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# Centralizing public procurement and competitiveness in Directive 2014/24

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**Abstract:** Centralized purchasing benefits contracting authorities and society in general as it may reduce purchasing prices and transaction costs, lead to administrative economies of scale, and help specializing procurement officers across Member States. Centralization techniques are also used to pursue broader economic goals, such as fostering innovation, create competitive markets and sustain development. Directive 2014/24 reinforces the impulse given to central purchasing bodies due its popularity and establishes two different types: either wholesalers/wholebuyers or intermediaries that carry out procurement on behalf of other contracting authorities. However, the competitive benefits that may be generated by centralization can also be eroded by its abuse and inadequate implementation, particularly when dynamic efficiency is jeopardized by focusing on pure cost-saving and short term results. This paper addresses the benefits and concerns derived from centralized purchasing from a microeconomic and legal perspective and proposes that centralization should be carried out in a pro-competitive manner with an emphasis on long term efficiency, benefiting all stakeholders, and not purely tender cost saving. To do so, central purchasing bodies and their purchasing power should be regulated by adopting conducts in line with competitive standards and public procurement "best-practices" guaranteeing that buyer power is not abused and the competitive playing field is preserved.

**Key words:** EU public procurement law, central purchasing bodies, EU competition law.

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# 1. Introduction

Efficiency, best value for money and reduction of inefficient public spending are some of the main policies driving the recently adopted Directive 2014/24/EU of the European Parliament and of the Council on public procurement (“Directive 2014/24”).<sup>1</sup> Stake holders, particularly Member States (MS), received positively central purchasing techniques for the award of public contracts and their impact leading to procurement professionalization, increase of intra-procurement competition, creation of administrative economies of scale and aggregation of public buyer power. In practice, MS increasingly employed centralized purchasing techniques as shown by the available data. By 2012 more than 10% of all public contracts in some MS were awarded by means of central purchasing bodies (“CPBs”) from a mere 3% in 2006.<sup>2</sup>

The importance of public demand in certain economic sectors, for example healthcare, where the state constitutes the main buyer of goods, works and/or services<sup>3</sup> is irrefutable. This privileged position affects markets in which contracting authorities operate and, if not properly channeled, may distort the competitive playing field. An impulse for centralization reinforces the state’s privileged position, but its excessive use may pose serious competitive risks for all stakeholders. Consequently, the employment of centralized purchasing techniques must address its economic and legal tradeoffs to avoid creation of market distortions in the short term – tender cost saving concerns – and long term – the procurement market as a whole and the competitive process.

In this paper I discuss demand aggregation in public procurement markets through CPBs and offer suggestions to reconcile centralizing trends with a competitive playing field. The paper adopts the following structure: Section 2 discusses the figure of CPBs, their legal nature under the current Directive, what and how they are structured, the nature of the agreement between the CPB and the contracting authority and the provision of framework agreement services. Section 3 discusses the types of CPBs: pure “agents”<sup>4</sup> acting on behalf of contracting authorities, and wholesalers/wholebuyers carrying out an economic activity. Sections 4 and 5 analyze the economic and administrative incentives and risks generated by procurement centralization. Section 6 reviews the new provisions of Directive 2014/24 concerning the creation of an internal market for CPBs. Section 7 introduces some practices and policy recommendations for MS and CPBs to guarantee the competitiveness of public markets, safeguard the wellbeing of market

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<sup>1</sup> Recitals (2), (47), (69), (70), (71), (91) and (97) of 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 [2014] OJ L 94/65.

<sup>2</sup> European Commission *Annual Public Procurement Implementation Review 2012* Brussels (2012) 25.

<sup>3</sup> To minimize unnecessary repetition from hereon I will employ the term «goods» as including also the purchasing of works and services.

<sup>4</sup> Sue Arrowsmith, *The law of public and utilities procurement: regulation in the EU and UK*, vol 1 (3rd edn, Sweet & Maxwell 2014) para 5.38 and 5.41.

structures, minimize buyer power risks, and promote efficiencies for all involved stakeholders, in compliance with the principle of competition embedded in Art. 18 of Directive 2014/24.<sup>5</sup>

## 2. Central purchasing bodies

### 2.1 CPBs in Directive 2014/24

EU public procurement law allows contracting authorities to employ “agents” to award public contracts on their behalf. These agents may be private or public bodies that may or not have a profit-making aim and, consequently, may fall under the scope of application of public procurement law as either contracting authorities or economic operators. Along with other procurement procedures centralized purchasing services constitute tools for demand aggregation carried out on behalf of a contracting authority; this is, purchasing *en masse* the inputs necessary to provide public services.<sup>6</sup> Centralized purchasing incorporates to the public sector techniques previously employed in private markets with the aim of pooling buyer power, generate economies of scale, reduce costs and increase competition. All in all, allowing contracting authorities to acquire goods in more favorable terms and increase best value for money.<sup>7</sup>

CPBs are contracting authorities entrusted on a permanent basis to make acquisitions of goods, award and manage specific contracts - such as dynamic purchasing systems or framework agreements -, and provide ancillary purchasing services related to the conclusion and management of public contracts for or on behalf of other contracting authorities.<sup>8</sup> In other words, CPBs act as a specialized entity whose function is to carry out on a daily basis public procurement procedures on behalf of other contracting authorities, constituting professional buyers employed in the provision of public services. In their function as providers of ancillary purchasing services CPBs act as “procurement advisors or trainers” for other contracting authorities, further strengthening professionalization of public procurement.<sup>9</sup>

From a legal personality perspective the service contract between the contracting authority and the CPB who offer its services to the former is not required to be subject to the public

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<sup>5</sup> For a thorough discussion of the competition principle in EU public procurement law see: Albert Sánchez Graells, *Public procurement and the EU competition rules* (2nd edn, Hart 2015) Chapter 5.

<sup>6</sup> For a discussion of aggregated procurement techniques in the light of the Directive 2014/24 see, inter alia: Albert Sánchez Graells and Ignacio Herrera Anchustegui, ‘Impact of public procurement aggregation on competition. Risks, rationale and justification for the rules in Directive 2014/24’ 14-35 University of Leicester School of Law Research Papers [2014]; Carina Risvig Hamer, ‘Regular purchases and aggregated procurement: the changes in the new Public Procurement Directive regarding framework agreements, dynamic purchasing systems and central purchasing bodies’ 4 Public Procurement Law Review [2014]; Gabriella M. Racca, ‘Collaborative procurement and contract performance in the Italian healthcare sector: illustration of a common problem in European procurement’ 3 Public Procurement Law Review [2010];

<sup>7</sup> Sigma, *Central Purchasing Bodies* (Brief, 2011) 4; OECD *Centralised Purchasing Systems in the European Union* (2011) 4.

<sup>8</sup> Art. 2(15) Directive 2014/24.

<sup>9</sup> Hamer [2014] 207 to 208.

procurement rules. Furthermore, CPBs are generally created under national legislation as publicly owned limited companies. Their financing varies from MS to MS but can be classified in four different mechanisms: i) pure public funding by central authorities; ii) funding through service fees paid by contracting authorities using their services; iii) payment of participation or call-off fees by economic operators wishing to submit tender offers; and iv) a combination of the former.

From a historical perspective CPBs were firstly introduced to EU public procurement law through Directive 2004/18 which contained few and unsophisticated provisions dealing with this modality of demand aggregation.<sup>10</sup> However, centralized public purchasing is not new. For example in Finland a central “monopoly” buyer (*rectius* monopsonist) was introduced as early as 1941, or in the case of France some few years later in 1949.<sup>11</sup> Under the transposition of Directive 2004/18 all MS except for Estonia, Germany and Luxembourg had by 2012 included a provision in its national law contemplating the figure.<sup>12</sup> I expect that with the Directive 2014/24 all MS will contemplate the figure in their legislation.

Building upon the CPB’s success, Directive 2014/24 introduced several changes increasing CPB’s functions, modifying their nature and improving the basic regulation in Directive 2004/18.<sup>13</sup> In the following paragraphs I briefly discuss the main CPB provisions in Directive 2014/24. Firstly, Art 37(1) of Directive 2014/24 clarifies that MS may require contracting authorities to conduct purchases through CPBs (either in general or designating a specific body). The Directive, however, did not impose a general obligation to force purchases through CPBs, a possibility suggested during the Directive’s negotiation and which is a common practice among some MS concerning central government administrations.<sup>14</sup> Not imposing a general duty to employ centralized purchasing is an adequate policy because it grants MS discretion when organizing their public services and avoids excessive centralization.<sup>15</sup>

Secondly, Directive 2014/24 allows contracting authorities to employ CPBs’ services in four ways: i) acquire goods through public contracts awarded by the CPB; ii) use dynamic purchasing systems run by the CPB; iii) employ framework agreements that have been concluded by a CPB; and iv) employ their ancillary purchasing services.<sup>16</sup> In subsection 2.4. I discuss framework agreements administered by CPBs due to their centralization importance.

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<sup>10</sup> Art. 1.10 and Art. 11 of Directive 2004/18/EC of the European Parliament and of the Council on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L 134/114.

<sup>11</sup> OECD (2011) 36.

<sup>12</sup> European Commission (2012).

<sup>13</sup> Sánchez Graells and Herrera Anchustegui [2014] 15.

<sup>14</sup> European Commission (2012) 25.

<sup>15</sup> Cf this view with the opinion of Telles who appears to favor the possibility to mandate the use of centralised procurement for certain contracts in Pedro Telles, ‘Public Contracts Regulations 2015 - Regulation 37’ (April 17, 2015) <<http://www.telles.eu/blog/2015/4/17/public-contracts-regulations-2015-regulation-37>> accessed July 3, 2015.

<sup>16</sup> Art. 37.1 Directive 2014/24.

Thirdly, Art. 37.2 of Directive 2014/24 regulates the relation between the CPB and the contracting authority concerning both compliance with the provisions of EU public procurement and contractual responsibility vis-à-vis economic operators. This provision is welcomed as it clarifies which entity is responsible for which part of the procurement building up from the basic provision incorporated in Art. 11.2 of Directive 2004/18. According to Art. 37.2 a contracting authority is exempted from complying with public procurement rules when it acquires goods through centralized purchasing services (*infra* in Section 2.3). However, the contracting authority must comply with the procurement provisions when it carries out by itself part of contract award phases such as: awarding the definitive contract under a CPB operated dynamic purchasing system, conducting calls off and mini competitions under framework agreements, and determining which economic operator party to a framework agreement shall perform a particular task.<sup>17</sup> Albeit not explicitly mentioned by Art. 37.3 CPBs are bound to comply with the Directive when performing its functions vis-à-vis economic operators.

Fourthly, and subject of discussion under Section 6, Directive 2014/24 introduces a peculiar provision according to which “a Member State shall not prohibit its contracting authorities from using centralized purchasing activities offered by central purchasing bodies located in another Member State”.<sup>18</sup> This provision aims at the creation of an internal market for central purchasing services or at least to increase public-public MS collaboration.

## 2.2 What and how CPBs tend to acquire?

CPBs usually offer procurement services for the purchase of input of common interest to several contracting authorities and which are frequently needed across the public administration.<sup>19</sup> In practice CPBs typically carry out repeated purchases of similar goods and award contracts on behalf of other contract authorities.<sup>20</sup> However, their purchases are not limited to “off-the shelf” goods or standardized products. Practice across MS reveals that CPBs are also involved in the award of complex public contracts.<sup>21</sup> Among the kind of input frequently purchased by CPBs there are: information technology and communication goods and services (computers, photocopiers, servers, software, IT technology services, hardware, etc); office furniture and supplies; travel services; catering and food services; fuel; hospital supplies and drugs.<sup>22</sup>

Sometimes the centralized purchasing is carried out by a sectoral CPB, for example the Helseforetaketenes Innkjøpsservice in Norway purchases all supplies required by all Norwegian

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<sup>17</sup> Art. 37.3 Directive 2014/24.

<sup>18</sup> Art. 39.2 Directive 2014/24.

<sup>19</sup> Sigma (2011) 7.

<sup>20</sup> Gian Luigi Albano and Marco Sparro, ‘Flexible Strategies for Centralized Public Procurement’ 1 Review of Economics and Institutions [2010] 16.

<sup>21</sup> OECD (2011) 10.

<sup>22</sup> Sigma (2011); OECD (2011) 42.

hospitals,<sup>23</sup> or the specialized Swedish system.<sup>24</sup> More commonly, CPBs are configured as a national body that conducts procurement in many fields for the whole public administration, such as in the case of SKI in Denmark; Hansel in Finland; UGAP in France; KSzF in Hungary; and Consip in Italy.

### 2.3 CPB's agreement nature, and links with non-contracting authorities

Centralization contracts involve two different relations among its parties: i) the CPB who acquire goods from the economic operator; and ii) the contracting authority and the CPB as a centralization services provider. The relation between economic operators and CPBs, if above the procurement thresholds will be covered by the Directive, is not discussed in this paper. In contrast, the relation between the contracting authority and the CPB (above or below thresholds) is *exceptionally excluded* from the procurement rules in accordance to Art. 37.4 and Recital (70) of Directive 2014/24. This is, the contracting authority enters into a public-public collaboration scheme in which it chooses how and who provides the centralized purchasing service.<sup>25</sup> Consequently, the award of centralized purchasing service contracts is not subject to a tender procedure, situation which bring implications that I discuss in the following paragraphs.

Firstly, the public-public collaboration exemption in Directive 2014/24 is broader when compared to Art. 11 of Directive 2004/18. Under the previous regime there was no explicit exemption for the provision of ancillary purchasing services, nor to allow CPBs to acquire works or construction services to later be sold to other contracting authorities.<sup>26</sup> Directive 2014/24, clarifies that the award of ancillary purchasing activities when performed by CPB does not require to be tendered; reversely, if a non-CPB offers the same services it should be subject to the procurement rules.<sup>27</sup> As Sánchez Graells remarks, this exclusion has a dubious justification, particularly if the CPB has some private capital participation, because it puts CPBS in a privileged position when compared to undertakings and other contracting authorities offering ancillary purchasing services.<sup>28</sup> This begs to question why only ancillary purchasing services provided by a CPB are excluded from complying with the Directive but not others provided by

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<sup>23</sup> Jørn Dreyer, 'The Norwegian healthcare system and Market'. The Helseforetaketenes Innkjøpsservice annually handles contract for a value that is higher to NOK 2.6 billion, which is equivalent to €300 million. The Directive also applies to the EEA MS as it was transposed to the EEA pillar under Article 65(1) and Annex XVI of the EEA Agreement.

<sup>24</sup> OECD (2011), 17.

<sup>25</sup> Arrowsmith, [2014] para 6.212.

<sup>26</sup> Ibid, para 6.214.

<sup>27</sup> Recital 70 Directive 2014/24.

<sup>28</sup> Albert Sánchez Graells, 'Centralised purchasing activities and central purchasing bodies under Reg. 37 Public Contracts Regulations 2015' (April 17, 2015) <<http://howtocrackanut.blogspot.no/2015/04/centralised-purchasing-activities-and.html>>. See also: OECD (2011).

means of public-public collaboration? Neither the provisions nor recitals of the Directive clarify the grounds for this exemption.<sup>29</sup>

Secondly, is it possible for a body carrying out centralized services for entities other than contracting authorities – undertakings – to be considered as a CPB because it carries out centralization activities “on a permanent basis”? If the answer to this is “yes”, several competition concerns arise, particularly related to risks of cross-subsidization of purchases by private or public undertakings through the CPB, which may constitute unlawful state aid. Under the Directive 2004/18 Art. 1(10) expressly contained the wording of “intended for”, and its Recital (15) further clarified that the activities of CPB were “dedicated to contracting authorities”.<sup>30</sup> In my opinion, this wording should be interpreted as leaving no room for a CPB to engage with non-contracting authorities. If a body offers its procurement services to private parties, even if partially, it should not be considered as a CPB but instead an economic operator. However, Arrowsmith argues that the concept should be used “even for bodies that carry out some activities for the private sector or utilities”.<sup>31</sup>

This restrictive interpretation changes with Directive 2014/24. The new wording does not refer to expressions such as “intended for” “nor dedicated”. Instead, it speaks of “on a permanent basis”, which is broader than Directive 2004/18’s wording and eliminates an exclusivity or quasi-exclusivity requirement.<sup>32</sup> Consequently, if a CPB offers its services to undertakings it will still be a CPB; however, the agreements between a contracting authority and the CPB will be excluded from the rules on public procurement. This may lead to cross-subsidization of the services offered by the CPB as it employs public funds to benefit undertakings by offering cheaper centralization services. Additionally when a CPB offers its services in the “private market” to non-contracting authorities it acts as an undertaking and not as a contracting authority, and, should be under the scrutiny of EU competition law and particular the rules governing purchasing behavior.<sup>33</sup>

A way in which the restrictive approach can be reconciled is by interpreting the provision in light with the public-public collaboration rule in Art. 12 of Directive 2014/24. With this, it can be interpreted that CPBs have limited capacity to engage with private buyers not exceeding the limit of 20% of activities concerned with the cooperation on open markets imposed to horizontal non-

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<sup>29</sup> See also raising serious concerns regarding ancillary activities provided by CPBs: OECD (2011) 41 to 42.

<sup>30</sup> Art. 1.10 and Recital (15) of Directive 2004/18/EC.

<sup>31</sup> Arrowsmith, [2014] para 6.217.

<sup>32</sup> See also raising this argument without reference to the wording of the Directives, Sánchez Graells and Herrera Anchustegui [2014] 20.

<sup>33</sup> Martin Burgi, ‘Contracting authorities, in-house services and public authorities cooperation’ in François Lichère, Roberto Caranta and Steen Treumer (eds), *Modernising public procurement: the new directive* (DJØF Publ. 2014) 59 to 64.

institutionalized collaboration.<sup>34</sup> This interpretation does not solve the competitive problems but at least puts a ceiling to the amount of CPB commercialization.

## 2.4 Centralizing framework agreements

CPBs not only acquire goods or services for or on behalf of contracting authorities. They also prepare, administer and award public contracts by using complex procurement procedures, in particular framework agreements.<sup>35</sup>

Framework agreements constitute two-tier procedures through which one or more contracting authorities and one or more economic operators define the terms upon which purchasing may be carried out over a period of time,<sup>36</sup> and which may be supplemented by subsequent agreements once the individual procurement is made.<sup>37</sup> These agreements, originally introduced by Directive 2004/18,<sup>38</sup> have been quite successful in practice and kept in the Directive 2014/24.<sup>39</sup> Due to the scope of this paper I limit the discussion of framework agreements when they are entered into or administered by CPBs.<sup>40</sup>

Framework agreements are commonly employed by several contracting authorities by means of *ad hoc* public-public collaboration, or administered in a more permanent basis by CPBs in accordance with Art. 2.1(14) of Directive 2014/24. CPBs frequently use “centrally procured framework agreements”<sup>41</sup> organized in call-off procedures or ranking systems as revealed by an OECD study from 2011.<sup>42</sup> CPBs may conclude framework agreements by employing different procedures: open and restricted, competitive dialogue and competitive procedure with negotiation, being the latter a new option introduced with Directive 2014/24.<sup>43</sup>

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<sup>34</sup> Art. 12.4 of Directive 2004/18/EC; Sánchez Graells and Herrera Anchustegui [2014]. See also in the ECJ case law before the enactment of Directive 2014/24: C-480/06 - *Commission v Germany (Stadtreinigung Hamburg)*, EU:C:2009:357 E.C.R. [2009] I-04747; C-159/11 - *Ordine degli Ingegneri della Provincia di Lecce and Others*, EU:C:2012:817 [2012] published in the electronic Report of Cases; and C-386/11 – *Piepenbrock*, EU:C:2013:385 [2013] published in the electronic Report of Cases. For a discussion of the horizontal collaboration see: Burgi [2014]; Christopher H. Bovis, *EU public procurement law* (Edward Elgar Pub. 2012) 472 to 473.

<sup>35</sup> Art. 2.1.(15)(a) and (c) of Directive 2014/24.

<sup>36</sup> Art. 33.1 Directive 2014/24. Arrowsmith, [2014] para 11.01.

<sup>37</sup> Sune Troels Poulsen, Peter Stig Jakobsen and Simon Evers Kalsmose-Hjelmborg, *EU public procurement law: the public sector directive : the utilities directive* (DJØF Publ. 2012) 398 to 399.

<sup>38</sup> Art. 1.2(10) Directive 2004/18.

<sup>39</sup> See also supporting this view from: Recital (60) Directive 2014/24; Carina Risvig Hansen, *Contracts not covered, or not fully covered, by the public sector directive* (DJØF Publ. 2012) 201; Telles.

<sup>40</sup> For some literature dealing with framework agreements see, inter alia: Carina Risvig Hamer, ‘Regular purchases and aggregated procurement: the changes in the new Public Procurement Directive regarding framework agreements, dynamic purchasing systems and central purchasing bodies’ *Public Procurement Law Review* [2014]; Arrowsmith, [2014] chapter 11.

<sup>41</sup> OECD (2011) 15.

<sup>42</sup> *Ibid* 11 and 15.

<sup>43</sup> Hamer [2014]; Arrowsmith, [2014] 11.20.

From a competitive perspective framework agreements may generate risks which increase if administered by CPBs. Firstly, framework agreements constitute closed systems in which no originally involved and identified party is allowed to enter it as either a buyer or seller during its validity<sup>44</sup> which in principle cannot exceed four years.<sup>45</sup> Thus, it creates a legal entry barrier to suppliers and buyers which narrows competition. Also, undertakings not part of the agreement will be in a worse situation and may in practice be locked out of an important client. Lastly, while the valid length of framework agreements is already long, it can also be extended in “duly justified cases” and contract’s “calls of” – the purchases of goods within the framework agreement – may go beyond its four year period.<sup>46</sup>

Secondly, contracting authorities are precluded from entering into framework agreements services with any non-contracting authority body (i.e.: private providers), granting a special position to CPBs as the default providers of framework agreement services.<sup>47</sup> This preclusion appears disproportionate and restrictive. Why cannot a private undertaking (a procurement consultant) offer services for the administration of framework agreements for contracting authorities? Why its freedom to provide services is restricted? Is this restriction proportionate, even if due because of public security reasons? These are questions that ask for further research.

Thirdly, framework agreements may be concluded with single or multiple providers.<sup>48</sup> If a single provider agreement is entered into there will be only competition in the original phase award but not in the call-off phase. In multi-provider agreements competition exists both in the award phase and the calls-off, unless the original framework agreement suppresses mini competitions, with a ranking system, for example. Concerning multi-provider agreements Art. 33.4 of Directive 2014/24 takes a step back in competitiveness when compared to its predecessor as it now allows for these types of agreements to be entered into with only two economic operators in contrast with the minimum three previously required.<sup>49</sup>

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<sup>44</sup> Art. 33.2 Directive 2014/24.

<sup>45</sup> Art. 33.1 Directive 2014/24. The Parliament proposed a period of validity of five years which was, ultimately, not adopted, see: Amendment 135 suggested in: European Parliament *Report on the proposal for a directive of the European Parliament and of the Council on public procurement (COM(2011)0896 – C7-0006/2012 – 2011/0438(COD))* Brussels (2013).

<sup>46</sup> Recital (62) of Directive 2014/24.

<sup>47</sup> “A framework agreement means an agreement between one or more contracting authorities and one or more economic operators.” Art. 33.1 Directive 2014/24 (emphasis added).

<sup>48</sup> For a discussion of the tradeoffs between multi and single supplier agreements see: OECD (2011). See also: Arrowsmith, [2014] para. 11.05 to 11.08.

<sup>49</sup> Cf with Art. 32.4 which required at least three economic operators, insofar as there is a sufficient number of economic operators to satisfy the selection criteria and/or of admissible tenders.

Fourthly, framework agreements administered by CPBs are prone to the “principal-agent” problem between the CPBs and the contracting authority for which the agreement is administered, problem I discuss in Section 5.2.3 of this paper.<sup>50</sup>

### 3. Central purchasing bodies types

Directive 2014/24 contemplates two types of CPBs in opposition to Directive 2004/18 which left doubts concerning this issue.<sup>51</sup> According to Recital (69) CPBs act in “two different manners”. Firstly, they act in their traditional and undisputed role of *agents-intermediaries* “by awarding contracts, operating dynamic purchasing systems or concluding framework agreements to be used by contracting authorities”.<sup>52</sup> Secondly, CPBs can also act as “wholesalers by buying, stocking and reselling” goods to other contracting authorities as traditional retailer and acting as “undertakings”. In the following paragraphs I discuss these two modalities.

The traditional role of CPBs is to act as “agents” by making acquisitions or awarding public contracts/framework agreements for other contracting authorities.<sup>53</sup> When doing so, CPBs can follow the instructions of the contracting authority using its services or autonomously conduct the procurements.<sup>54</sup> Their purchases, however, are always intended for a third party, the contracting authority requiring it, and not for itself. This “agent role” does not involve an “economic activity” *stricto sensu* as the goods are not purchased and later on-resold but used for the provision of public services by contracting authorities, link which cannot be dissociated to determine the nature of the activity.<sup>55</sup>

In contrast to the agent function, Recital (69) of Directive 2014/24 clarifies a *lacuna* by acknowledging the capacity of CPBs to act as wholesalers or intermediaries. Directive 2004/18 did not expressly acknowledge the possibility for CPBs to act as wholesalers but from the wording of its Article 11.1 it could be argued that this possibility was compatible with the Directive.<sup>56</sup> The text indicates that “contracting authorities may purchase works, supplies and/or services **from or through** a central purchasing body”.<sup>57</sup> When the purchases are made *from* the central purchasing the contracting authority buys goods from the CPB as a particular would do would a retailer; whereas when the goods are acquired *through* a CPB this latter acts as an agent on behalf of the contracting authority. This is confirmed by the fact that, for example, in France

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<sup>50</sup> Arrowsmith, [2014] para. 11.02

<sup>51</sup> Recital (69) of Directive 2014/24. See also supporting this: Sánchez Graells, *Public procurement and the EU competition rules* [2015] 254.

<sup>52</sup> Recital (69) Directive 2014/24/EU.

<sup>53</sup> Recital (15) and Art. 1(10) of Directive 2004/18/EC.

<sup>54</sup> Recital (69) of Directive 2014/24.

<sup>55</sup> C-205/03 *P FENIN v Commission* [2006] ECR I-6295; and C-113/07 *P Selex v Commission* [2009] ECR I-2207.

<sup>56</sup> Also supporting this view see: Arrowsmith, [2014] para 6.212 and 6.213; and Bovis, [2012] 480.

<sup>57</sup> Art. 11.1 Directive 2004/18.

the CPB UGAP carried out its functions under Directive 2004/18 as a wholebuyer.<sup>58</sup> Interestingly, the wholesaler/whobuyer modality mirrors the former “monopoly model” in which a MS created a central purchasing office to make “bulk” purchases, abandoned because it was rigid and lacking autonomy.<sup>59</sup>

When a CPB acts as a “wholebuyer”/wholesaler<sup>60</sup> it performs two interrelated functions. As a wholebuyer it acquires goods from a supplier in the upstream (input market). As a wholesaler these goods are subsequently re-sold in the downstream (output market) to contracting authorities who will allegedly make use of them for the provision of public services, even though there is no certainty of what the subsequent use of the good will be.<sup>61</sup> By acting as a retailer the CPB acts in the same way a retailing undertaking would do in an intermediate market, being this later under the scrutiny of EU competition law.<sup>62</sup> This leads to complex situations in which the same CPB may be under or outside the scrutiny of competition law depending on which type of purchases it carries out. An additional problem arising for wholebuyer CPBs is their propensity to take unnecessary commercial risks as CPBs will not be punished by market forces as a normal undertaking would do after a commercial failure.<sup>63</sup> This could occur, for instance, when the CPB decides to acquire large quantities of a new “innovative” product that no contracting authority later desires.

#### **4. Rationale of centralized purchasing<sup>64</sup>**

Pooling public buyer through CPBs may grant benefits to procurement stakeholders from a pure cost saving perspective (intra tender) or dynamic/market structure (extra-tender) perspective. Centralization may considerably reduce tendering costs, and improve the quality of the acquired goods and soundness of public tenders.<sup>65</sup> This maximizes the contracting authorities’ surplus and, arguably the economic operator’s as well; hence promoting efficiency.<sup>66</sup> These efficiencies are achieved by fostering competition between economic operators, lowering purchasing prices, generating economies of scale by reducing and streamlining tender procedures, and minimizing public expenditure helping in the achievement of better value for money in public procurement.<sup>67</sup>

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<sup>58</sup> OECD (2011) 57.

<sup>59</sup> Ibid 16.

<sup>60</sup> The term wholebuyer is coined by the author.

<sup>61</sup> C-205/03 *P FENIN v Commission* [2006] ECR I-6295, para. 26.

<sup>62</sup> Sánchez Graells, *Public procurement and the EU competition rules* [2015] Chapter 4; Sánchez Graells and Herrera Anchustegui [2014].

<sup>63</sup> OECD (2011) 20.

<sup>64</sup> Sections 4 and 5 build up on a previous work by the author and Sánchez Graells in Sánchez Graells and Herrera Anchustegui [2014].

<sup>65</sup> Albano and Sparro [2010] 2.

<sup>66</sup> Regarding efficiency as a measure of economic surplus see, inter alia: Robert S. Pindyck and Daniel L. Rubinfeld, *Microeconomics* (Pearson Prentice Hall 2009) 315 to 319; Jeffrey Church and Roger Ware, *Industrial organization: a strategic approach* (McGraw-Hill 2000) 25 to 29.

<sup>67</sup> Recital (15) Directive 2004/18/EC. See also Albano and Sparro [2010] 4.

Ideally, these benefits should affect all associated stakeholders – including end consumers and economic operators - and not exclusively contracting authorities.<sup>68</sup>

## 4.1 Benefits derived from CPBs

The main benefits of centralized purchasing are the accumulation of public buyer power<sup>69</sup> and the creation of economies of scale.<sup>70</sup>

### 4.1.1 Economic benefits

#### *i.* Bargaining (buyer) power

Centralized purchasing pools *public purchasing market power*, in a same manner as a purchasing alliance among undertakings does, maximizing profits by reducing costs. Buying cartels, but not buying alliances, are forbidden as object restrictions in EU competition law.<sup>71</sup> By centralizing purchases the CPB exerts buyer power vis-à-vis its suppliers and obtains better terms and conditions, without withholding demand, when entering into public contracts on behalf of others or purchasing to later resale.<sup>72</sup> Buyer power acts as a competitive constraint over economic operators which will be incentivized to offer better terms and conditions to the CPB than to those bodies which lack buyer power.<sup>73</sup> This neutralizing force can make competition more vigorous by lowering prices paid and passing on the benefits to tax payers in the form of cheaper and better quality public services. Buyer power, then, neutralizes seller market power until reaching a point of equilibria; if too much buyer power is exercised economic operators will find too costly to offer their goods, works or services and prefer not to tender.

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<sup>68</sup> Also supporting this point: OECD (2011) 10.

<sup>69</sup> James Chard, Gustaf Duhs and John Houlden, ‘Body beautiful or vile bodies? Central purchasing in the UK’ *Public Procurement Law Review* [2008].

<sup>70</sup> Recital (59) Directive 2004/18/EC. See also: Office of Fair Trading *Assessing the impact of public sector procurement on competition* (2004) para 1.43 to 1.51; Hamer [2014] 201.

<sup>71</sup> Paradoxically, anti-competitive agreements, but not purchasing alliances, among competing undertakings are strictly forbidden under EU/EEA competition law in accordance with art 101 TFEU. See, inter alia: C-61/80 - *Coöperatieve Stremsel- en Kleursel-fabriek v Commission*, EU:C:1981:75 E.C.R. [1981] 00851; Communication from the Commission Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements [2011] OJ C11/1, para 213; Commission Decision relating to a proceeding under Article 85 of the EEC Treaty IV/27.958 National Sulphuric Acid Association [1980] OJ L260/24.

<sup>72</sup> This would be the case of bargaining power, see: OECD *Policy Roundtables: Monopsony and Buyer Power* (2009) 22.

<sup>73</sup> J. K. Galbraith, *American Capitalism*, Chapters IX and X in *The Affluent Society & Other Writings 1952-1967: American Capitalism; The Great Crash, 1929; The Affluent Society; The New Industrial State*, pgs. 97-135; Office of Fair Trading (2004) para 1.10.

ii. Creation of bureaucratic economies of scale

CPBs create bureaucratic economies of scale that foster operational efficiency and reduce transaction costs for contracting authorities and economic operators alike.<sup>74</sup> Economies of scale imply that the more tenders are carried out by the same contracting authority the cheaper they become or,<sup>75</sup> in the case of demand aggregation they do not become cheaper but become less frequent as the tenders are now concentrated on the CPB, sensibly reducing transaction costs.<sup>76</sup>

Centralization also allows for the reduction of fixed administrative costs of running tender procedures as there are less agencies conducting the procedures, and allows CPBs to carry out investments to innovate and improve their tendering abilities, for example by including state of the art e-procurement tools.<sup>77</sup>

iii. Economies of scale for operators

CPBs may also generate economies of scale and reduce transaction costs for economic operators. Economies of scale arise when large procurement contracts are awarded to the same undertaking for the purchase of *homogenous goods*. In this case the economic operator may be able to decrease its marginal costs due to the large production of the same good.<sup>78</sup> Transaction costs are also reduced because of the less frequent tenders – albeit now larger, more expensive and also complex -, particularly favoring medium to large undertakings.<sup>79</sup>

iv. Sponsoring of new entrants and spurring innovation

Lastly, centralization may foster new suppliers' entrance, encourage participation of local and/or regional SMEs,<sup>80</sup> or its use for spurring innovative solutions and R&D.<sup>81</sup> A preferential treatment

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<sup>74</sup> For some selected works on operational efficiency in the public sector, see: António Afonso, Ludger Schuknecht and Vito Tanzić, 'Public sector efficiency: evidence for new EU member states and emerging markets' 42 Applied Economics [2010]; Albano and Sparro [2010]; Hannu Rantanen and others, 'Performance measurement systems in the Finnish public sector' 20 International Journal of Public Sector Management [2007]; Lars Anwandter and Teofilo Jr. Ozuna, 'Can public sector reforms improve the efficiency of public water utilities?' 7 Environment and Development Economics [2002]; John Ruggiero, 'On the measurement of technical efficiency in the public sector' 90 European Journal of Operational Research [1996]; and Peter Smith and David Mayston, 'Measuring Efficiency in the Public Sector' 15 Omega, International Journal of Management Science [1987].

<sup>75</sup> Church and Ware, [2000] 54 to 59.

<sup>76</sup> Albano and Sparro [2010] 5.

<sup>77</sup> Ibid 6.

<sup>78</sup> Ibid 4.

<sup>79</sup> Also supporting that centralized sales sensibly reduce transaction costs see: OECD (2011) 19.

<sup>80</sup> Office of Fair Trading (2004) para. 1.26.

<sup>81</sup> Spurring innovation through public procurement has been a goal of the recently enacted Directive 2014/24 by means of introducing, for instance, the Innovation Partnership procedure in which contracting authorities act as a "venture capitalist" to finance R&D projects, see Art. 31 and Recitals (84), (95), (123) and (124) of Directive 2014/24. See also: Marta Andrecka, 'Innovation partnership in the new public procurement regime - a shift of focus from procedural to contractual issues?' 2 Public Procurement Law Review [2015]; Pedro Cerqueira Gomes, 'The innovative innovation partnerships under the 2014 Public Procurement Directive' 4 Public Procurement Law Review [2014]; Luke Butler, 'Innovation in Public Procurement: Towards the "Innovation Union"' in Francois Lichère,

to SMEs or sponsoring innovation through centralized purchasing is not without problems. Preferential SME treatment may breach the principle of equal treatment, its derived obligation of transparency and the general principle of (undistorted) competition, unless the measures are objectively justified and capable of overcoming very strict proportionality tests.<sup>82</sup> Also when spurring innovation these measures may constitute unlawful state aid, as the advantages given are of a selective nature,<sup>83</sup> and are prone to sponsor national champions and create internal market distortions.

#### 4.1.2 Administrative benefits

Purchasing through CPBs may generate two administrative benefits: the professionalization of procurement services and the centralization of procedures.

*i.* Professionalization of procurement services

By promoting centralization the professionalization of involved civil servants may increase thanks to the acquired expertise when awarding public contracts in a daily basis, as acknowledged by Recital (69) of Directive 2014/24.<sup>84</sup> Also, procurement professionalization helps streamlining the tenders and reducing legal risks. Furthermore, as a result of centralization knowledge-sharing emerges as a by-product as noted by Albano and Sparro.<sup>85</sup>

*ii.* Procedural control

By employing CPBs it is possible having larger control over the award and execution of public contracts.<sup>86</sup> This occurs when CPBs administer public contracts on behalf of other contracting authorities, or carry out ancillary tasks in the related to procurement management, training of civil servants, contract management, *inter alia*.<sup>87</sup>

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Roberto Caranta and Steen Treumer (eds), *Modernising Public Procurement: The New Directive* (DJØF Publishing 2014).

<sup>82</sup> Raising a somewhat similar issue, see Martin Burgi, 'Small and medium-sized enterprises and procurement law - European legal framework and German experiences' 4 *Public Procurement Law Review* [2007].

<sup>83</sup> Art. 107 TFEU. See also: Albert Sánchez Graells, 'Public procurement and state aid: reopening the debate?' 6 *Public Procurement Law Review* [2012]; Albert Sánchez Graells, 'Bringing the "market economy agent" principle to full power' 33 *European Competition Law Review* [2012]; Baudouin Heuninckx, 'Defence Procurement: The Most Effective Way to Grant Illegal State Aid and Get Away With it ... Or is it?' 46 *Common Market Law Review* [2009].

<sup>84</sup> See also: OECD, 'Public Procurement: The Role of Competition Authorities in Promoting Competition' DAF/COMP(2007)34 [2008]; OECD *Policy Roundtables: Buying power of multiproduct retailers* (1999); Marcel Stuijts, Ditmar Waterman and Jos Schreijen, 'Professionalising Communal Procurement: The Experience in the Dutch Public Sector' (2008) <<http://www.ippa.org/IPPC4/Proceedings/14ProcurementProfession/Paper14-4.pdf>>.

<sup>85</sup> Albano and Sparro [2010] 6.

<sup>86</sup> Racca [2010] 120.

<sup>87</sup> *Ibid* 121.

## 5. Risks generated by centralized purchasing

Aggregation of public buyer power and improper CPB conduct may restrict competition, causing harm to economic operators, other contracting authorities and competition itself. These situations may trigger by single or coordinated behavior among contracting authorities when designing tender procedures or imposing contracting conditions, as recognized by Recital (59) of Directive 2014/24.<sup>88</sup> Furthermore, competition risks are incremented if contracting authorities have a short term focus on pure “best-value for money” (intra-tender/cost saving) and overlook the consequences on market structures in a medium/long term. Centralized purchasing may also lead to administrative and legal risks, such as increase of complex and costly litigation, decrease of autonomy for contracting authorities, trigger principal-agent problems, and lead to overbuying and budgeting allocation issues.

### 5.1 Economic risks from a CPB’s perspective

#### i. Buyer power risks: Monopsony and abuse of bargaining power

CPBs may willingly or not exercise monopsony power. Monopsony is the reverse (but not mirror) of monopoly.<sup>89</sup> Monopsony surges whenever a buyer faces no real competition from other buyers and is able to lower the purchasing price it pays for a good below the competitive level by reducing the quantity it acquires,<sup>90</sup> which is known as the withholding effect.<sup>91</sup> This effects takes place if the supply curve the monopsonist faces is upward sloping, i.e.: the more you buy from a unit, the more expensive it will be. Hence, monopsony more than a “form” is a specific behavior –demand withholding. From a welfare perspective monopsony is *always* negative because too few resources are employed and there are unrealized gains from additional trade.<sup>92</sup>

Albeit monopsony is rare, public procurement markets may be susceptible of the practice, particularly if centralized procurement is frequently employed as MS usually enjoy a legal and/or

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<sup>88</sup> “(...) the aggregation and centralisation of purchases should be carefully monitored in order to avoid excessive concentration of purchasing power and collusion (...)”, Recital (59) Directive 2014/24 (emphasis added).

<sup>89</sup> For the description of the monopsony model see, *inter alia*: Pindyck and Rubinfeld, [2009] 373 to 381; B. Douglas Bernheim and Michael D. Whinston, *Microeconomics* (McGraw-Hill Irwin 2008) 648 to 652; Hal R. Varian, *Intermediate microeconomics: a modern approach* (W.W. Norton & Co. 2006) 471 to 474; Robert H. Frank and Amy Jocelyn Glass, *Microeconomics and behavior* (McGraw-Hill 1999) 503 to 508; James P. Quirk, *Intermediate microeconomics* (Science Research Associates 1987) 358 to 362.

<sup>90</sup> OECD (2009) 9.

This purchasing price needs to be below competitive levels in order for it to be considered as anticompetitive. See, for example the contribution of Canadian Competition Bureau as well as Germany’s contribution in *ibid* 142 and 176, respectively. See also Andrew Gavil, William Kovacic and Jonathan Baker, *Antitrust Law in Perspective: cases, concepts and problems in competition policy* (2nd edn, Thomson West 2008) 517 to 518.

<sup>91</sup> This conduct is named by Salop as “underbuying” in Steven C Salop, ‘Anticompetitive Overbuying by Power Buyers’ 72 *Antitrust Law Journal* [2004-2005]. See also Phillip Areeda and Herbert Hovenkamp, *Antitrust law: an analysis of antitrust principles and their application* (Kluwer 2006) 442.

<sup>92</sup> Roger D. Blair and Jeffrey L. Harrison, *Monopsony in law and economics* (Cambridge University Press 2010) 44.

de facto monopoly or quasi monopoly position in the market as the provider of downstream public services. However, as contracting authorities do not directly “fix” purchasing prices monopsony can be difficult to be traditionally exerted.

Additionally, a CPB may not necessarily use its privileged position to withhold demand but it may still abuse or inefficiently use its bargaining power to obtain purchasing conditions that will be welfare detrimental. This happens, for example, when a buyer exerts abusive purchasing conditions that push suppliers outside of the markets, or if there is no competition in the downstream market as the buyer is not constrained to pass on benefits to end consumers in the form of lower purchasing prices or better quality/accessibility.<sup>93</sup> In this regard, CPBs and contracting authorities in general are susceptible to inefficiently use their buyer power rather than abuse of it. This happens because their privileged market position shields them from competitive constrain by market forces – although theoretically not from political pressure – to pass on to end consumers the benefits of its bargaining power, for example by providing better quality or more quantity of the services and, ultimately, pay less taxes for the same services.

Both in the case of monopsony and abusive or inefficient bargaining power CBPs may impose anticompetitive conditions in the tender documentation— in the form of take it or leave it contracts or very restrictive terms. If this occur, some suppliers will refrain from submitting a tender and exit procurement markets to engage in a different economic activity which will lead to increased market concentration and less future competition. Other buyers will commit to them as otherwise they will have no access to the end customers. In both cases, competition is hurt in the short and long term.

## 5.2 Economic risks from the economic operators’ perspective

### i. Lack of innovative and investment incentives

Part of the literature argues that centralized purchasing may negatively affect investment and innovation if the emphasis is put into short term efficiency – cost savings – as suppliers might be unable to recoup their R&D investment.<sup>94</sup> However, centralized procurement techniques might have the reverse effect and create innovation incentives, which is one of the goals pursued by Directive 2014/24 when stating that “(p)ublic authorities should make the best strategic use of public procurement to spur innovation.”<sup>95</sup> Innovation can be incentivized for example by allowing CPBs and contracting authorities to enter into procedures such as the innovation

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<sup>93</sup> Zhiqi Chen, ‘Buyer power: Economic theory and antitrust policy’ 22 *Research in Law and Economics* [2007]; Office of Fair Trading, *The competitive effects of buyer groups* (2007) para 1.21.

<sup>94</sup> Office of Fair Trading, *The competitive effects of buyer groups* para 1.32; OECD (2009) 11 to 12.

<sup>95</sup> Recital (47) Directive 2014/24.

partnership,<sup>96</sup> allowing variant tenders,<sup>97</sup> and increasing competition among suppliers for innovative products or services.<sup>98</sup>

ii. Bid rigging – collusion risk

Centralized purchasing may increase risks and incentives for collusion among economic operators.<sup>99</sup> By rigging bids economic operators coordinate their behavior when tendering for the award of public contracts with the attempt to decide which bid will be successful.<sup>100</sup> Centralized purchasing fosters collusion as it allows for price signaling, and facilitates communication among players as less frequent purchases are carried out by the same contracting authority, minimizing coordination costs. Economic operators are incentivized to collude as the “prize” (the contract) is arguably larger and they cannot afford being “left out”;<sup>101</sup> hence they are more motivated to coordinate their behavior and take turns in a survival strategy.<sup>102</sup> If the incentives to cheat increase the retaliation mechanisms implemented by the collusive parties also become more robust and sophisticated which, in turns, reinforces parties not to deviate from the agreed conduct.

### 5.3 Economic risks from a markets’ perspective

iii. Market concentration and SMEs’ squeezing

Procurement centralization tends to concentrate markets both in the purchasing and supplying sides as recognized by Recital (59) of Directive 2014/24.<sup>103</sup> As markets concentrate it is likely that SMEs will be forced to exit the market as they are less able to compete with larger economic operators who offer better terms and are capable of complying with the financial tender requirements, particularly turnover demands.<sup>104</sup> Increased market concentration is a serious problem because it reduces the amount of market players and competitive pressure; leading to variety diminishment and few available alternative technical solutions.<sup>105</sup> Additionally, by entering into large and lengthy agreements – such as framework agreements - CPBs become “locked in” with a supplier who, benefiting from the absence of competition will exercise market

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<sup>96</sup> Art. 31 Directive 2014/24.

<sup>97</sup> Art. 45 Directive 2014/24.

<sup>98</sup> Generally, see Gomes [2014].

<sup>99</sup> For discussion and further references, see Albert Sánchez Graells, ‘Prevention and Deterrence of Bid Rigging: A Look From the New EU Directive on Public Procurement’ in Gabriella M. Racca and Christopher R. Yukins (eds), *Integrity and efficiency in sustainable public contracts: balancing corruption concerns in public procurement internationally* (Bruylant 2014); Marta Fana and Gustavo Piga, ‘SMEs and public contracts’ in Gustavo Piga and Steen Treumer (eds), *The Applied Law and Economics of Public Procurement* (Routledge 2013) 283.

<sup>100</sup> Recital (59) Directive 2014/24.

<sup>101</sup> Chard, Duhs and Houlden [2008].

<sup>102</sup> Supporting this view on the incentives to collude due to large sizes of public contracts, OECD, *Collusion and Corruption in Public Procurement* (Policy Roundtables, 2010) 24

<sup>103</sup> Recital (59) Directive 2014/24.

<sup>104</sup> Art. 58 of Directive 2014/24. See also: OECD (2011) 20.

<sup>105</sup> Chard, Duhs and Houlden [2008] NA29.

power vis-à-vis public buyers and raise prices.<sup>106</sup> High concentration may also increase oligopolistic-competition that can derive into collusion.

iv. Waterbed effect

Centralized purchasing may lead to an increase on the prices paid by other (weaker) buyers.<sup>107</sup> The intuition behind the *waterbed effect* is that suppliers will try to recoup the lost profit by increasing the selling prices that non-powerful buyers will have to pay to acquire their input. As competition has been reduced, sellers have more market power compared to smaller buyers and increase prices further.<sup>108</sup> Paradoxically, smaller contracting authorities - for whom public procurement tenders are already an economic and administrative burden - will see their purchasing prices increased. Consequently, the waterbed-effect incentivizes contracting authorities to further employ centralized purchasing and increasing the risks generated by them. This leads to a potentially vicious circle where contracting authorities to avoid the negative effects of centralization recur to these practices.

## 5.4 Administrative and legal risks generated by CPBs

Recourse to centralized purchasing techniques also prompts administrative and legal risks which mainly derive from the increased award complexity, diverging interest of contracting authorities, and the relations between the CPB and the contracting authorities that employ it.

i. Increase of complex and costly litigation

Contracts awarded by CPBs tend to be more complex and of larger economic value incentivizing economic operators to litigate if they are not awarded the contract. Also, as contracts are larger and risks for litigation increases the proportion of sanctions and CPBs' contractual responsibility also rises, leading to further expenditure and loss of the cost-saving efficiency.

ii. Decreased autonomy for contracting authorities

Recourse to CPBs lessens contracting authorities' autonomy, leading to increased uniformity and product homogeneity.<sup>109</sup> By centralizing purchases local contracting authorities transfer part of their decisional autonomy to a central body who will often decide what to acquire by either seeking consensus among the different contracting authorities or by making an arbitrary decision, which will be the case if it acts as a wholesaler/wholebuyer. This increase political discomfort

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<sup>106</sup> See also expressing this concern regarding the "lock in": Albano and Sparro [2010] and Piga in Christopher Yukins and Gustavo Piga, 'Diaogue' in Gustavo Piga and Steen Treumer (eds), *The Applied Law and Economics of Public Procurement* (Routledge 2013) 225.

<sup>107</sup> Paul W. Dobson and Roman Inderst, 'Differential buyer power and the waterbed effect: do strong buyers benefit or harm consumers?' 28 *European Competition Law Review* [2007].

<sup>108</sup> OECD (2009) 23; Office of Fair Trading (2004) para 1.35. *Cf* with the view of who argue that despite the intuitive appeal this argument is not entirely satisfying in, Paul W. Dobson and Roman Inderst, 'The Waterbed Effect: Where Buying and Selling Power Come Together' 331 *Wisconsin Law Review* [2008].

<sup>109</sup> Sigma (2011) 6; OECD (2011) 21.

and litigiousness between the contracting authorities generates further expenses. Also, by losing autonomy, local or regional contracting authorities have more difficult the implementation of tailor-made policies or end user satisfaction as the input they acquire tends to be standardized.

*iii.* Principal-agent problem

Centralized purchasing also prompts principal-agent effects, a well know-economic dilemma.<sup>110</sup> The CPB carrying out the procurement makes decisions that are not directly controlled nor observed by the contracting authorities. If the CPBs' goals or interest differ from those of the contracting authority for whom it purchases goods, a conflict of interest arises.<sup>111</sup> As the incentives for deciding which goods to buy may vary between the parties and partial decisions and negotiations are conducted by the CPB (particularly if it acts as a wholesaler), the outcome will depend on the tradeoff of risks and benefits for the CPB (agent) instead of those of the contracting authority (principal) for which the goods are ultimately intended for.<sup>112</sup> These risks will tend to appear when national legislation requires contracting authorities to purchases certain goods from a specific CPB in a "top-down"<sup>113</sup> approach as contemplated in Art. 37.1 of Directive 2014/24. As a consequence of the principal-agent problem securing apparent best value for money (or best value for money for the agent) may not necessarily achieve customer satisfaction.<sup>114</sup> If such is the case, then the quality of public services will be diminished as one size fits all does not really suit all situations nor it grants proper solutions to end users.

*iv.* Budget allocation and overbuying

Lastly, centralization benefits may be eroded due to overbuying and budget allocation issues. Practice shows that contracting authorities are incentivized to reach the same level of expenditure as the previous year or to match the earmarked budget.<sup>115</sup> The intuition is that if the earmarked budget is not matched these funds will be taken away in the future, particularly in times of economic crisis. Accordingly, CPBs might be tempted to overbuy goods or services to reach certain budget targets, or prevent an increase in the input price. Thus, by overbuying or reaching budget thresholds the costs savings generated by centralized procurement is washed away. Additionally, in the case of CPBs wholesalers/wholebuyers, CPBs will attempt to achieve the maximum level of economies of scale and may end up with excessive stocks of unnecessary goods. This may result in an economic loss for the public sector, or in further CPB attempts to

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<sup>110</sup> For a thorough analysis of the principal agent problem in public procurement, in general, Christopher R. Yukins, 'A Versatile Prism: Assessing Procurement Law Through The Principal-Agent Model' 40 Public Contract Law Journal [2010].

<sup>111</sup> Ibid 64.

<sup>112</sup> Sanford J. Grossman and Oliver D. Hart, 'An Analysis of the Principal-Agent Problem' 51 Econometrica [1983].

<sup>113</sup> This is the term used by Albano and Sparro in Albano and Sparro [2010] 20.

<sup>114</sup> Yukins [2010] 73 to 76.

<sup>115</sup> Also raising this issue, see Racca [2010] 123.

resell (even at a loss?) the products to non-public markets — which would trigger significant competition and state aid enforcement issues.

## 6. Internal market for CPBs?

Directive 2014/24 impulses the joint award of public contracts among contracting authorities from different MS and attempts to address the legal and practical problems faced by contracting authorities purchasing from CPBs in other MS or jointly awarding public contracts.<sup>116</sup> According to Recital (73) of the Directive, the aim is to encourage contracting authorities to make use of CPBs located in a different state to maximize the “potential of the internal market in terms of economies of scale and risk-benefit sharing” from a contracting authority’s perspective.<sup>117</sup> As highlighted in a previous paper, this aims at creating an internal market for CPBs fostering competition among the different national CPBs, and perhaps paving the way for the creation of European (sectoral) purchasing bodies.<sup>118</sup>

The possibility of cross-border recourse to CPBs has awkwardly implemented by the Directive in Art. 39.2 which precludes MS from prohibiting contracting authorities from using CPBs located in another MS. The final text is a watered down compromise – arguably due to the interest of MS not to foster excessive cross-border centralization – compared to the original less restrictive (or more receptive to cross-border centralization) Commission’s proposal. The proposal suggested contracting authorities to use CPBs from a different MS rather than the double prohibition wording adopted in the Directive.<sup>119</sup>

However, this effort towards creating an internal market of cross-border centralized purchasing is jeopardized by the contractual relation between a contracting authority and a CPB. As discussed in Section 2.3., the public contract awarding centralized purchasing services is excluded from the application of the public procurement rules. This implies that contracting authorities may directly award it to a CPB. By suppressing the award of centralized purchasing services from tender procedures, the creation of cross-border competition is weakened as there will be no real competition for the contract. Instead most centralization contracts will be directly awarded to the “national CPB champion” instead of carrying out a voluntary tender procedure, which is what happened (and still does) regarding economic operators before opening public procurement to the internal market. If this occurs CPBs located in another MS will not be informed of the interest in their services and will not offer them to the foreign contracting authorities. In my view this

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<sup>116</sup> Recital (73) Directive 2014/24. For a discussion on the status of cross-border procurement, particularly from an economic operators’-contracting authorities perspective see: DG Enterprise and Industry EU Commission, *Evaluation of SMEs’ Access to Public Procurement Markets in the EU* (2010) 14 to 19.

<sup>117</sup> Recital (73) Directive 2014/24.

<sup>118</sup> Sánchez Graells and Herrera Anchustegui [2014] 20 to 21.

<sup>119</sup> Art. 38.2, European Commission *Proposal for a directive of the european parliament and of the council on public procurement* (2011).

conflict is anchored on the regulatory ambiguity that affects the Directive 2014/24 in general,<sup>120</sup> and traditional views on the award of public contracts and fear to the internationalization of national administrations.

One way to reconcile these aims within the limits imposed by the Directive would be including a provision under national legislation requiring or suggesting contracting authorities to conduct a tender procedure when awarding a contract for centralized purchasing when contract is deemed to have a sufficient degree of cross-border interest,<sup>121</sup> and when the legislation does not make mandatory the provision of the services by determined national CPB.

## **7. Best practices for CPBs**

In this section I suggest some “best practices” that may foster intra (short) and extra tender (long term) competition. Achieving the goals pursued by centralized aggregation without jeopardizing the competitiveness of public procurement markets depends more on the behavior of contracting authorities themselves than on the legal regime, which as it stands is mostly adequate.<sup>122</sup> Thus, both the legal transposition and CPBs’ behavior must be aligned with the goal of achieving a competitive playing field for all involved stakeholders and centered in medium to long term benefits instead of pure cost-saving concerns. These best practices are organized as follows: i) general recommendations; ii) institutional design choices; and iii) centralization of framework agreements. This list does not pretend to be exhaustive; instead I intend to raise awareness on some desirable practices and legal structures that can be applied when centralizing procurement and that ought to be tailored in accordance with the particular needs of the case.

### **7.1 General recommendations**

Centralized purchasing should be mainly employed for the acquisition of standardized goods, as if demand is heterogeneous CPBs will less adequate means to fulfil the contracting authorities’ wishes.<sup>123</sup> The more standard the goods, the easier will be for an economic operator to benefit of economies of scale as it allows the latter to distribute the fixed costs of its operation and operate with a downward sloping marginal cost curve.<sup>124</sup> Furthermore, as confirmed by an empirical

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<sup>120</sup> Also discussing the legislative ambiguity of Directive 2014/24 regarding SMEs and centralization see: Anthony Flynn and Paul Davis, ‘The rhetoric and reality of SME friendly procurement’ March Public Money & Management [2015].

<sup>121</sup> For a recent decision of the ECJ clarifying what constitutes cross border interest and making emphasis on the value of the contract and the place of execution, see: C-113/13 - *Azienda sanitaria locale n. 5 «Spezzino» and Others*, EU:C:2014:2440 [2014], not yet published in the Courts Report, para. 49. See also: C-147/06 - *SECAP and Santorso*, EU:C:2008:277 E.C.R. [2008] I-03565, para. 24.

<sup>122</sup> Also supporting this assertion see: Flynn and Davis [2015].

<sup>123</sup> OECD (2011) 57.

<sup>124</sup> Albano and Sparro [2010] 4.

study by the OECD, centralizing heterogeneous demand neglects the economic and administrative benefits driven by centralization.<sup>125</sup>

Moreover, public stakeholders should acknowledge that centralized purchasing, and in particular the administration of framework agreements, constitute areas where collusion – tacit or explicit – may easily originate. Therefore, some form of competition surveillance and collaboration with competition authorities by the contracting authorities should be implemented, as suggested by Sánchez Graells.<sup>126</sup>

CPBs should favor division into lots in accordance to Recitals (78) and (79), and Art. 46 of Directive 2014/24. Division into lots enhances competition, allows for participation of SMEs, and reduces demand concentration risks. Consequently, it should be used unless particular circumstances of the contract make it inappropriate, for instance, if only one provider can perform it or the goods purchased are not-divisible. Hence, implementation of Art. 46 of the Directive should demand a high threshold for reasons not to divide into lots or make mandatory the division whenever the procurement is carried out by a CPB.<sup>127</sup> In connection with this, not only division into lots is necessary but also establishing case-by-case quota caps to the lots a single undertaking can win, which will ensure reliability of supply and preserve competition.<sup>128</sup>

In connection with the former, CPBs should allow as much as possible variant tenders linked to the subject matter of the contract to foster innovation and access of new technologies to procurement markets.<sup>129</sup> To do so, it should both accept and require variants in tender procedures, depending on the situation at stake.

Excessive procurement centralization should be avoided in economic areas where the supply market is highly concentrated or has been deemed by competition authorities not sufficiently competitive. If too much centralization is employed in such circumstances competition risks increase and the market may evolve into a bilateral monopoly. Contrastingly, targeted procurement centralization may have the opposite effect as public demand may act as a power constraint to promote competition and break a possible collusive game in highly concentrated markets.

To minimize the principal-agent problem, centralized purchasing ought to be under surveillance mechanisms of both economic operators and contracting authorities. Contracting authorities should adopt monitoring and supervising strategies to ensure that interests are aligned as closely as possible to achieve customer satisfaction. On the other hand, economic operators act as an indirect controller by initiating litigation against CPBs and contracting authorities. Nevertheless,

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<sup>125</sup> OECD (2011) 57.

<sup>126</sup> Sánchez Graells A, *Public procurement and the EU competition rules* (Hart 2011) 385 to 389.

<sup>127</sup> Art. 46.1 and 46.4 of Directive 2014/24.

<sup>128</sup> Recital (79) and Art. 46.2 of Directive 2014/24.

<sup>129</sup> Recital (48) and Art. 45 of Directive 2014/24.

despite these supervision measures the principal-agent problem is just mitigated and not eliminated in full.

A debated topic is whether CPBs should be employed to foster non-economic goals secondary procurement goals. Albano and Sparro favor employing CPBs as engines to “to target broader policy goals” and propose its use as an industrial policy tool.<sup>130</sup> In my view, however, CPBs are unsuited instruments to pursue “broader policy goals” as this tends to risk favoritism, unequal treatment, lack of transparency and deviate from the original goals of promotion of economic efficiency and market integration. This position should not be understood as neglecting the possibility of pursuing other goals apart from economic efficiency, but suggesting that other legislative tools (intra and extra procurement law) are better suited to address these needs and prevent regulatory ambiguity.

Lastly, the provision of ancillary purchasing services by CPBs should be limited or regulated in detail as because it is not subject to a tender procedure according to Art. 34.7 and Recital (70), which alters the competitive field for private undertakings offering these type of services. To do so, national implementation of the Directive could require contracting authorities – despite the waiver of the Directive - to carry out a tender procedure allowing undertakings to compete with CPBs and, therefore, improving the quality of the ancillary services to be provided.

## 7.2 Institutional design

Contracting authorities, at any levels and in any sectoral fields, should not be under an inflexible obligation to acquire goods through CPBs. Despite that mandatory centralization helps achieving benefits such as standardization of services, procedural control, demand expectation for economic operators, and may lead to shorter term lower prices, the benefits of a flexible system surpass those offered by the mandatory one. By establishing a flexible “opt-out” system CPBs must face competitive constraints that forces them to be efficient. This also reduces excessive centralization, guarantees autonomy, diminishes the chances of generating principle-agent problems and allows for further stakeholder’s satisfaction. Consequently, if the national legislator wishes to impose a duty to centralize purchasing in accordance to Art 37(1), it ought to include an “opt-out clause” allowing the contracting authority to escape the provision.<sup>131</sup> This could be the case, as for example it has been implemented in Sweden, by allowing contracting authorities

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<sup>130</sup> Albano and Sparro [2010] 3. For a discussion of the goals of EU public procurement see: Sánchez Graells, *Public procurement and the EU competition rules* [2015]; Peter Kunzlik, ‘Neoliberalism and the European Union public procurement regime’ in *Cambridge Yearbook of European Legal Studies* (2013); Sue Arrowsmith, ‘The Purpose of the EU Procurement Directives: Ends, Means and the Implications for National Regulatory Space for Commercial and Horizontal Procurement Policies’ in C. Barnard, M. Gehring and I. Solanke (eds), *Cambridge Yearbook of European Legal Studies* (Hart Publishing 2011-2012).

<sup>131</sup> Sánchez Graells, *Public procurement and the EU competition rules* [2015] 254 to 257.

to purchase from other sources if: i) the goods offered do not fulfil the contracting authority's needs; or ii) it is able to find better conditions than those offered by the CPB.<sup>132</sup>

Another institutional decision is whether the national CPB system should be specialized (i.e.: sectoral CPBs) or integrated (i.e.: a single CPB). EU practice reveals that MS adopt different forms and that both alternatives have pros and cons that should be analyzed before making a decision. Implementing a sectoral CPB system, however, appears to be less competition distorting, more flexible and tailored to suit the contracting authorities' requirements – albeit more expensive and complex to run – than a single CPB system. On the other hand, an integrated system fosters administrative economies of scale and procedural control. In my view, a sectoral “opt-out” based system is a more expensive but competitive choice.

Lastly, practice shows that most MS chose to use the form of publicly owned limited companies to create CPBs. This choice grants corporative flexibility while retaining the character of a contracting authority.<sup>133</sup> Other alternatives could be setting the CPB as an independent administrative organ, such as a government agency, which tend to be less independent but easier to control.

### 7.3 Centralization of framework agreements

Centrally procured framework agreements should be concluded with several suppliers unless the circumstances of the case make it impossible.<sup>134</sup> Single supplier agreements are easier to administer and may foster intense tender competition among interested economic operators. However, these type of agreements should be avoided as they increase chances for a “winner takes all situation”,<sup>135</sup> neglect intra-agreement competition, and hinder SME participation. On the other hand, multi-supplier agreements should be favored as the inclusion of “mini tenders” - alternatively ranking systems - foster competition in all phases of stages and minimizes being “locked in” to a supplier while helping decreasing market concentration.<sup>136</sup> Unfortunately, Art. 33.3 of Directive 2014/24 gave a turn for the worse concerning multi-supplier agreements when allowing framework agreements to be entered with two economic operators instead of a minimum of three required by Article 32.3 of Directive 2004/18.

The duration of centralized purchasing agreements should be limited to preferably less than three years and not be easily extendable beyond their initial phase (a possibility strengthened by Directive 2014/24), particularly in innovation intensive areas, such as IT - in which they are frequently used-, to avoid newcomers and parties not originally involved of the agreement to be

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<sup>132</sup> OECD (2011) 43.

<sup>133</sup> Ibid 59.

<sup>134</sup> Cf with Albano and Sparro [2010] 25.

<sup>135</sup> OECD (2011) 61

<sup>136</sup> Also supporting this idea see: ibid 18.

in a worse negotiation position when compared to those part of the agreement. Also, by limiting the duration the risks of waterbed effects generated by framework agreements to parties “clearly identified for this purpose in the call for competition or the invitation to confirm interest”<sup>137</sup> decrease.

Lastly, when implementing centrally procured framework agreements parties should carefully determine which one of them is in charge of placing the “call off” orders. If non-specialized civil servants from the contracting authority place the final order instead of the servants of the CPB and not subject to supervision the benefits of centralization can be washed away.<sup>138</sup>

## **8. Conclusion**

CPBs are here to stay and while they generally tend to bring desired benefits to the procurement stakeholders its implementation and practice should be aware of the risks they can generate, which is often overlooked (or forgotten). Directive 2014/24 continues the path signaled by Directive 2004/18 towards further centralization and procurement efficiency by promoting and expanding the centralization techniques. However, it fails to clearly point out what procurement practices are needed to prevent – or minimize - competition distortions. This efficiency driven move should be welcome by stakeholders, but MS and its contracting authorities should be made aware of the risks involved with procurement centralization.

As pointed out in this paper, the benefits of centralization can be jeopardized by the CPB’s behavior and an excessive focus on pure cost-reducing efficiencies. By being aware of the risks posed by centralization, properly implementing the new provisions in Directive 2014/24, and employing some pro-competitive alternatives suggested in this paper contracting authorities will be able to benefit of centralization techniques without imposing an unfair advantage to other procurement stakeholders - economic operators - and ultimately the end consumer. The key lies on transposing the provisions in line with the principle of competition imbedded in Art. 18 of Directive 2014/24 and, especially, to monitor and adjust the purchasing behavior of CPBs, who ultimately are masters of their own fate.

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<sup>137</sup> Art. 33.2 Directive 2014/24.

<sup>138</sup> Arrowsmith, [2014] para. 11.02