or at least not fully) focused on the efficient administration of the aid. Moreover, this selection procedure is not open for all undertakings that have the potential to deliver the envisaged outcome. The competitive selection procedure arguably aims at the communication of the applicants' private information: which applicant can make the most efficient use of the state aid in view of the objective

[443]Common Principles, par. 57.
[444] Environmental State Aid Guidelines, par. 99.

pursued? Public procurement procedures do not deliver an answer to this question. After all, obtaining aid to achieve the policy objective pursued is not what the tenderers compete for. They compete for the contract. One of the decisive elements to obtain this contract is whether or not they can comply with a requirement inspired by the pursuit of a policy objective. It follows that there is a clear risk that the subsidy administered via the public contract does not favour a 'deserving' company. The Environmental State Aid Guidelines indicate that this is an undesired effect.[445] Hence, the subsidy is likely to affect the normal market dynamics and to harm the competitive position of the competitors of the chosen tenderer on other markets than the public market at hand.

The examples elaborated above using the case of environmental state aid also work as to social policy concerns. Indeed, the Commission can endorse state aid to foster employment in deprived areas based on article 107 (3) (a) and (c) TFEU. Also, the Commission issued a few soft law documents to give substance to its discretion when examining state aid to remedy social issues, such as training aid[446] or aid to employ disabled persons.[447] Even though above we focused on the correction of market failures to ensure an efficient market, the Commission also can endorse state aid measures with an equity objective.[448] The principles as to proportionality, necessity, appropriateness of the measure and limiting competition distortions remain the same. However, these principles apply to a lesser extent to the state aid mentioned in article 107 (2) (a) TFEU. This provision states that the Commission is bound to approve aid "*having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned"*. An example could be ensuring transport from remote areas to urban centres.[449] However, achieving this outcome through public procurement law seems rather unfeasible. This is because the aid should be to the benefit of consumers regardless of the undertaking who can deliver the product or service at hand. After

[445] Environmental State Aid Guidelines, par. 90.
[446] Communication from the Commission - Criteria for the compatibility analysis of training state aid cases subject to individual notification, *OJ* C 188, 11 August 2009, 1.
[447] Communication from the Commission - Criteria for the compatibility analysis of state aid to disadvantaged and disabled workers subject to individual notification, *OJ* C 188, 11 August 2009, 6.
[448] Common Principles, par. 26-29.
[449]See e.g. State Aid N 169/2006 – United Kingdom. Aid of a Social Character Air Services in the Highlands and Islands of Scotland, 16 May 2006, C (2006) 1855 final.

all, the aid measure may not imply that the market is closed for certain tenderers. Hence, the Member State cannot subsidise a particular provider, they can only subsidise consumption.[450]

It follows that deploying a public procurement procedure in order to pursue policy objectives may imply the granting of a subsidy together with the award of the contract. This point of view is also expressed in the literature. Comba argues that the primary objective of the public contract is to address the public purchaser's needs. Other considerations, i.e. considerations relating to product features that are not necessary to have these needs addressed, are secondary. As to the former, the public purchaser acts as a consumer; as to the latter, he acts as a regulator.[451] It follows that the application of secondary considerations in a public procurement procedure results in fact in a public contract plus a state aid conferral.[452] Also Beckers reasons along the same lines. She argues that a lenient position vis-à-vis the notion of 'subject-matter', allowing public purchasers to pursue sustainability objectives, may make public procurement drift away from its economic conception towards becoming a tool of regulation. As a consequence, the 'best value for money' rationale is moved to the background, and the regulatory dimension will guide the procurement process.[453]

Also Arrowsmith's and Arrowsmith and Kunzlik's purchaser vs. regulator divide, which we referred to above, in fact already indicates implicitly a problem of subsidising. One of the criteria to categorise public contracts pursuing a policy objective was the purchaser-regulator divide. Also in EU state aid law, such a divide is relevant, i.e. with regard to the notion of 'advantage'. Presence of an 'advantage' is one of the cumulatively applicable conditions for application of the state aid prohibition. In case an act under review represents an economic act (i.e. an act the Member State adopts in the capacity of economic operator), no 'advantage' (and thus no state aid) is at hand if such measure reflects economic rationality. Crucial question is whether a private market operator would have proceeded to such an act as well in similar

[450] Aide d'Etat N 546/2006 – France. Fonds d'aide à des particuliers sous conditions de ressources dans la perspective de la fin de la radiodiffusion analogique, 6 December 2006, C(2006)5848 final, par. 28-29. However the Commission accepted that the Member State can purchase a particular good or service on the market followed by a distribution amongst eligible consumers. However, in doing so, the purchase is motivated by a policy outcome without implementing policy considerations in the procurement process itself.
[451] M E Comba, *l.c.*, 310 and 312.
[452] M E Comba, *l.c.*, 311.
[453] A Beckers, 'Using contracts to further sustainability? A contract law perspective on sustainable public procurement' in B Sjafjell and A Wiesbrouck (eds.), *Sustainable Public Procurement Under EU Law*, (Cambridge University Press, 2015), 223-224.

circumstances. More specifically as to our subject, the question arises whether the public contract is entered into at terms and conditions which would have been acceptable to a private purchaser as well.

However, if the act is not of an 'economic nature', i.e. when the Member State acts as a regulator, such test cannot be applied. After all, a private market participant would never adopt such behaviour.[454] Hence, to the extent the purchasing behaviour reflects the behaviour of a regulator, such behaviour qualifies economically as a subsidy. Hence, the public contract satisfies the condition of conferment of an 'advantage' to the extent the public purchaser's purchasing behaviour is defined by regulatory considerations. To be sure, previously we already argued that his 'advantage' converges with the 'negative externalities' we envisage here.

Admittedly, subsidising as a policy instrument has its merits. However, given its distortive effect vis-à-vis competition – the same kind of effect our negative externalities produce – public authorities should administer subsidies rationally. Therefore, we believe that, in order to avoid the negative externalities due to public contracts containing a subsidy component, public purchasers should be denied a too wide margin of discretion as to the integration of policy objectives in the procurement process. We believe that public purchasing is not an apt instrument to pursue such objectives. This claim is backed up by the argument that pursuing such policy objectives may give rise to the negative externalities we discussed in chapter 1. Even more, there is no guarantee that the adverse effects arising from these negative externalities are justified in view of the outcome achieved. Or put differently, if a government deems it necessary to intervene on a market because this market does not achieve a particular outcome – e.g. the provision of a public good – we consider public procurement not to provide for an adequate arena to address such market failure.

C. 'ENRICHED' PUBLIC PROCUREMENT REGULATION'S REQUIREMENTS

In the previous section we discussed the problems in terms of negative externalities the pursuit of secondary policy considerations can give rise to. This is because integrating requirements in

[454] Case C-124/10 P, EDF, ECLI:EU:C:2012:318, 79-81.

the public procurement procedure to have policy objectives achieved reduces competition for the contract. After all, only undertakings able to meet these requirements can participate in the tender procedure. Furthermore, chosen tenderers have an opportunity to recover investments that relate to the public purchaser's specific requirements. This strengthens their position on other markets. Their competitors on markets outside the market for the public contract are not in position to recoup investments through performing public contracts. Hence, this curtails these competitors' ability to compete.

More in particular, we see a problem as to the third leg of our 'standard for enrichment'.[455] This third leg requires, amongst others, that the public purchaser does not apply requirements alien to the contract.[456] This is because such requirements artificially reduce competition for the contract. Hence, pursuing policy considerations would only be permissible under 'enriched' public purchasing regulation if the award criterion or the technical specification represents a requirement that relates to the subject-matter of the contract.

In the previous section, we already drew a parallel with EU state aid law. A Member State grants an 'advantage' – which we consider to converge with the negative externalities we wish to address – when acting in the capacity of a regulator when purchasing, so we argued. Hence, 'enriched' public procurement regulation would not allow a public purchaser to deploy a requirement representing a policy objective if this objective has regulatory features. Furthermore, a public purchaser is believed to act as a regulator if the relevant requirement (the award criterion or the technical specification) is not merely confined to contract performance, regardless whether the requirement goes beyond what is provided for in the law or not. Also, we concluded that if the requirement is confined to contract performance but goes beyond what is required for by law, the public purchaser may act either as a purchaser or as a regulator.

The regulator-purchaser divide is helpful, but we suggest a more formalised criterion to establish whether a policy consideration is permissible under 'enriched' public purchasing

[455] For the purpose of the argument, we assume that the award criteria and/or technical specification were brought to the attention of all actual and potential tenderers and that those tenderers had equal and full information about the embedded requirement. If so, the first (competition) and second leg ('genuine' competition) of our 'standard for enriching' are satisfied.
[456] As we discussed in chapter 3 such requirement would limit the competition among interested parties and thus jeopardise the establishing of a genuine market price.

regulation. To recall, the third leg of our 'standard for enrichment' requires that requirements integrated in the public procurement procedure by way of award criteria or technical specifications relate to the subject-matter of the contract. Hence, they should not be alien to the contract. We argued that such requirements can limit competition for the contract. As a consequence, tenderers can set prices above the market equilibrium price. This allows them to recover investments. In this manner, they can strengthen their position on other markets.

It follows that we consider the difference between, on the one hand, the price which would have been established under perfect competition and, on the other hand, the price established pursuant to a public procurement procedure incorporating requirements based on policy objectives, to qualify (in economic terms) as a subsidy. We argued above that such subsidy can be assumed to produce our negative externalities, and this without justification from an overall social welfare point of view. After all, this subsidy is not granted in accordance with the requirements EU state aid law provides for. Hence, there is no guarantee that the subsidy is justified, appropriate or adequate in view of a market failure. Hence, 'enriched' public procurement regulation would prohibit such a policy oriented requirement.

But how to establish whether an award criterion or technical specification representing an environmental or social concern is permissible under 'enriched' public purchasing regulation? What we suggest is a test based on the notion of 'public good'. The crucial question here is: what does the public purchaser acquires through applying this award criterion or technical specification? The answer to this question reveals whether or not the aim of the social or environmental policy objective consists of the delivery a public good. It is submitted that if the delivery of a public good is envisaged, the policy consideration is alien to the purchasing process. After all, ensuring the provision of a 'public good' is a regulatory act, i.e. an act the public entity adopts in its capacity of the 'state' (or 'regulator') as such. This is because a certain good only qualifies as a 'public good' if and insofar the market does not provide for it. If the market does not deliver a 'public good', the market fails. It is then for the state, as a 'regulator', to correct this market failure. However, when addressing a market failure through public purchasing, such envisaged outcome is at best only indirectly connected to the subject-matter of the contract. The supra-competitive price then represents a subsidy to the chosen tenderer.

This provides him with an advantage when competing on other markets, i.e. outside the specific market for the public contract at hand.

Before developing an example, let us first clarify the notion of 'public good'. To establish whether a good is public or private the following questions have to be answered. First, is consumption rivalrous? This will be the case if one person's consumption excludes another person's consumption of that same good. If consumption is non rivalrous, anyone can consume the good without interfering with consumption by another person. Secondly, can certain people be excluded at a reasonable cost from the benefits produced by the good? If a good is non-rivalrous and if it is impossible or nearly impossible to exclude people from consumption at a reasonable cost, a public good is at hand. The market is not likely to provide such a public good as providing such a public good does not allow for profit-maximisation.

Applying the notion 'public good' as a decisive criterion also sits well with the purchaser-regulator divide. After all, a private purchaser (being an economically rational actor) would not pursue the delivery of a public good when purchasing. By nature, assuring the delivery of a public good is a *rationale* underpinning regulator's intervention. After all, as the market is not able (or willing) to provide the public good in the first place, it is for the regulator to intervene. Even though this is controversial in the literature,[457] this also triggers concerns as to EU state aid law. After all, arguing that a private purchaser would not enter into a contract that partly represents a regulatory nature – i.e. provision of a public good – implies that the compliance with EU state aid law is put into question. After all, pursuing such a policy objective implies, economically speaking, a 'subsidy'. This subsidy is a compensation for the supplier's contribution to the delivery of a public good.

We referred in the previous paragraph to the point of view Priess and Von Merveldt adopted. They argue that pursuing policy objectives in public procurement does not automatically bring the contract within the ambit of the EU state aid prohibition. This will only be the case if the price paid under that contract implies overcompensations of the counterparty.[458] Therefore, the

[457] H J Priess and H G von Merveldt, 'The impact of the EC state aid rules on horizontal policies in public procurement' in S. Arrowsmith and P. Kunzlik, *Social and Environmental Policies in EC Procurement Law. New Directives and New Directions*, (Cambridge University Press, 2009), 263.
[458] *Ibid.*, 263-264.

question to be asked is: given the good, service or work, would a private purchaser have entered into the contract under those conditions as the ones in the public contract? Whether or not the horizontal policy pursued relates to the subject-matter of the contract is of no importance, according to the authors. As we discussed in previous paragraphs, we disagree with this point of view. We also find support in the point of view Nicolaides and Shoenmaekers express. They argue that a *"private investor is motivated solely by the possibility of making profits or return on investment and ignore all other policy objectives, irrespective of how laudable or worthy they may be"*.[459] Also, the fact that all tenderers were faced with the pursuit of such a policy objective in the course of the procedure does not alter this point of view.[460] Furthermore, both authors also argue that a State behaves differently than a private consumer when a State accepts contractual obligations which can be deemed to increase the price.[461]Also Doern has argued that utilising secondary criteria not directly linked to the subject-matter of the contract raises doubts as to whether the contract is EU state aid law compliant.[462]

In essence, our criticism also echoes advocate-general Sharpston's analysis, dividing the 'private investor criterion' into a two-step test. First, it has to be established whether the behaviour at hand qualifies as an economic act. Secondly, it has to be established, if such behaviour is indeed of an economic nature, whether also a private party would have acted in the way the Member State did.[463] Here, we argue that pursuing policy objectives through public purchasing, may fail the first limb of the said test.

Apart from legal concerns, our point also raises practical issues. After all, the contract has to be divided into a 'purchasing' part and a 'regulatory' part. Hence, the public purchaser in fact only grants state aid for the amount paid that corresponds to the requirement (as to our analysis,

[459] Ph Nicolaides and S Schoenmaekers, 'The Concept of 'Advantage' in State Aid and Public Procurement and the Appication of Public Procurement Rules to Minimise Advantage in the New GBER' (2015) 1 *European State Aid Law Quarterly*, 143, 144
[460] Ph Nicolaides and E Rusu, 'Competitive Selection of Undertakings and State Aid: Why and When Does It Not Eliminate Advantage?' (2012) 1 *European Procurement and Public Private Partnership Law Review* 5, 18.
[461] Ph Nicolaides and S Schoenmaekers, 'Public Procurement, Public Private Partnerships and State Aid Rules: A Symbiotic Relationship' (2014) 1 *European Procurement and Public Private Partnership Law Review* 50, 52. See also: Ph Nicolaides, 'State Aid Advantage and Competitive Selection: What is a Normal Market Transaction?' (2010) 1 *European State Aid Law Quarterly* 65, 71.
[462] A Doern, 'The interaction between EC rules on public procurement and state aid' (2004) 3 *Public Procurement Law Review* 97, 121.
[463] Opinion AG Sharpston of 19 December 2013 in Case C-224/12 P, ING, ECLI:EU:C:2014:213, 35. See also: Case C-124/10 P EDF, ECLI:EU:C:2012:318, [84]. See also: Case T-103/14 Frucona Košice, ECLI:EU:T:2016:152, 97-98.

adopting the form of an award criterion or a technical specification) that represents the policy objective. It goes without saying that establishing this amount is difficult, and thus costly. Even though this issue does not relate to our problem as to negative externalities, the compliance, monitoring and enforcement costs that follow from EU state aid law control are an additional argument in favour of our strict stance following from application of our 'standard for enrichment'.

Before discussing the various scenarios, we first note that we deem certain requirements not relevant. This is because it is hard to see how these particular requirements would be applied in practice. We notably refer to award criteria and technical specifications aiming at ensuring law compliance, whether or not these requirements are confined to contract performance. Examples of such requirements going *beyond contract performance* could be: award criteria that favour tenderers (i) who have only vehicles in the catalogue that comply with emission rates provided for in the relevant law (cf. the consumption effects we discussed above), (ii) who comply, as a matter of general policy, with transport regulation when delivering (cf. the production and delivery effects we discussed above), (iii) who comply in general (i.e. vis-à-vis all customers) with the legally provided take-back obligation (cf. the disposal effects we discussed above) and (iv) whose board of directors is composed out of women for a number which is legally provided for (cf. the workforce effects we discussed above).

Examples of such requirements *confined to contract performance* could be: award criteria favouring tenderers (i) who offer vehicles that comply with the co2 emission regulations (cf. the consumption effects we discussed above), (ii) who guarantee to deliver the vehicles purchased in compliance with transport regulation (cf. the production and delivery effects we discussed above), (iii) who guarantee to honour their take-back obligation vis-à-vis the vehicles supplied (cf. the disposal effects we discussed above) and (iv) who comply with the relevant health and safety regulations at the production plant (cf. the workforce effects we discussed above).

Intuitively one can conclude that such considerations are merely theoretical as they simply incite the tenderers to comply with the law. It is however conceivable that the public purchaser integrates a general condition in the tender documents. Such 'general clause' would indicate

that the tenderer should guarantee that he complies with all relevant laws. If this appears not to be the case, the public purchaser can terminate the contractual relationship while the contractor is under an obligation to hold the public purchaser harmless for any harm arising from the non-observance of this condition. This would however constitute a specific condition.[464] This type of instrument falls outside the scope of our analysis.

Hereinafter, we will discuss some examples of situations that we deem feasible in practice. The first hypothesis we consider is that of an award criterion or a technical standard confined to contract performance but that goes beyond the law. We argue that a requirement confined to contract performance but going beyond what is provided for in the law is only permissible under 'enriched' public purchasing regulation insofar this requirement produces consumption effects. We believe that only such requirement producing consumption effects is sufficiently closely related to the subject-matter of the contract allowing to rule out the negative externalities we envisage here. The example in the next paragraph may demonstrate this.

Suppose the public purchaser wishes to purchase vehicles. The award criteria are such that the contract will be awarded to the tenderer who satisfies the following requirements: (i) the vehicles' co2 emission rate is zero (whereas the law merely provides for a co2 cap that may not be exceeded), (ii) the vehicles are produced in a co2 neutral production plant (whereas the law does not require such co2 neutral production process), (iii) after their depreciation, the vehicles are processed by the chosen tenderer thereby ensuring maximal recycling of the components (which is not required by law) and (iv) the contractor hires long-term unemployed workers for the performance of the contract (which is not required by law). Arguably, the requirements embedded in these award criteria and/or technical specifications and going beyond the legal requirements, are confined to contract performance. However, does this mean that they are allowed under 'enriched' public procurement regulation?

As to the first requirement, the public purchaser applies an award criterion (zero co2 emission rate) that favours the tenderer offering the most economically friendly vehicles. The outcome envisaged by applying this environmentally inspired award criterion is that the public purchaser purchases economically friendly vehicles. Hence, the answer to the question what is purchased

[464] Cf. supra.

pursuant to the application of this award criteria is, in the first place, a specific feature to the vehicles. The result of applying this award criteria is thus that the public purchaser purchases economically friendly vehicles. Consumption of this commodity is rivalrous – if the public purchaser acquires and uses the vehicle, no other party can buy and use the same vehicle. Also, other parties can easily be excluded from using this vehicle. The public purchaser's ownership suffices to this effect. Hence, the economic friendly vehicles are a private good.[465] One could however put forward that the outcome envisaged by the public purchaser of environmentally friendly vehicles is clean air. It would follow from this that the public purchaser actually purchases vehicles with these features with the intention to provide a public good. However, it is submitted that this line of reasoning is incomplete. More in particular, the public purchaser wishes to purchase a product that contributes to a policy objective when used, and thus the delivery of the public good follows from the use of the product after the purchase. Hence, the delivery of the public good requires an intervention on the part of the public purchaser. The feature that ensures the provision of the public good is intrinsically linked to the product, and thus inseparable. Hence, the delivery of a public good is at best indirectly linked with the public procurement process.

As to the second award criterion in our example, the public purchaser requires that the vehicles are produced in a factory with a zero co2 emission rate. In the test we suggested, the question would be raised: what is purchased through applying this award criterion? Here, the award criterion does not represent a product feature as such. It represents, primarily, the purchase of "clean air" (or environmental friendliness). After all, what is purchased is the production of a vehicle in a way that minimizes pollution. So, in fact, by utilising this award criterion the public purchaser purchases vehicles, but also a contribution to the delivery of a public good. Contrarily to the example of purchasing environmentally friendly vehicles, here the link between the

[465] Here a qualification is needed. Obviously, this qualification as 'private good' requires the public purchaser to be capable of internalising to a 'market-like extent' the positive externalities that may arise from these 'environmental friendly' features. This benefit does not necessarily have to be a purely economic benefit. Utility is to be conceived much wider. However, the possibility may exist that the requirements producing a consumption effect go beyond such an outcome. For instance, the public purchaser purchases 100 environmental friendly busses whereas it only needs 10, but such order is necessary for the manufacturer to offset his investment. However, this is the hypothesis where the purchaser is in no actual need of the purchased goods, giving rise to state aid as the purchase does not address an actual need (J Hillger, *l.c.*, 112). We however do not envisage such situations as they do not constitute a genuine purchase transaction in the first place, which we already argued at another occasion (T Bruyninckx, 'Recovery as a Multi-dimensional Remedy' (2014) 1 Competition Law Review 65, 76-77).

public good envisaged and the award criterion used in the public procurement process is a direct one.[466] After all, delivery of the public good does not require the public purchaser's intervention.

The public purchaser also applies an award criterion implying additional points for the supplier who commits to recycle the materials when taking back and processing the depreciated vehicles. Also here, the award criterion does not relate to a product feature. It relates to achieving the objective of a rational use of natural resources. The latter is a public good, as everybody can consume the benefits of such rational use without affecting consumption by others and it is difficult and costly to exclude people from consuming those benefits.[467] Also here, the delivery of the said public good does not require the public purchaser's intervention.

Lastly, the public purchaser favours tenderers who employ long-term unemployed workers for the performance of the contract. Here again, such an award criterion does not reflect a feature of the product. Contrarily, the public purchaser purchases "social justice" or "employment of vulnerable labour force". Also this is a public good which is directly delivered by the chosen tenderer.

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[466] To further clarify the problem we see as to negative externalities we discussed in the previous paragraph: applying such an award criterion restricts competition and impairs the establishing of a competitive price; we deemed the supra-competitive part of the price that relates to the award criteria of a zero emission production process to qualify economically as a subsidy; hence, the chosen tenderer receives a subsidy for contributing to the delivery of a 'clean environment' or 'clean air', both being a public good. Our problem is that this way of furthering the environmental policy objective may not be the most efficient way to address this market failure. Subsidising gives rise to two major concerns. The first is that subsidies are costly, in the sense that they have to be financed through public money, but also in the sense that collecting those funds and operating the subsidy mechanism is costly. This is however not our main concern in this thesis. Secondly, subsidies distort competition, and therefore (as the Commission already argued as well) it should be examined whether this market failure can be addressed in a less distortive way. These distortions converge with the negative externalities we wish to tackle in this thesis. In view of these adverse effects originating from subsidising, the question arises whether the same outcome (i.e. delivery of the public good) can be achieved through a more efficient and less distortive mechanism. In our example, the additional price following from the award criterion 'zero emission production process' might not be the efficient instrument to achieve delivery of the public good (e.g. regulation introducing a zero emission obligation or taxing emission may prove to be more efficient) or, should subsidising turn out to be an adequate solution, still it is unsure whether the amount is proportional and whether this way of administering (through a public contract) is efficient.

[467] Another question would be whether the same would hold for e.g. an award criterion through which points are awarded if the manufacturer commits to dismantle the busses in an economically friendly way once those busses are taken out of business. It is, however, believed, that such a requirement produces consumption effects. In fact, the public purchaser procures in such a situation busses plus a service to take care of the busses when no longer used. Hence, when this service is consumed, it produces the intended effects. The requirement therefore produces "consumption effects". Moreover, consumption of such a service is rivalrous and it is not costly to avoid persons from consuming it.

Applying the ‘public good test’ is more straightforward when the award criterion or technical specification is not confined to the contract performance, regardless whether or not the requirement goes beyond what is provided for in the law. Such award criterion or technical specification will represent a ‘public good’ consideration. This is irrespective of the nature of the effects (consumption, production/delivery, disposal or workforce effect) such requirement produces.

We will apply this to some practical examples, again starting from a situation where a public purchaser wishes to purchase vehicles. Suppose the tender documents provide for award criteria implying additional points for a tenderer (i) who is able, in general (thus outside the scope of the public contract) to deliver vehicles equipped for handicapped customers (being a consumption effect), (ii) who has as a general policy that it always (hence, no not only in the framework of the public contract at hand) delivers the vehicles with a means of transport that guarantees zero emission, (iii) who applies a general policy to take back vehicles after their depreciation and processes them in such a way that at least 50% of the raw material can be recovered and (iv) who applies a positive discrimination policy when hiring work force.

What does the public purchaser wish to achieve through these award criteria? As to the first criterion (producing a consumption effect), the purchased item is ‘social justice’, i.e. inciting the tenderer to accommodate the needs of handicapped persons. The second criterion (producing delivery effects) represents the purchase of ‘clean air’ or ‘a clean environment’, whereas the third criterion (producing disposal effects) envisages ‘rational use of resources’. The fourth criterion (producing workforce effects) aims at ‘achieving gender equality’. Hence, the requirements embedded in these criteria pursue the delivery of ‘public goods’. For such delivery to take place, no intervention on the part of the public purchaser is necessary; the public good is delivered directly by the chosen tenderer. Hence, such award criteria and technical specifications pursuing environmental or social policy considerations would not be allowed under ‘enriched’ public purchasing regulation.

D. 'ENRICHED' PUBLIC PROCUREMENT REGULATION AS TO PURSUING POLICY OBJECTIVES

a. EU public procurement law as to policy objectives in public procurement

In this section we will explore how 'enriched' public procurement regulation as to the use of environmental and social policy objectives would be conceptualised. To that effect, we will deploy EU public procurement law as a reference point. Therefore, we will first examine the relevant provisions in EU public procurement law.

The possibility to apply environmental or social award criteria was originally not explicitly laid down in the EU public procurement directives. Indeed, the wording in the preceding directives, i.e. Directive 92/50/EEC (contracts for services)[468], Directive 93/36/EEC (supply contracts)[469] and Directive 93/37/EEC (contracts for works)[470] indicates this. In the non-exhaustive[471] lists of potential award criteria, no reference was made to criteria embodying environment or social considerations. With the enactment of Directive 2004/18, an explicit legal basis came into existence.

Even though not explicitly provided for in the said directives, the ECJ recognised that contracting authorities (i.e. public purchasers) are entitled to award public contracts applying environmental award criteria. The leading case in this respect is the ECJ's *Concordia Bus* judgment. The City of Helsinki intended to contract out the city's public transport and a tender procedure was launched to this effect. The public contract would be awarded to the 'most advantageous tender' and the city applied three award criteria: the overall price of operation, the quality of the bus fleet, and the operator's quality and environment management. As to this last criterion, a tenderer could obtain additional points if various quality requirements were met and if compliance with a certified environment protection program could be demonstrated.

[468] Council Directive 92/50/EEC of 18 June 1992 relating to the coordination of procedures for the award of public service contracts, *OJ* L 209, 24 July 1992, p. 1.
[469] Council Directive 93/36/EEC of 14 June 1993 coordinating procedures for the award of public supply contracts, *OJ* L 199, 9 August 1993, p. 1.
[470] Council Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts, *OJ* L 199, 9 August 1993, p. 54.
[471] This stems clearly from the wording of the articles. See also Case C-19/00, SIAC Construction, [2001] I-7725.

Despite having submitted the offer with the lowest price, Concordia Bus did not win the contract. It appeared that a competing tenderer had been given additional points because of its good performance as to nitrogen oxide emissions and noise level. Concordia Bus did not receive extra points for this award criterion. Concordia Bus challenged the award decision. It advanced the argument that applying such award criterion was discriminatory since only one tenderer was able to meet that criterion.

This issue was brought before the ECJ, and was decided in favour of the public purchaser – and thus in favour of the application of such an environmental award criteria. The ECJ ruled that award criteria "[identifying] the economically most advantageous tender must [not] necessarily be of a purely economic nature. It cannot be excluded that factors which are not purely economic may influence the value of a tender from the point of view of the contracting authority".[472] The ECJ also noted the important role environmental concerns adopt in the Treaties at the time (and currently laid down in articles 3(3) TEU and 11 TFEU).[473] Therefore, also when applying the public procurement directives, which give substance to the free movement provisions, these concerns should be taken into account.[474] Additionally, the ECJ set the boundaries within which such environmental award criteria can be applied. The conditions can be summarized as follows: (i) the environmental award criteria applied should relate to the public contract to be awarded, (ii) the environmental award criterion should not confer an unconditional margin of discretion to the contracting authority and (iii) the general principles of non-discrimination amongst tenderers and transparency should be complied with (including the disclosure requirements).[475]

Award criteria as an instrument to pursue policy objectives are currently governed by article 58 (1) of Directive 2004/18 and by its successor, article 67 (2) of Directive 2014/24. Obviously, an public purchaser can only use an award criterion if the contract is to be awarded to the most advantageous offer. Then are also other criteria than the lowest price criterion relevant. The said article provides in this respect that, in case the award is made to the most economically

[472] Case C-513/99, Concordia Bus, [2002] I-7213, 55.
[473] See also in this respect: B Sjafjell and A Wiesbrouck, 'Why should public procurement be about sustainability?' in B Sjafjell and A Wiesbrouck (eds.), *Sustainable Public Procurement Under EU Law*, (Cambridge University Press, 2015), 11-12.
[474] Case C-513/99, Concordia Bus, [2002] I-7213, 57.
[475] Case C-513/99, Concordia Bus, [2002] I-7213, 61-64.

advantageous tender, the contracting authority can apply "various criteria linked to the subject-matter of the public contract in question, for example, quality, price, technical merit, aesthetic and functional characteristics, environmental characteristics, running costs, cost-effectiveness, after-sales service and technical assistance, delivery date and delivery period or period of completion".

The evolution as to the possibility for contracting authorities to apply technical specifications based on social and environmental considerations follows the same pattern as the one as to the application of environmental award criteria. Whereas Directive 92/50/EEC, Directive 93/36/EEC and Directive 93/37/EEC kept silent in this respect, Directive 2004/18 explicitly provides that this type of technical specifications is allowed, albeit within certain limits. More in particular, article 23 (3) (b) of Directive 2004/18 provides that technical specifications can be formulated in terms of performance or functional requirements,[476] possibly including social and environmental policy related characteristics on the condition that such parameters must be sufficiently precise to allow tenderers to determine the subject-matter of the contract and to allow contracting authorities to award the contract. Also, the limits set out by the ECJ in the *Concordia Bus* case apply equally to socially and environmentally inspired technical specifications.[477]

Technical specifications should comply with a number of requirements laid down in Directive 2004/18. Article 23 (2) provides for the basic principle:

> *"Technical specifications shall afford equal access for tenderers and not have the effect of creating unjustified obstacles to the opening up of public procurement to competition". Paragraph 29 of the preamble to Directive 2004/18 clarifies this principle to a certain extent. It is stated there that the technical specifications should allow public procurement to be opened up to competition. To achieve this, it should be possible "to submit tenders which reflect the diversity of technical solutions".*

[476] Contracting authorities can also apply the requirement of holding "eco-labels" as a technical specification.
[477] P Trepte, *Public Procurement Law in the EU – A Practitioner's Guide*, (Oxford University Press, 2007), 291.

Hence, the following requirements apply: (i) it must be possible to draw up the technical specifications in terms of functional performance and requirements and (ii) where reference is made to the European standard or, in the absence thereof, to the national standard, tenders based on equivalent arrangements must be considered by contracting authorities. Article 42 (3) (a) of Directive 2014/24 provides for a similar regime.

Even though there is no obligation to deploy social and environmental award criteria and technical specifications, pursuing environmental and social objective is high on the agenda nowadays in the context of EU public procurement law. Apart from a general policy concern, public procurement is deemed to play a major role in addressing the economic crisis and the challenge to foster economic growth. Achieving these economic policy objectives requires, amongst others, regaining economic growth through the creation of new markets. To this effect, fostering innovation is crucial. In the *Aho*-report, 'environment' is identified as one of the strategic areas where governmental involvement in innovation can have an impact on economic growth by, amongst others, creating new markets.[478] The report reads as follows:

> *"As well as being an area of significant technological opportunity and importance for quality of life, this sector is amenable to promotion through measures complementary to R&D such as the promotion of energy efficiency, and the use of green public procurement and economic instruments such as taxation*".[479]

This is also confirmed in the Proposal to Directive 2014/24:

> *"Public procurement plays a key role in the Europe 2020 strategy as one of the market-based instruments to be used to achieve these objectives by improving the business environment and conditions for business to innovate and by encouraging wider use of green procurement supporting the shift towards a resource efficient and low-carbon*

[478] D Dragos and B Neamtu, 'Sustainable Public Procurement: Life-Cycle Costing in the New EU Directive Proposal' (2013) 1 *European Procurement & Public Private Partnership Law Review* 19, 29-30.
[479] Creating an Innovative Europe. Report of the Independent Expert Group on R&D and Innovation appointed following the Hampton Court Summit and chaired by Mr. Esko Aho, January 2006, http://europa.eu.int/invest-in-research/ (hereinafter "Aho-report"), p. 8.

economy"[480]*. Also Directive 2014/24 reflects this. In addition to that, the preamble to Directive 2014/24 also refers to the need to foster "social innovation*".[481]

Even though the role of social and environmental concerns in selection criteria and performance requirements is not to be underestimated, especially award criteria and technical specifications take up an important role in achieving the said outcome. By imposing performance standards in contracting documents, public purchasers can require tenderers to meet environmental requirements. Hence, when performing the contract, the chosen tenderer contributes to policy objectives the public purchaser is pursuing in his capacity as a regulator. This was also flagged in the Aho-report, stating that current public procurement directives provide for "the facility to specify requirements in terms of functional performance or standards, which allows suppliers to produce any configuration of technology they feel can meet the need".[482] Fostering innovation through public procurement is however likely to be achieved in the most efficient way by applying award criteria.

Obviously, public purchasers can utilise technical standards to which goods or services offered should comply. However, technical specifications require thorough market knowledge. Since applying such requirement will mostly happen when tendering out complex products, public purchasers may not be able to clearly define the technical standards required to achieve the innovation envisaged. In part I we already discussed the fact that contracting authorities suffer from 'information asymmetry' in its relationship with the tenderers.[483] The public purchaser can bridge this information asymmetry by organising competition between tenderers. Since award criteria constitute the battlefield on which tenderers compete, environmental award criteria seem to be the main instrument to actually achieve innovation. After all, the score for compliance with the requirements embedded in award criteria is decisive for winning the public contract or not.

The aforementioned economic oriented outcome formulated in various communications goes also hand-in-hand with the intention not to lose sight of social policy objectives. After all, the

[480] Proposal for a Directive of the European Parliament and of the Council on public procurement, COM/2011/0896 final - 2011/0438 (COD), p. 2.
[481] Preamble to Directive 2014/24, par. 47.
[482] Aho-report, p. 6.
[483] P Trepte, *Public Procurement Law in the EU – A Practitioner's Guide*, (Oxford University Press, 2007), 406.

Europe2020 strategy does not merely pursue economic growth. It also envisages inclusive growth, thereby *"fostering a high-employment economy delivering social and territorial cohesion"*.[484] Therefore, also social policy considerations are high on the agenda, especially in the context of public procurement. After all, as we said, public procurement is believed to be a helpful instrument[485] to achieve the Europe2020 objectives.

b. The possibilities for public purchasers to pursue policy objectives through public purchasing

(a) Award criteria and technical specifications implementing social and environmental policy objectives requiring compliance with the law that are confined to contract performance

The public purchaser is, according to EU public procurement law, free to implement social or environmental objectives if they merely involve law compliance and if they relate to the subject-matter of the contract. The opposite would be illogical. All the public purchaser does is having its needs addressed while only requiring law compliance at the same time. In this respect, Arrowsmith contents that contractual requirements pursuing policy considerations limited to law compliance and confined to contract performance are allowed under Directive 2004/18, insofar the law at hand complies with EU law itself.[486] The same holds true for award criteria.

As such award criteria and technical specifications merely see to compliance with the law, we do not see a problem in terms of the negative externalities we envisage to tackle. This is however subject to the assumption that the law itself does not give rise to such negative externalities. This issue is however outside the scope of our analysis. Nonetheless, the question arises whether applying such requirements in the form of award criteria or technical specifications is effective. After all, tenderers are supposed to comply with the law anyway; using public procurement regulation as an enforcement mechanism may point to an

[484] Communication from the Commission. Europe 2020, a strategy for smart, sustainable and inclusive growth, 3 March 2010, COM(2010) 2020, p. 8. The communication states e.g. that one of the aims is to integrate more women, elder people and migrants into the labour market.
[485] B Sjafjell and A Wiesbrouck, 'Why should public procurement be about sustainability?' in B Sjafjell and A Wiesbrouck (eds.), *Sustainable Public Procurement Under EU Law*, (Cambridge University Press, 2015),16.
[486] S Arrowsmith, 'A taxonomy … ', *l.c.*, 198. The same holds for such an analysis in view of Directive 2014/24.

enforcement failure. We already discussed above[487] that such requirements serve the underlying objectives more effectively if integrated in the public procurement procedure as a 'special condition', or possibly as a selection criterion.

(b) Award criteria and technical specifications implementing social and environmental policy considerations going beyond compliance with the law that are confined to contract performance

As we have seen in the previous paragraphs, as long as the award criteria or technical specifications aim at compliance with existing laws and regulations and is confined to contract performance, pursuing such policy objectives seems to be allowed – even though such deployment of these instruments may be rather theoretical. However, what if the policy objective goes beyond law compliance? In the previous section we argued that award criteria and technical specifications should relate closely to the subject-matter of the contract. This is to assure the award criterion or technical specification to be in line with our 'standard for enrichment'. More in particular, the requirement should reflect a product feature, and should not be integrated in the public procurement process with the intention to have a public good delivered. This delimits to a large extent the leeway public purchasers enjoy when desiring to pursue social and environmental policy objectives through public purchasing. Authors however argue in favour of a larger margin for public purchasers who wish to pursue policy objectives through public purchasing.

In the following paragraphs, we will discuss that Arrowsmith, but also Kunzlik, McCrudden and Bovis, are in favour of a large margin of discretion for public purchasers in this respect. This point of view seems now to be supported by Directive 2014/24. Recital 97 of the preamble to this Directive indicates that public purchasers can employ contract performance requirements or award criteria that favour environmental and social policy objectives – even where such objectives are not a part of the material substance of the contract. Hence, the said Directive expresses a very lenient stance as to the question whether or not such a requirement relates to the subject-matter of the public contract. This is not only true for measures producing consumption effects, but also for measures producing production/delivery effects[488], disposal

[487] Cf. supra.
[488] Recital 97 provides the example of requirements prescribing that manufacturing of the purchased products did not involve toxic chemicals, or that the purchased services are provided using energy-efficient machines.

effects[489] or workforce effects.[490] Article 67 (3) to Directive 2014/24[491] confirms this as to award criteria, whereas article 42 (1) lays down these principles as to technical specifications.[492]

One additional remark regarding the use of technical specifications to pursue policy objectives is in place. This remark concerns the prerequisite formulated in article 23 (2) Directive 2004/18 (and article 42 (2) of Directive 2014/24), i.e. that technical specifications should not create barriers to access the market. This could be interpreted as a principle limiting public purchasers' discretion when pursuing policy objectives through the use of technical specifications. However, Arrowsmith refutes this interpretation. She submits that this principle merely introduces the prerequisites in the following paragraphs of article 23 of Directive 2004/18 (and article 42 of Directive 2014/24). Hence, this principle does not impose additional obligations.[493] This principle thus implies that technical specifications can be utilised to pursue policy objectives that go beyond the requirements set out in the law but that still are confined to contract performance. However, this is subject to the condition that all tenderers are able to live up to those requirements – possibly by offering equivalent solutions or products – and can take part in the competition for the contract.

Consequently, in general, integrating policy considerations in the public procurement process is allowed insofar the award criteria and technical specifications relate to the subject-matter of the public contract. Furthermore, we distinguish a lenient approach as to the relation of the

[489] This is confirmed in recital 97.
[490] Recital 98 provides the following examples: *"(…) favouring the implementation of measures for the promotion of equality of women and men at work, the increased participation of women in the labour market and the reconciliation of work and private life, the protection of the environment or animal welfare and, to comply in substance with fundamental International Labour Organisation (ILO) Conventions, and to recruit more disadvantaged persons than are required under national legislation. Even more, recital 99 also allows measures aiming at the protection of health of the staff involved in the production process, the favouring of social integration of disadvantaged persons or members of vulnerable groups amongst the persons assigned to performing the contract or training in the skills needed for the contract in question."*
[491]This article reads as follows: *"Award criteria shall be considered to be linked to the subject-matter of the public contract where they relate to the works, supplies or services to be provided under that contract in any respect and at any stage of their life cycle, including factors involved in: (a) the specific process of production, provision or trading of those works, supplies or services; or (b) a specific process for another stage of their life cycle; even where such factors do not form part of their material substance.*
[492]The relevant paragraphs of this article read as follows: *(...) The technical specification shall lay down the characteristics required of a works, service or supply. Those characteristics may also refer to the specific process or method of production or provision of the requested works, supplies or services or to a specific process for another stage of its life cycle even where such factors do not form part of their material substance provided that they are linked to the subject-matter of the contract and proportionate to its value and its objectives.*
[493] S Arrowsmith, 'Application of …', *l.c.*, 204.

policy objective to the subject-matter is, leaving the public purchaser wide a wide margin of discretion. Therefore, also requirements that go beyond merely ensuring law compliance would be permissible. We will further explore this by discussing the various effects applying such an award criterion can give rise to. This will also allow us to substantiate our 'enriched' public procurement regulation as to the pursuit of policy objectives when purchasing.

Suppose an award criterion or a technical specification confined to contract performance but embodying requirements going beyond the law produces consumption effects, would this criterion or specification be allowed? Arrowsmith refers to the *Concordia Bus* case to conclude that such criterion or specification is not problematic in view of article 53(1) Directive 2004/18.[494]

We can endorse this position from an 'enriched' public procurement regulation perspective. Even though the public purchaser pursues a cleaner environment or social justice, the award criterion or technical specification does not in itself produce this outcome. The public purchaser purchases a commodity which allows him to contribute to the delivery of a public good. Hence, the delivery of a public good is not the primary commodity purchased. The award criterion or technical specification represents a product feature and delivery of the underpinning public good requires an intervention on the part of the public purchaser. Therefore, we deem award criteria and technical specifications confined to contract performance, going beyond the law and producing consumption effects reconcilable with our 'standard for enrichment'. Therefore, they are permissible under 'enriched' public procurement regulation.

Under EU public procurement law, award criteria and technical specifications producing delivery or production effects are allowed as far as they are related to the subject matter of the contract. Arrowsmith concludes this referring to the *Wienstrom* judgment.[495] This case dealt with a public procurement procedure regarding a contract for the supply of electricity. The public purchaser applied an award criterion envisaging the capacity, in general, to offer energy produced from renewable energy sources. The tenderer able to supply the highest amount of such green energy received the maximum score. Hence, the award criterion did not relate to the

[494] S Arrowsmith, 'Application of … ', *l.c.*, 238.
[495] S Arrowsmith, 'Application of … ', *l.c.*, 238.

subject-matter of the contract, i.e. the electricity to be supplied to the public purchaser. The award criterion related to the nature of the energy that the tenderers supply in general, hence also to third parties. The ECJ found applying this award criterion to infringe the then applicable public procurement directive, as it did not have a connection with the subject-matter of the contract.[496] Furthermore, the ECJ held that such a requirement introduced an unjustified discrimination in favour of tenderers who were able to meet this requirement. Hence, large energy companies would be granted an advantage to the detriment of smaller companies even though the latter could be able to address the needs of the contracting authorities as well. Reliability of supply was not accepted as a justification.[497] It follows from this discussion that the ECJ's main problem with this award criterion was that it was not confined to contract performance. The Court did however not consider the award criterion introducing a requirement going beyond the law to be problematic.

Notwithstanding the seemingly strict stance of the ECJ, Arrowsmith nevertheless notes that the judgment does not precisely indicate when such an award criteria relates to the subject-matter of the contract. She takes a broad view and states that all measures related to the performance of the contract should be considered to be permissible. This includes also award criteria relating to production or supply.[498] Hence, for example an award criteria relating to the environmental friendliness of transport of the supplied product, should be considered to be admissible under EU public procurement law. Kunzlik takes this a step further. He argues that a public purchaser should also be able to apply an award criterion requiring that products to be supplied are produced taking into regard policy objectives. The author focuses on the use of green energy in the production process of a product which the public purchaser wishes to purchase. Kunzlik grounds his broad approach on the terminology the ECJ used in the *Concordia Bus* and the *Wienstrom* cases. He notes that the ECJ requires the award criterion to be *linked* with the subject-matter, but not to be *directly linked*.[499] Kunzlik nevertheless adds two caveats. First, this possibility should not be deployed to favour the use of green energy in the production

[496] Case C-448/01, EVN AG and Wienstrom, [2003] I-14527, 67-68.
[497] Ibid., 70-71.
[498] S Arrowsmith, 'Application of … ', *l.c.*, 239.
[499] Martens and de Margerie flag that the legal test developed in the ECJ's jurisprudence may be conceived as implying an implicit requirement of a reasonable link. M Martens and S de Margerie, 'The Link to the Subject-Matter of the Contract in Green and Social Procurement' (2013) 1 *European Procurement and Public Private Partnerships Law Review* 8, 17.

process of products that are not involved in the public contract. Secondly, in some cases a product goes through a long chain of production phases. It might prove difficult or even impossible to track down, throughout the whole production chain, whether a product meets the award criterion of being produced using green energy. This would imply the risk of discretion on the part of the contracting authority, which would conflict with EU law according to the ECJ in the *Wienstrom* case.[500]

The ECJ's *Max Havelaar* judgment seems to provide support for this broad view. This case dealt with the question whether a public purchaser was allowed to require the product in question to be produced in an ethically sound way. One of the award criteria concerned the question whether or not the product held a fair trade label. Hence, in fact, the public purchaser formulated a requirement as to the production method. The award criterion thus produced a production effect. The ECJ held that *"there is no requirement that an award criterion relates to an intrinsic characteristic of a product, that is to say something which forms part of the material substance thereof"*.[501] The ECJ thus approved the use of award criteria producing production effects.

Such viewpoint is however flawed from an 'enriched' public purchasing regulation perspective. Referring to the *Max Havelaar* judgement as an example, a technical specification that embodies the requirement that coffee has been ethically sound produced, does not relate to a product feature as such. Such a technical specification aims at ensuring 'social justice'. Hence, using such a technical specification subsidises suppliers who apply an ethical production process. Applying our 'standard for enrichment' to such a technical specification, reveals that such award criterion would not be endorsed under 'enriched' public procurement regulation. The actual problem is here that suppliers having invested (or investing) in an ethical production process can recoup this investment via the higher price they can obtain under a public contract. Even though such policy objective of assuring an ethical production process may be justified, pursuing this objective through public purchasing may not be an economically rational way to do so. This is because of the distortive effects such subsidies produce vis-à-vis competition on other markets. To be sure, we do not dispute the worthy causes underpinning the application of

[500] P Kunzlik, 'The Procurement of 'green' energy', in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law*, (Cambridge University Press, 2009), 403-404.
[501] Case C-368/10, Commission / the Netherlands, ECLI:EU:C:2012:284, 91.

such award criteria. We only argue that public purchasing is not the right arena for the efficient and effective pursuit of such policy objective.

As to award criteria producing disposal effects, Arrowsmith notes that no guidance is offered in the case law or legislation. Nevertheless, as contractual requirements producing such effects are permitted[502], award criteria producing such effects should be considered to be allowed as well.[503] The same would arguably apply to technical specifications. If this would be true, our point of view elaborated in the previous paragraph applies here as well: such would conflict with 'enriched' public purchasing regulation.

Are award criteria and technical specifications producing workforce effects – e.g. a tenderer receives additional points if he employs disabled people or long-term unemployed – allowed? Arrowsmith notes that this issue is controversial. She nevertheless argues that the better view is that such award criteria are admissible. The same would arguably apply to technical specifications. The first argument is that if certain contractual requirements producing workforce effects are permissible, than award criteria (and arguably also technical specifications) producing such effects should be allowed as well. Arrowsmith argues that public purchasers can implement workforce related requirements through technical specifications.[504] Secondly, Arrowsmith refers to the *Nord Pas de Calais* case to back up her point. The ECJ was faced with a public purchaser applying an award criterion favouring tenderers engaging local unemployed workers. The ECJ held that such an award criterion is, as a principle, not forbidden.[505] Nonetheless, it should comply with the requirements of EU law, such as the prohibition to discriminate. The Commission, however, merely stepped up against the very use of this award criterion, and not against the possible discriminatory effect. Hence, the ECJ did not rule upon this point and rejected the Commission's viewpoint.[506] In doing so, the ECJ contradicted the point of view advocate-general Alber adopted. The advocate-general stated that such a criterion is inappropriate to award the contract to the economically most

[502] Cf. supra.
[503] S Arrowsmith, 'Application of … ', *l.c.*, 239.
[504] Cf. supra.
[505] S Arrowsmith, 'Application of …', *l.c.*, 240 ; S Arrowsmith, *The Law of Public and Utilities Procurement*, (Sweet & Maxwell, 2006), 1289.
[506] Case C-225/98, Commission / France ("Nord Pas de Calais"), [2000] I-7445, 49-54.

advantageous tender; such a requirement would only be allowed if it were implemented in the form of a special condition, as was the case in the *Beentjes* judgment.[507]

Bovis shares Arrowsmith's view. He notes that the ECJ has contradicted the Commission's narrow view as to the leeway for public purchasers to implement workforce measures in public procurement.[508] Bovis refers to *Nord Pas de Calais, Concordia* and *Beentjes*. In the latter judgement, the tender documents provided that tenderers would be excluded from the procedure if they were not able to employ long-term unemployed persons when performing the contract. Bovis underlines that the ECJ held that such a requirement is in line with EU law if this requirement does not produce a direct or indirect discriminatory effect.[509]

McCrudden analysed whether and to what extent public purchasers can pursue social policy objectives in order to ensure equality through public procurement. He concurs with the point of view above to the extent that if a public contract has as an objective, at least partly, to achieve a social policy objective, a socially oriented award criterion should be permissible.[510] According to him, 'mixed purpose public contracts' should be admissible. Such contracts are 'mixed' because they incorporate two elements: the purchase of a commodity and the achievement of a social objective. Both elements constitute the subject-matter of the contract.[511] McCrudden contends that *Beentjes* does not contradict this. McCrudden sees two main interpretations and one alternative interpretation. These interpretations relate to the paragraphs in which the ECJ held:

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[507] Opinion AG Alber of 14 March 2000 to Case C-225/98, Commission / France ("Nord Pas de Calais"), ECLI:EU:C:2000:121, 45-49.
[508] C Bovis, *EC Public Procurement: Case Law and Regulation,* (Oxford University Press, 2006), 178.
[509]Case 31/87, Beentjes, [1988] 4635, 26-29.
[510] C McCrudden, *o.c.,* 538-543.
[511] C McCrudden, *o.c.*, 524. See also: C McCrudden, 'EC Public Procurement Law and Equality Linkages: Foundations for Interpretation' in in S Arrowsmith and P Kunzlik (eds.), *Social and Environmental Policies in EC Public Procurement Law,* (Cambridge University Press, 2009), 290; J Hettne, 'Sustainable Public Procurement and the Single Market – Is There a Conflict of Interest?' (2013) 1 *European Procurement and Public Private Partnership Law Review* 31, 37.
However, McCrudden makes an important *caveat*. When pursuing a social policy outcome, the public purchaser should make clear that this is the "product" it wishes to purchase. If not, the social policy objective becomes "secondary" to the actual subject-matter. However, the author does not elaborate the consequences of such qualification for its admissibility. The main question the author addresses is here whether or not a social policy can be the subject-matter of a public contract. C McCrudden, *o.c.*, 526.

> "*As regards the exclusion of a tenderer on the ground that it is not in a position to employ long-term unemployed persons, it should be noted in the first place that such a condition has no relation to the checking of contractors' suitability on the basis of their economic and financial standing and their technical knowledge and ability or to the criteria for the award of contracts (...). (...) in order to be compatible with the directive such a condition must comply with all the relevant provisions of Community law, in particular the prohibitions flowing from the principles laid down in the Treaty in regard to the right of establishment and the freedom to provide services".*[512]

One interpretation is that public purchasers cannot decide not to award the contract to a tenderer on the ground that the tenderer does not comply with a contractual condition. After all, the ECJ stated that such a condition does not relate to the selection of the tenderer or the award of the contract. This would imply that non-compliance can only be sanctioned once the contract is awarded and is being performed. Another way of interpreting *Beentjes*, according to McCrudden, is that the ECJ endorsed the pursuit of social policy objectives through integrating such requirements in the form of contractual conditions. This raises questions as to whether or not public purchasers can also integrate such a requirement in the selection and award phase. If not, this undermines the viewpoint (and thus also McCrudden's point of view) that social policy objectives are an admissible element to decide whether or not to award a contract to a tenderer. After all, in this reading of the consideration above, the ECJ mentioned that such a condition is not an element that relates to the selection of tenderers or the award of the contract. Hence, as this element does not say anything about the suitability of the tenderer to perform the contract, the point of view that such a social policy objective can be part of the subject-matter of the contract does not hold.

McCrudden sees however a third interpretation that counters the second interpretation. In this interpretation, *Beentjes* has to be understood in light of the distinction between, on the one hand, conditions that constitute the subject-matter of the contract and, on the other hand, conditions that do not constitute the subject-matter of the contract but that operate post-award in the performance stage. McCrudden thus concludes that the ECJ did not consider whether combating unemployment is a permissible subject-matter; it merely considered that this was

[512] Case 31/87, Beentjes, [1988] 4635, 28-29.

not the subject-matter in this case.[513] *Nord Pas de Calais*, discussed above, may strengthen this position. In this judgment, the ECJ confirmed the possibility to use an award criterion that promotes combating long-term unemployment insofar such use does not imply direct or indirect discrimination.

Nevertheless, from an 'enriched' public procurement regulation perspective, we deem such lenient position problematic. Indeed, the 'standard for enriching' objects to utilising a requirement aiming at the pursuit of an outcome that relates to employment policy or to a more general social policy. As we argued before, 'subsidising' the achievement of the delivery of such a public good through a public contract, gives risk to the risk of occurrence of negative externalities that adversely affect the well-functioning of other markets without such effects being justified from an efficiency or effectiveness point of view.

(c) Award criteria and technical specifications implementing social and environmental policy objectives going beyond contract performance (regardless whether or not beyond the law)

Literature deems award criteria or technical specifications inspired by social and environmental considerations admissible in EU public procurement law if they relate to the subject-matter of the contract. Hence if such an award criterion or technical specification is not confined to contract performance, its use will not be permissible under EU public procurement law. Arrowsmith notes that neither the *Concordia Bus* judgment nor Directive 2004/18[514] provides for a ground to require that social or environmental policy inspired award criteria (and technical specifications) relate to the contract's subject-matter in order to be admissible.[515]

Arrowsmith suggests nevertheless two possible justifications for such limitation. The first justification concerns the restrictive effect as to trade broad award criteria may produce. The second justification is the risk of abuse of the broad margin of discretion absence of such a condition would imply. The case for limitations makes Arrowsmith conclude that Directive 2004/18 allows public purchasers to pursue policy objectives the way a 'purchaser' would do.

[513] C McCrudden, *o.c.*, 526-529.
[514] And arguably neither Directive 2014/24.
[515] For the sake of clarity, as we discussed in the previous section, Arrowsmith takes a broad view on how to define whether or not a policy objective relates to the subject-matter. In the previous section, we argued this not to be in line with 'enriched' public procurement regulation.

However, pursuing policy objectives as a 'regulator' is not permissible.[516] To illustrate this, she refers to the *Wienstrom* case – discussed above – indicating that public purchasers are not allowed to reward energy suppliers for offering green energy on the market without such a requirement being (fully) linked to the electricity supply to the public purchaser involved.[517]

Directive 2004/18 does not allow technical specifications going beyond contract performance neither. Arrowsmith points to the wording of article 26 of Directive 2004/18 (and currently article 42 of Directive 2014/24). This wording clearly indicates that the special conditions should be confined to contract performance.[518] Admittedly, this provision deals with special conditions and thus not with technical specifications. However, both categories belong to the same overarching type of instrument, i.e. contractual requirements. Hence, what applies to 'special conditions' should arguably also apply to 'technical specifications'.[519] Furthermore, both instruments are subject to the same legal regime.[520] Hence, the argument drawn from article 26 of Directive 2004/18 is also applicable to technical specifications.

Arrowsmith also refers to the *Wienstrom* case. This judgment indicates – even though dealing with award criteria – that if tender documents provide for a technical specification not related to the contract and its performance itself, such technical specification is not allowed pursuant to Directive 2004/18.[521] Advocate-general Kokott shares this point of view. In her opinion to the *Max Havelaar* case, dealing among others with the question whether public purchasers may require tenderers to hold a fair trade label, the advocate-general stated:

> *"(...) Article 26 of Directive 2004/18 does not permit the contracting authority to exercise unlimited influence over the purchasing policy of its future contractor. Its requirements in respect of that purchasing policy must relate specifically to the subject-matter of the public supply contract and may not concern, for example, the contractor's purchasing policy in general. The contracting authority cannot therefore require that*

[516] S Arrowsmith, 'Application of …', *l.c.*, 237.
[517] S Arrowsmith, 'Application of …', *l.c.*, 237.
[518] S Arrowsmith, 'Application of …', *l.c.*, 226.
[519] Cf. supra.
[520] R Caranta, 'Sustainable Procurement in the EU' in M. Trybus en R. Caranta (eds.), *The Law of Green and Social Procurement in Europe*, (Djof Publishing, 2010), 47-48
[521] Case C-448/01, EVN AG en Wienstrom, [2003] I-14527, par. 67-68.

potential tenders have only fair trade products in their product range, but merely that the products to be supplied to it specifically under a public contract be fair trade. The Province of Noord-Holland has laid down no other requirement in the present case".[522]

Hence, the advocate-general confirms that special conditions are not permitted if they go beyond contract performance. This point of view is also transposable to technical specifications, as the advocate-general stated that her views are also applicable to technical specifications as envisaged in article 23 of Directive 2004/18.[523] Moreover, also advocate-general Kokott makes the link with ECJ cases[524] issued in the framework of award criteria, thus linking the case law regarding requirements as to award criteria with the contractual requirements.

Furthermore, this viewpoint is currently also confirmed in Directive 2014/24. The preamble mentions that public purchasers cannot require that tenderers, in order to be successful, must have a general social or environmental corporate policy in place.[525]

It follows that EU public procurement, prohibiting award criteria and technical specifications that go beyond contract performance, satisfies the prerequisites of our 'standard for enriching'. Also 'enriched' public purchasing regulation would contain a similar prohibition. After all, an award criterion or technical specification would pursue the delivery of a public good if it would go beyond contract performance. We have discussed this extensively in the previous section.

E. CONCLUSION

In this chapter we discussed how 'enriched' public procurement regulation would regulate the use of award criteria and technical specifications that represent the pursuit of social and environmental policy objectives. Such question is not only relevant from the perspective of avoiding the negative externalities we discussed in chapter 1, but also from a policy perspective.

[522] Opinion AG Kokott of 15 December 2011 in Case C-368/10, Commission / the Netherlands, ECLI:EU:C:2011:840, 88.
[523] *Ibid.*, par. 97.
[524] More in particular, the advocate-general refers to the *Wienstrom* case as well as to the *Concordia Bus* case.
[525] Preamble to Directive 2014/24, par. 97.

After all, in various documents, the Commission has indicated that public procurement can serve as a tool to achieve wider policy objectives, such as economic growth and social inclusion.

The view that public purchaser should enjoy a large degree of freedom to pursue such policy objectives when purchasing does not go unsupported in the literature. However, we argued that from the perspective of avoiding negative externalities distorting the well-functioning of other markets, the leeway for public purchasers should be limited. The idea underpinning this position is that public procurement is not an adequate instrument to pursue policy objectives. After all, this results in limited competition and, consequently, in a supra-competitive price. We argued that the additional price paid when applying a policy oriented award criterion or technical specification actually represents, in economic terms, a subsidy. Additionally, we argued that public procurement is not an apt method for subsidising as it does not provide for sufficient guarantees that the subsidy is adequate and effective, nor that the market-distortive effects are limited to their minimum. Therefore, we argued that only if the social or environmental policy consideration is closely related to the subject-matter of the public contract, such award criteria or technical specifications are permissible.

We suggested, as a decisive criterion in this respect, to apply the question whether the award criterion or technical specification represents the purchase of a product feature or whether it actually represents purchasing the delivery of a public good. Hence, the crucial question is: what does the public purchaser actually buy when applying such award criterion or technical specification? Application of this requirement gives rise to the following conclusions.

If the award criterion or technical specification is confined to contract performance and merely requires law compliance, such criterion or specification is permissible under ‘enriched’ public purchasing regulation (even though it is doubtful that a public purchaser will apply such a criterion or specification in practice).

If the award criterion or technical specification is not confined to contract performance, such criterion or specification is not permissible under ‘enriched’ public procurement regulation (regardless whether it goes beyond the law or merely requires compliance with the law). Such social or environmental award criterion or technical specification reflects the achievement of a

policy objective, i.e. provision of a public good. Hence, the price that corresponds with the achievement of the outcome envisaged is actually a subsidy for the contribution to achieve this policy objective.

When the award criterion or technical specification is confined to contract performance but goes beyond requiring merely law compliance, such criterion or specification is permissible under ‘enriched’ public purchasing regulation insofar it produces ‘consumption’ effects. This means that the criterion or specification relates to the use of the purchased commodity. On the other hand, if the award criterion or technical specification produces delivery/production effects, disposal effects or workforce effects, such criterion or specification is not allowed under ‘enriched’ public purchasing regulation. We argued that such award criterion or technical specification in fact relates to the delivery of a public good – whereas in case of consumption effects they relate to a product feature – for which the price paid has to be considered to be a subsidy.

8. CHAPTER 7. 'ENRICHED' PUBLIC PROCUREMENT REGULATION AS TO MODIFICATIONS OF EXISTING PUBLIC CONTRACTS

A. INTRODUCTORY REMARKS

In this chapter we will discuss the problem we see as to modifications in the light of our issue of negative externalities public purchasing may give rise to. Central here is our point of view that allowing the public purchaser to modify the contract in the course of the performance phase gives rise to a risk for the negative externalities we discussed in chapter 1 to occur or – if the initial contract already gives rise to the negative externalities – to be reinforced. To be sure, 'modifications' for the purpose in our analysis here does not refer to modifying elements during the award stage. An example of such a modification would be the modification of tender documents before the contracting authority award the public contract. Here, however, we envisage modification of the contract that is in the process of being performed by the chosen tenderer.

Admittedly, from the perspective of the negative externalities we discussed in chapter 1, modifications are not necessarily problematic. This would not be the case if the public purchaser can exercise countervailing buying power. Such buying power may imply that the public purchaser forces the chosen tenderer to set his price to perform the modified contract below[526] or at market equilibrium price. Our analysis, however, envisages the situation in which the public purchaser pays a supra-competitive price (i.e. a price above the market equilibrium price).

The foregoing does not imply however that if the public purchaser requires modifications himself, e.g. because of reasons of public interest, he can exercise buying power over the chosen tenderer. Public procurement regulation indeed sometimes provides that the public purchaser can, regardless of the terms of the contract, modify the contract terms. A common justification for such a modification refers to the demands of safeguarding the public interest.[527] This

[526] This is the problem Sanchez Graells deals with. Cf. supra.

[527] M E Comba, 'Principles of EU Law relevant to the Performance of Public Contracts' in M Trybus, R Caranta and G Edelstam (eds.), *EU Public Contract Law. Public Procurement and Beyond*, (Bruylant, 2014), 322. For instance, Belgian public procurement law provides that the public purchaser can unilaterally modify the terms

however does not necessarily imply buying power. It follows that for our analysis it is immaterial which party to the contract requests the modification.[528] The only relevant question is whether the public purchaser holds buying power. Our analysis relates to the situation in which the public purchaser lacks such buying power.

B. THE PROBLEM OF NEGATIVE EXTERNALITIES ARISING FROM MODIFICATIONS

Having discussed the concept of modifications and the contexts in which they can arise, the question now arises how allowing modifications to existing public contracts implies a problem of negative externalities. In view of our 'standard for enrichment', we deem 'competition' the central issue here. Applying modifications without organizing a public procurement procedure may *de facto* imply a new contract. However, absent an obligation to retender, the contract terms are not the outcome of proper competition. Earlier we identified the problem of imperfect competition (or not competition at all) to be the source for our negative externalities to occur.

But why is this lack of competition so detrimental? We argue that the fundamental problem lies within the public purchaser's negotiation position in the course of the performance of the contract. Whereas renegotiating in itself may not be problematic, the weak position a public purchaser holds when renegotiating is. This exposes him to the risk to agree upon modifications which foremost benefit the chosen tenderer.[529] This also undoes the results the competition for the contract produced in the award stage. Therefore, applying modifications raises the question whether the public contract still reflects best value for money.[530]

To illustrate the issue of public purchaser's weak position in renegotiations, we can refer to literature in the area of public private partnerships (PPP).[531] After all, renegotiation in public

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and conditions of the contract (albeit subject to limitations) if such modification is necessary in view of the public interest (art. 37 of the Royal Decree of 14 January 2013 regarding the performance of public contracts).

[528] See also O Dekel, 'Modification of a Government Contract Awarded Following a Competitive Procedure' (2009) 2 *Public Contract Law Journal* 401, 419.

[529] As to PPP projects, see J Temple Lang, 'EU State Aid Rules – The Need for Substantive Reform' (2014) 3 *European State Aid Law Quarterly* 440, 448.

[530] G L Albano and A Zampini, 'Strengthening the Level of Integrity of Public Procurement at the Execution Level: Evidence for the Italian National Frame Contracts' in G Piga en S Treumer, *The Applied Law and Economics of Public Procurement*, (Routledge 2013),187.

[531] For the purpose of this discussion, PPP will be understood as set out in the Commission's Green Paper on public-private partnerships and Community law on public contracts and concessions (/* COM/2004/0327 final

contracting is quite common.[532] The reason for this is rather obvious. Public purchasers[533] decide whether or not to employ a PPP governance structure at the very beginning of a project – probably even before the project is conceptualized. Many circumstances can emerge in the course of a PPP project's performance that require contract modification.[534] PPP projects involve a large degree of uncertainty, due to the complex nature of the transaction and the lengthy period for which the contract is entered into.

Hence, it is likely that the private partner will ask the public purchaser to renegotiate the terms and conditions of the contract. The private partner may require the public purchaser to agree upon an increase of the latter's commitments, financial or otherwise. In this respect, De Brux, Beuve and Saussier mention that the most common outcomes of renegotiations are delays, tariff increases and reductions in investment obligations. This indicates that most renegotiations have a negative impact on public purchasers.[535]

Henceforth, renegotiation in the framework of PPP contracts is a recurrent phenomenon. The question now arises on which footing the private partner and the public purchaser renegotiate. It was submitted earlier that, in order for the negative externalities to occur, the public purchaser should lack buying power. If we take this one step further, and we assume that modifications are problematic if the power is with the chosen tenderer, we encounter the holdup problem: the public purchaser has no choice but to consent to amending the terms and conditions of the PPP contract.

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*/): forms of relatively long cooperation on different aspects of a planned project between public authorities (concentrating primarily on defining the objectives to be attained and their monitoring) and the world of business (participating at different stages in the project such as design, completion, implementation and funding) which aim to ensure the funding (at least in part by the private sector), construction, renovation, management or maintenance of an infrastructure or the provision of a service, whereby risks are distributed between the public partner and the private partner according to the respective ability of the parties concerned to assess, control and cope with this risk.

[532] H-J Prieβ and S Saussier, 'Dialogue' in G Piga and S Treumer, *The Applied Law and Economics of Public Procurement*, (Routledge, 2013), 156.

[533] Even though in a PPP context, the notion 'public purchaser' might not be the most accurate one, we will nonetheless, for reasons of coherence throughout this thesis, employ this notion in this discussion.

[534] S P Ho and C W Tsui, 'The Transaction Costs of Public-Private Partnerships: Implications on PPP Governance Design', The Lead 2009 Conference, CA, (http://crgp.stanford.edu/events/presentations/CRGP_Alto_2010/Presentation/Ho_Tsui_PPP_Governance.pdf), 2009, 6.

[535] J De Brux, J Beuve and S Saussier, 'Renegotiations and Contract Renewals in PPPs. An Empirical Analysis' (http://papers.isnie.org/paper/728.html), 2011, 4.

The strong position of the private partner can be attributed to the information advantage he holds. The private partner – being the party actually performing the project – possesses private information which he is not likely to share with the public purchaser. After all, such information asymmetry may result in information rents to this private partner's advantage. Robinson and Scott[536] note – in the context of the issue of monitoring contract performance – that obtaining day-to-day information on the project depends, on the one hand, on the willingness of the private partner to communicate such information and, on the other hand, on the ability of the public purchaser to obtain such information independently. In the performance phase, the private partner has little incentive to communicate technical or other practical information to the public purchaser. Another aggravating element here is that the public purchaser is not likely to sanction the private partner for not being co-operative. This is due to 'asymmetric lock-in' and 'soft budget constraints'. These phenomena will be further discussed below.

Another explanation is that the public purchaser is in a situation of 'asymmetric lock-in'. This is tantamount to the public purchaser not being able to end the relationship with the private party without suffering severe damage himself.[537] In principle, this requires that the public purchaser made asset-specific investments, i.e. investments he cannot (fully) recover by deploying them in other situations or projects. It has indeed been argued that replacing a public partner in a PPP structure proves to be economically costly for the government. In this respect, the literature mentions the high opportunity cost involved in replacing the private partner.[538] This effect is further strengthened by the specific situation public purchasers are in by nature. Reeves refers to the statutory obligation for governments to provide public services. Performing such obligations may result in a situation in which the public purchaser has more to lose than his private partner in case the project fails. This may endow the private partner with a strong position when renegotiating.[539]

[536] H S Robinson and J Scott, 'Service delivery and performance monitoring in PFI/PPP projects' (2009) 2 Construction Management and Economics 181, 193.
[537] E Reeves, 'The Practice of Contracting in Public-Private Partnerships: Transaction Costs and Relational Contracting in the Irish Schools Sector' (2008) 4 *Public Administration* 969, 972; C Lonsdale, 'Post-Contractual Lock-in and the UK Private Finance Initiative (PFI): The Cases of National Savings and Investments and the Lord Chancellor's Department' (2005) 1 *Public Administration* 67, 70.
[538] S P Ho and C W Tsui, *l.c.*, 7.
[539] E Reeves, *l.c.*, 974.

Also, the public purchaser is likely to have a "soft budget constraint". Hence, the private partner may expect that in case of financial problems he will be bailed out.[540] As a PPP situation involves public authorities' participation, damages that can arise due to project failure are not only of a purely economic nature. They can also be of a political nature, such as a loss of votes due to poor government management.[541] Indeed, literature refers to political motivations as a source of a soft budget constraint. By this token, safeguarding a PPP project could be deemed necessary by politicians in order to increase popularity and political influence or in order to save or build reputation.[542] Another reason for a soft budget constraint is the economic impact of a failure of a PPP project.[543]

Ho and Tsui see a number of motivations for the existence of soft budget constraints in this regard.[544] First, a public purchaser may wish to avoid economic spillover effects resulting from the failure of a PPP project. After all, they may affect other economic sectors or operators, or may even affect the national economy as a whole or in part. Secondly, liquidating a project may be more costly than refusing to bring in more financial resources to ensure the continuing of the project performance. Fiscal centralization – leaving the spending public purchaser without fiscal responsibility – is believed to be a third reason. Authors submit that PPP projects are especially vulnerable to such soft budget constraints, as such projects are usually public service or public facility oriented. Thus, the said reasons relate to a large extent to the public interest. Private partners are aware of this. Hence, they have an incentive to bid aggressively – thus submitting (too) low offers – as well as a disincentive to behave efficiently when performing the PPP contract. After all, private partners can expect the government to bail them out when the project turns out not to be viable under the terms and conditions initially agreed upon.[545]

[540] S P Ho and C W Tsui, *l.c.*, 7.
[541] C Ménard, 'Is Public-Private Partnership Obsolete? Assessing the Obstacles and Shortcomings of PPP' in P de Vries and E B Yehoue (eds), *The Routledge Companion to Public-Private Partnerships* (Routlegde 2013) 149, 154.
[542] J Kornai, E Maskin and G Roland, 'Understanding the Soft Budget Constraint', (2003) 4 *Journal of Economic Literature* 1095, 1099.
[543] J Kornai, E Maskin and G Roland, *l.c.*, 1099.
[544] S P Ho and C W Tsui, *l.c.*, 7.
[545] As has been argued in the literature, when a project is 'too big to fail', the contracting authority has a 'soft budget constraint', and the contracting authority is thus likely to increase his financial means in order to have the project completed; see SP Ho, 'Game Theory and PPP' in P de Vries and E B Yehoue (eds), *The Routledge Companion to Public-Private Partnerships* (Routlegde 2013) 175, 201.

We discussed these issues in the context of PPP transactions. However, we deem the foregoing also true for other public purchase contracts. This will especially be the case in long-term and/or complex contracts.[546]

Hence, in general, we distinguish at least three elements which give rise to the public purchasers' weak position when renegotiating the terms of a public contract: (i) they do not have proper information to verify the claims of the private partner, and the private partner is likely to exploit such lack of information, (ii) the alternative to adhering to the demands of the private partner (i.e. replacing the private partner or annulling the project) is often not feasible as the public purchaser is locked into the project and (iii) the public purchaser is simply not in a position to consider alternatives to adhering to the private partner's demands since a soft budget constraint already determined the private partner's behavior which gives rise to the need for the public purchaser to increase his (financial) commitments to safeguard the performance and completion of the project. It follows from the above that, in case of renegotiations regarding modifications to an existing public contract, the market does not operate properly. Two market failures can be distinguished: information asymmetry and market power.

Admittedly, the purchasing authority could purchase expert advice from a third party to overcome this information asymmetry. However, this will imply additional costs. This is not only because of the expert's remuneration but also because of the additional transaction costs involved. After all, the public purchaser will probably have to acquire such services pursuant to a public procurement procedure. In any event, entering into such service contracts will imply searching, negotiation and monitoring costs. Moreover, such investments to overcome the information asymmetry problem do not address the problem of market power due to asymmetric lock-in or soft budget constraints.

In view of the foregoing, it is likely that the modified public contract will reflect a supra-competitive price.[547] If so, it will give rise to the negative externalities affecting the well-

[546]It is therefore paradoxical that it is argued in the literature that in the framework of such contracts, the public purchasers should have more leeway to amend existing public contracts. S T Poulsen, 'The Possibilities of Amending a Public Contract without a New Competitive Tendering Procedure under EU Law' (2012) 5 *Public Procurement Law Review* 167, 181.

[547] This is also backed by the fact the contract terms after such modifications may imply a state aid grant. See e.g. M Kekelis and K Neslein, 'Public Procurement and State Aid' in C H Bovis, *Research Handbook on EU*

functioning of markets where the chosen tenderer is active. We believe that applying our 'standard for enriching' to the possibility public procurement regulation may leave for renegotiations, instead of requiring new public procurement procedure, can help mitigating these negative externalities. In the next section we will discuss why we believe this is the case.

C. 'ENRICHED' PUBLIC PROCUREMENT REGULATION'S REQUIREMENTS

In the previous section, we sketched the problem modifying a public contract may give rise to in terms of negative externalities. We discussed that modifications without organising a new tender procedure may give rise to opportunistic behaviour on the part of the contractor. This enables him to obtain rents he would not have obtained under perfect competition. This implies the occurrence of the negative externalities we intend to tackle here. We see a role here for our 'standard of enriching' to avoid occurrence of the negative externalities, or at least to minimise chances that they occur.

A provision as to modifications in line with our 'standard for enrichment' would ensure, in the first place, competition for the modifications or the modified contract. Subsequently, such provision would ensure 'genuine' and 'fair' competition for the modification or the modified contract. Hence, a strict application of our 'standard for enrichment' would suggest a provision that prohibits modifications to the public contract in the course of their performance. This implies an obligation to put the new aspect to the contract out for tender. Alternatively, if the modification is inseparable from the initial contract, it would require organising a whole new tender procedure for the complete contract. In such event, the first leg of our 'standard for enrichment' would be complied with.

Arguing in favour of a principle of retendering accommodates the concerns we discussed in the previous section. This would indeed remedy the problems a public purchaser encounters when he lacks buying power, and thus when he has a weak renegotiation position. Reference to the *rationale* underpinning our 'enriching' effort demonstrates this. In chapter 3 we elaborated the

Public Procurement Law, (Edward Elgar, 2016), 477. We have argued this at length on another occasion. T Bruyninckx, 'Modification of Contracts during their Term: Principle or Exception? – A View from the Perspective of Negative Externalities', in G Skovgaard Ølykke and A Sanchez-Graells (eds.), *Reformation or Deformation of the EU Public Procurement Rules in 2014?*, (Edward Elgar, 2016), forthcoming.

ends and *rationale* underpinning our 'enriching' effort. Apart from avoiding that competitors to the chosen tenderer, benefitting from the supra-competitive price, have an incentive to lobby for compensatory measures[548] and, specifically as to the EU context, maintaining a level playing field on the internal market,[549] we also identified another economic *rationale*. The latter converges with the 'paternalistic' justifications for EU state aid law. It envisages immunising the public purchaser for opportunism and rent-seeking behaviour. To this effect, regulation should provide clear rules restricting the public purchaser's freedom.[550]

When renegotiating, public purchasers can be exposed to interest groups' pressure. These interest groups are arguably driven by their self-interest. Efficient spending of public money to the benefit of the community as a whole is not their first concern. Translated to the public procurement context: chosen tenderers can conceive the public purchasers' discretionary powers to modify (and when modifying) contracts as an opportunity to obtain rents. To this effect, they will turn to the public purchaser to request modifications. A clear-cut prohibition of modifications avoids this. If public procurement regulation does not provide for discretion on this point for public purchasers, such a strict provision allows resisting this pressure. Even more, such strict provision also provides for a signal to the chosen tenderer. It limits the freedom for public purchasers to modify public contracts so the margin to intervene financially is limited as well. Not only will the public purchaser be able to withstand pressure to modify, it also avoids that the chosen tenderer lacks the incentive *ex ante* to behave efficiently.

A straightforward application of our 'standard for enrichment' thus advocates a prohibition of modifications. However, we do admit that retendering is not always desirable (e.g. because of huge additional transaction costs or because of reasons of general interest) or feasible (e.g. because of intellectual property rights or exclusive rights). In economic terms: even though competition theoretically ensures efficiency gains (and thus avoidance of the occurrence of the negative externalities we intend to tackle), the costs such competition brings along may outweigh these gains. In addition to that, a too strict regime may also de-incentivise potential

[548] Cf. supra.
[549] Cf. supra.
[550] Further below, we will however suggest that, from a cost-benefit perspective, in certain situations deviations from such strict rule should be acceptable.

tenderers from participating in the public procurement procedure.[551] Hence, in certain situations, we deem derogating from the principle of retendering, from an economic perspective, justifiable. After all, the whole purpose of our 'enriching' exercise is to enhance social welfare; the exercise itself should not impair this outcome.

Both perspectives – the position favouring competition and the position aiming at minimising retendering costs – contribute to enhancing social welfare, so we deem it appropriate to strike a balance to the largest extent possible between the two extremes. In doing so, we first recall that our aim is to avoid negative externalities that have their origin in the supra-competitive character of the contract price. Our concern in the context of modifications is that discretion on the part of the public purchaser would result in rents for the chosen tenderer because the public purchaser has a weak renegotiation position in the performance stage. We identified information asymmetry, symmetric lock-in and soft budget constraints to be the factors which create this weak position. A prohibition of modifications would deal with these factors. Hence, transaction and opportunity cost considerations should only be given priority in the balancing if such does not impair the outcome we seek for through applying the 'standard for enrichment', which entails the primacy of competition.

It follows that we see the problem of modifications as a battlefield where considerations as to undistorted competition and cost-efficiency collide. We expressed our preference for competition, but this can be derogated from for reasons of proven cost-efficiency. Admittedly, such approach is rather strict and it remains to be seen whether such position finds support in the literature.

Arrowsmith distinguished in an 1997 article two possible approaches towards modifications.[552] The first, strict, approach entails the point that any increase or change as to the scope of the contract resulting in benefits for the chosen tenderer is not allowed under the (then applicable)

[551] This refers to the necessity that potential tenderers must have confidence in the public purchaser. If the public purchaser can escape his contractual obligations by advancing that changed circumstances require modifications which, in turn, require a new public procurement procedure, potential tenderers may consider it too risky to compete for the public contract and invest their resources elsewhere.

[552] Arrowsmith deemed there is no legal problem when negotiating and modifying the public contract in the performance phase if this yields a reduction in the contract price or an increase in the chosen tenderer's obligations without a price increase.

directives. Based upon the justifications to utilise a negotiated procedure, Arrowsmith argues that modifications are only permissible in the following cases: (i) in case of unforeseen circumstances requiring additional works, services or supplies to accomplish the contract purpose and provided that the additional works, goods or supplies are inseparable from the original contract, (ii) in case of repetitive works or services[553] and (iii) in case retendering and the subsequent award of the contract to another party would imply disproportionate adverse consequences because of technical reasons. Hence, if negotiations in the award stage are permitted, renegotiation in the performance stage should be permissible as well.[554]

The strict approach thus entails a broad prohibition, with only exceptions in a very limited number of circumstances. Exceptions are only allowed if renegotiation and modification is the only option. The underpinning *rationale* is that a lenient stance towards renegotiation and modification would open the door for favouritism. Public purchasers could enter into a (tacit) agreement with the chosen tenderer, this being in breach of economic rationality. More in particular, the tenderer could submit a bid with very favourable conditions so as to assure winning the contract. Yet, in the course of the performance phase, the chosen tenderer may ask the contracting authority to modify the contract to his benefit.[555]

However, Arrowsmith considers that such a strict approach may not always achieve an optimal outcome. Retendering a contract, or part of a contract, is costly. The benefits resulting from competition may not always outweigh the costs involved in such retendering. In this context, Arrowsmith also discusses a broader approach. Renegotiation and modification is allowed when the modifications are non-material (e.g. details in building plans) or when the changes concern matters which do not have to be disclosed in the contract notice. Arrowsmith notes, however, that such leeway implies a risk for abuse.[556]

In view of that last concern, Arrowsmith also suggests an intermediary way. Modifications are allowed as long as they do not reach a *de minimis* threshold. In this respect, the author gives the

[553] Such 'repetitive works or services' involve new works or services consisting in the repetition of similar works or services entrusted to the tenderer to which the same public purchaser awarded the original contract.
[554] S Arrowsmith, 'Amendments to Specifications under the European Public Procurement Directives' (1997) 3 *Public Procurement Law Review* 128, 134.
[555] S Arrowsmith, *l.c.*, 134.
[556] S Arrowsmith, *l.c.*, 134-135.

example of a public purchaser entering into a public contract for the purchase of 200 vehicles. If this purchaser would wish to purchase 3 or 4 additional vehicles, this would fall within the *de minimis* exemption. Contrarily, should the public purchaser wish to acquire 40 additional vehicles, such modification would only be allowed in case one of the exemptions, mentioned when discussing the strict approach, can be advanced.[557]

Arrowsmith's suggestion aims at striking a fair balance between competition for the contract and transaction and opportunity cost considerations. The notion 'competition' in this balancing exercise does, however, not represent the competitive process which produces best value for money. It refers to the role of ensuring competition for public contracts in the achievement and maintaining of the internal market. Hence, the regime the author suggests, aims at maintaining equality amongst tenderers and incapacitating public purchasers to proceed to protectionist purchasing.

Our approach too envisages to a certain extent avoiding barriers to the market for the public contract and protectionist purchasing. Nevertheless, our approach also envisages another element, i.e. avoiding occurrence of the negative externalities that arise from public purchasing at terms reflecting a supra-competitive price. Hence, the competition issue in our analysis goes further than ensuring a well-functioning internal market as to public contracts. We believe competition to provide, in principle, a safety device against such negative externalities. This also appears from the 'standard for enriching' we developed in chapter 4. It follows that where Arrowsmith strikes a balance between, on the one hand, equality amongst tenderers (thus ensuring competition as an instrument to maintain the well-functioning of the internal market as to public contracts) and, on the other hand, transaction and opportunity costs, we add the element of ensuring 'best value for money' to the equation. In this respect, best value for money serves as a device to avoid that our negative externalities occur.

We will discuss the regulatory solution we deem appropriate based on our 'standard for enrichment'. First, however, we want to clarify that we do not deem review clauses problematic in terms of our negative externalities, provided certain conditions are met.

[557] S Arrowsmith, *l.c.*, 135-136.

The first condition is that the review clause was known at the time parties were competing for the public contract. If so, then the actual and potential tenderers had known about this clause so they could factor its existence and its content in while competing for the contract. The anticipation of the review would then also have determined the terms of the offer.

The second condition is that the review clause does not leave room for discretion. Therefore, it should clearly indicate which the circumstances are that trigger the clause. Together with Dekel,[558] we argue that the question whether the clause provides for unilateral modifications by the public purchaser or for modifications with mutual consent is immaterial.[559] In both cases, the negative externalities may occur. The essential requirement for such clauses to be in compliance with 'enriched' public procurement regulation is that they do not provide for discretion as to the content of the modification.

The third requirement is that the review clause reflects normal market practice. In other words, the review has to be such that also a private market participant could have applied such a review clause so that it can be considered to be economically rational market behaviour.[560]

If these three conditions are complied with, the three legs of our 'standard for enriching' are satisfied, we believe. After all, while being part of the tender documents and known to actual and potential tenderers while competing for the contract, competition (with the review clause as an element) has been organised. Also, as the tender documents have to contain full information about the modalities of the review clause and the conditions for its application, competition is 'genuine'. Lastly, competition can deemed to be 'fair' as the public purchaser is not left with discretion and the market-like character of the clause is guaranteed.

In this respect, we refer also to the EFTA court's Hurtigruten judgment, stating that an open ended renegotiation clause in a contract conflicts with EU state aid law as such "*would go against the structure and the purpose of the State aid rules. It cannot be accepted, since it would*

[558] S Arrowsmith, *l.c.*, 136.
[559] O Dekel, *l.c.*, 419.
[560] Admittedly, such requirement resembles a 'standard' (instead of a 'rule'), as it has to be substantiated in view of the facts at hand. However, we do not deem this to be contrary to our point of view in favor of a rule based approach. After all, the obligation of inserting a review clause that complies with the said requirements remains as a 'rule'.

render the control mechanisms established under the EEA Agreement ineffective".[561] We refer to our discussion in chapter 3 of Part I above. There we argued that the negative externalities we envisage here, converge to a large extent with the notion of advantage in EU state aid law. Therefore, if a review clause is believed to rule out the risk of a state aid conferral, it is safe to assume that such review clause does not entail a negative externality. The foregoing also demonstrates that – if the said conditions are not fulfilled – the risk emerges that the review clause opens the door for the negative externalities we envisage here.

Having clarified that review clauses are not necessarily problematic, we now can develop our 'enriched' provision as to modifications of public contracts through applying our 'standard for enrichment'. We suggest employing a two layer reasoning.

As a first layer, we suggest a general principle prohibiting modifications. This principle is based on the three legs of our 'standard for enrichment'. Such prohibition implies an obligation to retender. As we discussed above, this would not only assure 'competition'. Also the requirement of 'genuine competition' and 'fair competition' would necessarily be accommodated.

Only if derogation can be justified by advancing cost-efficiency arguments, this principle can be deviated from. This is the second layer. Obviously, it would be for the public purchaser, together with the chosen tenderer (as he can be considered to possess the information necessary to substantiate this argumentation), to deliver proof. Such a principle of prohibition which can be derogated from if adequately motivated, addresses the issues of asymmetric lock-in and soft budget constrain. After all, both the public purchaser and the chosen tenderer are bound by the principle of prohibition. Even if the public purchaser would virtually have a more important interest in having the contract completed compared to the chosen tenderer, the prohibition to modify counterbalances this strategic advantage on the part of the chosen tenderer. The same applies to the problem of soft budget constraints: even if the public purchaser would be willing to intervene, the said principle prevents this.

[561] Joined cases E-10/11 and E-11/11, Hurtigruten, Report of the EFTA Court 2012, 762, 119-130.

Hence, room for an exception to the principle of the prohibition of modifications should be allowed. As a preliminary point, this exception cannot be used to circumvent public procurement regulation. This should be an open provision, to be applied in view of the facts. Dekel's analysis proves helpful here as it provides for a number of elements that can be useful in the assessment. Relevant elements can be the point in time when the need for the modification is brought up. More in particular, the closer to the starting date of the public contract, the more suspicious.[562] Furthermore, the connection to the actual subject-matter of the contract could be relevant. A modification which is not connected to the subject-matter of the contract or which falls outside the scope of the contract is problematic.[563] Also proof that the modification is the result of collusion between the tenderer and the public purchaser is obviously relevant.[564]

This two-layered provision, i.e. a principle of prohibition of modifications without retendering combined with an exception based on economic rationality, is closely linked to the solution Dekel formulates in the context of the US regime as to public purchasing. Dekel establishes that the US regime, the 'Federal Acquisition Regulation', leaves it (apart from a few specific cases) for the judge to verify whether a modification to an existing public contract is permissible. The author distinguishes two types of cases wherein the US courts have developed their approach vis-à-vis modifications. The first type entails cases in which a chosen tenderer challenges the modifications the contracting authority unilaterally imposed. In these cases, the courts generally accept the authority for public purchasers to do so as long as the modifications fall within the 'scope of the contract'. This stance is referred to as the 'cardinal change doctrine': the public purchaser should not modify the contract so drastically that it requires the chosen tenderer to perform obligations materially different from the original obligations. The second type of cases comprises cases relating to actions brought by unsuccessful tenderers to challenge the post-award modifications to which the public purchaser agrees. In this line of cases, the courts usually hold that the modification is permissible if such modification falls within the scope of the contract and if a reasonable tenderer could have anticipated the modifications in the award stage. Dekel draws from this analysis the conclusion that courts start from a presumption of permissibility. This presumption is rebuttable, notably the modification is

[562] O Dekel, *l.c.*, 421.
[563] O Dekel, *l.c.*, 422.
[564] O Dekel, *l.c.*, 425.

demonstrated to be cardinal (or material) and that such modification was unforeseeable at the award stage.[565]

However, the author advocates a reversion of the presumption: instead of a presumption of permissibility, the author suggests a presumption of impermissibility. The argumentation is built upon the principle that regulation should strike a balance between protection of the integrity of the process, efficiency and equal opportunity for all interested tenderers. A presumption of permissibility is not the adequate means to this effect. First, pubic purchasers are faced with an 'institutional conflict of interests'. In general, they are concerned with efficient public spending. This could bring them to focus on short term economic benefits (i.e. limiting transaction costs). However, this involves the risk that they ignore the distortive effects these short term results bring along. This would endanger the achievement of a fair balance between the three aspects mentioned. Secondly, the presumption of permissibility implies a broad margin of discretion while there is no counterbalancing transparency. Hence, it is uncertain that a fair balance between the three abovementioned considerations is struck, and the lack of monitoring provides further support for a principle of impermissibility which can be rebutted by the party requesting the modification.[566]

In the following paragraphs we will endeavour to provide for a framework to structure the exceptions. However, before doing so, we first have to make a distinction between two types of costs which are relevant in this respect: 'transaction costs' and 'opportunity costs'. The notion 'transaction costs' refers to the costs a new public procurement procedure would imply.[567] This notion is relevant in those situations where organising a public procurement procedure is very costly. We will refer to these costs in our analysis when we deem retendering practically possible (yet costly). The notion 'opportunity costs' refers to the costs that follow from to the very choice (thus not from organising the transaction itself) to conduct a new procurement procedure, thus instead of simply modifying the contract in the course of its performance. This category of costs is relevant in cases where modifications are justifiable in

[565] O Dekel, *l.c.*, 413-416.
[566] O Dekel, *l.c.*, 417.
[567] Transaction costs are, for the purpose of our analysis, to be considered as the costs arising from the organisation of a new public procurement procedure. It could be argued that also opportunity costs related to the organisation of a new procedure are to be considered as a transaction costs. However, here we will consider the opportunity costs separately, as indicated.

view of the general interest or because replacing the chosen tenderer is extremely costly. An example would be the *de facto* irreplaceability (because of the huge costs involved the case may be) of the chosen tenderer because, due to intellectual property rights or technical reasons, only the chosen tenderer is able to perform the modified contract. We will rely on the notion of 'opportunity costs' when we consider organising a new public procurement procedure practically impossible.

When the transaction or opportunity costs outweigh the presumed competition gains, a modification should be allowed without giving rise to an obligation to retender. In this respect, it is important to have an idea about those 'competition gains'. Those gains are equal to the difference between, on the one hand, the price as a consequence of the modification the chosen tenderer would ask given his strong position vis-à-vis the public purchaser and, on the other hand, the equilibrium price a situation of perfect competition would have produced. Also, this amount must further be reduced with the transaction costs the establishing of the equilibrium price would bring along.[568]

Obviously, the actual figures are difficult (if not impossible) to compute *ex ante*. Therefore, we suggest the following criteria to establish whether or not the competition gains outweigh the transaction or opportunity costs. First, it is important to stress the role of competition in a public procurement process. In principle, competition forces tenderers to set prices as closest as possible to their costs. In doing so, they actually reveal private information as to the costs of performance and possibly other information as to the way in which they can perform the contract. Competition is therefore, and we discussed this extensively in the introductory chapter, a tool for the public purchaser to gather information. Hence, competition allows the public purchaser to address the problem of information asymmetry. This information problem is not only relevant when choosing the tenderer. As we discussed above, this is also a concern in the field of modifications.

[568] To be sure, we provide the following example to illustrate this point. Suppose a contract is entered into for a price of EUR 1,000,000. After a while the contract is modified, however without organising competition, and the price in increased to EUR 1,500,000. Suppose, the public purchaser would have organised (perfect) competition and the contract price *post* modification is EUR 1,200,000. The competition gain is EUR 300,000. However, organising competition involves a cost as well. Suppose here the costs is EUR 100,000. The competition gain thus amounts to EUR 200,000.

This information asymmetry goes hand-in-hand with a risk. In our analysis, we will call this risk the 'information risk'. This risk refers to the rents that the public purchaser will pay when lacking the information competition would have produced. Hence, the risk converges with the negative externalities modifications give rise to. In fact, this is the risk to be balanced with the transaction and/or opportunity costs. In other words, the question is whether the information risk is worth incurring the costs. For the purpose of the analysis to follow, we will consider transaction costs and opportunity costs together. Later on, we will distinguish between, on the one hand, situations where the former is relevant and, on the other hand, situations where the latter is relevant.

For now, the decision whether or not to allow modifications without retendering depends on the answer to the following question: do the transaction/opportunity costs outweigh the costs affiliated to the information risk? More in particular, do the costs related to the retendering obligation outweigh the benefits following from a new public procurement procedure? This will be further discussed in detail below.

For our analysis a study commissioned by the Commission on the cost and effectiveness of public procurement in Europe[569] is helpful. As to transaction costs, the study examines *inter alia* the costs a public procurement procedure involves. The study uses, as a proxy, *"the number of person-days spent by authorities and firms on each of the activities per purchase*".[570] The notion 'each of the activities' refers to the four stages giving rise to costs.

The first stage is the pre-award stage. Both public purchasers and tenderers incur costs here. Public purchasers identify their needs, draft the tender documents, publish the tender notice and other documents, reply to requests for information and receive the bids. Tenderers search the market for opportunities, assess whether or not to participate (possibly in a consortium) and (in case of a restricted procedure) express their interest to participate in the actual competition for the contract.

[569] Public Procurement in Europe – Cost and effectiveness. A study on procurement regulation, prepared for the European Commission, March 2011 (hereinafter the 'Cost and Effectiveness Study').
[570] Cost and Effectiveness Study, p. 84.

The second stage is the award stage. Here public purchasers have to evaluate the bids and/or conduct negotiations. Tenderers have to draft a bid and comply with administrative formalities (e.g. applying for administrative documents to be included in the bid).

The third stage is the post-award stage. This is the stage where the public purchaser has to inform all participating tenderers about the decision, answer to questions in this regard and formalize the contract. Unsuccessful tenderers may request for feedback and assess whether or not to bring a legal action against the award decision. The successful tenderer may have to provide additional information and formalize the contract.

The fourth stage is the litigation stage where all actors in the award phase may incur costs.

For the purpose of our analysis the following conclusions from the Cost and Efficiency Study are relevant. First, costs increase significantly if the contract is awarded pursuant to other criteria than merely the price criterion.[571] The Cost and Effectiveness Study points out that this is due to the fact that complying with such criteria may turn out to be complex for the tenderers and to the more complex assessment public purchasers have to make.[572] It seems safe to conclude from this that the more award criteria are applied, and the more elaborated or complex they are, the more costs this will generate.

Secondly, the Cost and Effectiveness Study indicates that, both as to pubic purchasers and tenderers, contracts for works imply the highest costs. Furthermore, costs related to the award

[571] Cost and Effectiveness Study, p. 78. According to the figures in the Cost and Efficiency Study, deploying solely a price criterion implies 20 full-time equivalent days for the public purchaser and 14 full-time equivalent days for a tenderer. When deploying also other criteria (i.e. also qualitative criteria (the Cost and Effectiveness Study does not, however, differentiate among such criteria in accordance with complexity or degree of elaboration)), the public purchaser incurs a cost equal to 23 full-time equivalent days and a tenderer 17 full-time equivalent days. To compute the total cost incurred by the tenderers, their figures have to be multiplied by the number of bids submitted for each contract. In procedures where the lowest price criterion is applied, the average number is 4.6; if also other criteria are applied, the average number is 5.5.
[572] Cost and Effectiveness Study, p. 78.

of services contracts are higher than those for the award of supplies contracts.[573] However, the contract value in itself is immaterial in its impact on the costs.[574]

Thirdly, as to the type of public procurement procedure applied, the Cost and Effectiveness Study concludes that the open procedure is, overall, the least costly one.[575] The restricted procedure proves to imply more costs, especially for public purchasers.[576] The negotiated procedure implies a comparable cost for the public purchaser compared to the costs incurred in an open procedure. Yet, negotiations imply a higher cost for the tenderers. If the negotiated procedure does not require publication, costs for the public purchaser are even lower.[577]

Fourthly, another significant aspect in terms of costs is the likelihood of litigation. In a small number of cases, litigation costs are high, while on average litigation costs seem to be small.[578] This indicates that when litigation is likely – i.e. when there is room to challenge the purchase decision which will presumably be the case in complex transactions – chances are that litigation costs will occur. As also pointed out in the Cost and Effectiveness Study, such risk of litigation influences the behaviour in the pre-award stage (but arguably also in the award phase) as the public purchaser can be considered to be willing to avoid litigation.[579] For instance, assuming that a complex contract may imply a considerable risk of litigation, the public purchaser may put more effort (and thus incur more costs) in the assessment of the bids.

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[573] Cost and Effectiveness Study, p. 79 and 81. The Cost and Effectiveness Study reveals that in case of contracts for works, the cost for public purchasers amounts to 27 full-time equivalent days and 29 full-time equivalent days for tenderers (with on average 7.4 bids submitted). Services contracts imply 22 full-time equivalent days for the public purchaser and 16 for the tenderer (with on average 5.3 bids per contract). Contracts for goods require 20 full-time equivalent days as to public purchasers and 14 as to tenderers (with an average of 4.5 bids per contract).

[574] Cost and Effectiveness Study, p. 81 and 91.

[575] The Cost and Effectiveness Study also envisages the 'framework agreement' procedure, but in view of our problem of modifications to existing contracts, we deem this procedure to be irrelevant. After all, it is hard to see how a public purchaser can enter into a framework agreement when the purpose is to amend an existing contract or put out for retender a new (modified) contract.

[576] This finding is however not material to our analysis as public purchaser are usually left with discretion when choosing between the restricted and open procedure. See e.g. art. 26 (2) Directive 2014/24.

[577] Cost and Effectiveness Study, p. 78. An open procedure requires 21 full-time equivalent days for public purchasers and 15full-time equivalent days for tenderers (with an average of 5.7 bids per contract). When organising a restricted procedure, public purchasers spend 28 full-time equivalent days and the tenderer 19 (with an average of 5.5 bids per contract). A negotiated procedure costs 22 full-time equivalent days to the public purchaser whereas tenderers spend 20 full-time equivalent days (with an average of 4.8 bids per contract). If no publication is required for the award of the public contract pursuant to a negotiated procedure, the public purchaser's costs amount to 18 full-time equivalent days and the tenderer's to 20 full-time equivalent days (with an average of 1.8 bids per contract).

[578] Cost and Effectiveness Study, p. 80.

[579] Cost and Effectiveness Study, p. 80

A last element discussed in the Cost and Effectiveness Study we deem important as to costs regarding retendering is that, especially for public purchasers, the pre-award stage is the most costly one.[580]

Where the Cost and Effectiveness Study envisages costs public procurement procedures give rise to, it merely refers to pure transaction costs. Hence, the study tells us little about the opportunity costs related to retendering in case of a need for modifications.[581] We believe that, for our analysis, opportunity costs can emerge in two forms. First, the opportunity cost can represent the costs for society because a project is not completed in time or not completed at all. Such cost is in general difficult to compute, and requires in any event a case-by-case analysis.

Secondly, the opportunity cost can also represent the cost of replacing a tenderer who is *de facto* irreplaceable, e.g. because of intellectual property rights or exclusive rights. Here, the cost is easier to compute. After all, retendering would imply winding up the existing contract *ab initio*. The cost amounts in such a case to the winding up costs (e.g. penalty payments, liabilities, compensation for delivered performance) and the costs to enable another party to compete and perform the contract. After all, suppose due to intellectual property rights, only one tenderer can perform a contract. In theory, stretching our competition principle, the public purchaser should terminate the contract to be amended. However, in order for the competition gains to materialise, interested tenderers should compete. Does this amount to an obligation for the public purchaser to enable other parties to compete with the holder of the intellectual property rights? This would involve significant costs for the public purchaser.[582]

[580] The Cost and Effectiveness Study reveals that in the pre-award phase the public purchaser spends the following number of full-time equivalent days: 16.9 as to the open procedure, 18.7 as to the restricted procedure and 16.1 as to the negotiated procedure. Only the costs incurred in the award phase –being respectively 11.7, 15 and 13.3 full-time equivalent days – approximate these costs. The costs incurred by tenderers in the pre-award tend to be limited though (respectively 4.3, 3.5 and 4) in comparison to the costs incurred in the award stage (10, 10.4 and 9.5 full-time equivalent days).

[581] Which is not surprising as the Cost and Effectiveness Study is concerned with the initial public procurement procedure, and not with such procedures in the case of retendering.

[582] However, further below, we will demonstrate that this is a merely theoretical discussion.

It is also important to consider two elements in this respect. First, opportunity costs – if they emerge – would come on top of the transaction costs related to the retendering process. Hence, suppose abandoning a project of huge importance for society for the purpose of retendering does not only involve a cost for society (opportunity cost), but also transaction costs due to retendering. Secondly, opportunity costs do not always arise, possibly because the public purchaser can avoid their occurrence. They will not occur when the delay in the project completion does not directly affect the general interest. A contract for the purchase of office furniture, even if such furniture has specific features only one tenderer can supply, may not impact the general interest in the same drastic way as the purchase of medical equipment. Also, opportunity costs can be limited as the public purchaser can purchase rights of use or licenses and transfer them if need be to the new contractor.

As we now have an idea about the costs the organizing of a public procurement procedure involves, we can now return to our main question: when do retendering costs (transaction and/or opportunity costs) outweigh the benefits competition brings along? We will consider four situations.

The first situation is the one where the retendering costs are low and the information risk is high. In such a situation, the public purchaser does not incur significant transaction costs and the contract is such that opportunity costs are inexistent or minimal. Especially contracts for the purchase of goods may fall within this ambit, and even more so if such contract is awarded based on the price criterion or on other yet simple qualitative criteria. Nevertheless, also contracts for works and services can reflect these cost-risk features. This would be the case if the award criteria are straightforward (only price criterion or straightforward qualitative criteria). Such situation could also emerge if the public purchaser incurs limited pre-award and award costs when retendering the contract. This may be the case if the public purchaser has already conducted important study work in the initial procurement procedure and the previous assessment can partly be recycled in the new procedure. As for tenderers, this may be the case if they are able to limit their costs, e.g. because of earlier participation or when the tender documents can be drafted more precisely because of experience built up during the initial procedure thereby limiting the tenderers' information costs. Furthermore, another indication for this situation to occur is that the modification or the modified contract can be awarded pursuant

to a negotiated procedure. Such a procedure implies moderate costs, we saw. The fact that the public procurement procedure itself is rather straightforward – thus no complex assessments or specific procedural requirements – also limits the chances that litigation costs will occur.

On the other hand, a high information risk implies that the modification is either complex or innovative vis-à-vis the subject-matter of the initial contract. Hence, the public purchaser does probably not have adequate information to assess the value of the modification. Thus, competition will prove valuable as it allows the public purchaser to gather information on the market.

Hence, a situation of low retendering costs and a high information risk would require a new public procurement procedure instead of modifying the public contract without more without a possibility to derogate.

Secondly, the situation of high retendering costs and a low information risk may rise. As we discussed above, as to retendering costs, we have to distinguish between two situations: on the hand, a situation of high transaction costs and, on the other hand, a situation of high opportunity costs possibly in combination with high transaction costs. However, for the purpose of discussing the situation of high retendering costs and a low information risk, this distinction is not material for the analysis.

The first hypothesis in this situation is that transaction costs are high. This may be the case in the hypothesis of a contract for works or, to a lesser degree, a contract for services. The problem of transaction costs may even be reinforced if the subject-matter requires application of an elaborated body of qualitative requirements.[583] As the procurement process becomes more complex to apply, also possible litigation costs should be factored in. The second hypothesis is that, regardless of the magnitude of the transaction costs, the opportunity cost is high. Furthermore, also another hypothesis may apply, i.e. emergence of opportunity costs. Such costs may (or may not) come along with significant transaction costs.

[583] However, if the modification as to the initial subject-matter would enable the public purchaser to recoup investments made in the initial public procurement procedure, thus implying less pre-award and award costs when retendering, the low retendering costs-low information risk hypothesis may be applicable.

While the transaction and/or opportunity costs are high, the information risk may be low. This will be the case when the public purchaser is familiar with the subject-matter and thus is already adequately informed so as to allow for a rational purchase decision. Also, given the subject-matter, it could be easy for the public purchaser to gather the necessary information to allow for a rational decision. If such a situation emerges, economic rationality advocates a modification without the need for retendering. The added value competition can offer is limited after all. However, as this constitutes as derogation from the principle of retendering, the public purchaser will have an obligation to justify the modification of the contract by demonstrating that the retendering costs are high and the information risk is low. After all, above we submitted that application of our 'standard for enrichment' departs from the principle of competition. Derogations are the exception, and thus to be interpreted strictly, and only permissible if justified for reasons of economic rationality.

Thirdly, the retendering costs as well the information risk may be high. Here a distinction should be made between transaction costs and opportunity costs (regardless whether the latter comes on top of the transaction costs[584]).

The situation giving rise to high transaction costs will arguably emerge in the hypothesis of contracts – probably foremost contracts for works and services – which address a complex need on the part of the public purchaser and which requires an open or restricted procedure.[585] The costs may even increase if the public purchaser proves to have limited knowledge on how to address these needs. He may have to conduct a preliminary market examination. Also, this situation will occur if the modification is not or not directly linked to the subject-matter of the initial public contract. After all, in such case, investments made in the pre-award and award stage when the initial contract was awarded, are probably difficult to recoup in the new public procurement procedure. Such complex procedures may also imply an increased risk for disputes and thus for litigation costs to arise. On the other hand, however, the information risk can be high. Hence, the public purchaser has little knowledge about the solutions the market has to

[584] Hence, this high retendering costs-high information risk hypothesis may also apply when the transaction costs are low but the opportunity cost is high.
[585] However, intuitively one can argue that also negotiated procedures can give rise to high transaction costs, as such complexity may imply costly negotiations (e.g. because of the long duration or because of information costs related to obtaining precise information on the public purchaser's needs).

offer or about the question which conditions would be market-like. This problem could be addressed by organising competition.

Hence, the high transaction costs advocate modifications without retendering whereas the information risk favours retendering. The problem we face here is the one of information asymmetry – a problem which would have been counterbalanced through organising competition. To accommodate the concern as to incurring burdensome transaction costs, we suggest explore other ways to mitigate this information risk following from asymmetric information. A first possible solution can be drawn from paragraph 10 of the preamble to Directive 2004/18. This paragraph provides for a possibility to conduct a 'technical dialogue'. Before launching a procedure for the award of a contract, public purchasers may, using a technical dialogue, seek or accept advice which may be used in the preparation of the specifications. However, such dialogue may not distort competition. Article 40 of Directive 2014/24 reiterates this principle.[586] Arguably, this possibility is able to address the problem of information asymmetry when modifying the contract: before modifying the contract, the public purchaser consults the market to examine what the price would be if the modified contract would have been put for tender. However, a number of elements cast doubt about the effectiveness of such a mode of operation. First, the question remains whether undertakings will be willing – insofar a request thereto is compliant to public procurement regulation – to share strategic private information. Secondly, if the contracting authority uses this possibility to extract information out of the market, than this implies costs (transaction costs being just a part of such costs) as well. Organising competition could prove to be a more efficient and effective method to gather the necessary information.

Another possible solution to avoid exuberant transaction costs is based on EU state aid law as to public selling contracts. For this suggestion, we refer to the EU state aid regime as to the sale of real estate. The Commission held in its 1997 Communication,[587] that in case a Member State

[586] The second sentence of article 40 of Directive 2014/24 provides: "[…] contracting authorities may for example seek or accept advice from independent experts or authorities or from market participants. That advice may be used in the planning and conduct of the procurement procedure, provided that such advice does not have the effect of distorting competition and does not result in a violation of the principles of non-discrimination and transparency."

[587] Commission communication concerning aid elements in land sales by public authorities, *OJ* C 209, 10 July 1997, 3-5.

intends to sell real estate, two methods rule out the risk of granting state aid. The first method is organising an open and unconditional bid procedure. In such case, competition for the purchase of the real estate guarantees the contract being entered into at market price. However, the Commission also presumes compliance when the sale price is established pursuant to an *ex ante* expert valuation. In such case, the Commission accepts absence of an advantage – and thus of state aid, as the granting of an 'advantage' is one of the cumulative conditions for the state aid prohibition to apply.[588]

Translated to the public purchasing context we are in here, this would imply that the works, services or supplies covered by the modification have to be put out for tender. However, this method is for the sake of the argument out of question. The second method the 1997 Communication discusses is to sell the real estate at conditions that are established by an independent expert. It is believed that if such an expert – who has to meet a number of requirements guaranteeing his expertise and independence – establishes the sale conditions, the sale is entered into at market conditions. As the sale contract is assumed reflect market conditions, thus not entailing an advantage, it does not entail a state aid conferment. Hence, while in the first method the Member State extracts information out of the market about the price a market participant is willing to pay for the real estate, this lack of information is compensated for in the second method by seeking expert advice. The foregoing suggests that the purchasing authority can reduce the information risk it is exposed to when modifying an existing public contract by procuring expert advice. This advice would provide knowledge as to the market conformity of the conditions the parties have agreed upon when modifying the public contract.[589] Obviously, procuring such expertise implies a cost (remuneration for the services, transaction costs, …). Intuitively, this is another element to take into account. If the costs related to the procurement of this expertise outweigh the benefits arising from the decrease in the information costs, it does not seem economically rational to acquire that expertise. However, as this conclusion can only be dawn after the facts, we deem such consideration not relevant. After all, this would give rise to circle reasoning: how would a public purchaser, taken

[588] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ 2016, C 262/1, 103.
[589] This expert intervention can in principle take place *ex ante* (i.e. the public purchaser obtains the expert's advice about the market terms under which the modification should be applied prior to actually modifying the contract) or *ex post* (i.e. the public purchaser agrees to a modification and its conditions and next he consults the expert to examine the market conformity of the conditions).

into account his information problem, assess whether or not the competition gains will justify the intervention of an expert? By commissioning expert advice?

It follows from the foregoing that if the public purchaser can advance that retendering would imply huge transaction costs, while these are in principle necessary to mitigate the information risk, the public purchaser can nevertheless disregard the obligation to retender. However, this is only permissible if he demonstrates that he counteracted the asymmetric information problem in a less costly way. This would still require demonstrating that the benefits competition would have produced are achieved. It follows that if the public purchaser would wish to derogate from the principle of retendering based on the argument that transaction costs are high while the information risk is significant as well, the public purchaser will have to motivate such derogation by proving three elements: (i) the transaction costs are high, (ii) the transaction costs outweigh the presumed competition gains and (iii) the terms related to the modification reflect market conditions or measures are adopted to ensure the market conformity of those terms.

However, when the opportunity cost is high (implying that the chosen tenderer is nearly impossible to replace or that general interest would disproportionately be affected), the alternative solutions the public purchaser can rely on are even more limited. After all, if the concern is limited to high transaction costs (thus not to high opportunity costs), it is still feasible to compel the public purchaser to incur these transaction costs anyway. If, however, a new public procedure is impracticable because of opportunity costs, alternative solutions to avoid the negative externalities are all the more important. It follows that when the public purchaser refers to opportunity costs to avoid retendering, he does not have to demonstrate that these costs outweigh the gains retendering would produce. Such retendering is not feasible anyway. Therefore, the alternative solution, thus the solution replacing competition, can be presumed to be an adequate alternative to avoid the opportunity cost. We refer to our discussion above as to the possibilities to conduct a ‘technical dialogue’ and to commission expert advice. However, the leniency following from this stance should be mitigated. This calls for an obligation for the public purchaser to provide overriding proof of the existence of the alleged opportunity cost. Hence, if the public purchaser wishes to derogate from the principle of retendering because the opportunity cost makes retendering infeasible while another solution is able to achieve the same result, the public purchaser should substantiate this by delivering proof (i) as to the existence

of the opportunity cost and (ii) as to the fact that the terms related to the modification reflects market conditions or that measures are adopted to ensure the market conformity of those terms.

The fourth, and last, hypothesis refers to the low retendering costs combined with low information risk scenario. This scenario will probably only materialise in absence of opportunity costs. After all, given the nature of opportunity costs, we consider these costs to have a significant impact anyway. Hence, only transaction costs are to be considered here. This scenario will e.g. occur in case of a purchase for standard goods for which the price is the only relevant criterion, for which a straightforward set of alternative award criteria are relevant or for which a negotiated procedure, possibly without publication, can be applied. The straightforward nature of such procedures also limits chances of litigation.

We admit that modifications without retendering could be allowed if the public purchaser provides adequate motivation that it is rational to avoid the transaction costs and that the terms are market-like. However, such motivation comes with a cost as well, i.e. (i) information gathering costs and possibly also transaction costs when the public purchaser relies upon a third party to produce the required proof or information to draft the motivation and (ii) 'administrative' costs to be incurred due to the additional motivation requirement. Given these cost, an as the retendering costs are low anyway, we deem it justifiable to rule out the possibility of a derogation in this hypothesis. This is also in line with the basic principle of our 'standard for enrichment' as applied to the question of modification, i.e. that competition is the principle, and exceptions are to be applied restrictively. Furthermore, such strict stance avoids that public purchaser utilise this leeway to confer an advantage to the chosen tenderer or to engage in fraudulent behaviour or collusion. It also avoids misconceptions on behalf of the public purchaser about the market, i.e. because the public purchaser possesses – contrary to what he believes – imperfect market information.

It follows from the previous discussion that an 'enriched' public procurement regime as to modifications would be constructed as follows. In the first place, the provision would formulate a clear principle of retendering, stating that a modification of the public contract is not allowed. Furthermore, if such need to modify arises, two possibilities emerge: (i) if the modification is separable from the initial contract, the modification itself constitutes a new contract which has

to be put out for tender and (ii) if the modification is inseparable from the initial contract the modified contract has to be put out for tender. Secondly, this principle can be derogated from, provided that two cumulatively applicable conditions are met: (a) the derogation may not be deployed to act in a way that conflicts with economic rationality or to act in a way that jeopardizes the integrity of the public procurement process and (b) derogation is only possible insofar the public purchaser demonstrates that the costs related to the retendering procedure outweigh the hypothetical competition gains and that the price the modification is agreed upon is market-like.

As to point (b) the scheme is as follows. In case of high retendering costs and low information risk, modification without retendering is possible if adequately motivated through proving the high retendering costs and the presumably low competition gains (as the information risk is low anyway).

If retendering costs and the information risk are both high, then modifications without retendering are possible if adequately motivated. To clarify the motivation requirement, we distinguish two sub-hypotheses. First, in case of high transaction costs, the public purchaser has to prove (i) the existence of high transaction costs, (ii) that the transaction costs outweigh the competition gains that presumably would have materialised in case of retendering and (iii) that the terms related to the modification reflect market conditions or that measures were adopted to ensure the market-like character of those terms. Secondly, in case of a high opportunity cost (possibly but not necessarily combined with high transaction costs), the public procurement has to prove (i) the existence of the opportunity cost and (ii) that the terms related to the modification reflect market conditions or that measures were adopted to ensure the market-like character of those terms.

Furthermore, in case of low retendering costs – no matter whether the information risk is low or high – no derogation from the principle of retendering is possible.

Lastly, and ‘enriched’ provision as to modifications would also clarify that the prohibition of modifications does not apply to modifications pursuant to a clear and precise review clause. Furthermore, such clause should contain a full description of the modifications (so as to not

leave room for discretion for the parties to the contract) it can give rise to as well as its price. Lastly, the terms of the clause as well as the clause itself should be in line with market practice.

D. 'ENRICHED' PUBLIC PROCUREMENT REGULATION AS TO MODIFICATIONS

a. The provisions as to modifications in EU public procurement regulation

Earlier, in the introductory chapter, we clarified that the relevant provisions of EU public procurement law will be our reference point to substantiate 'enriched' public procurement regulation. As to modifications, EU public procurement law provides for regulation in article 72 of Directive 2014/14. This provision is organised in five paragraphs.

The first paragraph provides that modifications to contracts and framework agreements are allowed in five situations. The first is when such modification was provided for in the initial procurement documents in clear, precise and unequivocal review clauses (e.g. price revision clauses and options). The value of the modification is immaterial. Furthermore, the provision provides for two additional requirements: the review clause must formulate the modifications' scope as well as the conditions for the clause to apply. Likewise, the modifications or options should not alter the overall nature of the contract or the framework agreement.

The second ground refers to the situation where additional goods, works or services become necessary while such additional performance cannot be assigned to another contractor for two cumulatively applicable reasons: (i) for economic or technical reasons such as requirements of interchangeability or interoperability with existing equipment, services or installations procured under the initial procurement and (ii) because assigning another contractor would cause significant inconvenience or substantial duplication of costs for the public purchaser. In addition to these conditions, a modification without retendering is only allowed if the corresponding price increase does not exceed 50 % of the value of the original contract[590] and this ground should not be abused to circumvent the provisions of Directive 2014/24.[591]

[590] In case of several successive modifications, this limitation will apply to the value of each modification.
[591] If the public purchaser effectuates a modification on the basis of this ground, he is obliged to publish a notice in the Official Journal of the EU.

Thirdly, modifications are also permissible in case of unforeseen and unforeseeable circumstances. More in particular, the relevant circumstances should be such that a diligent public purchaser was unable to anticipate them. Furthermore, the modification should not alter the overall nature of the contract. In addition to this, the price increase due to the modification should not exceed the amount equal to 50 % of the value of the original contract or framework agreement and also here reliance upon this ground to circumvent Directive 2014/24 is prohibited.[592]

Fourthly, modifications in the form of a change of the original contractor are permissible in three scenarios. The first scenario envisages the situation where the replacement is effectuated pursuant to a clause or option in this respect, provided that the clause or option (i) is clear, precise and unequivocal, (ii) states the scope and nature of possible modifications as well as the conditions for the clause to be relied upon and (iii) the review clause should not alter the overall nature of the contract or the framework agreement. The second scenario refers to the event of an universal or partial succession following a corporate restructuring. A modification is allowed in such a hypothesis if the replacing contractor fulfils the initially established criteria for qualitative selection. Furthermore, replacing the contractor should not entail other substantial modifications to the contract and such modification does not aim at circumventing the application of Directive 2014/24. The third scenario encompasses the situation in which the public purchaser himself assumes the main contractor's obligations vis-à-vis his subcontractors.

Lastly, modifications are permitted if they are not substantial. The value of the modification is irrelevant in this respect. Paragraph four of article 72 of Directive 2014/24 clarifies the notion 'substantial modification'. This qualification applies when the modification renders the contract or the framework agreement materially different in character from the one initially concluded. In any event, a modification is considered to be substantial when one or more of the following conditions are met: (i) the modification introduces conditions which, had they been part of the initial procurement procedure, would have allowed for the admission of other candidates than those initially selected or for the acceptance of a tender other than that originally accepted or

[592] If the public purchaser effectuates a modification on the basis of this ground, he is obliged to publish a notice in the Official Journal of the EU.

would have attracted additional participants in the procurement procedure; (ii) the modification changes the economic balance of the contract or the framework agreement in favour of the contractor in a manner which was not provided for in the initial contract or framework agreement; (iii) the modification extends the scope of the contract or framework agreement considerably and (iv) a new contractor replaces the one to which the contracting authority had initially awarded the contract while none of the situations provided in paragraph one of article 72 applies.

The second paragraph of article 2014/24 provides for a *de minimis* regime. Whether or not the subject-matter of the modification falls within the scope of one of the grounds provided for in paragraph one, modifications are allowed as long as its value does not exceed a double threshold. The value of the modification should not exceed the relevant thresholds for application of Directive 2014/24 and that value should be below 10 % of the initial contract value for contracts as to service and goods and below 15 % of the initial contract value as to contracts for works.[593] Likewise, the modification may not alter the overall nature of the contract or framework agreement.

The third paragraph provides for guidelines as to the calculation of the 'price'. The fourth paragraph clarifies when a modification is 'substantial' – which we already discussed above. Lastly, paragraph five provides that if a modification is not allowed pursuant to one of the grounds mentioned in paragraph one and two, the public purchaser is required to organise a new tender procedure.

This is the current stand of EU public procurement law as to modifications of existing public contracts. However, for the purpose of the discussion to follow, which suggests an obligation to retender, it is interesting to consider the 'history' behind this provision. Directive 2004/18, Directive 2014/24's predecessor, did not contain a provision as to modifications. Nevertheless, the ECJ was called upon to provide guidance as to conditions that must be met in order for modifications to be EU public procurement law compliant. The question that emerged was whether and if so, under which conditions, a modification to a contract actually entails a new

[593] Where several successive modifications are made, the value shall be assessed on the basis of the net cumulative value of the successive modifications.

contract that should be put out for tender. The ECJ's guidance resulted in the *Pressetext Nachrichtenagentur* doctrine. The case dealt with an internal reorganisation within a company providing press agency services to a public authority with whom the latter entered into a public contract. Also, some minor changes were applied to the contract, such as substitutions of amounts due to the conversion to the Euro (in fact leading to a price decrease), an increase of the price reduction for certain services the chosen tenderer delivered and an extension of the waiver of the early termination possibility.

Hence, in *Pressetext Nachrichtenagentur*, the question emerged when the intention to modify a public contract in fact amounts to the issuing of a new tender. This would imply the need to organise a new public procurement procedure. According to advocate-general Kokott, the essential criterion to answer such question is whether the modification is a "material contractual amendment". Opposite to such "material contractual modification" is the concept of "slight amendments".[594] The ECJ ruled along the same lines. In assessing the facts against the background of EU public procurement law principles, the advocate-general and the ECJ agreed upon the principle such amendments should be governed by. This principle goes as follows: amendments to the provisions of a public contract constitute a new award of a contract when the changes are materially different in character from the original terms and, therefore, demonstrating the intention of the parties to renegotiate the essential terms of that contract.[595] Such a material difference between the contract terms pre-renegotiation and post-renegotiation are material in the following events: (i) the amendment (or modification) introduces conditions which, had they been part of the initial award procedure, would have allowed for the admission of tenderers other than those initially admitted or would have allowed for the acceptance of a tender other than the one initially accepted, (ii) the amendment extends the scope of the contract considerably to encompass services not initially covered and (iii) the amendment changes the economic balance of the contract in favour of the contractor in a manner which was not provided for in the terms of the initial contract.[596]

[594] Opinion AG Kokott of 13 March 2008 in Case C-454/06, Pressetext Nachrichtenagentur, ECLI:EU:C:2008:167. 47-49.
[595] Case C-454/06, Pressetext Nachrichtenagentur, [2008] I-4401, 34.
[596] Case C-454/06, Pressetext Nachrichtenagentur, [2008] I-4401, 35-38. These principles were reiterated in the *Wall* judgement, which concerned a contract falling outside the scope of the EU public procurement directives. Case C-91/08, Wall, [2010] I-2815, 37-38.

This case law prompted the Commission, not least because of the practical issues that arise when applying *Pressetext* in practice,[597] to introduce a regime as to modifications in Directive 2014/24. In the initial version of article 72, the Commission adhered to a large extent to the ECJ jurisprudence in *Pressetext*.[598] In the Commission's proposal for what would become Directive 2014/24,[599] article 72 starts with the principle that substantial modifications of the provisions of a public contract during its term require a new procurement procedure. This first paragraph is further clarified in paragraph two, where the Commission clarifies the notion 'substantial'. A modification is 'substantial' if it renders the contract substantially different from the one initially entered into. A modification does so in any case if one of three situations to come – the situations that were also mentioned in *Pressetext* – occur: (i) the modification introduces conditions which, had they been part of the initial procurement procedure, would have allowed for the selection of other candidates than those initially selected or would have allowed for awarding the contract to another tenderer, (ii) the modification changes the economic balance of the contract in favour of the contractor and (iii) the modification extends the scope of the contract considerably to encompass supplies, services or works not initially covered.

Paragraph three, four and five of the Proposal's article 72 discuss three situations in which a modification is not considered to be 'substantial'. The first is the one of a replacement of the contractual partner (thus the original contractor) if such replacement is brought about due to a corporate restructuring or insolvency and the replacing contractor fulfils the criteria for qualitative selection initially established. In addition to these conditions, the replacement should also not imply other substantial modifications to the contract and not be effectuated to circumvent the application of the future directive. The second hypothesis concerns a *de minimis* regime, providing that a modification is not substantial if its value (insofar the value of a

[597] Impact assessment, Accompanying the document Proposal for a Directive of the European Parliament and of the Council on Public Procurement and the Proposal for a Directive of the European Parliament and of the Council on procurement by entities operating in the water, energy, transport and postal sectors, COM(2011) 896 final, SEC(2011) 1586 final, 20 December 2011, 148

[598] S Treumer, 'Contract changes and the duty to retender under the new EU public procurement Directive' (2014) 3 *Public Procurement Law Review* 148, 149. Nevertheless, the Commission is believed to be somewhat stricter as it uses the term 'shall' instead of 'may' in the Proposal when listing the events when a modification gives rise to a duty to retender in any case (e.g. when the economic balance is shifted to the benefit of the contractor this modification 'shall' (the Commission's proposal) instead of 'may' (*Pressetext*) give rise to an obligation to retender).

[599] Proposal for a Directive of the European Parliament and of the Council on public procurement, COM/2011/0896 final - 2011/0438 (COD) (hereinafter the "Proposal").

modification can be expressed in monetary terms) does not exceed the thresholds for application of the future directive and that value is below 5 % of the price of the initial contract. Also here, the modification should not alter the overall nature of the contract. The third hypothesis is the one of the public contract containing a review clause or an option, which is clear, precise and unequivocal and states the scope and nature of possible modifications or options as well as the conditions for their use. Also here, effectuating such clause or option should not alter the overall nature of the contract.

Paragraph 6 of the Proposal's draft of article 72 provided for derogation from the principle that substantive modifications should give rise to an obligation to retender. This derogation refers to 'unforeseen' circumstances, or more specifically, circumstances a diligent public purchaser could not foresee. Apart from being unforeseeable, the price related to the modification should also not exceed 50 % of the value of the original contract and the modification itself should not alter the overall nature of the contract.

The Proposal's draft of article 72 also provided for a seventh paragraph, listing two circumstances in which the public purchaser would not have recourse to the possibility of modifications without the need for retendering: (i) where the modification would aim at remedying deficiencies in the performance of the contractor or the consequences, which can be remedied through the enforcement of contractual obligations and (ii) where the modification would aim at compensating risks of price increases that have been hedged by the contractor. This paragraph was however entirely omitted in the final version of article 72.

It follows from this 'historical survey' that article 72 of Directive 2014/24 is rooted in a stricter regime than the one that is laid down in the article the EU legislator eventually enacted. Hence, the initial wording of article 72, as well as the *Pressetext* jurisprudence, reflects our suggestion of a 'enriched' provision as to modifications to existing contracts, containing an obligation to retender. The final wording, representing a rather flexible stance, does however not reflect such an approach.

b. Article 72 Directive 2014/24: the principle

The first issue we have to examine is whether article 72 of Directive 2014/24 provides for the principle that modifications are allowed albeit subject to limitations or whether, alternatively, it starts from the general requirement to organise a public procurement procedure and that in exceptional circumstances modifications do not give rise to an obligation to organise a public procurement procedure. This may not be an element that in itself determines whether or not the negative externalities will occur, but it sets the tone for the interpretation of the grounds listed in article 72.

Earlier we discussed that an 'enriched' public procurement provision as to modifications would provide, as a starting point, for a principle that prohibits modifications. The Proposal's draft of article 72 articulates such principle, stating that 'substantial modifications' should give rise to an obligation to organise a new public procurement procedure, followed by a broad definition of what makes a modification 'substantial' and a list of type of modifications that are not to be considered as 'substantial'. Also, the fact that this draft states that modifications because of unforeseen and unforeseeable circumstances is in general to be considered as substantial, as this ground for modifications is a 'derogation' from the principle enshrined in paragraph one, indicates a strict stance.

The final version of article 72 in Directive 2014/24 indicates a more lenient approach as it starts with listing the cases in which modifications are permissible. Four of these grounds – review clauses, need for additional works, goods or services while retendering is undesirable or impossible, unforeseen and unforeseeable circumstances and replacement of the contractor – are considered to be 'substantial'. This follows from the fifth ground for modifications, i.e. non-material modifications. This last ground is further clarified in paragraph four and reiterates (apart from the replacement of the contractor in a way not permitted by article 72 (1)) the circumstances set out in *Pressetext* and in paragraph two of the Proposal's draft of article 72. Hence, what was once the Proposal's leading principle in the context of modifications (a prohibition for modifications without retendering in case of a material change) has in the final version of article 72 been reversed into a ground for modification provided that the modification is immaterial.

Even more, as a last paragraph, article 72 of Directive 2014/24 contains the provision that if a modification does not fall within the scope of the grounds listed in paragraph one or two, a new public procurement procedure is required.

It follows from the foregoing that article 72 of Directive 2014/24 in its final version conveys the idea of supremacy of flexibility, pushing the concern for competition to the background. This, however, has to be put into its proper context. As was also the case in *Pressetext*, the concerns that are weighed against each other are the one of competition (in the sense of ensuring an internal market for public contracts) and the one of flexibility. Hence, for the purpose of the effectiveness of the Directive guided by the idea to establish an internal market as to public contracts, it would suffice that equality amongst tenderers is not jeopardised due to modifying an existing public contract actually giving rise to a new contract. After all, this would allow public purchasers to favour certain tenderers over others as it can manipulate the public procurement process to the benefit of a particular tenderer. Such threat to equality would however not arise if such modification was foreseeable to a diligent tenderer in the award stage (so this modification could have been factored in during the competition for the contract)[600] or if the modification is not of such nature that it impairs the equal opportunity of tenderers.[601] Examples of the former are modifications pursuant to a review clause and modifications tenderers are able to anticipate when they are aware that the public contract is incomplete. Such incompleteness gives rise to a probable future need for additional goods, services or works. Examples of the latter are modifications due to unforeseen and unforeseeable circumstances (including the replacement of a contractor) and small modifications that, would they have been known to tenderers participating in the public procurement procedure, would not have affected the outcome of the procedure.

In view of the foregoing, the structure of article 72 of Directive 2014/24 could be justified. However, it is only 'equality among tenderers' which counterbalance 'flexibility' in this equation. Hence, the elements stem from the 'internal dimension' of public purchasing. Ensuring that public purchasing does not give rise to negative externalities – hence taking the 'external dimension' of public purchasing into consideration – seems not to have been an

[600] See also, O Dekel, *l.c.*, 420.
[601] See also, O Dekel, *l.c.*, 420-421.

element of significance when drafting the current version of article 72. In an 'enriched' public procurement regime vis-à-vis modifications this would have been an element of concern. We already argued before that the rationale underpinning our 'enriching exercise' requires for a clear principle of retendering, implying a prohibition to modify, but subject to certain modifications based upon considerations of economic rationality.

Such principle of retendering also indicates that derogations have to be interpreted and applied strictly. Such strict approach does not only guarantee that the problem of information asymmetry is dealt with. It also tackles the soft budget constraint and commitment problems.[602] Such signal to both public purchasers and the tenderers is absent in article 72's wording. It rather conveys the message that modifications are allowed within the limits provided for instead of conveying that modifications are the exception and only allowed if sound reasons to do so can be advanced. A provision of 'enriched' public procurement regulation as to modification would mirror the latter approach. In that perspective, the Commission's suggested article 72 in the Proposal adherers more closely to the requirements such a modification should answer to under 'enriched' public procurement regulation.

c. Article 72 Directive 2014/24: the grounds allowing modifications

(a) Review clauses

Article 72 (1) (a) to directive 2014/24 provides for a possibility for public purchasers to use review clauses. In the literature, it is pinpointed that this provision provides for a large margin of discretion.[603] For the purpose of our analysis it is important to add to that statement, that this might be true but apparently only as to its drafting. Hence, this provision allows for a review clause no matter what the content is. However, once inserted in the tender documents, the clause should not provide for discretion. After all, article 72 (1) (a) states that if the possibility to modify contract terms was provided for in the initial procurement documents in clear, precise and unequivocal no need to retender the contract will arise. This is true irrespective of the monetary value of the modifications.

[602] Cf. supra.
[603] S Treumer, *l.c.*, 150.

An example the preamble to Directive 2014/24 contains, is the possibility to insert price indexation clauses in public contracts.[604] If such clause was disclosed in the initial tender documents, meaning that all actual tenderers as well as the potential tenderers were aware (or should have been aware) of this clause, obviously such causes no problem as to transparency and equality amongst tenderers. Hence, little can be advanced to dispute the validity of such a possibility from the 'internal perspective' to public procurement regulation. The question arises, however, how this deals with its 'external dimension'?

Above we already argued that a review clause is admissible under 'enriched' public procurement regulation, provided that three conditions are met. The first is that the review clause was brought to the intention of the tenderers in the award phase so that it could be factored in when competing for the public contract. This converges with the first leg of our 'standard for enrichment' (i.e. competition). The second condition was that the clause does not endow the public purchaser with discretion. This converges with the second leg of our 'standard for enrichment' (i.e. fair competition). The third condition is that the clause should reflect normal market practice. This adheres to the third leg of our 'standard for enrichment'.

Our 'standard for enriching' provides that, in the first place, the public purchaser should create competition by adequately informing the market about the upcoming procurement procedure and its modalities. The wording in article 72 (1) (a) of Directive 2014/24 implies that the public purchaser should inform the actual and potential tenderers about such clauses. Indeed, the tender documents should mention them. Henceforth, we deem the first leg of our standard to be fulfilled.

Secondly, the public purchaser should allow for genuine competition, i.e. allowing the tenderers to compete based on equal and full information. Also here, the 'standard for enriching' does not seem to give rise to problems. All tenderers are equally and fully informed as article72 (1) (a) provides that the information in the tender documents as to the review clause is 'clear, precise and unequivocal' and the clause states the scope of the possible modification as well as the conditions that trigger its application. We draw from this that the actual clause, describing

[604] Paragraph 111 of the preamble to Directive 2014/24.

the circumstances that trigger the application of this clause as well as the actual modalities of the clause, should be mentioned in the tender documents. We deem this to constitute 'full information' and *ipso facto* also 'equal information'.

The third aspect of our 'standard for enriching' concerns assuring 'fair competition'. This entails in the first place that the public purchaser should behave objectively and transparently and abstain from anti-competitive and discriminatory behaviour. As the public purchaser is supposed to insert the review clause in the tender documents in a 'clear, precise and unequivocal' way, this requirement seems to be fulfilled. The risk that the review clause is tailor-made to accommodate one specific tenderer seems limited. Insofar this provision would leave room for this, this is forbidden by the more general requirement that the public purchaser should behave objectively and transparently which is laid down in article 18 of Directive 2014/24. In the second place, the margin of discretion of the public purchaser should be curtailed. Also here no problem seems to occur, given the 'quality requirements' put to the information in the tender documents in this respect.

There is, however, one caveat as to the third leg of our 'standard for enriching'. The review clause should reflect normal market behaviour. Here an issue may arise, i.e. when the review clause would not have been inserted by a private purchaser. The concern here is that the wording of this provision does not clearly guarantee that the review clause does not provide the chosen tenderer with an advantage.[605] Suppose the review clause in fact implies a shift of a risk which in normal circumstances would have been borne by the performer of the contract. This is not necessarily a problem, but it will become one if the price does not reflect this shift of risk. Therefore, an 'enriched' provision allowing review clauses would provide that the review clause should be in line with market practice in this regard.

(b) Additional works, services or supplies

[605] One could argue that if such clause was inserted in the tender documents, competition for the contract amongst the tenderer is not distorted. This may be true, but this does not imply that the public contract containing such a clause does not produce the negative externalities we discussed in chapter 1. After all, although potentially every tender could benefit from this clause, such benefit is still able to produce adverse effects vis-à-vis markets outside the public market for the contract at hand.

If a need to acquire additional works, services or supplies becomes necessary in the course of the performance of a public contract, article 72 (1) (b) Directive 2014/24 provides for a possibility to have these needs addressed without organising a new public procurement procedure. This possibility is subject to the following conditions. A new public procurement procedure should not be feasible because of economic or technical reasons and would imply significant inconvenience or substantial duplication of costs for the public purchaser. In addition, modifications may not give rise to price increases for more than 50 % of the value of the original contract.

Actually, this ground for modification comprises two aspects. The first is the fact that economic or technical reasons undermine the feasibility of a new procurement procedure. This is a situation where opportunity costs may justify modifications without retendering. The second aspect seems to incorporate a mix of opportunity and transaction cost considerations, as it is required that a new public procurement procedure would imply a significant inconvenience[606] or duplication of costs. However, mentioning transaction costs does not seem to add much to the ground for modifications, at least not from the perspective of 'enriched' public procurement regulation. We argued before that once it can be established that opportunity costs are high, the magnitude of the transaction costs is immaterial.[607] Even more, once it is established that the opportunity cost is high, transaction costs can *ipso facto* be considered to be high too (as, generally speaking, the opportunity cost can be considered to be a transaction cost as well). Applied to article 72 (1) (b), the first leg of the condition states that modification is allowed if a change of contractor 'cannot be made for economic or technical reasons'.[608] The second leg of the condition is that the change of contractor 'would cause significant inconvenience or substantial duplication of costs' for the public purchaser. However, if the change is impossible anyway, the transaction costs such a change would imply are irrelevant.

It follows that this ground for modifications deals with the problem of opportunity cost. Pursuant to our analysis in the section above, two issues arise when assessing this provision from the perspective of 'enriched' public procurement regulation. The first issue concerns the

[606] We assume that 'significant inconvenience' is to be understood as 'huge transaction costs' as well as an opportunity cost in terms of jeopardising the completion of the public contract.
[607] Cf. supra.
[608] In this respect we deem 'economic reasons' not to refer to transaction costs, but to economic consequences beyond the scope of the public contract.

question whether or not such a ground is acceptable under 'enriched' public procurement regulation. The answer depends on how to interpret 'economic or technical reasons'. If interpreted broadly, this ground would not be permissible under 'enriched' public procurement regulation. Hence, 'enriched' public procurement regulation would require from the public purchaser to deliver proof demonstrating that an opportunity cost exists which makes retendering unfeasible or impossible. The second issue is the one of guaranteeing a competitive price for the modifications. Article 72 (1) (b) does not provide for such a guarantee. It only provides for a cap on the value of the modification. Whereas a cap as to the value is in principle not contradictory with the requirements following from 'enriched' public procurement regulation – even though it is hard to see the relevance of such cap in view of the impossibility of changing the contractor in the first place[609] – the lack of a mechanism that ensures that the terms and conditions related to the modification are competitive is contradictory.

'Enriched' public purchasing regulation would not *a priori* prohibit modifications without retendering in case of the need for additional works, services or goods. However, this provision would only envisage procurement situations where retendering would give rise to an opportunity cost, implying that retendering is most unfeasible or even impossible. The provision would require in the first place from the public purchaser to demonstrate a justifying opportunity cost. Secondly, the provision would also oblige the public purchaser to demonstrate the market conformity of the conditions under which the modification has been agreed upon. When the information risk is low, the public purchaser can limit himself to explaining why he deems the risk to be low. If the information risk is high, the public purchaser will have to demonstrate that he has adopted adequate measures to overcome this risk or that terms of the modification are market-like.

As we discussed before, relying upon expert advice to guarantee a competitive price may be an apt measures to bridge the information asymmetry and thus to rule out supra-competitive terms. Hence, in order for article 72 (1) (b) to be in line with 'enriched' public procurement regulation, it should state that it is for the public purchaser to demonstrate the existence of the opportunity cost (i.e. that the change of contractor cannot be made for economic or technical reasons) and,

[609] After all, the provision requires a new public procurement procedure when this cap is exceeded, suggesting that once this cap is exceeded the benefits of integrating a modification without retendering are neutralised by the disadvantages following from the lack of competition.

in case of an alleged low information risk, that this risk is indeed low or, in case of a high information risk, that the terms of the modification are market-like or that measures have been taken to ensure the market conformity of the terms of the modifications.

On the other hand, from an 'enriched' public procurement regulation perspective it would not be necessary to indicate in the provision that, as a condition for the modification to apply, retendering would cause substantial transaction costs. The fact that the required level of opportunity cost is demonstrated suffices in this respect. Also, the provision would not necessarily contain a cap as to the value of the modification. The fact that the provision provides for a mechanism to ensure market conformity suffices to limit the effects vis-à-vis competitors. Such cap can even be inefficient as it may give rise to a duty to retender even if the retendering cost is higher than the opportunity cost plus the transaction costs. On the other hand, such a cap can be useful to indicate when the modification can be considered to imply a high information risk. By this token, as from a certain percentage the contract value may represent a presumption that the information risk is high without prejudice however to the possible existence of a high information risk if the value of the modification is beneath this percentage.

(c) Unpredictable circumstances

In case unpredictable circumstances occur – i.e. circumstances that were impossible to anticipate even for a diligent public purchaser – a public contract can be modified without giving rise to an obligation to organise a new public procurement procedure. As discussed earlier, such modification should not entail a price increase of more than 50% of the original contract value and the overall nature of the contract should not be changed.

Also here, from the perspective of 'enriched' public procurement regulation, this ground for modifications is too widely conceptualised. It also comprises situations where unpredictable circumstances intervene but where the costs of retendering are low. This is unsatisfactory when the information risk is high, but may also imply adverse effects when the information risk is low. An 'enriched' provision would provide that modifications due to unpredictable circumstances are only allowed by way of derogation when the costs of retendering outweigh the benefits following from competition, which is for the public purchaser to demonstrate. It follows that when retendering costs are low, such derogation should not be permitted

Thus, a derogation based upon 'unpredictable circumstances' is only conceivable under 'enriched' public procurement regulation in case of high retendering costs. If the information risk is low, the obligation to retender can be derogated from if the public purchaser delivers the proof of the high retendering costs and the low information risk. If the information risk is high, we have to differentiate –contrary to what was the case as to the ground for modifications because of the need for additional works, services or goods – between two situations : (i) high transaction costs but no opportunity cost and (ii) high opportunity cost whether or not combined with high transaction costs. In the former situation, the public purchaser can modify without retendering but he will have to demonstrate that high transaction costs are present, that the retendering costs outweigh the competition gains and that the terms relating to the modification are market-like or that measures have been adopted that ensure that those terms are market-like. In case of the latter situation, i.e. presence of an opportunity cost, the public purchaser will have to demonstrate the existence of the opportunity cost (i.e. that retendering is practically unfeasible or impossible) as well as that he adopted the necessary measures to ensure that the terms of the modification are market-like or that the terms themselves are market-like.

From the perspective of 'enriched' public procurement regulation, a cap based on the value of the modification would not be necessary and they may even be counterproductive – as was discussed in the previous section. However, also here a percentage may be useful to indicate when a modification can be assumed to give rise to a low or high information risk.

(d) Replacing the subcontractor

Article 72 (1) (d) of Directive 2014/24 provides, in the first place, for an exemption from the retendering obligation if the replacement of the chosen tenderer was provided for in the tender documents (by way of an unequivocal clause or option). A second exemption is when the public purchaser itself assumes the main contractor's obligations towards its subcontractors. Thirdly, no new public procurement procedure is necessary in case the new party to the contract succeeds universally or partially the chosen tenderer following a corporate restructuring provided that the new contractor fulfils the initial criteria for qualitative selection and that this succession does not entail other substantial modifications to the contract and is not aimed at circumventing the provisions of Directive 2014/24.

Replacing the subcontractor in the hypotheses referred to in article 72 (1) (d) of Directive 2014/24 does not seem to affect the terms and conditions of the public contract itself, but only the identity of the parties to it. Hence, such a modification seems to be neutral in terms of the negative externalities we wish to address.

(e) Immaterial modifications

Amendments that are not material do not give rise to an obligation to organize a new public procurement procedure according to article 72 (1) (e) of Directive 2014/24. A modification is considered not to be material if the modification does not introduce conditions which, had they been part of the initial procurement procedure, would have allowed for the admission of other candidates than those initially selected or for the acceptance of a tender other than that originally accepted or would have attracted additional participants to the procurement procedure. Furthermore, a modification is also immaterial if it does not change the economic balance of the contract in favour of the contractor in a manner which was not provided for in the initial contract. When the modification extends the scope of the contract considerably or when it implies replacement of the contractor in other situations than the ones in which allowed for, such modification is material.

For our analysis, the requirement of absence of a change in the economic balance in the initial contract is important. After all, modifications are in our analysis only problematic if the risk exists that the modification will imply occurrence of the negative externalities we discussed in chapter 1. These externalities would arise in the context of modifications if such modifications would be agreed upon at a supra-competitive price. From an 'enriched' public procurement procedure it is therefore essential that a provision as to 'immaterial' modifications is interpreted strictly. It follows that no information risk at all is involved in such a change. Hence, the essential question is: does the possibility to modify provide for a possibility for the chosen tenderer to behave opportunistically? If so, this ground cannot apply. However, the provision clarifies that a modification changing the economic balance in favour of the chosen tenderer is allowed for in the public contract, probably pursuant to a review clause, such modification is

permissible. In that respect, we refer to our discussion of the 'enriched' regime vis-à-vis review clauses.[610]

(f) *De minimis* modifications

Directive 2014/24 also provides that a modification to an existing public contract does not entail an obligation to retender if the value of the modification falls within the scope of application of the *de minimis* regime. That is, if the value of the modification is both lower than the relevant thresholds for application of Directive 2014/24 and lower than 10 % of the initial contract value for service and supply contracts and below 15 % of the initial contract value for works contracts, the modification is believed to be too limited to put out for tender.

The idea underpinning this *de minimis* regime is that if a modification is limited in terms of value, no new public procurement procedure has to be organised. In economic terms: if the value is that limited so that the competition gains would be limited as well, the public purchaser does not need to incur the retendering costs. Hence, this regime actually encompasses the following scenarios we discussed above: (i) high retendering costs and low information risk and (ii) low retendering costs and low information risk. As to the former, we indeed acknowledged that under 'enriched' public procurement regulation a derogation is acceptable provided that the public purchaser delivers proof that the transaction costs are high and that the information risk is low. As to the latter, however, we argued that no derogation should be permitted.

Hence, overall, a *de minimis* regime as laid down in article 72 (2) of Directive 2014/24 would not be acceptable under 'enriched' public procurement regulation. This is because this regime does not take into consideration the retendering costs. However, a *de minimis* regime could fit within 'enriched' public procurement regulation as to modifications, but only to clarify when the competition gains can be considered to be limited. Next, however, this assumption has to be put into an equation with the retendering costs.

[610] Cf. supra.

Another question is whether the percentages combined with the cap, both mentioned in article 72 (b), are acceptable. When discussing the ends and *rationale* underpinning our 'enriching' effort we indicated that we deem those ends and *rationale* to converge with the ones underpinning EU state aid law. The latter body of law provides also for a *de minimis* regime, albeit that the threshold for its application are, especially when considering the threshold in Directive 2014/18 as to works, lower. The EU state aid law threshold in the *de minimis* regime is EUR 200,000 over three fiscal years.[611] When modifying a contract for works, the 'advantage' may theoretically be equal to an amount between EUR 0 and EUR 5,186,000. This sits uneasily with the EU state aid law *de minimis* regime.

E. CONCLUSION

In this chapter we discussed the regime of modifications of contracts in the course of their performance from the viewpoint of negative externalities. We argued that the information asymmetry between the chosen tenderer and the public purchaser and the problems of soft budget constraint and asymmetric lock-in the public purchaser is faced with, provide for a fertile soil for opportunistic behaviour on the part of the chosen tenderer. Hence, we argued in favour of a regime starting from the principle of retendering, which can be derogated from if justified.

For such justification, we deem it essential – in view of total welfare considerations – that they are rooted in the concern not to pursue competition gains if such gains do not equipoise the transaction and/or opportunity costs. To this end, we balanced the competition gains (i.e. in terms of avoiding information risks) with the transaction and opportunity costs. If the costs outweigh the benefits, modification without retendering can be permissible. However, then it would still be for the public purchaser to demonstrate the magnitude of the transaction or opportunity cost, the limited competition gains (if compared to the transaction costs – hence, only in case of transaction costs, not in case of opportunity costs) and the market-like character of the terms and conditions agreed upon when modifying or that measures are in place to guarantee such a market-like outcome.

[611] Article 3 (2) Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid, *OJ* L 352, 24 December 2013, 1

9. CONCLUDING CHAPTER

In this thesis, we envisaged to address the problem of negative externalities public purchasing may give rise to. These negative externalities concern the effects public purchasing may produce vis-à-vis markets outside the particular public market for the contract at hand. In essence, we identified a problem of cross-subsidising. Public contracts may give rise to rents to the benefit of the chosen tenderer. The latter can use these rents to strengthen his position on the market, and consequently the economic interests of his competitors are harmed. Overall, this results in a loss of social welfare because of the damage to the competition dynamics in the relevant markets.

We argued that these negative externalities are rooted in public procurement regulation's inability to provide for a framework allowing for the creation of a perfectly functioning market for the public contract at hand. Indeed, whereas public procurement regulation in itself is actually an answer to a market failure – i.e. by introducing market-like mechanisms into public purchasing – such regulation fails nonetheless to guarantee a market-like outcome. The reason we pinpointed is that such regulation is focused on the internal dimension of public purchasing. It shapes the behaviour a public purchaser should adopt vis-à-vis actual and potential tenderers. However, public procurement regulation does not envisage the 'external dimension', no matter which conception of public procurement regulation applies (i.e. the conception of public procurement regulation as providing for 'structures and institution', the neoliberalist conception or the ordoliberal conception). For the purpose of the thesis here, we considered the 'external dimension' to be the markets outside the specific public market for the public contract at hand. This was deemed to constitute the source of the externalities we envisaged.

The foregoing also allows positioning our research within current public procurement regulation scholarship. This scholarship is currently predominantly concerned with the 'internal dimension' of public purchasing. Questions addressed are, for instance, how to ensure equality among tenderers and transparency or what meaning should 'competition' be endowed with in the context of public procurement regulation. These questions relate to the 'internal dimension' of public purchasing as it sees to the relationship between the public purchaser and the actual and potential tenderers. It is true, however, that 'competition' is an essential element to this thesis. Nevertheless, whereas the said scholarship is mainly concerned with the meaning of

'competition' in the framework of public procurement regulation, we are concerned with the consequences for competition outside the specific market for a particular public contract. In this respect, another line of debate recently emerged in this field. Sanchez Graells was among the first to pinpoint the external effects public procurement regulation produces in providing a legal framework for public purchasing. His research focussed on the effects public procurement regulation may produce in 'publicly dominated markets', i.e. markets where the public purchaser is the only or the most important purchaser. Sanchez Graells – criticising the fact that public procurement regulation is conceptualised as a means to create markets, whereas public purchasing acts within the market – argues that the competition distortions resulting from such regulation may reduce social welfare. Such reduction of social welfare is the backbone of our analysis as well.

However, while Sanchez Graells sees the public purchaser's buying power, vested in the public purchaser by virtue of public procurement regulation, as the social welfare reducing element, we argue that public procurement regulation provides a context in which chosen tenderers may obtain undue advantages. Such advantages produce the adverse outcome we envisage to tackle. This is, so we argue, because these advantages enable the receiving tenderer to strengthen his position in the wider market (i.e. the market for the product at hand or adjacent markets, both being markets where the chosen tenderer competes with other undertakings). Therefore, our research complements Sanchez Graells' work. While Sanchez Graells addresses the issue of competition distortions because the public purchaser can exercise buying power to obtain favourable contract terms, we address the problem of supra-competitive contract terms due to fact that public procurement regulation is not conceptualised in a way that allows taking into account the external dimension of public purchasing.

Having identified the issue at the heart of our thesis, we also explored how to address this issue. To this end, we argued that EU state aid law is a valuable source of inspiration. We deemed this justified for a couple of reasons. First, the 'negative externalities' we envisaged converge to a large extent with the notion of 'advantage', its presence being one of the constitutive conditions for the state aid prohibition in article 107 (1) TFEU to apply. Secondly, we also argued that the ends we pursue in addressing the negative externalities, converge with the ends the state aid prohibition pursues. Thirdly, we argued that the underpinning economic rationale of the state

aid prohibition resembles to a large extent the economic rationale underpinning our enriching exercise.

Based on this, we examined certain fields within the area of EU state aid law to identify principles which we could rely on when dealing with the negative externalities we identified. This allowed us to build our 'standard for enrichment'. This is a framework to apply when interpreting or enacting public procurement regulation. It aims at addressing already in the regulation itself the issue of negative externalities, as an ex ante regime.

This 'standard for enriching' consists of three legs. First of all, public procurement regulation should assure the organising of 'competition', including informing the market adequately about the intention to award a public contract and about the modalities for doing so. Secondly, the public purchaser should allow for 'genuine competition'. This implies that all tenderers should be fully and equally informed. The concern here is to avoid horizontal information asymmetry (i.e. among tenderers) as well as vertical information asymmetry (i.e. between tenderers and public purchaser). This contributes, in general, to the quality of the competition. Thirdly, the public purchaser should assure 'genuine competition'. To this effect, he has to abstain from discriminating and anti-competitive behaviour. We argued that applying our 'standard for enriching' avoids the occurrence of the negative externalities we envisage in this thesis or, at least, to reduce the risk of occurring.

We deemed application of this 'standard for enriching', as a framework to draft or interpret public procurement law, justified for a few reasons. Apart from the fact that the market cannot remedy this failure itself, and thus that this problem requires a regulatory intervention, we also specifically justified why we deem such an ex ante regime preferable in view of efficiency considerations. First of all, such an 'enrichment exercise' avoids that a parallel enforcement system, specifically aimed at neutralising the negative externalities, must be put in place. Hence, enforcement can be assured in a more cost-efficient way than in case of two parallel enforcement systems. To illustrate this, we elaborated the example of the parallel remedy schemes in public procurement regulation and EU state aid law. Secondly, we argued that such an ex ante regime to tackle our negative externalities is more cost-efficient, and also more effective, than an ex post regime, such as a tax or a liability regime. Thirdly, we also found that

applying the ‘rule’ based system of ‘enriched’ public procurement regulation to be more adequate in terms of efficiency than a standard prescribing that a public contract may not involve the negative externalities we envisage. We also made the point that our suggestion would contribute to a better administration of EU state aid law.

Having developed our ‘standard for enrichment’, we applied this standard to a number of topics within EU public procurement law where ‘competition’ has a prominent role. Indeed, to demonstrate how our ‘standard for enrichment’ can produce practical results, we utilised EU public procurement law as to the classical sectors (as currently laid down in Directive 2014/24) as a point of reference. This allowed us to demonstrate how ‘enriched’ public procurement regulation as to certain aspects of public purchasing would look like. However, to be sure, this thesis is not limited to ‘enriching’ EU public procurement law. The point we made also applies to public procurement regulation in general. We only relied on EU public procurement law as a reference point to demonstrate how our ‘standard for enriching’ would work in practice. Furthermore, we deem this standard also useful for reform of other aspects of public procurement regulation. Therefore, also other provisions of public procurement regulation can be tested against this ‘standard for enrichment’.

Another point emerged while applying our ‘standard for enrichment’ to EU public procurement regulation for which the standard can be criticised. As we will discuss further below, adhering to our standard may in some cases result in an undesirable outcome. This is because applying our ‘standard for enrichment’ comes with a cost. In some cases, however, the gains this standard gives rise to may be outweighed by the costs it produces. If so, economic rationality pleas in favour of setting our standard aside. We admit that such situations can occur. Nevertheless, we argued that when drafting (or interpreting) a provision of public procurement regulation, application of our ‘standard for enrichment’ should be the principle. Only if justified in view of cost benefit considerations, this standard can be deviated from.

First, we considered the regime as to the disclosure of award criteria and their belongings (the award criteria’s weighting, sub-criteria and their weighting and the quotation method). We argued that an ‘enriched’ provision of public procurement regulation would prescribe complete disclosure (i.e. of all elements, being the award criteria and their weightings, the sub-criteria

and their weightings and the quotation method) in the tender documents, i.e. at the time the tenderers can integrate the information enshrined therein into their bid. For this we relied on all of the three legs of our 'standard for enriching'. Only if justified from a cost-benefit perspective, deviations from such obligations can be allowed. Yet, we suggested that such derogations would be difficult to justify given the availability of other, more competition friendly possibilities to overcome objections to a full disclosure obligation.

To further illustrate this 'enriched' provisions as to the disclosure obligation, we relied upon the relevant provisions in Directive 2004/14 and Directive 2014/24 and the GC's and ECJ's jurisprudence. It was demonstrated that these provisions, as applied by the said courts, do not entail the full disclosure obligation we advocate. This discussion also allowed underscoring our point that current public procurement regulation is generally focussed on its internal dimension and therefore gives rise to the risk for our negative externalities to occur. It envisages assuring equal treatment of tenderers and objective and transparent behaviour on the part of the public purchaser. After all, these elements were the criteria for the GC and ECJ to determine the extent of the disclosure obligation. However, the criteria that give substance to our 'standard for enrichment' prove to be absent in the reasoning applied in this respect. This stresses the added value of an 'enriched' public procurement regulation, pursuant to our 'standard for enrichment'.

Secondly, we considered the pursuit of policy considerations (i.e. environmental and social considerations) in public purchasing by applying award criteria and technical specifications to this effect. Our concern here was with the fact that we deemed the pursuit of such policy consideration to limit competition for the public contract at hand and, hence, to possibly imply a de facto subsidy conferment. Here, we discerned a problem in view of the third leg of our 'standard for enriching'. Such pursuance would endanger 'fair' competition, as the corresponding requirement would restrict participation. We argued that when the award criteria or technical specifications in fact result in the 'purchase' of a contribution to the delivery of a public good, the problem of negative externalities emerges. Such purchase would amount to the granting of a subsidy (i.e. to the extent the public procurement procedure yields a supra-competitive price due to the flawed competition), however without being subject to the requirements EU state aid law prescribes to ensure proportionality, necessity, etc. We argued that such risk occurs whenever the award criterion or technical specification goes beyond

contract performance but also when the award criterion or technical specification is confined to contract performance, goes beyond requiring the mere compliance with the relevant law and produces production/delivery effects, disposal effects or workforce effects.

To illustrate how 'enriched' public procurement regulation as to this aspect of public purchasing would be substantiated, we referred to the relevant provisions in Directive 2004/18 and Directive 2014/24. We discussed that the prevailing view in the scholarship and the ECJ's jurisprudence is that such pursuance is allowed insofar the public purchaser acts objectively and transparently and insofar he treats all tenderers equally. However, we argued that the integration of policy considerations give rise to the risk of in fact constituting a barrier to entry. Hence, this limits competition and gives rise to the risk of paying a supra-competitive price due to reduced competition. At the same time, it cannot be ascertained that the supra-competitive price, in fact being a compensation for delivering a policy outcome, is proportionate and necessary. Hence, such purchase contract may give rise to the competition distortion we envisage to avoid. This further demonstrates that public procurement regulation, as currently conceptualised (i.e. merely addressing its internal dimension), does not envisage the negative externalities it is able to produce.

Finally, we also considered modifications to public contracts in the performance phase. Here, we found that an 'enriched' public procurement provision would provide for a principle of retendering, with a possibility to derogate if justified for reasons of economic rationality. In this respect, we relied upon two essential elements: the information risk (i.e. the risk that the public purchaser absent competition will modify at supra-competitive terms, implying that competition would actually produce gains to the benefit of the public purchaser) and the opportunity and transaction costs such retendering implies. Only if these costs would outweigh the gains, and thus would outweigh the information risk, derogation from the obligation to retender the contract (in whole or in part) would be acceptable. Such obligation to retender follows in the first place from the first leg of our 'standard for enrichment'. It implies competition for the modification, or possibly for the modified contract (if the modification is not separable from the original contract). Furthermore, it naturally also implies 'genuine' competition and 'fair' competition, as under 'enriched' public procurement regulation the new

tender procedure would have to comply with the requirements stemming from these legs as well.

The starting point for the construction of the 'enriched' provision as to the modification of existing contracts was article 72 of Directive 2014/24. We demonstrated that a conception that is based on flexibility, as is the case as to the said article 72, indeed gives rise to the risk of negative externalities. Therefore, an 'enriched' provision in this respect would provide for competition – insofar rational in view of cost-benefit analysis – in order to diminish the negative external effects such modifications can produce, thereby harming competition.

In sum, this thesis primarily aimed at further developing the rather young scholarship dealing with negative externalities public purchasing produces. Even though young, the importance of this research should not be underestimated. It contributes – or at least it aims at contributing – to the enhancement of social welfare. In this thesis, the social welfare enhancing effort lied within the concern that public purchasing may adversely affect competition in the broader market. To address this, it is important to see, so we argued, the potential of public purchasing to produce negative external effects, i.e. adverse effects vis-à-vis markets outside the specific market for the public contract. Thoroughly dealing with this, requires a paradigm shift. Public procurement regulation should not only envisage the internal dimension of public purchasing. It should also take into account its external dimension. To this end, we suggested a tool for regulatory reform and, to the extent possible, for interpretation of current regulation. We have named it the 'standard for enrichment'.

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