

SECOND ANNUAL CONFERENCE ON  
COMPETITION AND REGULATION IN NETWORK INDUSTRIES

20 NOVEMBER 2009

CENTRE FOR EUROPEAN POLICY STUDIES, BRUSSELS, BELGIUM

Draft – Not for quoting

**Implications of EU public procurement law on water service governance:  
The case of Italy<sup>1</sup>**

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*Abstract*

EU public procurement law identifies competitive tendering as the primary instrument for the selection of operators in the water sector. However, the merits of competition for the market are highly contested in the literature and theoretical debate. This paper looks at empirical evidence from Italy and assesses the implications of competitive tendering on “good governance”, with particular reference to efficiency, transparency and accountability. We draw on the policy networks tradition to capture the interdependency of actors’ interests, actors’ resources and applicable rules. Our analytical framework allows us to identify the structural limitations of competitive tendering and the associated regulation by contract. More precisely, we observe the combined effect of resource allocation (in terms of asymmetry of knowledge and power) and the nature of the applicable rules (e.g. ex-ante regulation and long term contracts). This allows for interest-seeking behaviour during both the tendering procedure and the execution of the contract. In turn, opportunistic behaviour undermines the achievement of both governance and reform objectives. Finally, we posit that introducing stronger transparency, accountability and participatory mechanisms would align actors’ interests to intended reform objectives. We put forward the following hypothesis for further empirical testing. The strengthening of governance requires the creation of opportunities for: a) involving civil society in decision making and the monitoring of operations; b) investing in the knowledge of actors participating in decision making and monitoring; c) sanctioning behaviour unaligned with reform objectives through simple and effective rules.

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<sup>1</sup> The authors wish to acknowledge the financial support from the European Commission for the WaterTime project (EVK4-2002-0095, <http://www.watertime.net>). This article is based partly on the work and results of that project. The findings are the responsibility of the authors and should not be construed as representing the views of the European Commission

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*Keywords:*

## **1. Introduction**

This article addresses the impact of EU public procurement law on the governance of water supply and sanitation. It does so by looking at the reform of the institutional framework underlying water service operations in Italy, the reform of which has resulted in protracted conflicts between the European Commission and Italian authorities due to alleged breach of EU competition law. Furthermore, the observation of Italian experience with resort to competitive tendering for the selection of private water and wastewater operators allows for testing the validity of theoretical perspectives informing the introduction of competition at sectoral level.

The technical characteristics of water supply and sanitation delivery affect their organisation and regulation. As a result of technological constraints, water services are regarded as typical natural monopolies. This implies that the prevalent form of competition in the sector consists in the selection of operators via tendering procedures, whereby the successful bidder enters into a long term contract for the exclusive right to provide the service. This is known as Demsetz competition, from the author who first elaborated on it (Demsetz, 1968), or competition for the market, as opposed to competition in the market. Demsetz competition is usually associated with regulation by contract, as the conceding public authorities assume the responsibility for monitoring operational performance in light of contractual targets and standards<sup>1</sup>. A substantial body of literature contends that competition for the market, regulation and elaborate contracts entered into by private operators would mimic efficiency-driving competition in the market (Braadbaart, 2001: 6).

To date no EU directive has liberalised the water sector, contrary to other public services or Services of General Economic Interest. However, the jurisprudence of the European Court of Justice identifies the conditions under which local authorities have the obligation to competitively appoint an operator. Such criteria are inspired by the proposed construction of the EU internal market and, to that effect, *de facto* promote the predominance of competition for the market over other appointment procedures. They result in increasing restrictions for the legal provision of in-house, public water operations.

This article first investigates the effectiveness of Demsetz competition and regulation by contract in achieving good governance in the water sector. In order to do so, we observe the strategic games entered into by different actors around the procedure leading to the competitive award of concessions. Furthermore, we examine interest-seeking practices unfolding during the conduction of operations under regulatory scrutiny. The article then addresses the merits of competition for the market in water supply and sanitation, specifically considering whether this is conducive to good governance.

The case studies selected depict a variety of experiences with the competitive award of contracts. This ranges from bidding for the construction, financing and operation of two major wastewater treatment plants in Milan to the appointment of private water supply and sanitation operators in Arezzo and Latina. Arezzo represents the longest-

running case of private operations since the 1994 reform of the Italian water sector and provides a useful setting for the observation of interaction between actors under regulation by contract. Among the tenders held for the selection of water supply and sanitation operators after the 1994 reform that of Latina has to date attracted the highest number of bidders. This allows us to separately evaluate the effects of the competitiveness of the procedure from other intervening factors. Empirical evidence has been primarily obtained via the EU-funded research project WaterTime<sup>2</sup>, and complemented by data gathered through the PSIRU global database on the effects of public service reform<sup>3</sup> and the database of the Italian Forum of Movements on Water<sup>4</sup>.

In the next section we develop an analytical framework drawing on relevant theoretical perspectives. We then illustrate EU public procurement law as applicable to the water sector in member countries, sectoral reforms introduced in Italy in the last 15 years and the disputes between the European Commission and the Italian government that ensued. Moving from such premises, a fifth section is devoted to presenting the experiences with competitive bidding for the selection of water supply and/or sanitation operators in Milan, Arezzo and Latina. A final section discusses findings and puts forward conclusions, considering both the theoretical and policy implications of our analysis.

## **2. Analytical framework and relevant theoretical perspectives**

Even the most fervent proponents of competition in the water sector acknowledge that competition is not an end in itself and that is rather aimed at enhancing efficiency (WRc and Ecologic, 2002: 36). In this article, we observe the impact of competition for the market, and some of the public-private partnerships (PPPs) that are associated with its introduction, on water service governance. Governance refers to: the process and outcome of institutional reform; the role of public, private and social actors; and their economic, but also political and institutional, social and environmental implications (Green, 2007: 2-9). It thus provides a comprehensive setting against which to judge the results of competition and interpret how this is affected by a variety of factors. In turn, we use policy networks as an analytical framework to gather insights on the roles of different actors, and the formal and informal rules which governance encapsulates. This enables us to address the complexity of institutional reforms such as the competitive appointment of private water operators, overcoming the limitations of static economic models chiefly concerned with price levels as recorded immediately after the award of concessions (Lobina and Hall, 2003; Lobina and Hall, 2007).

### **2.1. Water service governance**

Rogers and Hall (2003: 7) refer to water service governance as the range of political, social, economic and administrative systems that are in place to develop and manage the delivery of water services. Castro (2007: 761) elaborates further on the concept of governance as emerging from mainstream literature. This consists of the interaction between different management regimes: state authority (hierarchy), private management (market competition), and civil society (voluntary participation).

Among the preconditions to good or effective governance in water service provision, Rogers and Hall (2003: 9, 27-29) identify inclusiveness, predictability, accountability,

transparency, participation, equity and ethics, coherence, efficiency, responsiveness and sustainability. These principles provide a framework for the evaluation of governance resulting of the reform of water services, including the selection of operators via competitive bidding.

Green (2007: 2-9) identifies three dimensions of water governance: a) the process and outcome of institutional reform; b) the role of public, private and social actors; and, c) the economic, but also political and institutional, social and environmental implications of the first two dimensions. The preconditions to good governance refer to both the process and outcome of institutional reform. Among those, however, sustainability is the guiding principle informing governance.

The most popular definition of sustainability, provided by the World Commission on Environment and Development in 1987, is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." The needs addressed by development according to the concept of sustainability are multiform and are captured by the acronym PESTE: Political and institutional; Economic; Social; Technical; and, Environmental (ERL-UCM and PSIRU, 2003). PESTE sustainability thus coincides with Green's (2007) third dimension of governance.

Green (2007: 2) observes that mainstream definitions of governance, for example that provided by UNDP (1997), correspond to Aristotle's notion of politics. It is thus possible to redefine governance as decision making in a multi-polar, fragmented society, aimed at enhancing sustainability.

For the purposes of our analysis, the distinction between internal and external water governance is particularly significant. The former refers to the "functions, balances and structures internal to the water sector", including legal agreements governing property rights. The latter extends the concept to embrace the influence of civil society and political actors on the management of water services (Rogers and Hall, 2003: 16-17). In that sense, Hall et al. (2007: 154, 156, 158) emphasise the importance of public participation and transparency in strengthening the democratisation, coherence and responsiveness of decision making on water sector reform.

## 2.2. Theoretical foundations of competition in the water sector

Demsetz (1968) is regarded as the first contribution on competition for the market as a surrogate for competition in the market. This concept relies on the assumption that sufficient ex-ante competition, for example in terms of the number of bidders, would result in enhanced operational efficiency.

In that sense, Cabral (2000: 137) infers from bargaining theory and anecdotal evidence that the higher the number of bidders the lower the probability of collusive behaviour among the participants in a tendering procedure. In addition, Williamson (1976) points to the completeness of contractual specifications as a requirement for successful competition for the market. Operational efficiency would thus be a function of contract design, as the bidder committing to supply the service at the more favourable conditions would be awarded the contract (Baron and Myerson, 1982; Riordan and Sappington, 1987).

Baldwin and Cave (1999: 258) argue that the competitive selection of service operators “provides a means of ... inducing monopolists to behave as if subject to competitive pressures ... It offers an effective sanction for poor performance, namely the threat of (contract) termination, suspension, or non-renewal and it reduces the dangers of regulatory capture by minimising agency discretion”.

On the other hand, Sappington and Stiglitz (1987) suggest that the expected benefits of competition for the market might not realise as firms are adverse to risk and competition for the service concession is limited. Furthermore, there are difficulties in designing contracts and anticipating all possible contingencies, and these constraints imply limits on the liability of producers and limited commitment on the part of government. Goldberg (1976) also elaborates on contract failure as a limitation of franchise bidding. Finally, problems with contract implementation are likely to originate because of difficulties in measuring performance and obstacles derived from complicated hierarchies of control (Sappington and Stiglitz, 1987).

Demsetz' (1968) work found ample resonance among the doctrine interested in the reform of water services and still informs the position of the European Commission on competition in the sector. Rees (1998: 18-20) argues that competition for the market per se will not necessarily result in the enhanced efficiency of what remain monopolistic operators, unless this is accompanied by regulatory scrutiny including regulation by contract. Regulation by contract would serve the twofold purpose of minimising regulatory risk faced by private operators and attracting the highest number of bidders thus enhancing the effectiveness of competition for the market. “Highly specific contract terms, setting out duties, performance targets, water price uprating rules, and dispute arbitration procedures, allow the companies to better predict the profitability of the venture and decide what it is worth paying to win the contract. Such contracts may also be advantageous for governments in that more bidders could be attracted and a better deal struck” (Rees, 1998: 29-30). In summary, regulation and competition would be mutually reinforcing as regulation is supposed to compensate for the limited extent of competition in the sector, while competitive pressures would reduce the required regulatory burden (Rees, 1998: 4).

Similar perspectives on competition, regulation and PPPs in the water sector are embraced by Franceys (2000) and Lorrain (1997c) to cite but a few. They also find echoes in WRC and Ecologic (2002: 53-56), and appear to inform European Commission's position on competition in the water sector illustrated by Gee (2008). As noted by Hall (2003: 3), WRC and Ecologic (2002: 53, 94) acknowledge that “The key test to the successful implementation of competition pressures in these areas is the degree of ‘contestability’ that exists for each contract and the processes that ensure transparency and opportunity and that deal with concerns related to incumbent advantage and possible collusion”. However, they fail to elaborate on the extent to which the identified factors affect the suitability of competition in practice.

Furthermore, Lobina and Hall (2003) show that the success of competitive bidding cannot be judged on the contractual conditions valid at the moment of the award. Concessions are in fact subject to renegotiations which often alter the content of the original agreement. In order to interpret the complex interaction among different stakeholders prior to and after the award of a long term concession, we refer to the policy networks tradition. It is possible to identify two phases, one leading to the award of the contract and the other starting with the inception of operations, on which

depends the effectiveness of Demsetz competition and regulation by contract in the water sector. This can be evaluated in light of the attributes of governance. For example, the predictability of the rules governing the bidding is often emphasised by operators and observers of competition issues. Also, the results of competition and regulation are often assessed in terms of efficiency. Focussed on actors' interests, resources and the underlying rules, policy networks represent a valid framework to support explanations of divergence from expected outcomes of institutional reform.

### 2.3. Policy networks as an analytical framework for the investigation of strategic behaviour

Much literature explores governance through the lens of social and policy networks. Governance is in fact a multi-actor process based on interaction in a context of fragmented interests. Adopting a networks approach to the investigation of governance allows for reconciling and going beyond the apparent dichotomy between agency and structure. In fact, networks do not exist in a vacuum and both their origin and evolution are a result of the interdependence between agency and structure (Lobina et al., 2009).

Klijin and Koppenjan (2006: 144) define networks as “patterns of social relationships between mutually dependent actors”. These relationships are formed around policy problems or policy programmes (Klijin, 1997: 30), thus including the award of a water concession or operating contract and the supervision of operations. Actors strategically interact in pursuit of their own interests and objectives and such interaction is informed by the respectively available resources and the context which shapes the relationships. Resources include powers, status, legitimacy, knowledge and money. In turn, one actor's power is given by the perception other actors have of his or her power (Klijin et al., 1995: 439-441). Context includes rules informing actors' engagement in the network, but also the technology which defines the limits of policy making and decision making (compare De Bruijn and Dicke, 2006: 721 on the interdependency between public values and technical infrastructure). Finally, relations can be characterised as transactional or conflicting. In the first case, actors exchange resources for the achievement of common objectives. In the latter, resources are deployed for the attainment of divergent goals which generate antagonism (Hermans and Timmermans, 2001).

Lobina and Hall's (2003) empirical investigation of post-award dynamic interest-seeking behaviour by private water operators is guided by policy networks. They thus explain the divergence between the expected benefits and the outcome of private sector participation (PSP), irrespective of resort to competition for the market and the content of contractual provisions. Lobina and Hall (2007) adopt policy networks as an analytical framework to illustrate the power games between public and private actors under regulation by contract. In so doing, they observe interaction among stakeholders in terms of principal-agent relationships. For the purposes of our analysis, we use policy networks as an analytical framework to test the cogency of theoretical perspectives on Demsetz competition in the water sector.

First, we refer to the process of network structuring (Klijin et al., 1995: 442) to derive insights on the strategic games which take place around bidding procedures. It is in this phase that local authorities, acting as network managers, decide which actors can access the network by selecting the service provider among the bidders. The strategic

importance of this decision, resulting in long term access to a captive market, might induce strategic behaviour.

Conversely, the concept of game management is instrumental to investigating interactions between regulator and regulated operator during the course of the concession. Games are series of actions occurring between different actors in light of formal and informal rules (Klijn et al., 1995: 439-442). This perspective allows for evaluating the extent to which formal rules such as contractual provisions are adequate to inform the behaviour of operators.

Finally, the impact of EU competition policy on water service governance is observed through the lens of the categories identified by Klijn and Koppenjan (2006: 149-154) to study institutional design. They argue that the strategies for institutional reform can be aimed at affecting network composition, network outcomes and network interactions. For example, network composition can be changed via rules governing access to games. Strategies aimed at network outcomes are represented by modification of evaluation criteria for the judgment of achieved outcomes. Network interactions are affected by rules governing supervisory relationships and conflict, such as adjudication procedures in case of dispute. This approach enables a more accurate analysis of the impact of EU competition policy on water service governance. This analysis can in fact be conducted in view of policy correspondence with the principles of good governance, and in consideration of the alternative strategies available to achieve the intended objectives.

### **3. EU competition law and the water sector**

To date no EU directive has liberalised the water sector, for example by providing for competition in the market or the freedom of operators to offer their services to any customer. This is also unlikely to occur due to the high fixed costs associated with distribution and the high costs of transporting water over long distances, which would contain the economic impact of liberalisation (Gee, 2008: 8, 12).

No European directive disciplines the granting or award to public or private undertakings of the right to operate water services, either in the form of concessions or other special or exclusive rights (WRc and Ecologic, 2002: 15-16). In other words, no directive determines how local authorities should grant or award water services to public operators or private companies.

The Court of Justice of the European Communities (ECJ) has ruled, in the judgment *Commission v. France*, that those contracts excluded from the scope of public procurement directives should nonetheless be subject to the fundamental rules of the Treaty of the European Communities (now renamed Treaty on the Functioning of the European Union, henceforth the Treaty), and particularly the principle of non-discrimination on grounds of nationality<sup>5</sup>. In the *Teleaustria* case, the ECJ clarified that concession contracts falling outside the scope of public procurement directives should nonetheless be granted or awarded in compliance “with the fundamental rules of the treaty, in general, and the principle of non-discrimination on the ground of nationality, in particular”<sup>6</sup>.

Even in the absence of a specific directive, the award of water concessions should thus be subject to the principles enshrined in the rules of the Treaty and to the

principles identified by European case-law. Relevant principles emanating from the Treaty include the principles of equality of treatment, transparency, non-discrimination, mutual recognition and proportionality (WRc and Ecologic, 2002: 15, 67-69). Furthermore, ECJ jurisprudence has identified the conditions under which local authorities have the obligation to competitively appoint a water operator or can choose to grant exclusive rights to a publicly-owned undertaking, also called in-house operator.

### 3.1. Principles governing competitive tendering in the water sector

Issued in April 2000 by the European Commission, the Commission Interpretative Communication on Concessions under Community Law identifies the competitive tendering regime applicable to concessions. It states that concessions are subject to the provisions of the articles of the Treaty concerning right of establishment and freedom to provide services and to the principles emerging from ECJ jurisprudence. These are the principles of non-discrimination, equality of treatment, transparency, mutual recognition and proportionality (WRc and Ecologic, 2002: 15)<sup>7</sup>.

The Interpretative Communication also states that “the Community does not give preference to any particular way of organising property, whether public or private”<sup>8</sup>. In fact, Article 345 (ex Article 295) of the Treaty provides for the Treaties not to “prejudice the rules in Member States governing the system of property ownership”, thus guaranteeing neutrality with regard to whether enterprises are public or private<sup>9</sup>. This implies that, in principle, the provisions of the articles of the Treaty concerning right of establishment and freedom to provide services and to the principles emerging from ECJ jurisprudence equally apply to public and private enterprises.

Referring to the ECJ *Überschär* judgment<sup>10</sup>, the Interpretative Communication identifies the principle of equality of treatment as “one of the fundamental principles of Community law. This principle requires that similar situations shall not be treated differently unless differentiation is objectively justified”<sup>11</sup>. The ECJ *Commerzbank* judgment clarifies that the principle of equality of treatment does not only exclude differentiation on grounds of nationality but also “all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result”<sup>12</sup>.

The Interpretative Communication and much ECJ case law focus on the procedural implications of the principle of equality of treatment for open and competitive bidding. These pertain to ensuring that all potential concessionaires have prior knowledge of the rules governing the tender, that such rules equally apply to all bidders so that they enjoy equal opportunities in formulating their tenders, and that all offers conform to the tender specifications “to guarantee an objective comparison between offers”. Conversely, an awarding entity is prohibited from taking account of changes to the initial offers of one tenderer, as this would obtain an advantage over his competitors (WRc and Ecologic, 2002: 67-68)<sup>13</sup>.

However, the Interpretative Communication also refers to the two ECJ judgments *Raulin*<sup>14</sup> and *Parliament/Commission*<sup>15</sup> to state that ECJ case law “lays down that the principle of equality of treatment requires ... that conditions of access to an economic activity be non-discriminatory”<sup>16</sup>. Such requirement, coupled with the principle of neutrality on enterprise ownership, means that all potential concessionaires, whether



publicly or privately owned, should be granted the ability to compete for the award of a concession on a non-discriminatory basis.

The Interpretative Communication states that the ECJ case law identifies the principle of proportionality as one of the general principles of Community law<sup>17</sup>, binding national authorities in the application of Community law<sup>18</sup> even when these enjoy broad discretion<sup>19</sup>. Pursuant to the principle of proportionality, any measure adopted by a national or public authority “should be both necessary and appropriate in the light of the objectives sought”<sup>20</sup>. The Interpretative Communication refers to ECJ and CFI (Court of First Instance) jurisprudence<sup>21</sup> to assert the principle that, “in choosing the measures to be taken, a Member State must adopt those which cause the least possible disruption to the pursuit of an economic activity”<sup>22</sup>. The requirement for Member States to adopt measures that are necessary and appropriate to achieve the intended objectives translates into a prohibition for national authorities from adopting measures which are excessive and disproportionate to achieve the same objectives<sup>23</sup>.

Finally, the principle of proportionality requires that the pursuit of the financial viability of concessions should not undermine competition. “The duration of the concession must be set so that it does not limit open competition beyond what is required to ensure that the investment is paid off and there is a reasonable return on invested capital, whilst maintaining a risk inherent in exploitation by the concessionaire”<sup>24</sup>.

### 3.2. Local authorities’ obligation to resort to competitive tendering and the conditions for the appointment of in-house operators

Pursuant to ECJ case-law, the granting of a concession without resorting to competitive tendering is admissible only in exceptional circumstances. The ECJ Teckal judgment established that public procurement law shall be in principle applicable in cases where the juridical personality of the awarding authority was distinct from that of the undertaking which was awarded the contract, with one exception. More precisely, it provided that Directives 92/50/EEC and 93/36/EEC did not apply and that the granting of a concession without putting it out to competition was legal under EU law, “only in the case where the local authority exercises over the person concerned a control which is similar to that which it exercises over its own departments and, at the same time, that person carries out the essential part of its activities with the controlling local authority or authorities” (Lobina, 2005: 16)<sup>25</sup>. The exemption from public procurement law for in-house operators is valid even if these have a distinct legal personality from the awarding authority<sup>26</sup>.

The Teckal judgment aimed at safeguarding “the objective of ensuring free and undistorted competition which the Community legislature seeks to achieve through the coordination of procedures for the award of public supply contracts”<sup>27</sup>. In the Carbotermo case, the ECJ reiterated that the two requirements set out in Teckal for the existence of an in-house relationship, and thus for the lawful appointment of a service provider without competitive tendering, “are aimed precisely at preventing distortions of competition”<sup>28</sup>.

The first condition to be satisfied for local authorities to lawfully grant a service concession to an in-house operator concerns the control exercised by the local authority over the grantee. In the Parking Brixen case, the ECJ clarified that, for this

condition to be satisfied, the concession-granting authority had to exercise “decisive influence over both (the concessionaire’s) strategic objectives and significant decisions”<sup>29</sup>. Satisfaction of this condition might imply the full ownership of the in-house operator by the granting authorities. In the *Carbotermo* judgment, the ECJ stated that “The fact that the contracting authority holds, alone or together with other public authorities, all of the share capital in a successful tenderer tends to indicate, without being decisive, that that contracting authority exercises over that company a control similar to that which it exercises over its own departments”<sup>30</sup>.

In the *Stadt Halle* case, the ECJ ruled that a company majority owned by the awarding authorities, and minority owned by a private undertaking, cannot be regarded as an in-house operator. Therefore, such company can only be appointed as concessionaire through competitive tendering, in application of public procurement law<sup>31</sup>. This is justified on the grounds that: a) an in-house relationship is expected to be informed by public interest objectives, not by the pursuit of private interests<sup>32</sup>; and, b) the direct award of a contract to a public-private company would be in breach of the principle of equal treatment as it would give the private company holding a minority share in the grantee an advantage over its competitors<sup>33</sup>.

Furthermore, in *Parking Brixen*, the ECJ ruled that a public authority could not lawfully award a public service concession, without resorting to competitive tendering, to a company limited by shares displaying the following characteristics: a) the company limited by shares resulted from the conversion of a special undertaking of the awarding authority; b) the company’s objects had been extended to “significant new areas”; c) the company’s capital had to be opened in the short term to other owners; d) the geographical area of the company’s activities had been extended to the entire country and abroad; e) the company’s Administrative Board enjoyed “very broad management powers” and independence<sup>34</sup>. The ruling was issued in consideration that: a) the awarding authorities could not exercise over such a company a control similar to that which it exercises over its own departments<sup>35</sup>; and, b) the principle of equal treatment of tenderers, intended as affording equality of opportunity to all tenderers, irrespective of their nationality and even in absence of discrimination on the grounds of nationality, had to be respected<sup>36</sup>.

The second condition required by the *Teckal* judgment for the existence of an in-house relationship is that the contracting party carry out the essential part of its activities with the awarding authority or authorities, which in turn control the contracting party. In *Carbotermo*, the ECJ clarified that an in-house operator had to devote its activities “principally” to the controlling authority and that any other activities had to be “only of marginal significance”<sup>37</sup>. The rationale for such provision is that public procurement law should apply “in the event that an undertaking controlled by one or more authorities is active in the market and therefore likely to be in competition with other undertakings”<sup>38</sup>. It should be noted that national courts are competent to determine whether the essential part of an undertaking’s activities are carried out with the controlling authority or authorities. Such decision has to be made on the basis of factual qualitative and quantitative elements<sup>39</sup>.

In summary, the two conditions set out by the *Teckal* judgment for the existence of an in-house relationship, and the lawful direct award of a concession, aim at ensuring free and undistorted competition and at safeguarding the principle of equal treatment of tenderers.

#### **4. The 1994 reform of the Italian water sector and conflicts with EU competition law**

Italian law governing the water sector has undergone a number of reforms in recent years, first with the adoption of the 1994 Galli Law, requiring the restructuring of water supply and sanitation operations in broader concession areas, generally under a unique operator subject to regulation. The Galli Law did not require the introduction of PSP (private sector participation), but a number of subsequent laws have addressed the organisational form of water service providers, limiting the scope for public operations. Since 1994, legislative developments have facilitated growth in PSP, although publicly-owned water operators remain the large majority. Irrespective of a considerable initial delay in its implementation, the Galli Law is proving a major determinant of change with local authorities taking decisions on how to reform water supply and sanitation services at a pace that at the moment appears to have few equals in Europe.

The so-called Galli Law (l. n. 36/94) aimed at addressing past underinvestment and new investment requirements by introducing entrepreneurial management and reducing the territorial and functional fragmentation of water operations. The Italian water sector has in fact known a long period of underinvestment caused by poor cost recovery. Estimates indicate that aggregate yearly capital investment in water supply and sanitation declined from ITL 4,478bn (€ 2.31bn) in 1985 to ITL 1,049bn (€ 542.8m) in 1995, equal to a 76.57% reduction, due to excessively low tariffs and insufficient cost recovery. Also, it has been estimated that ITL 85,000bn (€ 43.9bn) would be required to upgrade water supply and sanitation services in order to meet the needs of the population and comply with EU legislation. In order to reduce the fragmentation of the sector, the Galli Law required not only the reduction of the number of operators and an increase in their relative size but also the vertical integration of water supply and sanitation operations. As of 1990, the water sector was in fact highly fragmented with over 5,500 independent management bodies responsible for the provision of water supply, 7,000 for sewerage and 2,000 for wastewater treatment.

In order to overcome operational fragmentation and ensure the adequate dimensions of water operators, the Galli Law provided for the identification of 91 Optimal Territorial Basins or ATO (Ambiti Territoriali Ottimali). In each ATO, water supply and sanitation operations would be typically carried out under concessions of up to 30 years, irrespective of whether these were awarded to a private or a public undertaking. Municipalities and provincial governments were to be responsible for the organisation and operation of water supply and sanitation services, according to Italian law as applicable to the selection of operators. In each ATO, local authorities were required to set up a joint body (“Autorità di Ambito” or AATO), responsible for planning and the regulation of water operators on their behalf. The provision of water operations had to be in conformity with the principles of efficiency, effectiveness and cost-effectiveness and, in order to ensure economic viability, the Galli Law required the achievement of full cost recovery through tariffs. Local authorities had to set tariffs in relation to the organisational mode adopted – thus taking into account profitability requirements under different ownership and management arrangements. Average tariffs had also to reflect investment plans, in consideration of real costs and the economies obtained from efficiency improvements and the reduced fragmentation of

operations. Although not explicitly mentioned by the Galli Law, an important motivation underlying its adoption was allowing for the liberalisation of the Italian water sector and for a more prominent role of private operators as a reaction to Italy's enormous public sector deficit. Prior to the enactment of the Galli Law, water undertakings active in the Italian water sector were mostly publicly-owned with private water companies accounting for only 4.9% (Lobina, 2005a).

## **5. National legislation on the ownership and selection of water operators in light of European Commission initiatives**

Before 2001, Italian law had required the provision of public water operations under one or more of the following organisational modes: a) direct municipal management, whereby the service was provided by a department of the municipal authority with no distinction between the municipal budget and the operator's accounts; b) "azienda municipalizzata", a municipal undertaking deprived of juridical personality; c) "azienda speciale", a municipal undertaking enjoying juridical personality and managerial autonomy in light of the general objectives and overall strategy defined by local authorities; d) private concession; e) Public Limited Companies (PLCs) or limited companies majority owned by local authorities.

At the end of 2001, in order to prevent the emergence of conflicts with EU competition law, the Italian Ministry of the Environment adopted a number of initiatives restricting the options for local decision makers and aimed at introducing compulsory competitive tendering for the selection of water operators. Favour for compulsory competitive tendering in the selection of water operators was retained by the 2002 Budget Law adopted in December 2001, which attracted the attention of the EU Commission for alleged breach of EU law. The incriminated article of the 2002 Budget Law was thus substantially amended and, as of December 2004, Italian law provided for water supply and sanitation services to be operated under any of the following types of undertaking: a) a PLC selected through competitive tendering; b) a public-private joint venture whereby the private partner is selected through competitive tendering; c) semi-privatised PLCs listed on the stock exchange; d) a PLC wholly-owned by local authorities, subject to conditions laid out in the Teckal case (Lobina, 2005a).

### **5.1. Integration of the Galli Law and conflict avoidance with the EU Commission: the two circulars and decree issued by the Ministry of the Environment, October and November 2001**

On 17<sup>th</sup> October 2001, the Ministry of the Environment issued a circular on majority publicly-owned companies and the provision of water supply and sanitation services. The October 2001 circular was prompted by the fact that the EU Commission had initiated an infringement procedure against Italy, as the award of a number of operating contracts would have allegedly taken place in breach of EU Competition Law. The October 2001 circular did not elaborate on the specific provisions and principles of EU competition law breached by the actions of Italian local authorities, but argued that Italian law required local authorities to select water operators through competitive tendering "in all cases", so that the in-house provision of water services would be *de facto* made impracticable. The circular also prescribed that public-private joint ventures could only be awarded water operating contracts through competitive tendering. The Ministry of the Environment explained that the adoption of such

recommendation would have the advantage of resulting in the end of the infringement procedure initiated by the EU Commission without the need to modify the existing Italian legislation. Successively, Italian law could have been modified in order to make the requirement for compulsory competitive tendering explicitly binding beyond any doubt of interpretation<sup>40</sup>.

On 22<sup>nd</sup> November 2001, the Ministry of the Environment, after consulting with the national watchdog Supervising Committee, issued a decree regulating how local authorities should award water operating contracts to third parties. Art. 2.1 of the ministerial decree, which was issued nearly 8 years after the enactment of the Galli Law, established that the governing bodies of ATOs were responsible for selecting water operators through open and public tender, whereby the evaluation of bids would be based on the economic value of the offer (“offerta economicamente più vantaggiosa”). A number of undertakings were listed as being entitled to put forward bids in the competitive procedure, including PLCs, limited companies (“società a responsabilità limitata”), cooperatives, consortia of undertakings but not the municipally-owned “aziende speciali”. Also, the decree excluded the possibility of the so-called one-bidder tenders as it required that, in case only one candidate had been allowed to put forward a final bid, there would be no tendering and the contract could not be awarded. As regards the criteria for the selection of the operator, the main ones related to the improvement of the economic and financial plan elaborated by local authorities, in terms of the reduction of operating and capital costs and of their incidence on the average tariff. In the evaluation of the bids submitted, such criteria would have to account no less than the total of the points attributed in the light of the following considerations: a) safeguard of the environment, reduction of environmental impact to the lowest possible level and improvement of safety; b) early achievement or improvement of the standards set in the investment plan elaborated by local authorities and improvement in service quality; c) plan for the reallocation of workers employed under previous operations; d) technical and operational capability of the candidate undertaking and the structure responsible for carrying out operations.

On 22<sup>nd</sup> November 2001, the Ministry of the Environment issued a circular aiming to clarify the rationale for the adoption of the decree issued on that same day as well as the legal requirements the decree was intended to meet. The November 2001 circular explained that the choice of competitive tendering, in the form of an open and public procedure, as the only mechanism to award a water operating contract to a third party was made as this was an agile and rapid instrument ensuring maximum transparency while complying with the requirements and safeguarding the interests of all stakeholders and involved parties. This time, contrary to the October 2001 circular, the Ministry of the Environment referred more explicitly to the EU law provisions and the infringement procedure which had represented a major motivation for identifying compulsory competitive tendering as the preferred solution. More precisely, the November 2001 circular reiterated that the establishment of mixed economy enterprises or public-private joint ventures were in breach of EU Competition Law and referred in that sense to the EU Council Directive 92/50 relating to the coordination of procedures for the award of public service contracts, as amended by Directive 52/97, as well as to no better specified decisions of the European Court of Justice. The circular further explained that since 1999 the EU Commission had initiated infringement procedure n. 2184 against Italy, which had been prompted by complaints against the award of the operating contract for Arezzo’s ATO 4 Alto

Valdarno and which, it seemed, would have addressed other complaints. On 8<sup>th</sup> November 2000, the EU Commission had started another infringement procedure against Italy arguing that the provisions contained in art. 22, l. n. 142/90 and successive modifications were in breach of the said Directive 92/50, as amended by Directive 52/97, and of EU Directive 93/38 coordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors (the so-called Utilities Directive), as well as in breach of the principles of transparency and equal treatment. As noted, the censored Italian provisions identified the organisational modes allowed for the provision of water services in: a) direct municipal management; b) municipally-owned “azienda speciale”; c) PLC or limited company, majority or minority owned by local authorities; d) concession to a third party (Lobina, 2005a).

## 5.2. Legislation integrating the Galli Law: organisational mode pursuant the 2002 Budget Law

Although the Galli Law did not require restructuring to take place through privatisation or PPPs, the Budget Law for the year 2002 (l. n. 448/2001) contained a number of provisions encouraging the adoption of some form of PSP in the provision of water supply and sanitation. First, it provided for operators to be selected exclusively through competitive tendering and called for further legislation to regulate the expiry or anticipated cessation of concessions awarded without competitive tendering. Then, it barred any enterprise which had been granted the right to operate either in Italy or abroad, without taking part in a competitive tendering, from bidding for prospective tenders. In the water sector, local authorities were exceptionally allowed to award concessions to wholly publicly-owned corporations provided they did so within two years from enactment of the Budget Law and that within two years of the concession award an equity stake of at least 40% would be sold to a private operator selected through competitive tendering<sup>41</sup>.

Apart from encouraging the adoption of some sort of PSP, art. 35, l. n. 448/2001 would have drastically restricted the options for the involvement of wholly publicly-owned water operators. In fact, it contained a provision requiring that by 30<sup>th</sup> June 2003 local authorities transformed municipal enterprises known as “aziende speciali” and public consortia into publicly-owned PLCs<sup>42</sup>. The combined effect of legal provisions contained in art. 35, l. n. 448/2001 appeared to be that of limiting public water operations to the case of publicly-owned PLCs which were to succeed in competitive tendering for the award of long term concessions. However, it remained to be seen whether Italian law allowed for the long term existence of wholly publicly-owned water PLCs as is the case, for example, in the Netherlands and Sweden. Art. 115, DL 267/2000 provided that local authorities transforming “aziende speciali” into PLCs could remain the sole owners of the company for no longer than two years from the restructuring<sup>43</sup>. Art. 35, l. n. 448/2001 further discouraged resort to public water operators as it forbid any favourable treatment among providers of public services, *de facto* requiring that private and public operators were subject to the same discipline. For example, no public or private water operator would have been entitled to receive a more favourable treatment from the fiscal point of view or in terms of financial contributions and subsidies<sup>44</sup>.

Finally, it should be noted that art. 35, l. n. 448/2001 introduced an incentive for local authorities to merge water operations at ATO level, as required by the Galli Law. In

fact, art. 35.2 called for the adoption of a regulation to define the terms of expiry or anticipated cessation of concessions awarded without competitive tender, provided these terms were no less than 3 years and no more than 5 years. Art. 35.3 provided for the extension of the transitional period depending on a number of circumstances. The transitional period could have been extended for no less than one year in case the operator, through one or more mergers, at least doubled the customer base served by the major of the merged undertakings. The transitional period could have been extended for no less than two years in case the operator, through one or more mergers, was active across the whole territory of the respective ATO. The transitional period could have been extended for no less than one year in case the operator selected a minor private partner holding an equity stake of at least 40% and an additional year in case the private partner held an equity stake of at least 51%. It should be noted that art. 35.4 allowed for a longer extension of the transitional period in case more than one of the above conditions was met. For example, if a number of mergers enabled the operator to double its original customer base and become active across the whole ATO at the same time, the transitional period could have been extended for no less than 3 years (and no less than 4 years in case the same operator had also selected a private partner holding a 40% equity stake)<sup>45</sup> (Lobina, 2005a).

### 5.3. Alleged conflicts between the 2002 Budget Law and EU legislation

Art. 35, l. n. 448/2001 has led to a considerable amount of controversy, both at EU and national level, resulting in the implementation of its provisions being frozen first and substantially amended by legislation introduced in November 2003. The infringement procedure initiated by the EU Commission against Italy, which was referred to in the 17<sup>th</sup> October 2001 circular issued by the Ministry of the Environment (see section 3.1 *Integration of the Galli Law and conflict avoidance with the EU Commission: the two circulars and decree issued by the Ministry of the Environment, October and November 2001* above) was in fact transfused into an infringement procedure prompted by the enactment of art. 35, l. n. 448/2001<sup>46</sup>.

On 26<sup>th</sup> June 2002, the EU Commission wrote a letter to the Italian government - letter n. 1999/2184 C(2002)2329 - opening the preliminary phase of an infringement procedure in the light of alleged conflicts between a number of provisions contained in art. 35, l. n. 448/2001 and EC law (Belfiori, 2002). The Commission (the letter was signed by Commissioner Frits Bolkestein) argued that art. 35.2, 35.3 and 35.4 – related to the transitional period enjoyed by operators previously selected without undergoing competitive tendering – were in conflict with Directive 92/50/EEC relating to the coordination of procedures for the award of public service contracts, with Directive 93/38/EEC coordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors, as well as in conflict with Articles 43 and 49 of the Treaty establishing the European Community, respectively on the right of establishment and on services. More precisely, the Commission censured the excessive duration of the envisaged transitional period.

The Commission also argued that art. 35.5 – exceptionally entitling local authorities to award water concessions to wholly publicly-owned corporations based in the respective ATO, provided that within two years of the concession award an equity stake of at least 40% should be sold to a private operator selected through competitive tendering - was in conflict with EU law principles on the concession of services. The

Commission pointed out that, according to the case-law of the Court of Justice of the European Communities (ECJ), the award of concessions without public and competitive tendering was only admissible in exceptional circumstances but not in the cases contemplated by art. 35, l. n. 448/2001. More precisely, the Commission referred to the ECJ ruling known as the “Teckal” case (ECJ C-107/98, 18th November 1998) as establishing the principle that EU competition shall be applicable in cases where the juridical personality of the awarding authority was distinct from that of the undertaking which was to run the service. ECJ C-107/98 provided that Directives 92/50/EEC and 93/36/EEC did not apply and that the award of a concession without public and competitive tendering was legal under EU law, “only in the case where the local authority exercises over the person concerned a control which is similar to that which it exercises over its own departments and, at the same time, that person carries out the essential part of its activities with the controlling local authority or authorities”<sup>47</sup>.

The Commission specifically referred to a number of cases as examples of water concessions awarded against EU competition law, including the award to Acea Ato 2 SpA (covering ATO 2 Lazio Centrale-Roma), Publiacqua SpA (covering ATO 3 Toscana del Medio Valdarno) and Acque SpA (covering ATO 2 Toscana del Basso Valdarno). The last two companies had been initially set up by locally authorities as wholly publicly-owned PLCs and directly awarded long term operating contracts without facing competition. After the awards, both had proceeded to select private operators as minority shareholders and thus were transformed in public-private joint ventures (Lobina, 2005a).

#### 5.4. Legislation integrating the Galli Law in response to the EU Commission: art. 14, D.L. n. 269/2003

On 19<sup>th</sup> November 2003, the lower house of the Italian Parliament approved a decree containing urgent provisions for the improvement and the correction of the public budget, which partially amended previous legislation integrating the Galli Law. Even so, the legislative framework was not definite yet, as further provisions were expected to be introduced by the upcoming 2004 Budget Law. Nonetheless, art. 14, D.L. n. 269/2003 appeared to contribute to the clarity of the legal framework governing water supply and sanitation, in that it amended rules introduced with the 2002 Budget Law as a response to the reprimand of the EU Commission and an attempt to thoroughly integrate EU law into Italian legislation, especially in the light of the jurisprudence of the European Court of Justice (ECJ)<sup>48</sup>. Art. 14 of the November 2003 decree did so first by abolishing the transition period allowed to undertakings which had been awarded a concession non-competitively, whose duration the EU Commission had been judged as excessive; then, by clarifying rules on the ownership and control of undertakings allowed to operate water services. For example, art. 14 appeared to redefine the scope for public water operations, eliminating some of the restrictions and conditions introduced by the 2002 Budget Law and offering local decision makers a clearer set of alternative organisational forms for the provision of water services.

Integrated by art. 14, D.L. n. 269/2003, the new legislation stipulated that, subject to compliance with Italian sectoral legislation and EU law, water supply and sanitation services may be operated by undertakings established under three alternative organisational forms:



- a) a company selected through competitive tendering;
- b) a public-private joint venture whereby the private partner is selected through competitive tendering, pursuant to Italian and EU competition law as defined by guidelines issued by the competent authorities through specific measures or administrative instruments;
- c) a company wholly-owned by local authorities, provided that the local authority or authorities owning the capital “exercise over the undertaking concerned a control which is similar to that which they exercise over their own departments and, at the same time, that undertaking carries out the essential part of its activities with the controlling local authority or authorities” (author’s translation)<sup>49</sup>. It should be noted that this part of art. 14 was phrased after the wording of the “Teckal” case (cit. par. 50).

In other words, the selection of a PLC wholly-owned by local authorities without competitive tendering was subjected to the fact that the local authorities owning the whole of the undertaking’s capital not only controlled it through a number of procedures but also that the undertaking carried out the most important part of its activity – that is to say, the operation of local public services - in the territory governed by the controlling local authorities (Barbiero, 2003). Provisions specifically allowing for the possibility of legally granting water operations to 100% publicly-owned companies represented a major innovation in respect of the content of the 2002 Budget Law and aimed at adopting principles of EU law as elaborated by ECJ jurisprudence on the provision of services in-house, with particular reference to the “Teckal” case. Other relevant rulings include ECJ C-108\98 (9th September 1999), ECJ C-176\98 (2<sup>nd</sup> December 1999), ECJ C-324\98 (7<sup>th</sup> December 2000), ECJ C-94\99 (7<sup>th</sup> December 2000)<sup>50</sup>. On the other hand, art. 14, D.L. n. 269/2003 like the 2002 Budget Law appeared to exclude other organisational forms under public ownership and management apart from the publicly-owned and controlled company (Barbiero, 2003)<sup>51</sup>. In other words, the traditional municipal enterprises such as those established in the form of “azienda speciale” would not survive the reform. Art. 35, l. n. 448/2001 explicitly required that any “azienda speciale” or publicly-owned consortia be transformed into a company, for example a PLC, by 31<sup>st</sup> December 2002<sup>52</sup>. Art. 14, D.L. n. 269/2003 confirmed that provision and established that all concessions awarded without competitive procedures would expire by no later than 31<sup>st</sup> December 2006, but that this did not apply to public-private joint ventures, whereby the private partner had been selected through competitive tendering, nor to publicly-owned and controlled companies. At the expiry of the December 2006 deadline, local authorities would be left to choose the new organisational mode among the three forms described above<sup>53</sup>, whereby the publicly-owned and controlled company represented the only form of public provision. According to Barbiero (2003), such a publicly-owned and controlled company was to be assimilated to entities governed by public law. Belfiori (2003) explained the rationale for the exclusion of publicly-owned companies from EU competition law in the fact that, although the formal corporate structure of the PLC originated from commercial law, this was *de facto* used to convey public sector interests through public ownership of the PLC and the control exerted by local authorities.

Although art. 14, D.L. n. 269/2003 did not specify the type of ownership of the companies allowed to participate in the competitive tender for the selection of

operators (private, public-private or public), it did confirm the exclusion from the bidding procedure of any undertaking which had been awarded a concession non-competitively. It also remained to be seen whether the validation of public-private joint ventures, whereby the private partner was chosen through competitive tendering, would meet the objections raised by the EU Commission in its letter n. 1999/2184 C(2002)2329. In fact, public-private partnerships were not covered by the Teckal case which the Commission saw as the only possible justification for allowing exceptions to the general rule of concessions having to be awarded through competitive tendering. Quite importantly, art. 14, D.L. n. 269/2003 reaffirmed that no public or private water operator would be entitled to receive a more favourable treatment from the fiscal point of view or in terms of financial contributions and subsidies.

Art. 14, D.L. n. 269/2003 amended provisions of the 2002 Budget Law encouraging the concentration of operations at ATO level by reducing the allegedly excessive duration of the transition period, but retained the same objective. More precisely, it established that the above December 2006 deadline for the cessation of all concessions awarded non-competitively could be postponed subject to a prior ad hoc agreement with the EU Commission. Local authorities could extend the transitional period for no more than 1 year in case that, by 31<sup>st</sup> December 2005, a new undertaking had been created through one or more mergers, whereby the new company served at least twice the original customer base of the major of the merging operators. Local authorities could extend the transitional period for no more than 2 years in case that, by 31<sup>st</sup> December 2005, the undertaking operating the concession to be terminated had managed to extend its operations to the entire ATO, even through one or more mergers (Lobina, 2005a).

#### 5.5. Legislation integrating the Galli Law in response to the EU Commission: art. 4.234, Budget Law 2004 (L. n. 350/2003)

On 24<sup>th</sup> December 2004, the Italian Parliament adopted the 2004 Budget Law (l. n. 350/2003)<sup>54</sup>, whose art. 4.234 contained a number of provisions integrating art. 14, D.L. n. 269/2003 approved less than one and a half months before. Among such provisions, two types of concessions obtained without competition were made exempt from cessation by 31<sup>st</sup> December 2006. The first type included concessions awarded before 1<sup>st</sup> October 2003 to companies listed on the stock exchange and/or their subsidiaries, provided those were the exclusive concessionaires. The second type was constituted of concessions awarded to companies which were initially entirely owned by public authorities and that, before 1<sup>st</sup> October 2003, had placed equity stakes on the market through open and public procedures. In both cases, the concessions would not last longer than the average duration of water concessions awarded through competitive tender unless that period was extended, on a case by case basis, in order to allow for the full depreciation of specific investments made by the operator.

Furthermore, art. 4.234 provided that the exclusion from competitive tendering of international and Italian companies which had obtained concessions without facing competition in Italy or abroad would apply starting from 1<sup>st</sup> January 2007. However, there would be an exception in case a company was participating for the first time in bidding procedure for services in a given sector. The government was required to issue secondary legislation (“regolamento”) defining the conditions for allowing foreign companies to participate in tenders, provided that the reciprocity principle was respected and that the timing for the opening of the relative markets was guaranteed.

The same statutory instrument would also set the discipline for the participation of Italian companies that had obtained concessions abroad without going through open and public procedures<sup>55</sup>.

In May 2004, the Italian government expected the infringement procedure initiated by the EU Commission to be closed soon, as the new legislative provisions had been agreed word by word with the EU Commission itself. This was done in order to ensure that Italian law on the appointment of water operators addressed the Commission's concerns and complied with EU Competition Law<sup>56</sup> (Lobina, 2005a).

## **6. Experiences with implementation of water sector reform in three Italian cities**

### **6.1. Public-private concession in Arezzo**

As of 1990, water supply, sewerage and wastewater treatment services in the commune of Arezzo were provided by municipal departments, under direct municipal management. The prospect of the adoption of the Galli Law prompted local authorities to prepare for sectoral reform and a decision was made in 1992 to award the operation of water supply, sewerage and wastewater treatment services to the publicly-owned gas supplier Coingas, which would previously be transformed into a "azienda speciale". Arezzo mayor Valdo Vannucci could not implement the decision as his mandate terminated in 1995 and new mayor Paolo Ricci opted in favour of the award of water services to a public-private single purpose company, rather than to a wholly municipally-owned multi-utility. Mr. Ricci argued that the latter solution would have not ensured financial transparency as cross-subsidisation could have taken place between gas and water operations<sup>57</sup>. The only way to have full financial transparency was, according to Mr. Ricci, to award a water supply and sanitation concession to an operator selected by competitive tendering. A public-private joint venture would have ensured the private operator's contribution in terms of expertise and ability to tap investment finance as well as local control and attention for public interest considerations<sup>58</sup>. The debate on the merits of the two options was limited to the political domain and no comparative evaluation of business plans elaborated under the two hypotheses was carried out.

In 1999, water supply and sanitation operations in the Arezzo area (ATO 4 "Alto Valdarno") were semi-privatised as a 25-year concession was awarded to a public-private joint venture managed by a Suez-led consortium. The decision to appoint a public-private PLC was justified by local authorities as it would allow for benefiting from the private operator's experience in terms of entrepreneurial management and its ability to provide considerable financial resources to fund projected investments. However, such decision was also motivated by fiscal gains the Arezzo municipal government and other local authorities expected as a result of handing operations over to public-private PLC Nuove Acque. According to local consumer organisation FederConsumatori, the municipality of Arezzo obtained substantial fiscal gains from the transfer of water operations from its departments to the public-private concessionaire, which have been used to relieve the municipal budget. This is the longest standing case of implementation of water sector reform pursuant to the Galli Law and has proven highly controversial. Issues emerging from the case of Arezzo include restricted competition, poor performance in achieving the intended objectives of the reform, high level of conflict between local authorities and the private operator,

the questionable dynamics of water pricing and investments under PSP, and concerns for regulatory capture (Lobina, 2005b).

#### 6.1.1 Competition-related issues

The call for tenders required candidate companies to meet criteria so demanding that only three companies, two of which were the world leading water multinationals (MNCs), did put forward bids. Apart from Suez and Vivendi (now called Veolia Environnement), the other bidder was Rome's Acea. Although it had been providing water supply and sanitation services to a population of some 3 million people in Rome (almost 10 times that of the Arezzo concession area) for 15 years, Acea barely met the requirements set by local authorities to participate in the tender. More precisely, restricted competition was the result of, among other factors, the prominence of operating experience as a criterion, not only in the admission of candidates to the tender, but also in the evaluation of bids put forward.

On 14<sup>th</sup> January 1999, the evaluation commission ruled that the Suez-led consortium had won the bidding procedure with a total of 83 points, compared to 59 points attributed to Vivendi and 43 to Acea<sup>59</sup>. Suez obtained more points than its two competitors in each of the broad areas of evaluation: a) 41 of the available 45 points for the acquired experience<sup>60</sup>; b) 26 of the available 35 points for proposed improvements to the investment plan<sup>61</sup>; c) 12 of the 15 points available for project finance<sup>62</sup>; d) 4 of the 5 points available for the payment of equity shares<sup>63</sup>.

It should be noted that Suez projected tariff levels higher than both competitors as well as the tariff based on the provisional PdA. However, the evaluation commission decided unanimously to disregard tariff levels projected by bidders, as these were based on different managerial and accounting hypotheses. When compared on a like-for-like basis, tariff levels under the three bids showed little difference and the evaluation commission appreciated that the causes of disparity between projected tariffs could have been easily eliminated during negotiations prior to the concession award<sup>64</sup>. In terms of rational decision making, such decision appears questionable as the effects of different approaches informing the three bids were taken into account in any other aspect of the evaluation. Furthermore, the commission adjusted the technical evaluation of bids by taking into account the effect of a political decision, that to renegotiate tariff levels prior to the concession award, which rested exclusively on the "Autorità d'Ambito" and which the commission itself could not control<sup>65</sup>. In fact, no revision of tariffs took place prior to the concession award and the business plan put forward by the Suez-led consortium was accepted without changes<sup>66</sup>.

It should also be noted that Suez projected operating costs higher than Vivendi by ITL 112 billion, higher than Acea by ITL 83 billion and higher than the amount set in the provisional PdA by ITL 96 billion. The commission commented that the higher operating costs projected by Suez were justified by the necessity to spend to achieve efficiency. More precisely, in order to achieve efficiency savings in the cost of the workforce, in electricity and sludge disposal, Suez would have sustained higher costs in terms of consultancy and technical assistance. Suez projected savings of ITL 31 billion in light of reduced personnel costs, although the progression of remuneration formulated in the Suez bid (+3% annually on the costs projected by the provisional PdA) would result in an increase of ITL 70 billion in the cost of the workforce<sup>67</sup>.

Interestingly, Suez formulated the hypothesis that it would perceive dividends for the first 14 years of operations, so that all profits could be reinvested in the system reducing the necessity to resort to external finance and allowing the public-private water company to reduce its indebtedness. In the remaining part of the concession, dividends projected would compensate shareholders for dividends foregone during the first 14 years. On the other hand, Vivendi and Acea projected dividends in the first 14 years of operations totalling respectively ITL 87.4 billion and ITL 41.4 billion<sup>68</sup>.

As regards the evaluation of the arrangements for project finance, Suez prevailed as it had indicated a more favourable interest rate but also as it accompanied its bid with a binding agreement from supporting banks to provide at least a part of the required amount. Conversely, Vivendi and Acea only submitted generic declarations on the banks' intentions to finance the project (Lobina, 2005b)<sup>69</sup>.

#### 6.1.2 Experience with private operations following the competitive award of the concession

The concession agreement requested the operator to constantly improve efficiency by reducing operating costs as a result of projected investments and provided for investments totalling over ITL 365.5 billion across the lifetime of the concession, with more than 75% of all investments concentrated in the first 12 years. The public-private concessionaire had a contractual obligation to start project financing in March 2000, tapping a total of ITL 70 billion in order to fund investments to be realised in the first six years of the concession. Not only has the private operator failed to tap project finance by the agreed date and subsequent extensions, but the expected efficiency has also failed to materialise as considerable losses were recorded in the first operating years.

Conflicts between local authorities and the private operator have arisen as the local regulator moved to sanction alleged inefficiencies in the conduction of semi-privatised water operations, after probing the costs and effectiveness of technical assistance (known as "prestazioni accessorie") purchased from the private shareholders and specifically Suez. Although local authorities owned 54% of the public-private joint venture, the latter forcefully reacted by taking a number of tactical initiatives against the very same local authorities, including blocking local authorities' decisions by resorting to the administrative justice and suspending payment of concession fees, which put communes under considerable pressure from the fiscal point of view as the foregone payments were undermining the ability of the municipalities to respect the stability pact. Also, the municipalities renounced exerting regulatory pressure due to the perceived threat of having to pay multi-million compensation in front of an arbitral tribunal. As a result, at the end of 2003 the municipal governments agreed to renegotiate the terms of the concession in favour of the private operator. While projected volumetric tariffs were maintained at stable levels, fix charges for access to the services were substantially increased and part of the investment programme was postponed.

According to the local citizen organisation Forum Sociale Arezzo, total investments projected by the 2003 business plan were some €9.2 million less than what projected by the 2000 business plan in nominal terms, although the difference in real terms amounted to some €17.9 million. Also, the aggregate value of the controversial "prestazioni accessorie" to be purchased from the private operator decreased by a

mere €0.8 million while total revenues from the fix charge for access to the service were projected at €52.1 million. Furthermore, the overall result of the renegotiation completed in December 2003 was that Nuove Acque would gain a total €115.02 million in respect of what projected by the 2000 business plan, while taxpayers and consumers would only gain a total €0.84 million. The net gain for the public-private concessionaire would thus amount to €114.18 million (Lobina, 2005b).

## 6.2. Wastewater BOTs and in-house restructuring of water supply and sewerage operations in Milan

The reform of water supply and sanitation services in the city of Milan has followed two different sets of developments. Until recently, virtually all of Milan's sewage was discharged untreated into water courses due to the lack of adequate wastewater treatment plants. PSP in the wastewater sector has been introduced through the award of three wastewater treatment contracts, including two major BOT-style contracts and a minor construction contract, which have proved highly controversial in many respects. Protracted delays have led to condemnation of the city on grounds of breach of EU Law, with other issues including allegations of excessive costs, corruption and restricted competition. It should be noted that French MNCs have resorted to a number of tactics and eventually succeeded in dominating the local market. By contrast, PSP in water supply and sewerage has not been introduced yet and, despite initial plans to part-privatise the operations which were carried out under direct municipal management, a short term concession has been awarded to a municipally-owned PLC and recently been extended.

### 6.2.1 The limits of competition in wastewater treatment

In July 1998, Milan deputy prosecutors turned down a 103 pages long dossier, submitted by former Milan vice-mayor Giorgio Malagoli and a number of Milan city councillors, without bringing charges. The dossier denounced the anti-competitive practices of a number of Italian and foreign companies in relation to the award of the wastewater BOTs in Milan. More precisely, the dossier exposed a December 1988 accord between 6 companies including EMIT (the former Acqua of the Pisante brothers, which owned 100% of SIBA until 1999 when Veolia's subsidiary OTV acquired 50% of its capital), and Suez Degrémont, aiming at rigging the award of works contracts related to Milan's wastewater treatment system. In case a wastewater treatment plant had been awarded to any of the parties to the accord, titled "Progetto Milano", works contracts would be distributed to all the signatories according to a predetermined percentage of total value: EMIT would be entitled to 16.70%, Degremont would be also entitled to 16.70%, and so on. The judges decided not to proceed arguing that no corruption had taken place, although Mr. Malagoli had requested magistrate to investigate on the possibility of other crimes having been committed<sup>70</sup>. However, this suggests that private companies might have incentives at rigging competition in pursuit of commercial considerations.

In July 2001, Milan court magistrates convicted Alain Maetz, a senior manager in Veolia's water division, and local politicians for bribery in connection with the award of the tender for the construction and operation of the Milan South wastewater treatment plant. Former president of Milan city council Massimo De Carolis and Mr. Maetz received prison sentences. In May 2003 the appeal sentence confirmed corruption charges against both Mr. De Carolis and Mr. Maetz. In August 2000, the

contract for the construction and management of the Milan South plant was awarded to a consortium led by small Spanish MNC Pridesa (now owned by RWE/Thames), but Suez Degrémont appealed to the administrative justice and succeeded in having the award annulled more than one year after works had started. The Milan South contract was effectively awarded to Degrémont in late 2001 without holding a new competitive tendering, nor a competitive assessment of Pridesa's and Degremont's bids. The threat of the EU-imposed multi-million penalty apparently was a major factor in the local decision to expeditiously award the contract. However, this led to a surge in the total costs of the construction and management of the plant as Degrémont had projected higher construction costs than Pridesa. As a result, the Milan South BOT is now more expensive than the Nosedo BOT although the former is smaller (1,050,000 population equivalent vs. 1,250,000 population equivalent) and is going to be managed by the private operator for a shorter period (5 years vs. 12 and a half years).

Conversely, the Nosedo BOT was awarded in March 2001 to a private consortium led by Veolia subsidiary Siba and including Suez Degrémont and Veolia's OTV. Works have been carried out by Siba, which is 50% owned by Veolia with the remaining 50% held by Italian company Emit. The municipality of Milan will directly contribute 45% of total costs (equal to some €60.66 million), by tapping into an ad hoc fund constituted by water bills paid by consumers since 1997, while the remaining 55% (corresponding to €74.14 million) is to be tapped by the private consortium in the form of project finance. Interestingly, the opposition had criticised the scheme for its soaring costs overtime and for the fact that the starting offer for the procurement auction had been fixed at 5/4 of the starting offer for the auction held for the smaller Milan South plant, instead of being set at 5/4 of Pridesa's successful bid. It should also be noted that Siba's mother company Emit had won the tender for the Nosedo BOT in 1984, before OTV acquired 50% of Siba. Following that, Emit's management was investigated on alleged irregularities in the award and the scheme was suspended for 4 years pending an environmental impact assessment. Emit then resorted to arbitration seeking damages for the delays suffered and in 1998 the two parties settled the dispute by agreeing that the city council would pay ITL 3billion damages to Emit. Also, the municipality of Milan would have contributed 45% of project costs, thus reducing the amount of project finance to be tapped by the private operator. Finally, construction of the minor Peschiera Borromeo wastewater treatment plant has been lately awarded to a joint venture between Veolia Siba and Suez Degrémont. It is worth noting that the conviction of Veolia's senior manager Alain Maetz on grounds of corruption has apparently not affected the MNC's ability to bid for wastewater contracts in Milan.

Although the "Progetto Milano" accord appeared to be confined exclusively to works contracts, the behaviour of the two major multinationals in the sector (Suez through Degrémont and Veolia through OTV and SIBA) has resulted in restricted competition in the award of the three contracts for the Milan wastewater treatment plants. In fact, the SIBA-led consortium awarded the BOT for Nosedo also includes Degrémont while the construction of the Peschiera Borromeo plant has been awarded to a joint venture between SIBA and Degrémont.

Furthermore, the conviction of Veolia's senior manager Alain Maetz on grounds of corruption has apparently not affected the multinational's ability to bid for wastewater

contracts in Milan. It should be noted that the court ruling on the corruption case was rendered in July 2001, but the scandal broke out in March 2000 as it emerged that the Italian police had obtained hard evidence of Maetz's plans to bribe local politicians in the majority and opposition parties.

In relation to the bidding procedure for the Milan South plant, OTV, which had submitted a higher bid than Pridesa and Degrémont, was excluded for failure to comply with formal requirements in the presentation of the economic offer. The contract was awarded in August 2000. As regards the bidding procedure for the Peschiera Borromeo plant, the conviction of Alain Maetz did not prevent Veolia from bidding through its subsidiary SIBA (Lobina and Paccagnan, 2005).

### 6.2.2 In-house operations in water supply and sewerage

Following the adoption of the Galli Law, the restructuring of operations has been considered a number of times until the award of a short term concession to wholly municipally-owned PLC Metropolitana Milanese (MM) in 2003. The performance of water operations under direct municipal management had been satisfactory, as suggested by the relatively low level of UFW at less than 10%. However, considerable resources were diverted to the municipal budget to fund expenditure in other services rather than reinvestment into the water system, so that the ensuing under-spending affected not only infrastructure maintenance but also human resources development with the employment of new personnel being blocked despite the need for highly skilled technicians.

In March 1997, the administration of Milan mayor Marco Formentini approved a resolution to form a municipally-owned “Azienda Speciale” which would be responsible for operating water supply and sanitation services under a concession. That would have allowed for the introduction of financial transparency by separating the water service book-keeping from the municipal budget and addressing the issue of under-investment. Nonetheless, the decision could not be implemented as the Formentini administration did not have enough time prior to the 1997 municipal elections which saw the victory of Gabriele Albertini. The new mayor decided to reverse the decision of the prior administration and in October 1999 the city council adopted a decision to abolish the municipal department which had operated water supply and sewerage since the late XIX century, and to transfer operations to a PLC majority owned by the city council, after the latter had been set up. The PLC, which was to be named SOGEA, would be 99% owned by the city council and 1% owned by the partly municipally-owned electric utility AEM Milan. SOGEA was expected to start operations at the end of 2001 and, apparently, the city administration intended to proceed with its privatisation. However, before SOGEA was set up, the Italian Parliament approved l. n. 448/2001 in December 2001 (the 2002 Budget Law) whose art. 35 imposed *de facto* the selection of water operators exclusively through competitive tendering, with the only exception being represented by the direct award of a concession to a wholly publicly-owned company provided that within two years of the concession award an equity stake of at least 40% was sold to a private operator selected through competitive tendering.

As a reaction to the adoption of art. 35, l. n. 448/2001, in June 2003 a water supply and sewerage concession of between 2 to 5 years was awarded to Metropolitana Milanese (MM), a publicly-owned engineering and construction company operating



the underground service in Milan. The direct award of the short-term concession to MM was motivated by: a) the municipal government's willingness to avoid competitive tendering pursuant to the national 2002 budget law, as it was feared that one of the French MNCs would have won the tender; b) the municipal government's willingness to take advantage of MM's experience and technical know-how, its potential and to enhance MM's valorisation, as its core activity was stagnating. Although MM appeared fully equipped to address the weaknesses observed under direct municipal management, in terms of limited technical capacity and due to a bureaucratic rather than flexible management style, the mayor was considering whether to list MM on the stock exchange or to sell around 40% of its capital to a private partner (Lobina and Paccagnan, 2005).

The proposed privatisation was functional to increasing the value of Milan's energy company AEM, which the municipal administration wanted to acquire MM, in view of its merger with Brescia's multi-utility ASM. In other words, the deal would not aim at enhancing MM's efficiency. In August 2007, with the merger between AEM and ASM already completed and public water supply and sewerage operations showing positive results, the hypothesis of privatising MM was abandoned and a 20-year water supply and sewerage concession was about to be awarded to MM. In its 5 years of operations, MM had systematically reinvested all profits into the system, totalling € 31 million investments in water supply only over 3 and a half years, while keeping tariffs at €0.46 per cubic metre since 2001. Efforts for reducing the already low levels of UFW were constant and MM spent €2 million per year on interventions. In 2006, out of revenues of nearly €110 million, it paid a €22.87 million fee to the municipal government for the use of the infrastructure (Martinelli, 2007).

## **7. Discussion of findings**

This paper addresses the merits of competition for the market as a regulatory instrument in water supply and sanitation. It does so in light of the overarching function EU public procurement law and Italian national legislation reserve to competitive tendering for the selection of water service operators.

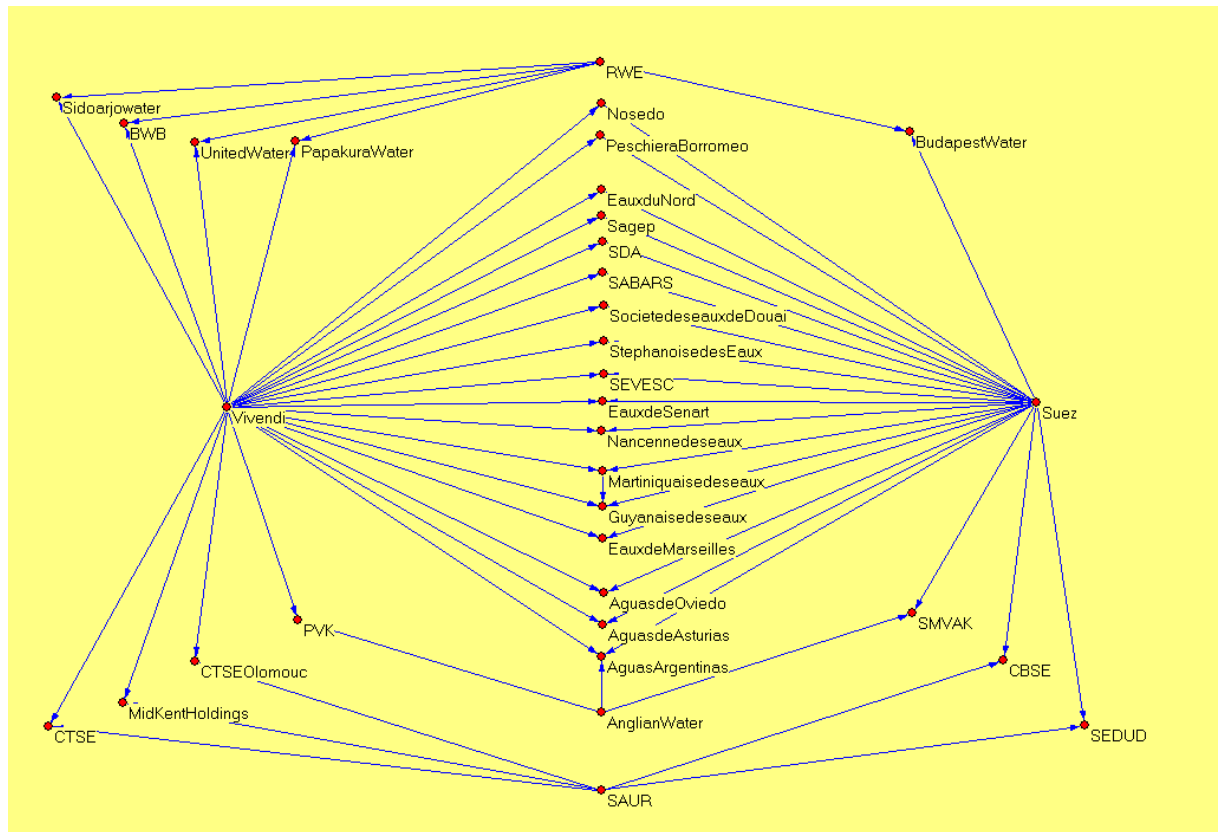
### **7.1. Competitiveness of the bidding procedure**

The cases of Arezzo and Milan suggest that Demsetz competition is a limited tool to regulate a natural monopoly such as water supply and sanitation services. More precisely, the case of the Milan wastewater BOTs shows how tendering procedures might be affected by collusion among bidders and bribery of public official by private executives (respectively, private-private and private-public corruption according to the taxonomy used by the Water Integrity Network). The case of Arezzo shows that the rules governing competitive tendering might be defined as to *de facto* restrict competition, while the behaviour of Acea and Suez in their joint bids for a number of contracts in Tuscany illustrates that the water market is characterised by high barriers to entry and that alliances and cooperation among a limited number of major players/competitors might result in lowering contestability.

Following the competitive tendering for the Arezzo concession, in which Suez prevailed over Vivendi and Acea, and Suez' failed attempt to annul the decision to uncompetitively appoint ACEA as operator in Rome, the two companies found it expedient to forge an alliance. This led to the two companies putting forward a

number of joint bids, and successfully so in Siena/Grosseto, Pisa and Florence, thus acquiring a dominant position in Tuscany. At the same time, Suez owns nearly 10% of Acea which is the largest Italian private operator. Such dynamics have made the object of scrutiny by the Italian antitrust authority and a decision on the validity of the joint Acea and Suez bid in Florence is expected by end November 2007.

Figure. Joint ventures between leading water multinationals, 2002



In this respect, Lobina and Hall (2003: 6) note that “In France, where they control 85% of private water operations, Suez and Vivendi have created joint subsidiaries in a number of towns and regions, with the effect of restricting competition in the French private water market. In July 2002, the French competition council (“Conseil de la concurrence”) ruled that Suez (Lyonnaise des Eaux - SLDE) and Vivendi (Générale des Eaux - CGE) had been abusing their market dominance in France: a report by the Competition Council listed 12 joint ventures in France, including cities such as Marseille and Lille – two of these joint ventures also involved SAUR, the third largest water company. The Competition Council recommended that the Ministry of Economy act to force CGE and SLDE to remedy the situation by dismantling their joint ventures (Conseil de la Concurrence, 2002)”. As shown by the above figure, this forming of joint ventures is not restricted to France and Italy and it has contributed to restricting competition in the global water market (Lobina and Hall, 2003: 5-6, 42).

## 7.2. Regulation by contract, contract execution and efficiency

The Latina bidding procedure has attracted the highest number of tenders since the 1994 reform of the Italian water sector. Nonetheless, the execution of the contract proved highly controversial as the use of contracting out by the concessionaire undermined the efficiency of operations. Taking advantage of sectoral rules guaranteeing the commercial viability of the concession by allowing for passing operational costs on to consumers, the operator resorted to transfer pricing. This practice was exposed by investigations by the Italian criminal justice.

Furthermore, the cases of Arezzo and the Milan wastewater treatment BOTs suggest that Demsetz competition cannot be expected to deliver efficiency in a sector where contract renegotiation might begin immediately after inception of operations and where there is a marked asymmetry of resources between private operators, and particularly so large MNCs, and local authorities. This extends beyond the asymmetry of information on the operations, which has been addressed by regulatory theory, and includes asymmetry of resources such as access to legal resources, economic clout and knowledge of the sector. In both Arezzo and Milan, such asymmetry resulted in failure to achieve intended objectives such as efficiency and in MNCs effectively controlling the process of reform. In Milan, the experience with wastewater treatment BOTs informed the municipal government's decision not to resort to competitive tendering for the selection of the water supply and sewerage operator.

The natural monopoly characteristics of water services, and the ensuing asymmetry of information and resources between operators and regulators, provide ample opportunities for private concessionaires to escape competitive pressure and indulge in interest-seeking practices. Competition for the market thus appears as unsuitable to achieving intended governance and reform objectives such as efficiency and effectiveness. This calls for abandoning the emphasis on competitive tendering as the primary instrument for the selection of water operators. It also calls for exploring alternative governance strategies in the pursuit of sustainability. A body of literature emphasises the merits of in-house operations as opposed to PSP, irrespective of whether the private operator is selected through competitive tendering (Lobina and Hall, 2007). For the purposes of this exercise, we contend that efforts to enhance accountability networks via greater transparency and public participation represent a more promising approach to sectoral regulation than the current reliance on Demsetz competition and the associated regulation by contract.

The argument in favour of strengthening governance via transparency, accountability and public participation equally applies to private and public operations. Lobina and Hall (2007) argue that local authorities' fiscal considerations might provide incentives for establishing cooperative relationships with private operators to the detriment of sustainability objectives and that this calls for the introduction of greater transparency, possibly via advanced forms of public participation. This seems to be required also under public operations, as suggested by the case of Milan in relation to water supply and sanitation. Greater transparency and public participation have the potential to reduce asymmetry of information and power, enhancing the effectiveness of regulation and the alignment of the operator's interests with the intended governance objectives.

### 7.3. Inadequacy of current EU law to promote transparency and public participation in the water sector

The Aarhus Convention (Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters) represents one of the most important initiatives to promote transparency and public participation in environmental matters. It provides for rights to the public in three specific areas: a) the right to have access to information on the environment held by government authorities; b) the right to participate in the decisions taken by these authorities that affect the environment; and, c) the right to review and legally challenge such decisions.

These three “pillars” of the Aarhus Convention were adopted by the European Union in 2003 through two directives (Directive 2003/4/EC on public access to environmental information and Directive 2003/35/EC providing for public participation in environmental plans and programmes). Both directives contain provisions on access to justice, the third pillar.

Nonetheless, current EU law fails to provide for public rights to seek and obtain information on the accounts of water service operators, nor for the right to participate in decisions on the reform of water services and the appointment of water operators.

Lobina (2005b: 22) explains the limited resort to public participation in the case of Arezzo with the failure by national and regional legislation to require local authorities to engage in advanced participatory exercises, that is to say beyond sporadic consultation.

Lobina and Paccagnan (2005: 17) address the fact that the decision making process on the reform of water supply and sanitation services in Milan was characterised by little if any public participation. They refer to the reluctance of local authorities as an obstacle to the introduction of effective forms of public participation (compounded by the historical absence of a participatory culture in Italy, see Lobina, 2005a: pp. 22-23). In that sense, it should be noted that the 1998 regional law implementing the Galli Law is silent on public participation<sup>71</sup>, while the December 2003 regional law provides for Lombardy’s regional government to promote public participation in water resources management, but not in water supply and operations<sup>72</sup>.

In the absence of specific requirements enshrined in EU and national laws, it is extremely unlikely that meaningful mechanisms of transparency, accountability and public participation be introduced at local level. Failure to provide for specific legal requirements for local authorities to act in that sense is an impediment to the strengthening of water service governance in Europe.

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## Notes

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<sup>1</sup> It is not the purpose of this article to address other forms of competition than competition for the market, or other forms of regulation than regulation by contract. For a critical analysis of regulation by independent agency Ofwat, see Hall and Lobina (2007: 13-17).

<sup>2</sup> Decision making in water systems in European cities (WATERTIME - <http://www.watertime.net>), European Commission, 5<sup>th</sup> Framework Programme, 2002-2005. Contract No. EVK4-2002-0095. The findings are the responsibility of the author and should not be construed as representing the views of the European Commission.

<sup>3</sup> <http://www.psuru.org>.

<sup>4</sup> <http://www.acquabenecomune.org>.

<sup>5</sup> Judgment of 20 november 2005, C-264/03, *Commission v France*, para 32.

<sup>6</sup> See C-324/98, *Telaustria* [2000].

<sup>7</sup> OJ C 121 of 29.4.2000, Section 3 Regime Applying to Concessions, p. 6.

<sup>8</sup> OJ C 121 of 29.4.2000, Section 1 Introduction, p. 1.

<sup>9</sup> OJ C 121 of 29.4.2000, Section 1 Introduction, p. 1.

<sup>10</sup> Judgment of 8 October 1980, C-810/79, *Überschär*.

<sup>11</sup> OJ C 121 of 29.4.2000, Section 3.1.1 Equality of Treatment, p. 6.

<sup>12</sup> Judgment of 13 July 1993, C-330/91, *Commerzbank*.

<sup>13</sup> OJ C 121 of 29.4.2000, Section 3.1.1 Equality of Treatment, pp. 6-7.

<sup>14</sup> Judgment of 26 February 1992, C-357/89.

<sup>15</sup> Judgment of 7 July 1992, C-295/90.

<sup>16</sup> OJ C 121 of 29.4.2000, Section 3.1.1 Equality of Treatment, p. 6.

<sup>17</sup> Judgment of 11 July 1989, Case 265/87, *Schröder*, ECR p. 2237, point 21.

<sup>18</sup> Judgment of 27 October 1993, Case 127/92, point 27.

<sup>19</sup> Judgment of 19 June 1980, Joined Cases 41/79, 121/79 and 796/79, *Testa et al.*, point 21.

<sup>20</sup> OJ C 121 of 29.4.2000, Section 3.1.3 Proportionality, pp. 7-8.

<sup>21</sup> Judgment of 17 May 1984, Case 15/83, *Denkavit Netherlands*; judgment of the CFI of 19 June 1997, Case T-260/94, *Air Inter SA*, point 14.

<sup>22</sup> OJ C 121 of 29.4.2000, Section 3.1.3 Proportionality, pp. 7-8.

<sup>23</sup> OJ C 121 of 29.4.2000, Section 3.1.3 Proportionality, pp. 7-8.

<sup>24</sup> OJ C 121 of 29.4.2000, Section 3.1.3 Proportionality, pp. 7-8.

<sup>25</sup> Judgment of the Court (Fifth Chamber), (Public service and public supply contracts - Directives 92/50/EEC and 93/36/EEC - Award by a local authority of a contract for the supply of products and provision of specified services to a consortium of which it is a member), in Case C-107/98, 18 November 1999

(<http://europa.eu.int/jurisp/cgi-bin/form.pl?lang=en&Submit=Submit&docrequire=alldocs&numaff=C-107%2F98&datefs=1999-11-18&datefe=&nomusuel=Teckal&domaine=&mots=Teckal&resmax=100>).

<sup>26</sup> Judgment of 19 April 2007, *Asemfo/Tragsa*, para. 55.

<sup>27</sup> Opinion of Advocate General Cosmas delivered on 1 July 1999, Case C-107/98, *Teckal Srl v Comune di Viano and Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia*.

<sup>28</sup> Judgment of 11 May 2006, C-340/04, *Carbotermo*, para. 59.

<sup>29</sup> Judgment of 13 October 2005, *Parking Brixen*, para. 65.

<sup>30</sup> Judgment of 11 May 2006, C-340/04, *Carbotermo*, para. 37.

<sup>31</sup> Judgement of 11 January 2005, C-26/03, *Stadt Halle*, para. 49.

<sup>32</sup> Judgement of 11 January 2005, C-26/03, *Stadt Halle*, para. 50. "In this respect, it must be observed, first, that the relationship between a public authority which is a contracting authority and its own departments is governed by considerations and requirements proper to the pursuit of objectives in the public interest. Any private capital investment in an undertaking, on the other hand, follows considerations proper to private interests and pursues objectives of a different kind".

<sup>33</sup> Judgement of 11 January 2005, C-26/03, *Stadt Halle*, para. 51. "Second, the award of a public contract to a semi-public company without calling for tenders would interfere with the objective of free and undistorted competition and the principle of equal treatment of the persons concerned, referred to in Directive 92/50, in



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particular in that such a procedure would offer a private undertaking with a capital presence in that undertaking an advantage over its competitors”.

<sup>34</sup> Judgment of 13 October 2005, *Parking Brixen*, para. 72.

<sup>35</sup> Judgment of 13 October 2005, *Parking Brixen*, para. 70.

<sup>36</sup> Judgment of 13 October 2005, *Parking Brixen*, para. 48.

<sup>37</sup> Judgment of 11 May 2006, C-340/04, *Carbotermo*, para. 63.

<sup>38</sup> Judgment of 11 May 2006, C-340/04, *Carbotermo*, para. 60.

<sup>39</sup> Judgment of 11 May 2006, C-340/04, *Carbotermo*, para. 64.

<sup>40</sup> Circolare 17 ottobre 2001, “Società a prevalente capitale pubblico locale per la gestione del servizio idrico integrato. - GAB/2001/11559/B012. Ministero dell’Ambiente e della Tutela del Territorio.

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<sup>41</sup> [http://www.taxellex.it/utentilex/legis01/lex\\_448\\_01\\_T3C9T4\\_53a79.htm](http://www.taxellex.it/utentilex/legis01/lex_448_01_T3C9T4_53a79.htm).

<sup>42</sup> [http://www.taxellex.it/utentilex/legis01/lex\\_448\\_01\\_T3C9T4\\_53a79.htm](http://www.taxellex.it/utentilex/legis01/lex_448_01_T3C9T4_53a79.htm); and

[http://www.taxellex.it/utentilex/legis00/dlgs\\_267\\_00\\_107a140.htm](http://www.taxellex.it/utentilex/legis00/dlgs_267_00_107a140.htm).

<sup>43</sup> [http://www.taxellex.it/utentilex/legis00/dlgs\\_267\\_00\\_107a140.htm](http://www.taxellex.it/utentilex/legis00/dlgs_267_00_107a140.htm).

<sup>44</sup> [http://www.taxellex.it/utentilex/legis01/lex\\_448\\_01\\_T3C9T4\\_53a79.htm](http://www.taxellex.it/utentilex/legis01/lex_448_01_T3C9T4_53a79.htm).

<sup>45</sup> [http://www.taxellex.it/utentilex/legis01/lex\\_448\\_01\\_T3C9T4\\_53a79.htm](http://www.taxellex.it/utentilex/legis01/lex_448_01_T3C9T4_53a79.htm).

<sup>46</sup> Interview with Federico Bona Galvagno, Capo del Settore Legislativo, Dipartimento per il Coordinamento delle Politiche Comunitarie, Presidenza del Consiglio dei Ministri, held in Rome on 26th May 2004.

<sup>47</sup> Judgment of the Court (Fifth Chamber), (Public service and public supply contracts - Directives 92/50/EEC and 93/36/EEC - Award by a local authority of a contract for the supply of products and provision of specified services to a consortium of which it is a member), in Case C-107/98, 18 November 1999

(<http://europa.eu.int/jurisp/cgi-bin/form.pl?lang=en&Submit=Submit&docrequire=alldocs&numaff=C-107%2F98&datefs=1999-11->

[18&datefe=&nomusuel=Teckal&domaine=&mots=Teckal&resmax=100](http://europa.eu.int/jurisp/cgi-bin/form.pl?lang=en&Submit=Submit&docrequire=alldocs&numaff=C-107%2F98&datefs=1999-11-18&datefe=&nomusuel=Teckal&domaine=&mots=Teckal&resmax=100)).

<sup>48</sup> “Italy amends Galli Law”, *Global Water Report*, Issue 184, 5<sup>th</sup> December 2003, p. 3.

<sup>49</sup> Barbiero, Alberto (2003) Testo delle disposizioni in materia di servizi pubblici locali contenute nel d.lgs. n. 267/2000 e nella legge n. 448/2001 modificato ed integrato con le disposizioni previste dall’art. 14 del d.l. n. 269/2003 “Disposizioni urgenti per favorire lo sviluppo e per la correzione dell’andamento dei conti pubblici”:

<http://www.dirittodeiservizipubblici.it/legislazione/index.asp?sezione=legislazione>. Accessed on 24<sup>th</sup> November 2003.

<sup>50</sup> Source: interview with Fabio Belfiori, Dipartimento Sviluppo Economico, Regione Marche, 1st December 2003.

<sup>51</sup> This view is also shared by Mr. Belfiori. Source: interview with Fabio Belfiori, Dipartimento Sviluppo Economico, Regione Marche, 1st December 2003.

<sup>52</sup> Source: “Gruppo di Lavoro Tributario: Incontro del 31/1/2002 – Art. 35 della Legge Finanziaria 2002”

([http://www.confservizi.emr.it/Database/cispel/cispel.nsf/b4604a8b566ce010c125684d00471e00/92480fe577cdc1d9c1256b60003858ca/\\$FILE/gruppo%20tributario%20art%2035.doc](http://www.confservizi.emr.it/Database/cispel/cispel.nsf/b4604a8b566ce010c125684d00471e00/92480fe577cdc1d9c1256b60003858ca/$FILE/gruppo%20tributario%20art%2035.doc)).

<sup>53</sup> Barbiero, Alberto (2003) Testo delle disposizioni in materia di servizi pubblici locali contenute nel d.lgs. n. 267/2000 e nella legge n. 448/2001 modificato ed integrato con le disposizioni previste dall’art. 14 del d.l. n. 269/2003 “Disposizioni urgenti per favorire lo sviluppo e per la correzione dell’andamento dei conti pubblici”:

<http://www.dirittodeiservizipubblici.it/legislazione/index.asp?sezione=legislazione>. Accessed on 24<sup>th</sup> November 2003.

<sup>54</sup> Legge 24 dicembre 2003, n. 350 “Disposizioni per la formazione del bilancio annuale e pluriennale dello Stato (legge finanziaria 2004)”.

<sup>55</sup> Art. 4.234 l. n. 350/2003.

<sup>56</sup> Interview with Federico Bona Galvagno, Capo del Settore Legislativo, Dipartimento per il Coordinamento delle Politiche Comunitarie, Presidenza del Consiglio dei Ministri, held in Rome on 26th May 2004.

<sup>57</sup> Interview with Paolo Ricci, President, Nuove Acque S.p.A. and former mayor of Arezzo (May 1995-June 1999), 10<sup>th</sup> March 2004.

<sup>58</sup> Interview with Paolo Ricci, President, Nuove Acque S.p.A. and former mayor of Arezzo (May 1995-June 1999), 10<sup>th</sup> March 2004.



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<sup>59</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, p. 16.

<sup>60</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 2-5.

<sup>61</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 5-15.

<sup>62</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 15-16.

<sup>63</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 1-2.

<sup>64</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 12-13.

<sup>65</sup> The statutory powers of the commission did not extend beyond the evaluation of bids put forward. Art. 9.3 and Art. 10, Accordo di Programma, AATO n° 4 "Alto Valdarno". Arezzo, 10th July 1998.

<sup>66</sup> The fact that no revision of tariffs as projected by the Suez-led consortium "Intesa Aretina" took place prior to the concession award to the same undertaking is confirmed by the following two sources. Email communication with Giovanni Mancini, Technical Director (1997-2001) and Director (2001 to date), Ufficio tecnico, Autorità di Ambito Territoriale Ottimale n° 4 "Alto Valdarno", 17th January 2005. Phone interview with Carlo Schiatti, former President, Autorità di Ambito Territoriale Ottimale n° 4 "Alto Valdarno" (March 1996-October 2003), 19th January 2005.

<sup>67</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, p. 13.

<sup>68</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 10-11.

<sup>69</sup> Verbale di gara n° 18 per la selezione di un socio privato di minoranza per la costituenda società mista di gestione del servizio idrico integrato dell'ATO n° 4 "Alto Valdarno". Arezzo, 14th January 1999, pp. 15-16.

<sup>70</sup> Source: "L'Odissea di un esposto - Parla il tecnico che preparò il documento di 103 pagine", La Padania, 5th August 1998, p. 6 (<http://old.lapadania.com/1998/agosto/05/050898p06a2.htm>).

<sup>71</sup> Regione Lombardia. L.R. 20 ottobre 1998, n. 21. Organizzazione del servizio idrico integrato e individuazione degli ambiti territoriali ottimali in attuazione della legge 5 gennaio 1994, n. 36 "Disposizioni in materia di risorse idriche" ([http://www.minambiente.it/Sito/cvri/docs/lr\\_20\\_10\\_98\\_n21.pdf](http://www.minambiente.it/Sito/cvri/docs/lr_20_10_98_n21.pdf)).

<sup>72</sup> Regione Lombardia. Art. 45.5, Legge Regionale n. 26 del 12 dicembre 2003. Disciplina dei servizi locali di interesse economico generale. Norme in materia di gestione dei rifiuti, di energia, di utilizzo del sottosuolo e di risorse idriche ([http://www.arpalombardia.it/contrattidifiume/olona/area\\_down/norm\\_rif/LR\\_26\\_2003.pdf](http://www.arpalombardia.it/contrattidifiume/olona/area_down/norm_rif/LR_26_2003.pdf)).