

## **Comment on Advocate General's position that "Teckal" companies can't eat their cake and have it too**

### **Summary**

In April this year, the Advocate General suggested closing the door on a loophole under the EU procurement directives. "Teckal" companies are proxies for their Contracting Authorities and therefore are bound by the Directives when they let contracts – whether or not they have commercial character. This has potential wider implications for the definition of "Contracting Authority" when applied to any companies in which public bodies have an interest.

### **Background**

A "Teckal" company is the common name for a company which benefits from contracts for works, services or supply from its controlling Contracting Authority (or Authorities) without having to go through a competitive tender process. "Teckal" refers to the originating case<sup>1</sup> which has since been codified within Article 12(1) to (6) of EU Directive 2014/24 (and Regulation 12(1) to (6) for the purposes of the Public Contracts Regulations 2015). Under Article 12(3) a company which is jointly controlled by a number of Contracting Authorities can also benefit from the Teckal exemption (e.g. "shared services companies").

For many years, local authorities and other public bodies have established companies to deliver public services and projects. Local Authority Trading Companies (LATCs) in particular have become prevalent delivering, for example, social care, IT and other services. Perhaps the most infamous Teckal company is of course London Authorities Mutual Limited, the local authority insurance company challenged by Risk Management Partners in *Brent v Risk Management Partners*<sup>2</sup>. They are also used to deliver regeneration or development projects.

When establishing such a "trading" vehicle a Contracting Authority is likely to ask itself, "do we need this company to be a "Teckal" company or not?". The answer is usually "yes", at least initially.

In order to benefit from the Article 12 exemptions, as well as there being no private capital participation in the company (i.e. JV's with private entities don't qualify) the following circumstances must exist:

- the Contracting Authority/ies must exercise a control which is similar to that which it exercises over its/their own departments – this means it/they must exercise a decisive influence over both strategic objectives and significant decisions of the controlled company either itself or through another subsidiary; and
- more than 80% of the activities of the company must be carried out in the performance of tasks entrusted to it by the controlling Contracting Authority/ies.

A local authority is likely to want its LATC to be Teckal compliant so that it can kick-start the business by transferring staff and budgets. It will also want to meet its own statutory needs first, before trading more widely to generate additional income to supplement its stretched resources.

Besides being able to trade commercially, one of the perceived benefits of these vehicles is that as separate 'commercial' vehicles they can act nimbly, with less bureaucracy and

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<sup>1</sup> Teckal (Case C-107/98 Teckal ([1999] ECR-I-8121).

<sup>2</sup> Brent London Borough Council v Risk Management Partners Ltd ([2009] EWCA Civ 490), Court of Appeal judgment of 9 June 2009.

compete on an even playing field in the market to generate that vital additional income. But does this mean that these Teckal companies can avoid complying with the Regulations when they let their own contracts?

“Contracting Authority” means the state, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law and includes central government authorities”.

It has long been considered<sup>3</sup> that a vehicle which has a separate legal identity is not caught by the reference to “*associations formed by one or more of*” as that refers to unincorporated alliances. They are only Contracting Authorities if they are also a “body governed by public law”.

The definition of “body governed by public law” requires that, firstly, the vehicle must have its own legal personality and be established to “*meet needs in the general interest not having an industrial or commercial character*”. Only if this test is met, to be regulated, the company must also be either financed for the most part by another Contracting Authority or be subject to the management supervision of another contracting authority or have an administrative managerial or supervisory board, more than half of whose members are appointed by the relevant Contracting Authority.

By comparing the test for “Teckal” companies and the definition of a “Contracting Authority”, one can see that it would not be difficult on paper to set up a separate company which qualifies for the Teckal exemption because it meets the control tests but which might also argue (in the drafting of its constitutional documents and objectives) that it has a commercial character and so is not a Contracting Authority when it sub-contracts the work.

Clearly this opens something of a loophole that is incompatible with the proper enforcement of the procurement Regulations. Contracting Authorities could delegate the performance of all activities to a subsidiary but argue that because it wishes to trade with other clients too to make a profit it has a commercial character and so doesn’t have to advertise in OJEU for its suppliers or contractors – which in reality could be providing the works or services to the relevant Contracting Authority.

### **Advocate General’s Opinion**

VLRD was a company established by a Lithuanian state-owned railway company and benefited from the Teckal exemption to manufacture and maintain rolling stock for it. This accounted for approximately 90% of its revenue. When procuring metal bars without an OJEU Contract Notice, it was challenged by LitSpecMet and the Lithuanian Court referred a number of questions to the Advocate General.

The opinion from the Advocate General (given on 27<sup>th</sup> April in respect of the case of *LitSpecMet UAB v Vilniaus lokomotyvu remonto depas UAB*) has two key messages:

- Firstly that under the definition of “Contracting Authority”, a company will be considered a Contracting Authority itself and will be subject to the Directives where the in-house exemption is justified when concluding contracts with third parties for the purposes of performing tasks entrusted to it by that Contracting Authority;
- Secondly that in any event it would be a “body governed by public law” where it has legal personality, is controlled by a Contracting Authority and the essential part of its activity is to supply the contracting authority free from any pressure from competitors and not in free market conditions.

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<sup>3</sup> Gemeente Arnhem v BFI Holding BV [1998] Case C-360/96

The first point is interesting because it could essentially create a new implied limb within the definition of "Contracting Authority" linking it to the wording of the Teckal exemption in Article 12 (by making use of the "tasks entrusted to it" phrase). It is also an exception to the rule in *Arrhem* that if the vehicle has separate legal personality you must jump immediately to the question as to whether it is a "body governed by public law" and can consider whether it has been established to meet needs in the general interest and has commercial or industrial character before concluding whether it is caught. The Advocate General states that if a company wants to argue it is "in-house" when being awarded the bulk of its activities from the Contracting Authority then it must also accept it is a *proxy* for the Authority if it needs to go to the market to deliver the very tasks which have been "entrusted" to it without competition. The "industrial or commercial character" test is irrelevant – you don't get there. This pierces the "corporate veil" which had been thought to apply when looking at the definition of Contracting Authority. A separate company can be considered a *proxy* for a Contracting Authority and therefore must operate as if it is one.

This is all unsurprising where the Authority is trying to make use of Teckal but the Lithuanian court, which sought the opinion, also asked the Advocate General whether the outcome would be different if the relevant company ceased to owe at least 90% of its turnover to the Contracting Authority, for the purposes of Teckal would it then cease to be a Contracting Authority in its own right? Another way to phrase this is, could there be a situation where a Contracting Authority controls an entity which does trade for a profit on the free market (and so to which is not trying to make use of the Teckal exemption) which is nevertheless a Contracting Authority *by proxy*?

The Advocate General was reluctant to rule out this possibility stating that "*it would be necessary to evaluate the new circumstances and decide accordingly*". In other words, a genuine commercial vehicle within which a Contracting Authority has a controlling interest but to which it is not looking to rely on Teckal to entrust a works or services contract to, may still be a Contracting Authority in some circumstances. The only explanation for this is that the Advocate General is prepared to take a broad view of what form "activities entrusted to it" may take. This gives rise to significant uncertainty.

Secondly, in terms of the definition of a "body governed by public law", the Advocate General was asked to consider the correct interpretation of what "*established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character*" actually means. The advice given to the referring court by the Advocate General was that it should look at "*whether the [company] operates under market conditions, and beyond that, to factors such as whether or not it was largely publically financed, whether it aimed to make a profit and whether it bore the risks (and losses) associated with its activity.*"

Needless to say this interpretation is not immediately obvious when looking at the words in the Directive. The issue is not about whether the company's Articles allow it to operate commercially and grant profit dividends to its shareholders, as you might expect. The company's Articles and its stated objectives play a minor part in whether the test is met, and indeed the Advocate General does not mention the contents of a company's corporate constitution at all.

The issue is whether it is operating under fair open market conditions or has any element of monopoly from its Contracting Authority sponsor. Will it or its sponsor in reality bear the risks and losses of the venture? There is an obvious overlap with state aid law here. Essentially the Advocate General is saying that if a Contracting Authority is supporting a vehicle in some way by giving it a market advantage (e.g. opportunities for which it has not tendered) the vehicle will be a "body governed by public law" anyway.

## **Key points to take away**

**For “Teckal companies”;** Companies which are making use of the Teckal exemption are Contracting Authorities when procuring services or works to deliver the tasks that have been awarded to them from the parent – whether or not they consider themselves commercial entities.

**For non-Teckal companies controlled by Contracting Authorities;** These companies cannot rely on the fact their constitutions state they have a commercial purpose and allow them to make a profit to avoid compliance with the Directive and UK Regulations or even that more than 20% of their income comes from commercial activities. If it could be argued they are procuring to carry out tasks entrusted to them by the controlling authority (even in a broad sense, for example to buy and develop land), it could be argued that they are not operating under normal market conditions because they have some kind of monopoly over the activities in question, then they may still be caught by the definition of “Contracting Authority”.

If you have any questions or would like to learn more, please get in touch with Katherine Calder at [katherine.calder@blplaw.com](mailto:katherine.calder@blplaw.com)

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