

## “Supplying the Public Sector: a Case for a Cartel?”

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1. A continuing concern of those who advise suppliers to the public sector has at last come before the Courts. How can such suppliers ensure that increasingly sophisticated public procurement departments use their exceptional buying power fairly without the protection of the Competition Act 1998? A number of trade associations and suppliers have been accepting the public sector's assurances that they enjoy immunity because they are not “undertakings” for competition law purposes, as has the Office of Fair Trading.
2. Two issues typically arise, before the question of any abuse or anti-competitive practice arises. First, the circumstances in which a public authority is to be regarded as an “undertaking” because it provides the same services as the private sector; albeit not for profit; secondly, the question whether a public authority can be an “undertaking” in respect of its purchasing function when the purchases are made in discharge of its public duties. (Some aspects of these issues are currently before the Competition Commission Appeals Tribunal in *BetterCare v DGFT*).
3. The first question, whether a public body is an “undertaking” because it is engaged in an economic activity which is or may be supplied by the private sector, is well trodden territory. *Poucet & Pistre* (Cases C-159 & 160/91 [1993] ECR I-637) and many cases since, add a gloss to the law established in *Hofner* (Case C-41/90 [1991] ECR-I 1979) that a state body is an “undertaking” if it offers goods and services on a market which can be supplied by private operators but not if, in relation to a pension or insurance scheme, for example, it offers “social” as well as economic benefits. In those cases the benefits are “social” in the sense that they are available to poor risk members on better than actuarial terms, with the result that the “good risks” pay more than they could obtain on the private market, hence the potential unfairness.

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4. The second question, whether there are there circumstances in which a public authority can be an “undertaking” simply because it makes purchases, has never been taken seriously - it has seemed inappropriate to classify a public body as an “undertaking” on the grounds that it makes purchases alone, when it is not doing so in order to engage in an economic activity. But if the test is economic then it seems positively perverse to assert that “purchasers”, as the counterpart to “suppliers”, are not, in fact, first line “undertakings” fundamentally engaged in an “economic or commercial activity” in respect of the market on which that purchase is made, without reference at all to the social or other use to which that purchase may be put. That is surely the case whatever their corporate or public complexion.
5. There appears now to be recognition of the fact that an organisation may be an undertaking for some purposes and not for others (described by Advocate General Jacob in Case C-475/99 *Ambulanz Glockner*, 17 May 2001, paragraphs 70-71). This is consistent with the somewhat different distinction in English law between the public law and private law functions of public bodies, a distinction drawn in this context by a strong Divisional Court in *R v The Lord Chancellor's Department ex p. Hibbet & Saunders* (The Times 12<sup>th</sup> March 1993). In that case shorthand writers who had tendered to the Lord Chancellor's Department had, the Court decided, been treated unfairly, but had no *public* law remedy. The contract fell outside the public procurement regime at the time, so there was no private law remedy either. In private law matters public bodies are subject to the same law as other purely commercial organisations, and there seems no reason of principle why that law should not include competition law.
6. “Purchasing power” appears rarely to be the source of anti-competitive behaviour, but where it is there is no reason why Articles 81 and 82 and the English law counterparts should not apply to it. In *Gottrup-Klim* (Case C-250/92 [1994] ECR I-5641) the court considered the point rather indirectly. A buyers' co-operative, with a market share in excess of 30%, for the purchase of fertilisers restricted members from joining other co-operatives. The court held that the restriction was lawful providing it did not go “beyond what is necessary to ensure that the cooperative functions properly and maintains its contractual power in relation to producers” (paragraph 50). The Court thus recognised the importance of buyer power, but also that its use must be subject to limitations. It is impossible to see the *economic* distinction between the purchases of fertilisers in *Gottrup-Klim*, which were clearly subject to Articles 81 & 82, and any purchases made, for example, by a government agricultural agency, irrespective of the purpose of the purchase.
7. “Monopsonists” (monopoly buyers) are associated with exerting unfair downward pressure on prices in the same way as monopolists exert upward pressure. But that is not the only possible source of abuse. Another example of where an abuse might be found is provided by the OFT in its report on Funerals (OFT 346, July 2001) concerning the problems of the contracts NHS Trusts and coroners enter into with local funeral directors for the removal of bodies. The funeral director in possession of the body has a major advantage in securing the funeral itself, as the family are unlikely to insist on a transfer of the deceased from one funeral director to another. Funeral directors therefore have an incentive to offer loss leading terms to public bodies in order to reserve a large part of the local market (coroners have jurisdiction in around 20% of deaths) for funerals to one funeral director. So far no-one has felt inclined to challenge any agreements between funeral directors and coroners or NHS

Trusts in the expectation that they will be held not to be agreements between "undertakings".

8. Another example would be the free provision of computer hardware to public bodies on condition that sufficient on-line purchases are made to a particular wholesaler. More intriguing is the free provision of street furniture to local authorities. Local authorities cannot lawfully trade, and are thus unable to sell advertising space on their buildings, bus shelters and so on. Instead they can accept free goods and equipment on which the supplier places advertising. In such cases the local authority has little interest in providing regular or any competitions.
9. These are, perhaps, exceptional examples. But any public body may be able to exert exceptional purchasing power if it is dominant in its own product or geographical market (this is an important aspect of the Competition Act which brings within its scope local markets which are outside the ambit of Article 81 and 82 because of the absence of an effect on interstate trade). Public bodies are increasingly and systematically seeking to achieve economies through bulk purchasing, including beyond their own departments. In *R v Yorkshire Purchasing Organisation ex p. British Educational Suppliers Ltd* ([1998] ELR 195), the suppliers succeeded in their claim that a schools' purchasing organisation was acting unlawfully in taking commission on introductions it made between suppliers and schools requiring one-off purchases (its principal activity was the purchase of schools equipment in bulk for onward sale to schools as and when required). The supplier was to that limited extent successful in resisting the exceptional purchasing power of the organisation, which was reducing the price effectively realised by the supplier, on the grounds that it had exceeded its *vires* under the Local Authorities (Goods and Services) Act 1970.
10. Since then a number of other government purchasing organisations have emerged with a view to bulk purchasing across otherwise autonomous organisations, in effect creating a cartel. PITO, the Police Information Technology Organisation, was established under the Police Act 1997, Sections 109-110, with the power to procure or assist the police authorities to procure information technology equipment. It advertises that it "also has a role in the purchasing of goods and services for the police with the aim of providing best value through collective procurement". PASA, the NHS Purchasing and Supply Agency, describes itself in the following terms: "the agency contracts on a national basis for products and services which are strategically critical to the NHS. It also acts in cases where aggregated purchasing power will yield greater economic savings than those achieved by contracting on a local or regional basis".
11. These agencies are not only potentially able to exert the buyer power with which *Gottrup-Klim* was indirectly concerned, but are also potentially to be viewed as "undertakings" following the *Hofner* line of authorities: they are buying not for themselves, but as agents, and thus arguably undertake an economic function that could easily be carried out by the private sector. The accepted view has been that they can maintain their position that they are not "undertakings", if only because as agencies they are part of a central government department, which, it is said, cannot be "undertakings" under any circumstances.

12. This attitude contrasts with a much earlier experience in which a central government department was approached by a supplier with a view to setting standards for relevant purchases by the department (and, if possible, drawing in other departments too) which would have favoured the supplier's products. When informed that this was potentially contrary to Article 81, the department's immediate reaction was that it had every wish to comply with the spirit of Article 81, even though it was not bound by it.
13. The market position taken by these new central government purchasing agencies bears direct comparison with the private sector. Consider the situation in which all the private hospitals in the UK decided to purchase jointly, through an agency or industry association, some expensive diagnostic technique not available through the NHS. Is there any doubt that Articles 81 and 82 (and the Competition Act) would apply? Similarly if an association of security firms sought to buy building surveillance equipment on behalf of its members, it would immediately be alleged that an unlawful agreement had been entered into, if the association was a sufficiently large buyer on the market to affect competition.
14. Of course a natural reaction to an industry faced with a single buyer is to form a suppliers' organisation to meet that power with joint selling. That is the flipside of the facts approved by the European Court in *Gottrup-Klim* where joint buying was a proper reaction to powerful suppliers. But it would be a brave cartel that would attempt to defend this response with the possibility of fines under the Competition Act and criminalisation just around the corner. Nevertheless it is a reaction that affected industry associations might reasonably consider putting before the Director General under Section 14 of the Competition Act in an application for an exemption, obtaining protection from the effects of the Act pending determination.
15. A common reaction to the problems of purchasing from the public sector is to presume that it has been resolved by the public procurement regime, which controls the tendering procedures of public authorities. That regime was established as part of the "single market" with a view to opening up contracting to tenderers in other Member States. That aim has been singularly unsuccessful and largely forgotten, but lives on in the Recitals to the Directives and in the provisions which are designed solely to ensure fairness between tenderers, and not between buyers and sellers.
16. The original aim of the Directives also lives on in the exclusion from their scope of services which would not be likely to be traded between Member States (Part B Services). Thus "health and social services; education and vocational education services; recreational, cultural and sporting services; legal services; supporting and auxiliary transport services" are excluded. In those cases public bodies who are the sole buyer, either because the market is local, or because of national buying, can effectively dictate their prices until the supplier leaves the market. The Regulations also do not apply to contracts below certain thresholds (approximately £100,000 in the present context), and thus to goods and services provided free or at low cost, even if they are above the thresholds in terms of their value to the supplier in terms of other business expected.
17. Where they do apply the Regulations should ensure fair pricing because each tenderer is free to set its own price. But there may still be unfair downward pressure on prices, because failure to win the bulk contract may result in the penal result of exclusion altogether of some suppliers from the market, with the incidental

end result of no choice of supplier next time the tenders are sent out. It may also result in a reduction in product choice if, for example, a medical supplier of a more expensive but more complex alternative product which would have been the preferred choice in some, though not the majority of, applications leaves the UK market, perhaps taking other product ranges with it.

18. Of course central purchasing does not necessarily result in any abuse of the dominant position a central purchaser may necessarily have. Such organisations may be keenly aware of their responsibilities not only to their clients in ensuring that a choice of suppliers and products remain available in the longer term, but also to their suppliers. They also have to confront the problem of allocating scarce resources between competing statutory duties. Although responsible procurement officers are keen to foster and encourage diversity in the market, it is difficult to achieve both that and their duty to maximise the cost advantages of central procurement.
19. Under the Restrictive Trade Practices Act 1976 (now repealed) an agreement might be held to be in the public interest if it was "reasonably necessary to negotiate fair terms for the supply of goods to, or the acquisition of goods from, any one person not party thereto who controls a preponderant part of the trade or business.." (Section 10(d): Section 19(d) covered services in similar terms). Let us hope that some suppliers will apply to the Director General when the situation next arises for an individual exemption for cartel selling, on the grounds that the public interest will be damaged by any resulting unfair pricing or reduction of choice in the market place by any permanent exclusion of the unsuccessful tenderers.