

TOWARDS A NEW REGULATORY REGIME FOR CONCESSIONS

The European Commission has issued a draft directive that aims to incorporate operators of concessions into the European Union's public procurement regime..

Concessions

Concessions are agreements between public authorities ("PAs") and third parties (typically private sector companies) ("**cessionaires**"). These agreements can be categorised as either "works concessions", under which the concessionaire agrees to build or develop an infrastructure project such as a motorway, or "services concessions", under which the concessionaire agrees to operate a public service, such as a waste management service or port, for the PA.

Concessions are distinguishable from the contracts for works, supplies and services that PAs routinely conclude with third parties in that concessionaires are given a right to exploit the works or services they provide for their own potential gain, rather than accepting direct compensation from the PA as consideration. Under a works concession, for example, the party responsible for the construction of a motorway would be allowed to collect tolls for an extended period of time. Under a services concession, such as for the operation of a port terminal previously built by a port authority, the port operator would be allowed to retain fees for services rendered to those transporting cargo through the port in exchange for a set concession fee paid to the port authority to compensate it for the infrastructure investment.

Concessions tend to be awarded in relation to long-term and high-value projects and are consequently an important source of economic activity in the European Union ("EU"), worth €138 billion annually in the EU's water, waste, health and transport sectors alone. As most concessions are granted to private parties, they are a prime example of the public-private partnerships ("**PPPs**") that governments throughout the EU are keen to promote in the current climate of restrained public spending. The European Commission ("**Commission**") estimates that over 60% of all PPP agreements could be considered concessions.

Key issues

- The Commission has made an effort to design a procurement regime for concessions that is more flexible than the current regime for works and services contracts
- The proposed Concessions Directive is not expected to come into force until 2014 and will not apply retroactively
- The provision that is likely to cause the most debate is the draft directive's proposal to limit the duration of concessions

To encourage the expansion of this valuable market, the Commission has proposed a new regulatory regime for concessions, similar to the existing EU public procurement regime, in an effort to systematise the bidding process for concessions and level the playing field for prospective concessionaires. The Commission hopes to bring significant change to a process it sees as lacking in legal certainty but the proposals may, in fact, result in increased uncertainty regarding the recovery of concessionaires' investments as well as greater administrative costs overall.

Background

The current EU public procurement regime is primarily set out in The Utilities Directive (2004/17/EC), the Public Sector Directive (2004/18/EC) and the Remedies Directive (2007/66/EC) (collectively, the "**PP Directives**"). The PP Directives set out specific procedures for the publication and award of public tenders, as well as the appeal of awarded tenders by parties who believe they have been unfairly passed over. Publication and award criteria are highly prescriptive. Contract notices for most tenders with a value beyond certain set thresholds must be published in the Official Journal of the EU, specifying the weight the PA

(or "Contracting Authority") will give to various pre-set, technical and non-discriminatory award criteria. PAs must choose between certain set procedures (open, restricted, negotiated or competitive dialogue) with clearly defined timelines. Tenders must be awarded on either a lowest-cost or most economically advantageous ("MEAT") basis. Once awarded, tenders must be suspended for 10-15 days to allow for appeals. The regime was designed to avoid the arbitrary awarding of tenders by PAs by creating a precise and transparent process, but it has come under criticism for being overly rigid and administratively burdensome.

The EU public procurement regime is primarily concerned with the tendering for standard contracts (i.e. those where the PA directly pays the party that successfully tenders in compensation for the works, service or supplies that it provides), leaving the desired procurement procedures for concessions (where compensation consists of the successful concessionaire's right to exploit the project) only partially covered. The PP Directives currently only partially apply to works concessions (there are no specific provisions on award criteria), and services concessions are explicitly excluded from their operation. The award of works concessions (and the publication, award and appeal of services concessions) is therefore currently only governed by the general EU treaty principles of equal treatment, non-discrimination and transparency.

The Perceived Need for Regulation

Given the lack of clarity as to the application of the PP Directives' criteria to concessions, a significant number of disputes have ended up before the Court of Justice of the European Union ("CJEU"), some 25 cases in the past decade alone. The resulting case law has shed some light on the definition of a concession (concessionaires must assume the economic risk arising from the provision and management of the services, with no guarantee of a reasonable income) and the extent of publicity for concessions tenders ("*a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of the procurement process to be reviewed*" is required). In practice, most concessions are awarded transparently and, to avoid dispute, most PAs tend to adopt competitive procedures similar to those set out in the PP Directives.

Nevertheless, the Commission believes that the lack of a consistent legal framework across the EU creates barriers

to entry to the tendering process, particularly for SMEs. Some member states have no rules on concessions and EU treaty principles are understood and applied differently in different parts of the EU. The European Court of Auditors singled out public procurement (including concessions) as the source of nearly half of the errors in the spending of EU Cohesion Funds on energy and transport projects in poorer Member states. A third of the participants in the Commission's consultation on the harmonisation of the public procurement regime were aware of cases in which concessions were directly awarded without any transparent or competitive process. At a time when efficient spending of public money is seen to be essential, the Commission believes stimulating competition in a large but under-regulated market could help accelerate the return to economic growth by stimulating investment and encourage more PPPs.

Proposed Directive

In late December of last year the Commission tabled (along with a series of proposals to update the current PP Directives) a proposal for a new directive on the award of concessions contracts (the "**Concessions Directive**")¹. The Concessions Directive will apply to both works and services concessions awarded following the Directive's entrance into force (the Commission aims to adopt the draft directives by the end of 2012 and require its implementation by individual states by 30 June 2014).

The draft directive codifies the existing case law on the definition of concessions, specifically the notion that the concessionaire must assume substantial operating risk and helpfully provides lists of specific concessions that could be covered. The Concessions Directive will only fully apply to large (over €5 million) concessions with a cross-border interest (this essentially excludes social security/benefits, health, religious and trade union services which the Commission considers as having only a limited cross-border dimension due to such service being provided "*within a particular context that varies widely between member states*").

¹ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0897:FIN:EN:PDF>

In a similar fashion to the PP Directives, the Concessions Directive includes rules for the publication and award of concessions tenders, provides set time limits (52 days for receipt of applications) and requires a standstill period for awards to be appealed (the Remedies Directive is applied). The Commission has, however, made an effort to design a more flexible procurement regime for concessions. Mandatory procedures are abandoned in favour of looser procedural guarantees of transparency, consistency and objective criteria. The lowest-cost award criterion is not imposed and a set of objective "general requirements", including financial soundness, experience and environmental policies, are offered as a justifiable alternative to MEAT as a basis for selection. The Commission has explained that, rather than simply applying the PP Directives to concessions, a separate, more flexible, set of rules is justified due to the high-value, complexity and long-term nature of concessions.

Issues to Consider

The Concessions Directive will not apply retroactively – in other words, it will not impact on concessions contracts in place at the time the Directive comes into force. However, an extension or renewal of an existing contract may qualify as a new concession and would, therefore, need to comply with the new Concessions Directive once it comes into force. Reflecting the existing case law, the draft Directive provides a safe harbour for minor changes to concessions contracts (amounting to less than 5% of the price of the initial contract) and only envisages permitting more substantial modification without the requirement to re-tender in the event of unforeseen circumstances. Otherwise material changes to the concession will trigger a new award procedure.

The provision that is likely to cause the most debate is the draft directive's proposal ("**Article 16**") to limit the duration of concessions to "*the time estimated to be necessary for the concessionaire to recoup the investments made in operating the works or services together with a reasonable return on invested capital.*" The Commission defends Article 16 as an attempt to define a flexible limit for concessions periods, which tend to vary greatly according to concession type, rather than stipulating a fixed time period. Given the uncertainties this may raise, however, Article 16 is liable to have the potential to discourage, rather than encourage, investment. The Commission has acknowledged that concession contracts derive their special status from being long-term projects yet, in practice,

concessions may not be long enough to hold out the promise of a return substantial enough to justify considerable investment (especially when compared to other markets - a recent study² revealed that French motorway toll concessions had an average duration of between 15 and 30 years, as compared to durations of between 75-99 years for toll roads in the Chicago area). The success of the Concessions Directive may, in the end, depend on the satisfactory definition of "a reasonable return on invested capital". Determining this may delay the Directive's adoption although, even if a satisfactory definition can be agreed, it may still give rise to considerable uncertainty when applied to individual projects.

Conclusion

Some of the proposed changes in the draft directive are likely to be welcomed, including increased transparency, which could help level the playing field for the award of concessions and reduce instances of national favouritism or other abuses. Although the Commission has sought to introduce more flexibility in the design and application of the Concessions Directive, it is likely to lead to additional cost and complexity in the tendering of concessions, and any limitations on the duration of concessions could in fact hinder the desired objective of increasing investment in vital infrastructure projects.

² Germà Bel (Barcelona) and John Foote (Harvard), "Comparison of Recent Toll Road Concession Transactions in the United States and France", presented at the 75th Annual Meeting of the International Bridge, Tunnel and Turnpike Association (Vienna, 2007).

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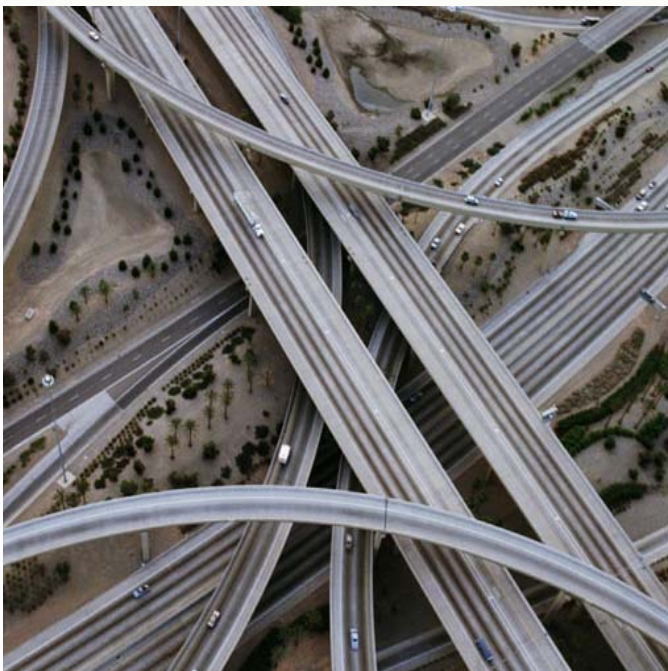
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