



Brief 18

September 2016

Public Procurement

Concessions and PPPs

CONTENTS

- [Development of EU legislation on concessions](#)
- [What are concessions?](#)
- [Different uses of the term “concession” under national laws](#)
- [Concessions involving a mix of works and services](#)
- [What is a PPP?](#)
- [How do the Directives apply to PPPs?](#)
- [Concessions in the utilities sector](#)
- [Further information](#)

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Development of European Union legislation on concessions

Prior to the reform of European Union (EU) procurement rules in 2014, the award of public works concessions was subject to the basic rules of the Directive 2004/18/EC¹.

The award of services concessions with a cross-border interest was subject to the principles of the Treaty on the Functioning of the European Union² (TFEU or Treaty), in particular the principles of free movement of goods, freedom of establishment, and freedom to provide services, as well as to the principles deriving from the TFEU, such as equal treatment, non-discrimination, mutual recognition, proportionality and transparency. The EU considered that there was a risk of legal uncertainty related to divergent interpretations of the Treaty principles by national legislators and of wide disparities among the legislations of the various Member States. This risk was confirmed by the extensive case law of the Court of Justice of the European Union (CJEU), which has only partially addressed certain aspects of the award of concession contracts. The lack of proper regulation of concessions also generated considerable economic inefficiencies and had a negative impact on getting the best value for public money.

Directive 2014/23/EU on the award of concession contracts (Concessions Directive)³ was adopted to meet these challenges, creating a more stable legal framework for public authorities and economic operators to ensure non-discrimination, fair access to markets and EU-wide competition for high-value concessions.

What are concessions?

Concessions are defined in the Concessions Directive as works or services concessions, where:

- **“works concession”** refers to “a contract for pecuniary interest concluded in writing by means of which one or more contracting authorities or contracting entities entrust the execution of works to one or more economic operators the consideration for which consists either solely in the right to exploit the works that are the subject of the contract or in that right together with payment”;
- **“services concession”** refers to “a contract for pecuniary interest concluded in writing by means of which one or more contracting authorities or contracting entities entrust the provision and the management of services other than the execution of works to one or more economic operators, the consideration of which consists either solely in the right to exploit the services that are the subject of the contract or in that right together with payment”.

The award of a concession must involve the transfer to the concessionaire of an operating **risk** in exploiting those works or services that encompasses demand or supply risk or both. The concessionaire must assume operating risk under normal operating conditions. The assumption of operating risk means that the concessionaire is not guaranteed to recuperate investments made or costs incurred in operating the works or services that are the subject of the concession. The transferred risk must involve “real exposure to the vagaries of the market, such that any potential estimated loss incurred by the concessionaire shall not be merely nominal or negligible”.

¹ Directive 2004/18/EC on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts, 31 March 2004.

² Treaty on the Functioning of the European Union – consolidated version of the Treaty on the Functioning of the European Union, *Official Journal of the European Union*, C 326, 26 October 2012. The Treaty is referred to in the Procurement Brief as “TFEU” or “Treaty”.

³ Directive 2014/23/EU on the award of concession contracts, 26 February 2014.

In line with the above definitions, when determining whether or not an arrangement falls within the definition of a concession, two key factors are of particular relevance:

- **Consideration**⁴: The source of the consideration should not come solely from the contracting authority in the form of payment of a price but partially or exclusively from the right to exploit the works/services. In practice this means that part or all of the consideration comes from a third-party source or sources.
- **Risk**: The risk in the exploitation of the opportunity should lie with the concessionaire. A concessionaire generally accepts, for example, the operational and/or financial risk of providing a public service or public work in return for the opportunity to generate income through the exploitation of that service or work. The absence of risk transfer to the economic operator suggests the existence of an ordinary public contract, therefore subject to the full rigour of the Public Sector Directive⁵ or the Utilities Directive⁶, rather than a concession, subject to the Concessions Directive. The requirement for risk to be inherent in the exploitation of the concession opportunity is emphasised by the European Commission as follows:

“..A key feature of concessions is the right of the concessionaire to exploit the construction or the delivered service granted as a consideration for having erected the construction or delivered the service. The main difference to public procurement is the risk inherent in such exploitation which the concessionaire, usually providing the funding of at least parts of the relevant projects, has to bear⁷”

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

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

If the contracting authority agrees to make payments to the concessionaire in the event that the income from third-party users does not suffice to permit the concessionaire to recuperate its investment, the possibility arises that insufficient risk is transferred to the concessionaire for the works to fall under the definition of a works concession. In that case it may then be classified as a works contract.

Services concession: Concessions are also used in projects requiring operation and maintenance but not construction of works, for example in the award of a concession to operate an existing railway or port, charging third parties for the use of those facilities, or in the award of a concession to run a government canteen, charging users of the canteen directly

⁴ The term "consideration" can mean financial or monetary payments received by the concessionaire, but the term can also cover other benefits or value derived from the work or service which may not be purely financial.

⁵ Directive 2014/24/EU on public procurement and repealing Directive 2004/18/EC, 26 February 2014

⁶ Directive 2014/25/EU on procurement by entities in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC, 26 February 2014.

⁷ European Commission (2005), *Communication on Public-Private Partnerships and Community Law on Public Procurement and Concessions*, COM (2005) 569, Berlin, paragraph 3.1.

for the food and beverages purchased. These types of concession are examples of “services concessions”.

When, in the above example of a government canteen, the contracting authority provides the canteen facility for use by the economic operator and also agrees to make payments to the economic operator to cover basic running costs or to subsidise part of the service, this support may mean that the economic operator does not bear sufficient risk for the arrangement to fall under the definition of a services concession. In that case it may then be classified as a services contract.

Different uses of the term “concession” under national laws

The concept of works concessions and services concessions is a concept of EU law and must be interpreted in line with EU law. National laws may define concessions differently. As a result, it is possible that some contracts or opportunities that are regarded as concessions under national law will not be considered as concessions for the purposes of the Concessions Directive. For example, the grant of a right to exploit natural resources, such as the extraction of coal, or the regulation of taxi services by granting operator licences, may be called “concessions” under national law but will not generally be regarded as concessions for the purposes of the Concessions Directive. Equally, some contracts that are not regarded as concessions under national law may still be classified as concessions under EU law.

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

Concessions involving a mix of works and services

When a concession involves a mix of both works and services, it is necessary to decide whether the concession is to be classified as a works concession or a services concession. The distinction between the two types of concession is important, as some differences in the legal regime apply. For example, various exclusions are available for services concessions, while for works concessions various rules on subcontracting apply.

In the case of mixed concession contracts that can be separated, the contracting authorities and entities are free to award separate concessions for the separate parts of the mixed contract. However, if the various parts constituting the contract are objectively inseparable⁸, the applicable rules must be determined with respect to the main subject of the contract at hand. Thus, a concession that has as its subject both works and services must be awarded in accordance with the provisions applicable to works concessions if the works element characterises the main subject of the particular contract in question, and vice versa. For example, a local authority decides that it wishes to award a concession contract to an economic operator for the running of an arts centre for a 20-year period. The local authority owns the arts centre building. The consideration that the economic operator receives will be by way of payments from members of the public who use the facilities, such as the café, and who pay to attend events at the arts centre, such as art exhibitions, films and theatrical productions. As part of the concession, the local authority requires the successful economic operator to undertake refurbishment works during the first five years of the concession period. The refurbishment works create a new restaurant and kitchens, improve access to the building for disabled people, upgrade the elevator, and install new toilets. In this case, it is

⁸ According to CJEU case law, the determination of inseparability is made on a case-by-case basis, taking into account the expressed or presumed intentions of the contracting authority to consider the various aspects making up a mixed contract as indivisible, supported by objective evidence justifying these intentions, and establishing the need to conclude a single contract.

legitimate to argue that the main subject of the concession is the long-term operation of the arts centre. The refurbishments works, which are part of the overall deal, can be regarded as incidental to the main subject. The concession should be classified as a services concession and not as a works concession.

For further information on the Concessions Directive, see SIGMA Public Procurement Brief 31, *2014 Directives: Concessions*.

What is a PPP?

The acronym PPP refers to a “public-private partnership”. There is no single or simple definition of a PPP, as the term covers a range of various types of contracts and other delivery models.

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

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

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

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

How do the Directives apply to PPPs?

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

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

A PPP that qualifies as a public contract under the Public Sector Directive must be awarded by using one of the procedures set out in that Directive applying to public contracts. The contracting authority needs to carefully consider the most appropriate award procedure for

the award of PPP contracts, which are often complex and usually require negotiation between parties. Where a PPP contract is regarded as sufficiently complex and the Member State has adopted the relevant provisions of the Public Sector Directive, the competitive dialogue may be an appropriate procedure to use. It may also be possible that the conditions are met governing the use of the competitive procedure with negotiation.

When a PPP is a concession, the Concessions Directive will apply.

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

Concessions in the utilities sector

The Concessions Directive applies to the award of works or services concessions by contracting entities, provided that the works or services are intended for the pursuit of one of the relevant activities in the utility sector.

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

Practical note on scoping, procuring and managing PPPs

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

The procurement process must rigorously test the economic operators' proposals to ensure that they meet and will continue to meet the authority's requirements throughout the contract term. See SIGMA Public Procurement Brief 10, *Public Procurement Procedures and when they can be used*, and SIGMA Public Procurement Brief 31, *2014 Directives: Concessions*, for further information on the relevant procurement procedures and the award of concessions.

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

Further information

Publications

SIGMA (2015), *Public Procurement Training Manual* – Module D3, OECD Publishing, Paris, <http://www.sigmaweb.org/publications/public-procurement-training-manual.htm>

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OECD webpage on Competition Issues in Public-Private Partnerships, <http://www.oecd.org/competition/competitionissuesinpublic-privatepartnerships.htm>

European Commission's webpage on Public Procurement and Concession Contracts, available since April 2016, <http://ec.europa.eu/growth/single-market/public-procurement/>

United Nations Economic Commission for Europe's webpage on International PPP Centre of Excellence, <http://www.unece.org/icoeppp.html>