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CSR in the utilities sector and the implications of EC procurement policy: a framework for debate

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1. Introduction

Corporate Social Responsibility (CSR) is one of the major developments affecting business over the last decade. CSR has been defined by the European Commission as 'a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis'[1]. Starting

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[1] European Commission, Green Paper, *Promoting a European Framework for Corporate Social Responsibility* COM (2001) 366, a definition also taken up in the later Communication on this subject: see *Communication from the Commission concerning Corporate Social Responsibility: A business contribution to Sustainable Development* COM (2002) 347 final p.3. A similar definition is used by, for example, the Institute of Business Ethics, which defines CSR as 'the voluntary actions taken by a company to address the ethical, social and environmental impacts of its business operations and the concerns of its principle

with roots in a wide variety of separate pressures upon corporations to become more socially responsible in areas such as environmental care, health, safety, and support for human rights, the pace of change has accelerated and CSR is now a major driver behind business decisions. From the 1990s, it is issues relating to the supply chain that have come to the forefront[2]. Most large western organisations have been able to clean up their own backyard, ensuring that within their own boundaries issues like human rights, labour standards, environmental care and occupational health are being dealt with through programmes aimed at ensuring consistency of treatment and minimum standards. However, with the growth and complexity of supply chains and the move to global sourcing, it has become increasingly difficult to ensure similar conduct further down the supply chain.

One sector affected, like others, by these developments, and in which CSR issues have recently started to come to the fore, is the utilities sector. In addressing supply chain issues, however, many companies in this sector are faced with legal constraints that do

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stakeholders': Institute of Business Ethics website www.ibe.org.uk. Other terms are also sometimes used to emphasise various facets of the concept: in particular, the term Business Social Responsibility is also sometimes found, especially to indicate that the subject examined embraces small businesses. Since this article is concerned with the concept in its EU context the term CSR will be used, and used in a broad sense to cover all kinds of business, since it is used by the Commission in this sense. On the definitional issues see further J.Moon, "Corporate Social Responsibility: an Overview", p.3 in *The International Directory of Corporate Philanthropy* (Europa Publications Limited, 2002), at pp.3-4.

[2] See generally D.Vogel, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (Washington DC: Brookings Institution Press, 2005), on the development of the agenda relating to improving working conditions down the supply chain in developing countries.

not apply to other private firms[3], namely the restrictions of the EC Utilities Directive (Directive EC 2004/17)[4]. As explained in chapter 1, this directive regulates the procurement of both public and private utilities in fields concerned with water, energy, transport and postal services, with the aim of opening their procurement markets to EC-wide competition. In doing so, the directive imposes significant restrictions on the policies that utilities can adopt on supply chain issues. The European Commission itself in its 2002 Communication on CSR has endorsed a strategy to promote CSR policies at EU level[5], which calls for the integration of CSR considerations into Community policies. However, there has been no serious consideration either within the EC or in academic literature of the implications of Utilities Directive for CSR, and of the interface between this area and EU initiatives on CSR.

This chapter explains the implications of the Utilities Directive for CSR measures in the supply chain, and the policy issues that these raise. The main aim of the chapter is to stimulate a debate on this subject at EU level, and to set out a framework for that debate. At a practical level, the analysis also serves to highlight for utilities the key legal

[3] Except, of course, for undertakings subject to the Public Sector Directive which are subject to even greater constraints. Whilst originally it may have been envisaged that most public undertakings were outside the directive, the ECJ has interpreted the directive broadly to cover many such undertakings: see S. Arrowsmith, *The Law of Public and Utilities Procurement, 2nd edn* (London: Sweet & Maxwell, 2005) at 15.8-15.9.

[4] Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, OJ 2004 No. L134/1, 30 April 2004

[5] Communication from the Commission concerning Corporate Social Responsibility, note 1, above.

requirements and risks that they must address in implementing CSR policies in this area. It is not intended, on the other hand, to make recommendations either on how utilities *should* implement CSR policies, or on how the EU should develop its own policies with respect to the Utilities Directive.

The chapter first briefly outlines the practical development and drivers for CSR policies in the supply chain, with particular reference to the regulated utility sectors (section 2) and then introduces the main principles of the Utilities Directive (section 3). It then examines in detail the implications of the directive for CSR policies in the supply chain (section 4). The chapter also considers briefly the position of utilities' procurement outside the directive (section 5). It then notes separately the particular issues that arise from increased globalisation and collaboration (section 6). Finally, based on the prior discussion, the chapter highlights the policy issues that need to be considered in developing regulatory policy in this area (section 7).

2. CSR and its relevance for utilities' supply chain policies

The proper role of a corporation as a narrowly focused creator of economic wealth principally for shareholders has been espoused by many, and most famously by Friedman who claimed that "Few trends could so thoroughly undermine the foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money as possible for their stockholders"[6]. Following this principle, some would claim that social responsibility policies that are motivated merely by a genuine concern for socially responsible behaviour have no place in corporate activity.

[6] M. Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962)

However, it is increasingly argued that adherence to policies on CSR is *not* contrary to the pursuit of maximum shareholder value and to a large extent CSR policies now appear to be driven by a concern for profitability. Pressure to act in a socially responsible manner for commercial reasons come from three main sources, namely consumers of an entity's products or services, investors, and employees and potential employees[7]. Firms are also influenced by other factors, such avoiding the greater burden of regulation that might result if they do not act on a "voluntary" basis[8]. (For example, in the utilities sector there is evidence that UK electricity companies changed their tough policy on disconnections because of the threat of action by the regulator). Even to the extent that action is driven by genuine social concerns, the need for profitability may place constraints on what can be achieved.

The view that CSR is "good for business" is contested by those who argue that corporations should not be "second guessing" true business drivers[9]. It is very difficult to measure the impact of CSR policies on profitability. Vogel, in a review of the empirical evidence of the financial impact of CSR, has concluded that the evidence is "inconclusive", and doubts whether there is any evidence that positively supports the business case for social responsibility[10]; and he suggests that its value may possibly be

[7] For a more detailed analysis of these drivers see Vogel, note 2 above, esp.Ch.3.

[8] In this respect, firms' behaviour can be seen as on the boundaries of a concept of CSR that is defined by reference to voluntary action in the sense of action that is not influenced by legal requirements.

[9] See recently, for example, Steinberg, **"**Does Corporate Social Responsibility Make Good Sense?" minutes of the AEI; March 2006 http://www.aei.org/events/filter.all,eventid.1265/summary.asp

[10] See generally Vogel, note 2 above, chapter 2 and 3.

confined to businesses that make CSR issues a specific part of their drive to attract business[11]. However, despite the difficulty of demonstrating commercial benefits, there are clear indicators that the various drivers for including CSR policies in the everyday activities of major organisations are having a significant effect. Most large corporations are starting to produce annual Corporate Responsibility Reports[12] and these reports have moved from being fairly bland descriptions of sporadic company activities to being statistically thorough and independently audited accounts of annual progress.

Currently, nowhere is seeing more pressure than the supply chain, which is an area where major western corporations feel particularly vulnerable and where the most difficult issues are arising. It is not, in fact, surprising that the supply chain is at the forefront of concern. The increase of outsourcing and the move to global sourcing, including sourcing from developing countries, has made the implementation of CSR in the supply chain both more important and at the same time immeasurably more difficult. When the average notebook computer may include work by over 1,000 different suppliers, it is not surprising that corporations have traditionally chosen to deal with the issue of supply chain CSR at the end of the process rather than the beginning, focusing on the so-called "top tier" suppliers who supply the major consumer-facing brand names rather than a myriad of smaller specialist companies within the overall supply process. Despite this reluctance to take CSR issues further into the supply chain, however, and the difficulties involved, the issue cannot be ignored permanently and there are now clear

[11] See, in particular, Vogel, note 2 above, chapter 3.

[12] See, for example, the CSR reports produced by BP and the report produced by the BBC – a public sector organization -available at www.bp.com and www.bbc.co.uk respectively.

signs that firms are moving down the road of trying to effect change to supplier behaviour more broadly. Amongst the first to go down the route of CSR policies for suppliers were the garment and textile companies. These suffered the effects of bad publicity and consumer boycotts in the mid-1990s as a result of their perceived failures, especially in the areas of labour conditions, and reacted by setting up processes to impose standards on unwilling suppliers and to monitor and enforce compliance. These processes were largely aimed at the top levels of the supply chain, even though the garment retail industry generally has a fairly short supply chain to evaluate. As the policies have spread into other industries, however, there have been major issues to resolve as many of these industries have much deeper and more complex supply chains. Furthermore, the range of CSR issues has been steadily increasing, and now includes areas such as bribery and corruption, occupational health and development of sustainable industry in the country of supply. These issues mean that the CSR agenda is growing and developing, with greater demands upon purchasers and pressure on their supply chains.

The utility industries are especially sensitive to public perception and pressure. This is, firstly, for historic reasons, with the utilities traditionally regarded as part of the public sector and, until recently, mainly publicly owned. Second, there is a real fear that even the private utilities remain under state influence, with most of their fees from customers in part set or agreed by state regulators. Thirdly, the utilities face very real public examination and criticism, as a source of environmental pollution. Given this sensitivity it is unlikely that utilities would take a negative approach to CSR. Further, the supply chain was bound to become an issue given its importance economically to the utilities and the fact that a great deal of activity has now been outsourced.

This general perception is reinforced by specific company activity: the utilities have been spending time and energy to develop sound CSR policies, to put themselves in the top quartile of the various indices measuring social accountability. Whether this is done for specific business reasons or as part of image building and social accountability is hard to elucidate. However this may be, it is clear that large utilities feel that it is strategically significant to do well in these indices, and put a great deal of resource and political capital into doing so. Further, many utilities are now publicly quoted, and these have been quick to pick up on the investment pressure for them to remain in the key Dow Jones Sustainability and FTSE4Good indices, believing that to drop out of either or both could have serious impacts on their share price and overall credibility. In addition, the growth in energy prices has led to interest in obtaining compensating cost reductions in procurement. National Grid have generally been at the top of the CSR pile for the utilities for the last few years, and have publicly indicated that they believe there are substantial strategic and profit related gains from investing in this area. CSR is also being used by some utilities as part of their overall strategy for risk management and for protecting their brand image. Both of these areas are regarded as vital at a time of consolidation in the utilities industry, when the opportunity to make politically sensitive acquisitions may hinge on the feelings of political and community leaders about an acquirer's CSR credentials, especially in areas such as community involvement and ethical conduct.

As we have seen, supply chain is a very important part of the mix both because of the size of utilities' supply chain spend, and because of the relative difficulty of dealing with the issues, especially as utilities look increasingly at sourcing in low-cost emerging economies. This trend has been accelerated by two factors, namely the emergence of

important new sources of supply, particularly India and China, and the growth in energy prices, which has led to interest in obtaining compensating cost reductions in procurement. Larger companies are seeking to source much more pro-actively in low cost areas such as Eastern Europe, India and China. (Two major European utilities have now opened sourcing offices based in China, whilst others are using sourcing services to find and qualify Chinese suppliers; and these qualification processes generally include CSR elements[13]). The growth of low cost country sourcing has had an impact upon utilities' attitudes to supply chain CSR as they have come to understand how their changing buying behaviour is creating new risks. These risks are not limited to those companies most actively seeking new supply sources; even those who continue to buy principally from traditional sources are finding that these sources are themselves increasingly outsourcing to low cost countries, or are opening factories or offices in emerging economies and transplanting their work for the utilities to these locations.

Finally, the problems facing utilities are, as with other companies, exacerbated by the broadening of CSR to embrace new issues, as mentioned earlier, and this is one aspect of CSR which has contributed to increasing concern over the effect of the EC procurement rules. The problems of the EC rules were less apparent when the issues related more to environmental care and health and safety, but as the list of areas covered by the CSR agenda has increased, so has the importance of the constraints placed on the companies.

3. The EC Utilities Directive

[13] **Colin to fill this in.**

Most corporations seeking to pursue the sort of CSR policies outlined above are subject to few, if any, regulatory constraints. However, as mentioned, many utilities are subject to significant legal restrictions in their supply chain activities under the EC's Utilities Directive 2004/17. As explained in chapter 1, this forms part of the EC's regime to open up EC procurement to EC-wide competition. As elaborated there, the EC Treaty prohibits discrimination and certain other measures restricting access to public procurement, and these Treaty prohibitions are supplemented by two directives, the Public Sector Directive 2004/18 and Utilities Directive 2004/17. These Directives require procuring entities to follow transparent award procedures for major contracts to ensure, in particular, that discriminatory behaviour cannot be hidden.

The current Utilities Directive has its origins in a directive on utilities adopted back in 1990[14]. It covers[15] the contracts of certain entities that operate in four covered sectors, namely water - chiefly the operation or provision of networks for transporting or distributing drinking water, and disposal and treatment of sewage; transport - chiefly the operation or provision of railway, bus and tram networks, and the provision of port and airport facilities (but not air and water transport itself); energy, notably provision and operation of networks for distributing gas, electricity and other heat sources and

[14]Council Directive 90/531 of 17 September 1990 on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors, OJ 1990 No. L297/1, 29 October 1990. Services were added to the regime in 1993 by Council Directive 93/38/EEC of 14 June 1993 coordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sector, OJ 1993 No. L199/84, 9 August 1993.

[15] For details of coverage see Arrowsmith, note 3 above, chapter 15.

exploring for/extracting oil, gas and solid fuels; and postal services (a sector added only in 2004). These are all utility sectors in which the EC considers there are significant problems with, or risks of, discriminatory behaviour, because the utilities involved do not operate in a fully competitive environment – for example, because of the high barriers to entry in setting up networks. (For Member States in which utilities do operate in a competitive market for the activity concerned, because the market has been liberalised, the Commission may give an exemption from the Directive[16]).

As explained in chapter 1, the Public Sector Directive is largely confined to traditional public bodies, namely the State, regional and local authorities, and bodies owned, controlled or supervised by these. These are collectively referred to as "contracting authorities"[17]. The Utilities Directive, however, is not confined to contracting authorities that are subject to the Public Sector Directive[18]: it covers, in addition, two other categories, namely:

[16] Under Article 30 of the Directive. Two exemptions have been given so far, covering the electricity generation sectors in, first, England, Wales and Scotland and, secondly, Finland (with the exception of the Aaland Islands).

[17] See xxxx. This directive has a very limited application to other entities (for example, some rules apply to works concessionaires and private firms awarded certain contracts subsidized by government).

[18] When they are involved in the utility activities covered by the Utilities Directive, the Utilities Directive applies instead. The Utilities Directive is more flexible in many respects than the Public Sector Directive, and the effect of this rule is to allow public sector utilities to enjoy the same flexibility as other entities in the same sector.

i) public undertakings, which are companies operating on the market that are subject to the dominant influence of a public authority[19], and

ii) any utilities (including private utilities) that operate on the basis of special or exclusive rights granted by government – for example monopoly or other special licences[20].

It is not common to subject state enterprises or private entities – even monopolies – to public procurement rules: this is because the commercial nature of these bodies is considered both to require significant flexibility in purchasing and to provide some market discipline that reduces the need for bureaucratic regulation. However, EC regulation is justified by reference to the objective of the EC regime, of preventing discriminatory behaviour[21]: the EC considers that there is a risk of discrimination because of the absence of sufficient commercial pressures combined with the susceptibility to governmental influence that arises from the dependency on government for licences or other special rights. The result is that the Utilities Directive is applied to many organisations that are owned wholly or partly by private shareholders, and which seek to make profits for those shareholders. As discussed below, it is not clear how far the EC Treaty rules prohibiting discriminatory traditional public bodies apply also to these utilities, and thus the Utilities Directive has always included an explicit prohibition

[19] See the definition in Article 2(1)(b) of the Utilities Directive. As mentioned in the text above, some public undertakings are also covered by the public sector rules.

[20] See the definition in Article 2(3) of the Utilities Directive.

[21] The WTO's Government Procurement Agreement (GPA), which has similar objectives, covers some public companies but does not cover private companies.

on discrimination (now found in Article 10), as well as requirements to follow transparent award procedures[22].

As we have seen in chapter 1, both EC procurement directives require the regulated entities to advertise their contracts in the *Official Journal of the European Union*, and to award contracts through a competitive procedure governed by a number of detailed procedural requirements. Under the Utilities Directive, a utility has a free choice between three types of competitive procedure[23] - the open procedure, the restricted procedure and the negotiated procedure with a notice. Utilities have more flexibility in this respect than applies under the Public Sector Directive - which generally requires entities to use either the open or restricted procedure - and also have more flexibility in other areas, such as use of qualification systems. (See section 4.6 below). The Explanatory Memorandum that accompanied the Commission's proposal for the original Utilities Directive justified this by the fact that "industrial enterprises" engage more in organic and cooperative relationships, rather than one-off arms-length transactions, particularly in purchasing complex equipment central to their mission[24]. This leaves it

[22] Such a general principle is now also stated in the Public Sector Directive as well as found in the EC Treaty, but this was not always the case with the public sector rules.

[23] Article 40(2). In limited cases defined in Article 40(3), such as certain cases of extreme urgency, a utility may use a negotiated procedure without a call for competition, which allows it to negotiate with one supplier without advertising the contract. On these procedures see xxx and for their detailed application to utilities, Arrowsmith, note 3 above, chapter 16.

[24] See European Commission, *Proposal for a Council Directive on the procurement procedures of entities providing water, energy and transport services*, COM (88) 377 final, *Bulletin of the European Communities 6/88*, Explanatory Memorandum, para.79.

unclear, perhaps, how far it is the nature of the purchases made rather than the nature of the organization that was considered crucial; both were probably influential. So far as the latter is concerned, entities that are more commercially motivated are less in need of strict regulation to eliminate restrictive procurement practices, even if some regulation is deemed necessary. In addition, some of these entities may in fact operate in an entirely commercial manner already, and the directives may then have a detrimental impact on their ability to do so, which may need to be tolerated to achieve the directive's broader goals; in this case providing for flexibility reduces any detrimental effect.

As noted in chapter 1, in addition to the specific transparency rules, award procedures covered by the directives are subject to three important principles, which are both the source of independent obligations and relevant for interpreting the directive's requirements, namely equal treatment, non-discrimination and transparency. These are set out in the Utilities Directive in Article 10.

4. The Utilities Directive's impact on CSR policies

4.1. Introduction

The Utilities Directive restricts the freedom of the regulated utilities to implement CSR policies in the same way as companies in other sectors[25]. There has been much debate in academic literature on the effect of the Public Sector Directive on socially responsible purchasing in the public sector - in relation to which the term "CSR", which originated to

[25] Except, as already noted, undertakings that are subject to the public sector rules.

describe private sector activities, is now sometimes used[26]. However, virtually no attention has been paid to the special position of utilities. To a great extent the same legal rules apply under both directives, and in this case the same interpretation must be applied[27]. However, the Utilities Directive differs from the Public Sector Directive in some important respects, notably (as discussed below) in the rules on excluding suppliers and on qualification systems, and the implications of these differences for CSR policies have not been explored. For example, the European Commission's Interpretative Communications on social purchasing merely mentions that there is a "wider" discretion in excluding suppliers under the Utilities Directive than under the Public Sector Directive, but does not comment on what the differences are or on the difficult questions of interpretation that arise[28]; and the guidance issued by the UK Office of Government Commerce on social purchasing deals only with the Public Sector Directive[29]. Further,

[26] The European Commission uses this term to embrace these issues in the public context in its Communication on CSR, and the term has become so widespread that many public sector organisations now have embraced the term CSR to cover their own ethical policies and even have job roles as CSR specialists.

[27] See, in particular, Case C-513/99, *Concordia Bus Finland v Helsinki* [2002] ECR I-7213.

[28] Commission of the European Communities, *Commission interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement*, COM(2001)566 Final, 15 October 2001 at 1.3. Likewise the *Commission interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, COM (2001)274 Final, 4 July 2001 does not specifically consider utilities.

[29] OGC, *Social Issues in Purchasing* (February 2006), available at www.ogc.gov.uk

the differing provisions have not yet been interpreted by the ECJ. There are also several policy issues not yet considered in the public debate that arise for many utilities, particularly because of their private nature and the fact that many operate in a market. It is also notable that the guidance issued by both the OGC and the Commission focuses on the kinds of social and environmental issues that are of concern for the traditional public sector, and has little to say, for example, on issues relating to labour conditions in developing countries, which are of major concern to some utilities. Further, whilst the Commission's recent general Communication on CSR contains a brief section on "Public Procurement"[30], this mainly refers back to the Commission's own Interpretative Communications on procurement, which do not address utilities. This absence of debate perhaps reflects the fact that it is only recently that the social dimension of purchasing policy has come to the fore with utilities

The analysis below is not intended to duplicate the extensive existing literature on the directives' impact on social and environmental purchasing, nor the review in the first two chapters of the book[31]. Rather, it focuses on issues relating in particular to utilities. It will become apparent that some CSR activities are clearly permitted for utilities, whilst others – even those common in some private firms - probably are not. In many instances, however – as with the directives more generally – the exact requirements of the law simply are not clear. Thus for utilities wishing to implement CSR policies the question is often one of whether or not the benefits of a particular policy outweigh the legal risks.

[30] European Commission, note 1 above, pp.21-22.

[31] See chapters 1 and 2 of the present book and the literature cited there.

4.2. Requirements concerning contract performance: technical specifications of the product/works/services and "special" conditions

4.2.1. Permitted requirements

One of the main mechanisms for implementing socially responsible procurement is through setting CSR requirements to be met in performing the contract, both by first-tier suppliers and others in the supply chain, so that the impact of the contract itself is positive, or at least neutral, from the perspective of social responsibility. Two major concerns, for example, are to safeguard the welfare of those employed on the contract, and to ensure that there is no negative environmental impact.

As explained in chapter 2, under the Public Sector Directive entities may lay down requirements relating to contract performance, which can be divided into two categories – technical specifications (such as a requirement for low energy light bulbs)[32], and special conditions (such as a requirement for suppliers to recruit long term job seekers to work on the contract[33]). This applies also under the Utilities Directive, which contains (in Article 34) definitions and rules on technical specifications that parallel those

[32] It should also be mentioned that both the 2004 directives introduced a new *requirement* for regulated purchasers to design specifications "wherever possible" to take into account "accessibility criteria for people with disabilities or design for all users. Public Sector Directive Article 23(1) and Utilities Directive Article 34(1). The effect of this may be to impose on private, as well as public, utilities a social obligation that goes beyond those that applies to other private companies and even to some of its competitors (for example, those that enjoy an exemption because they operate in market conditions). It is not clear, however, that this imposes a legal, or at least enforceable, obligation, see chapter xx of this book at xx, and Arrowsmith, note 3 above, at 17.75.

[33] See the discussion at xxx.

of the Public Sector Directive, and also a parallel provision stating that utilities may apply special conditions relating to performance of the contract (Article 38). It appears that utilities could in principle include conditions for a main contractor to ensure that certain standards are met further down the supply chain, and specifically require suppliers to include equivalent conditions in sub-contracts, as well as laying down conditions relating to the work of the main contractor itself.

These principles appear clear enough. However, as explained in chapter 2, there are question marks over how far entities may impose requirements on contract work undertaken outside the territory of its own Member State, either in other EC Member States or in third countries, where the conditions go beyond a mere requirement for the supplier to comply with the law or collective agreements of the state in which the work is carried out[34]. This issue may arise in the context of supply contracts - for example, where a utility purchases transformers or protective clothing made in the developing world – or (increasingly) in relation to services contracts - for example, where a call-centre function is outsourced outside the EC. We saw in chapter 2 that the Commission has cast doubt on the possibility under the EC Treaty of including conditions of this kind for supply contracts, apparently because of the potential impact beyond the contract – for example, by making it necessary in practice to adapt production methods in a whole factory that is involved in producing goods for the contract[35]. It would seem that this view is applicable equally whether the business is organized by providing the goods and services directly, or

[34] That utilities may require suppliers to comply with these is assumed in Article 39, which concerns provision of information on these matters to suppliers. See further the discussion of the public sector at xxx.

[35] See the discussion at xxx.

through sub-contracting. If the Commission's view is correct, it could considerably restrict the scope for useful CSR policies in the utility sector that relate to, for example, labour conditions in developing countries. It was explained in chapter 2, however, that there are some problems with this view, and it is not clear what approach the ECJ will take[36].

In assessing whether a condition of this kind that hinders access to the market is justified the ECJ will consider whether the measure is suitable to achieve its objective. In the context of the concerns of utilities, this raises a number of questions. One is whether the fact that the policy supports certain types of external norms, such as ILO standards, itself provides justification, without proving concrete beneficial effects in terms of the underlying objective, such as eliminating child labour. The second arises from the fact that, as discussed, utilities may impose CSR requirements as part of a commercial strategy – for example, to protect a favourable public image with customers, or to retain their position in the Dow Jones Sustainability and FTSE4Good indices. In this case the utility's objective is not necessarily directly linked to the social impact of the policy, but simply to the expectations of customers, investors etc (which may or may not be influenced by the actual social effects). The ECJ has repeatedly stated that economic objectives per se cannot be used as a justification under the EC Treaty's free movement provisions[37]. However, as suggested in chapter 2, this probably applies only to a limited number of objectives that per se contravene the principles of the free market[38], and in any

[36] See xxx.

[37] See xxx above.

[38] See the discussion in chapter 2 at xxx.

case arguably should not prevent concerns of profitability being relied on by corporate entities whose very objective is to make profits for shareholders, and which may be in competition with other entities that are not regulated in the same way. A third issue is the fact that a policy based simply on requirements for contract performance without supporting measures may be counter-productive. For example, prohibiting child labour without other measures concerned with providing schooling and alternative sources of family income may actually have a detrimental effect by forcing those concerned to turn to even more unsuitable occupations[39]. However, the directive itself possibly limits the scope for utilities to take supportive measures that do not relate directly to the contract, as discussed at xxx below. It is not clear how the ECJ will deal with these kinds of issues in considering the legality of conditions governing the performance of supply contracts.

The ECJ is perhaps most likely to accept requirements embodied in international instruments such as the ILO Conventions, and may possibly do so regardless of their trade impact – and thus even when they refer to supply contracts. At the very least, it may accept them when a Convention has been ratified by the country in which the work is done, even though the standards have not been implemented into national law; and conditions relating to "core" ILO standards[40] might even be accepted without ratification.

[39] On this issue see Vogel, note 2 above, pp.98-99.

[40] These relate to freedom of association and the right to collective bargaining; the elimination of forced and child labour; and elimination of discrimination in employment: ILO Declaration on Fundamental Principles and Rights at Work, June 1998 available at http://www.ilo.org/dyn/declaris/DECLARATIONWEB.INDEXPAGE

The existence of such standards may serve both to indicate a significant "independent" justification for the content of the utility's requirement, and to reduce the risk that it has been selected with a discriminatory intent, to favour national suppliers. The possibility of requiring compliance with ILO conventions may also find at least indirect support in the the recitals to the procurement directives, which give as examples of permitted "special conditions" requirements (when not implemented into national law) to comply with "basic" ILO Conventions[41]. However, even this reference does not rule out limits on the circumstances in which such standards may be set, and it is also not clear what is meant by "basic" conventions. (If limited to certain core conventions, it might even indicate a negative view on the possibility of imposing compliance with other Conventions)[42]. Further, whilst the recitals are relevant for interpreting the directives when they are not clear, the directives cannot authorize measures that contravene the Treaty.

In the absence of jurisprudence, it is also possible that EC law does not even rule out even requirements going *beyond* ILO conventions or other international treaties, even for supply contracts. If so, utilities may be able to require adherence to requirements that they have developed individually or in conjunction with other industrial partners, or to

[41] Recital 44 of the Utilities Directive.

[42] Another argument for suggesting a broad possibility for requiring suppliers to comply with ILO conventions is the fact that Article 59(4) provides for possible EC action to exclude third countries from EC contracts, when EC undertakings have experienced problem competing for contracts in those third countries because of the non-observance of certain ILO standards listed in Annex XXIII of the directive. Certainly this assumes that it is not acceptable for EC firms themselves to gain contracts through the fact that their own supply chain does not comply with these labour standards, and thus arguably it would be anomalous if the Treaty or directives were to prohibit conditions that require compliance by EC firms.

requirements reflected in recognized industry standards such as SA8000 (a voluntary code developed by a group of large private-sector organizations and others (such as Amnesty International), which is based on, but goes beyond, ILO standards, including by requiring a "living wage"). References to such standards may help promote their use, as well as ensuring ethical performance of the utility's own contracts. This is subject, how*ever, to the important point that utilities may not insist that suppliers or their facilities are certified* to external standard requirements, but merely that suppliers show – through certification *or* other means – that they are able to comply with the *substantive conditions* in the standard. This point is discussed at 4.5 below.

There is some scope for arguing that the EC Treaty's free movement obligations do not apply to all utilities, especially private utilities. (See further section 5 below). This could provide a basis for allowing a more autonomous approach for CSR matters for some utilities than for other regulated purchasers, to take account of their commercial interests. However, if the ECJ concludes that extra-territorial requirements for supply contracts are not legal under the Treaty, it may well reach the same conclusion through interpreting the rules on specifications and special conditions in the Utilities Directive, since, arguably, the Utilities Directive seeks to mirror for utilities the principles that apply under the Treaty to public sector procurement[43].

As explained in chapter 2, secondary requirements may also be restricted by the EC's agreements with third countries, most notably the World Trade Organisation's

[43] As noted earlier, the Directive has always included a prohibition on discrimination to ensure this applies to utilities not covered by the Treaty, and this possibly reflects an intention that any behaviour prohibited under the Treaty free movement rules is prohibited also for utilities.

Agreement on Government Procurement (GPA)[44]. The GPA's rules on the scope for extra-territorial requirements are no less clear than those of the EC, and raise similar issues of interpretation and trade policy[45]. However, the GPA is of limited importance for utilities since it covers only public utilities and not those private utilities that are regulated by the Utilities Directive merely because they have special or exclusive rights.

4.2.2. Monitoring and enforcement

Introduction

Purchasers who lay down social or environmental requirements are not always concerned with monitoring and enforcement. Such requirements may be intended to be purely symbolic or to encourage by example, or may be implemented simply to gain political support or the support of consumers or investors; or the purchaser may lack commitment to the costs of enforcement[46]. For example, few social and environmental programmes in public sector procurement make provision for monitoring and enforcement[47], and in the private sector the OECD has found that two-thirds of codes in the garment industry contain no monitoring provisions[48]. However, some purchasers do implement measures

[44] See xxx.

[45] See xxx above, and S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), Ch.13, and the works cited there.

[46] On these costs see Vogel, note 2 above, pp.92-96.

[47] S. Arrowsmith, G. Meyer and M. Trybus, '*Non-commercial Factors in Public Procurement*', Report produced for the Office of Government Commerce (2000).

[48] Citation from Vogel, note 2 above, p.89, n.52.

for monitoring and enforcement, or at least seek to apply sanctions when violations actually come to light.

Exclusion for anticipated non-compliance: general principles

As explained in chapter 2, regulated purchasers may – and indeed, must[49] - reject a tender that does not accept a requirement in the tender documents. Even when the tenderer does accept the requirement, however, the purchaser may wish to exclude the tenderer when it believes that the tenderer will not actually comply[50]. On this possibility, it was explained that the Public Sector Directive, at least, draws a distinction between technical specifications and special conditions. That directive allows exclusion of suppliers that accept the tender conditions only for lack of economic and financial standing or technical ability, and for specified reasons of "honesty, solvency and reliability" that include criminal convictions and grave professional misconduct. Inability to deliver according the technical specifications falls within these grounds, but inability to meet such special

[49] Under the equal treatment principle: Case C-87/94, *Commission v Belgium ("Walloon Buses")* [1996] ECR I-2043; and see Commission Communication on social considerations, note 28 above, at 1.6. (Note, however, that utilities using a negotiated procedure may arguably be able to seek new offers without the condition, rather than recommencing a wholly new award procedure as may be required under open or restricted procedures).

[50] In a restricted or negotiated procedure the issue must be dealt with at the stage of deciding whom to invite.

conditions does not[51]. Thus under the Public Sector Directive, whilst a purchaser can lay down special conditions, it cannot exclude suppliers that it believes will not comply.

The Utilities Directive merely states that utilities must select in accordance with "objective rules and criteria"[52], and that objective criteria include the "honesty, solvency and reliability" criteria set out in the Public Sector Directive[53]. Clearly "objective" criteria include, at least, economic and financial standing and technical ability within the meaning of the Public Sector Directive, so that utilities clearly can exclude for anticipated non-compliance with technical specifications. However, is not clear what other criteria, if any, are within the concept of "objective" criteria, including anticipated non-compliance with special conditions. The fact that the Utilities Directive does not contain the same precise list of grounds for exclusion as the Public Sector Directive, and that, in general, the award procedures under the Utilities Directive allow more discretion, suggests that the grounds for exclusion for utilities are broader[54]. However, in the absence of judicial interpretation the precise grounds remain unclear. The European Commission in its Interpretative Communication on social considerations confines itself mainly to

[51] See the discussion at xxxx.

[52] Utilities Directive Article 54(1) (open procedures) and Article 54(3) (restricted and negotiated procedures).

[53] Utilities Directive Article 54(4), referring back to Article 45 of the Public Sector Directive.

[54] The current Public Sector Directive, unlike the previous directives, now uses the phrase "objective criteria" in Article 44(3) when talking about disclosure of criteria, but this merely serves to refer back to the explicit and limited criteria set out in the other Articles of the directive (which are all types of objective criteria), for the purpose of setting out the disclosure rules.

discussing the public sector rules: for utilities it merely suggests at the end of the discussion that "their discretion in this respect is wider", without indicating how[55].

The concept of an "objective" criterion suggests, at least, a criterion that is suitable to achieve a legitimate policy of the utility[56]. It could also imply that any criterion used must not confer an excessive degree of discretion, and that its application is capable of being verified. On this basis, there are several interpretations that can plausibly be constructed. These all provide a different balance between the various interests involved – for example, transparency, and the commercial interests of utilities. (See section 7). Some of these interpretations would allow utilities to exclude suppliers unable to comply with special conditions, but some would not. It is useful to set out all these interpretations together:

i) That a utility may exclude based on any consideration relating to the contract being awarded, where done for reasons of commercial procurement. This could, for example, allow a utility to divide a procurement between two suppliers in order not to be too heavily dependent on a single supplier, which might not be possible under the Public Sector Directive. However, it would not appear to allow a utility to exclude for anticipated non-compliance with special conditions.

ii) That a utility may exclude based on any consideration relating to the contract being awarded, where done for any reason related to its legitimate objectives in procurement, including social objectives. This interpretation *would*

[55] Note 28 above, at.1.3.

[56] This would exclude otherwise unlawful policies, such as national protectionism.

generally allow the utility to exclude for anticipated non-compliance with any special conditions laid down for that procurement, without making a connection between the conditions and its commercial objectives.

iii) That a utility may exclude based on any consideration that relates to the contract being awarded, where done for any reason connected with the utility's commercial objectives (and not merely for reasons of commercial *procurement*). This interpretation would allow a utility to exclude for anticipated non-compliance with special conditions, but only when the exclusion is related to commercial, rather than purely social, objectives. In theory this would allow exclusion when the special conditions form part of the utility's commercial strategy based on attracting investment or consumers, for example. In reality, the scope for exclusion would depend on the degree of scrutiny applied by the courts in assessing whether particular conditions really do form part of the utility's commercial strategy and, in particular, whether the courts would require evidence that the CSR strategy actually produces commercial benefits. This latter may be almost impossible, given the difficulty of proof for specific utilities, and the limited general evidence on this, as discussed in section 2 above. However, it may at least be possible to demonstrate a specific link between CSR and commercial objectives, such as where a policy is implemented to meet the criteria of particular ethical fund indexes.

iv) That a utility may exclude based on any consideration relating to the performance of the contract being awarded, where this is connected with any

legitimate policy of the utility. This interpretation, like interpretation ii), could generally allow the utility to exclude for anticipated non-compliance with any special conditions, without showing any connection between the conditions and its commercial objectives.

v) That a utility may exclude for any reason of efficient commercial procurement, regardless of whether or not this relates to the performance of the contract awarded. This would, for example, allow a utility to exclude a supplier that already has significant work for the utility, to preserve competition for future contracts, even though this might not be allowed under the public sector rules[57]; or it might allow utilities to take into account possibilities for collaboration in product development when limiting the number of suppliers on a qualification system (see further 4.5 below). This would not, though, generally permit exclusion for non-compliance with social or environmental conditions.

vi) That a utility may exclude for any reason related to its legitimate objectives in procurement, including social objectives, whether or not these relate to performance of the contract to be awarded. This interpretation, as with interpretations ii) and iv), would generally allow the utility to exclude for anticipated non-compliance with any special conditions, without making a connection between the conditions and commercial objectives.

[57] It might also allow the utility to take into account a supplier's ability to undertake related follow-on contracts, where there are benefits from one supplier performing both contracts.

vii) That a utility may exclude for any reason relating to the utility's commercial objectives (and not merely its procurement objectives), whether or not this relates to performance of the contract awarded. As with interpretation iii), this would in principle allow exclusion for anticipated non-compliance with special conditions where linked to the utility's business strategy, but would raise the same problems of making the link in practice.

viii) That a utility may exclude for any reason connected to the utility's legitimate objectives, commercial or non-commercial, and regardless of any link to the performance of contracts being awarded. As with interpretations ii), iv) and vi), this interpretation would allow the utility to exclude for anticipated non-compliance with special conditions, without the need to make any connection between the conditions and the utility's commercial objectives.

Thus utilities – in contrast with the public sector - may be able to exclude for anticipated non-compliance with social conditions, either in general, based on interpretations ii), iv), vi) and viii), or where this is linked to their business strategy, based on interpretations iii) and vii). On the other hand, there are plausible interpretations – interpretations i) and v) - which would not allow a utility to exclude for anticipated non-compliance with special conditions. It is also not impossible that the ECJ could interpret the rules on exclusion as being the same as for the public sector. However, as noted above, the better view is that this is ruled out by the different wording of the two directives.

In interpreting the Utilities Directive on this question it is necessary to mention, in particular, the directive's specific provisions on environmental management measures.

As noted in chapter 2, both procurement directives provide that "For works and services contracts, and only in appropriate cases, [procuring entities] may require, in order to verify the economic operator's technical abilities, an indication of the environmental measures which the economic operator will apply when carrying out the contract" (Utilities Directive Article 52(3) and Public Sector Directive Article 48(2)(f)). In the Public Sector Directive this serves to authorize environmental management measures as evidence of technical ability that contracting authorities may demand from firms, since authorities may require only the evidence listed in the directive[58]. However, utilities are not limited to listed evidence and the provision's significance is unclear. It might be argued that it indicates that evidence of environmental management measures may *only* be required in the cases referred to. This would imply that *exclusion* for anticipated non-compliance with environmental conditions is possible only in these cases (since it cannot be intended that the directive allow exclusions without evidence). On this basis, it could be argued that exclusion for inadequate environmental management measures is permitted only to the same extent as under the Public Sector Directive, namely where there is absence of "technical ability" in the sense of the Public Sector Directive. It might even then be argued by analogy that exclusion more generally is limited to the same grounds as the Public Sector Directive, since it is anomalous to treat environmental considerations less favourably than others. Given the significant difference in wording and general approach between the directives however, this does not seem plausible. Thus a better interpretation of Article 52(3) of the Utilities Directive is that it merely confirms

[58] See xx. It may also serve to indicate that environmental management measures relating to production of suppliers are not in general to be considered as aspects of the technical specification: see xxxx.

that what is possible for the public sector is also possible for utilities, without ruling out the possibility of seeking evidence of environmental management measures for other reasons, including to ensure compliance with special conditions governing the contract (whether a works, supplies or services contract). Thus it is submitted that none of the interpretations of the Utilities Directive given above is ruled out by Article 52(3).

Exclusion based on non-compliance with existing or previous contracts

If a supplier awarded a contract *does* fail to comply with any requirements included as contractual obligations, the purchaser may wish to exclude the supplier from future work. This may be considered necessary to prevent a repeat of such violations. Further, the *threat* of exclusion could also serve to encourage compliance with special conditions. Exclusion, or the threat of exclusion, is even more potent as a sanction when implemented on a collaborative basis with other entities – for example, when entities implementing a common code of conduct for suppliers agree to exclude those that violate the requirements under contracts with any of them. Of course, as with a policy of including such conditions in the first place, exclusion may produce negative effects, such as loss of employment, both for those whom the policy is designed to protect and for others employed by the offending supplier, and consequent adverse publicity. This may need to be considered in deciding whether to implement any actual exclusions.

Does the Utilities Directive allow utilities to exclude suppliers from future work for not complying with special conditions?

A first question is whether the directives allow purchasers to terminate the *existing* contract that includes the special condition, either for a direct violation by the

supplier, or for violations through the actions of those further down the supply chain. As discussed in chapter 2, this has not yet been considered by the ECJ[59]. As was pointed out there, the directives do not expressly limit the contractual remedies that may be invoked, although their exercise is subject to the equal treatment and non-discrimination principles[60]. It was suggested that it is also arguable that if a priori exclusion from contracts is permitted for past violations of special conditions only for deliberate and/or serious conduct (as discussed at xxx and below), termination for violating special conditions might also be limited to such conduct. This means that if utilities may not exclude in advance for suppliers' inability to comply with special conditions (as discussed further below), their termination remedies may also be constrained. If that is the case, it might be particularly difficult to justify a termination when the violation is not committed by the utility's own supplier but by that supplier's sub-contractors. Apart from the other adverse consequences referred to above, such as loss of employment for the supplier's employees, the efficacy of any cancellation remedy that exists may, of course, be impaired by the delay and other costs in appointing a new supplier (especially if this must be done in accordance with the Utilities Directive)[61].

As to excluding those who violate special conditions from *future* contracts, under both directives this is clearly possible first (as mentioned) when the violation involves a criminal conviction or constitutes grave misconduct. It was suggested in chapter 2 that

[59] See xxxxx

[60] These are important for utilities that are not covered by the EC Treaty's free movement rules (as to which see section 5 below), in covering the ground of those Treaty rules.

[61] See the discussion at xxxx.

these grounds for exclusion need not involve any link with the ability to perform the contract awarded[62]. If that is so, they offer a clear possibility for utilities to exclude firms to support CSR policies where a supplier has a criminal conviction relating to its ethical, social or environmental obligations – for example, for criminal bribery, or for violating national laws on working conditions or environmental protection. We have seen in chapter 2 that the scope for exclusions under the concept of "grave misconduct" is unclear, but it was suggested that it could justify exclusion for some serious criminal behaviour - such as bribery – even without a conviction and also for violating professional codes of ethics or for an adverse decision imposing civil or administrative sanctions (for example, for anti-competitive conduct)[63].

It was also explained that violation of special conditions in a previous contract might *per se* constitute "grave misconduct", and that Advocate General Gullman has stated in one case that at least *deliberate* contractual violations could fall within this provision[64]. This might at least catch some direct violations of the main contract, although it might not cover many violations occurring further down the supply chain. If the directive does not limit the right to terminate for violations, it seems appropriate to allow exclusions for violations of special conditions in general under this provision, rather than limiting this to deliberate or serious cases; it would be anomalous to require utilities that terminate contracts for violations to accept any new tender by the same

[62] See the discussion at xxxx.

[63] See xxxx.

[64] Case C-71/92, *Commission v Spain* [1993] ECR I-5923, para.95 of the Opinion.

supplier, even to cover the same work[65]. Again, however, it is possible that *only* violations of a certain degree of severity – as assessed by the court – provide grounds for exclusion *and* termination.

This possibility of future exclusion for such violations, even more so than cancellation of a contract, may provide an incentive for compliance if the possibility is made clear to the supplier. On the other hand, there is a clear degree of legal risk involved in acting to exclude a supplier, given the uncertainty surrounding the scope of these provisions and the fact that – in contrast with exclusions by other private firms – any exclusion will be subject to judicial scrutiny.

To the extent that contractual violations do not amount to grave misconduct, it does not appear possible to exclude suppliers for these violations under the Public Sector Directive. Under the Utilities Directive, however, the power to exclude may be wider: as elaborated above, there is a general power to exclude for "objective" reasons which is capable of various interpretations. Several of the interpretations suggested would allow a utility to exclude suppliers from future contracts, so that such a threat can motivate those suppliers to comply with contract requirements of either a social or commercial nature. This applies to interpretation vi), allowing exclusions for matters relating to the utility's legitimate *procurement* objectives, and interpretation viii), allowing exclusions for *any* of

[65] If exclusion for anticipated non-compliance is not possible (as we have seen is clearly the case under the Public Sector Directive and possibly the case under the Utilities Directive, also), an alternative interpretation could be that special conditions cannot even give a right to terminate, an interpretation that could be based on the analogy of the restriction on exclusion. However, this would deprive entities of any meaningful sanctions to enforce special conditions.

the utility's legitimate objectives. Interpretation vii), permitting exclusion for any commercial objective, would allow an exclusion for CSR policies when these are linked to the utility's business performance strategy.

There may, however, be difficulties in excluding for violations of similar requirements under contracts with other organizations, as is discussed further in section 4.3 below.

Conclusion

In summary, there is some scope for utilities to lay down requirements concerning the performance of contracts. However, there are both constraints and uncertainties over the extent of the requirements permitted and the available enforcement mechanisms, which may inhibit the effective implementation of CSR policies. In particular, it is not clear how far utilities may lay down requirements concerning working conditions and other matters outside the utility's own Member State. In relation to enforcement there is uncertainty, in particular, over whether utilities can exclude suppliers in anticipation of breach of special or social environmental conditions, or for past violations of the utility's own contracts; and even if this is possible the fact that their exercise is subject to judicial scrutiny over, for example, the "grave" nature of any misconduct, introduces an element of risk into the exclusion that is absent for other private sector entities.

4.3. Requirements that are not limited to the performance of the contract being awarded

Conditions that are not related to the contract being awarded

There is more difficulty over including CSR requirements that are concerned more broadly with ensuring that the supply chain includes only socially responsible actors – for example, requirements for suppliers and their sub-contractors to comply with ILO labour standards in all their activities, or for suppliers to implement general programmes to avoid wasting water. At present, there is a significant element of legal risk for utilities that apply requirements going beyond the contract awarded. This arises because of Article 38 of the Utilities Directive, which – like Article 26 of the Public Sector Directive, discussed in chapter 2[66] - states expressly that procuring entities "may lay down special conditions relating to the performance of a contract"[67]. As explained in chapter 2, in the context of the Public Sector Directive probably rules out any conditions that do *not* relate to performance of the contract awarded[68]. Since the utilities' provision is effectively identical, it can be argued that the provision similarly limits the power of utilities to lay down conditions that do not relate to contract performance.

On the other hand, as with the provision on environmental management measures in Article 53(2) of the Utilities Directive, discussed above, there is scope for an argument that the very different context of the Utilities Directive indicates that the provision does not have this effect. The fact that in general the Utilities Directive gives greater flexibility than the Public Sector Directive and, in particular, the very different wording of the exclusion provisions, as discussed earlier, could support such an interpretation. In particular, if as a general rule utilities cannot include contractual requirements that go

[66] See xxxx.

[67] This is also referred to in Recital 44.

[68] See xxx.

beyond the contract awarded, it would seem that they also will not generally be able to *exclude* firms that do not meet norms unrelated to the contract, as discussed at 4.5 below. As explained there, this would substantially reduce the scope for any differences in the exclusion provisions in the two directives, in spite of their very different wording. In this context, it could be argued that the provision on special conditions in the Utilities Directive merely clarifies that entities under this directive have all the power to include special conditions that exists under the Public Sector Directive, but without *restricting* utilities' power to include special conditions. On this approach, there is scope to argue that utilities' power to include special conditions that do not relate to the contract, in accordance with whichever of the interpretations of the exclusion power is accepted. For example, if one were to accept interpretation vii) above, namely that a utility may exclude for any reason relating to the utility's commercial objectives (and not merely its procurement objectives), whether or not this relates to performance of the contract awarded, this might lead to the conclusion that not only may a utility exclude for anticipated non-compliance with special conditions where linked to the utility's business strategy, but that it may also include in the contract any *conditions* linked to its business strategy, regardless of whether these relate to the contract being awarded.

However, whilst this is a possible argument, the likelihood of the ECJ accepting contract requirements that do not relate to contract performance is probably significantly reduced by the inclusion of the explicit provision on special conditions in the 2004 directive. The fact that award criteria under the Utilities Directive have been held by the ECJ (and now stated in the 2004 Directive) to be limited to those relating to the subject-

matter of the contract (see section 4.5 below) may also indicate, by analogy, that contract conditions are limited to matters relating to the contract.

Often it is, of course, artificial and difficult to separate the performance of contracts with the broader question of the ethical conduct of the supplier, particularly with contracts for standard supplies. As discussed in chapter 2, work under the contract may not in fact be separate from other work, in that the same workers may be engaged on both, even in the same time period, and even when this is not the case it may only be possible to ensure compliance with the required standards through a regime that covers the whole workplace[69]. Further, when other work goes on at the same workplace, limiting requirements to the contract only could produce inequitable differences of treatment between workers or different work by the same worker, giving rise to discontent. This may effectively compel an organization to apply the requirements to the whole organization or unit.

As discussed at xxx above, the Commission considers that requirements relating to the performance of supply contracts may not be capable of justification under the Treaty because of their wider impact on a firm's whole business. If the Commission is correct that such requirements cannot generally be justified under the Treaty, it would seem *a fortiori* that requirements that go *beyond* the contract contravene the Treaty, where it applies, and would then probably in any case be considered contrary to the Utilities Directive. However, as discussed at xxx above, we have seen that the position in this respect is far from clear and the ECJ could adopt a much more nuanced approach when assessing such conditions for compatibility with the Treaty. In that case, the scope

[69] See xxx.

for contract conditions under the express terms of the Utilities Directive clearly becomes important.

If it is indeed the case that, under the directive and/or Treaty, a utility can lay down conditions *only* when these concern contract performance, this places very significant limits on the scope of CSR strategies – whilst a utility may to an extent ensure that work for the utility itself is not "tainted" with unethical conduct, it cannot lay down standards of ethical behaviour for its suppliers as a whole.

Further, such an approach may limit the scope for ancillary measures, such as requiring schooling for children excluded from contract work. However, ancillary measures might be possible through a broad interpretation of the concept of a condition relating to the performance of the contract, although it is not clear how far this could stretch – it is hard to see, in particular, how such a condition could be effective to achieve its objectives if, for example, limited to the lifetime of a contract, or to specific persons excluded from a particular contract.

Excluding firms for non-compliance with norms that do not relate to the contract being awarded

As noted above, if a utility cannot lay down conditions for suppliers of a "special" nature that do not relate to the performance of the contract being awarded, then it appears also that the "objective" criteria for excluding suppliers from contracts cannot include a supplier's failure to adhere to environmental or social requirements laid down by the utility that go beyond performance of the utility's own contracts: it cannot be expected that the directive would allow a utility to exclude suppliers for violating behavioural

standards that the utility is not permitted to lay down. This would mean that if one of the interpretations v) to viii) above were correct – meaning that utilities may in principle exclude from contracts for reasons that do not relate to the contract being awarded – these interpretations must be qualified to a significant extent, in that exclusion is not possible simply because of non-compliance with special requirements not related to contract performance. This would be a very significant qualification. It would not generally allow utilities to exclude for – for example – non-compliance with the utility's own labour codes, or general industry labour codes, even when this is done for commercial reasons (such as to avoid low ratings on investment indices). However, even with this qualification, interpretations v) to viii) could still give a broader scope for exclusions than the first four interpretations, in particular by allowing exclusions for past violations of the utility's own contracts that are not covered by the "grave misconduct" provisions.

As mentioned, whatever the general position on conditions and exclusions for non-compliance with norms that do not relate to the contract, clearly it is possible to exclude suppliers for past non-compliance with social or environmental norms where there is a criminal conviction or where non-compliance constitutes grave misconduct. The grave misconduct provision has been considered above, where it was pointed out that this could be invoked *de facto* where the utility's reason for wishing to exclude a supplier is its anticipated non-compliance with a special condition, or to encourage or sanction certain violations of the utility's own contracts. However, the utility does not need to make a link to its own contracts to invoke these provisions. Thus they may be invoked so that the utility can avoid associating itself with unethical conduct, whether for business reasons or simply to support the ethical standards in question.

This raises the question of how far the "grave misconduct" can be invoked as an effective limit on any principle that the utility may not lay down conditions for suppliers' businesses that go beyond contract performance. If, for example, it could be invoked to exclude suppliers that have violated contracts with other utilities or other companies, that have violated standards that they have themselves signed up to, or have violated practices accepted by others in the industry as embodied in widely-accepted codes, this would at least facilitate the scope for developing CSR policies through industry collaboration. This is important in the utility sector in practice, particularly with the recent growth of shared qualification systems, as discussed further at 4.6 below. However, accepting violations of norms this kind as gross conduct raises a number of problems. For example, excluding suppliers for not adhering to codes that they have themselves accepted could lead to more favourable treatment for suppliers that refuse to accept such codes at all, and/or discourage suppliers from accepting them; whilst if grave misconduct is not limited to standards accepted by the supplier, there would be considerable difficulties in identifying "objective" norms by reference to which grave misconduct can be defined.

Conclusion

Although Article 38 of the Utilities Directive refers expressly only to laying down conditions concerning the contract to be awarded in the procedure, there is some scope to argue that utilities – perhaps differently from entities under the Public Sector Directive – may lay down norms that have a wider application than the contract work. If that is the case, there is also scope to argue that utilities may exclude firms from contracts for not meeting such requirements, on the basis that such exclusions would be based on

"objective criteria". There are various possible interpretations of the precise scope for such conditions and exclusions, as have been discussed at xxx above. However, in practice, the inclusion of the new Article 38 on the 2004 Utilities Directive may make a flexible approach to these issues rather more difficult to sustain than it might have been under the old directives. If the ECJ does indeed take the view that utilities may neither lay down conditions unrelated to contract performance nor exclude firms that do not comply with such conditions, this will place a very significant constraint on the ability of utilities to pursue the kind of CSR policies that are currently high on the agenda.

4.4. Exclusion for offences of corruption, money laundering etc

As mentioned above, one growing concern of CSR policies in the supply chain is bribery and corruption. In this context it is appropriate to mention that new provisions of the 2004 procurement directives *require* bodies classified as contracting authorities to exclude from public contracts suppliers convicted of certain offences, namely participation in a criminal organisation, corruption, fraud and money laundering, as defined in relevant EU instruments[70]. These new provisions are examined in chapter xx.

Under the Utilities Directive the exclusion applies to contracting authorities carrying out utility activities but it does not apply to utilities covered by the directive merely because they are public undertakings or because they enjoy special or exclusive rights. This is one of the few cases in the Utilities Directive in which it is recognised that different treatment is appropriate for utilities that are not traditional public authorities – in

[70] New public sector directive Article 45(1), setting out all the relevant rules; new utilities directive Article 54(4) (making cross reference to the public sector rules).

this case to *limit* the social responsibilities of utilities. The reason given for the different treatment was the greater difficulties for these authorities of accessing information[71]. However, it seems plausible that fear of imposing an additional bureaucratic burden on commercial entities has also influenced the policy.

The practical effect of the new provisions, though, may be to make it easier for all utilities to implement policies in this area than before when they wish to do so: it seems likely to result in increased efforts at Member State and EC level to provide accessible information for applying the exclusions, which will be available equally for purchasers for whom the exclusions are not mandatory[72].

4.5. Other mechanisms for implementing CSR policies

Whilst interest in CSR policies in utilities has focused on setting minimum standards of conduct for those in the supply chain, CSR policies can also be implemented in other ways. One issue is whether utilities selecting between a number of suppliers that meet their minimum requirements when inviting tenders/offers[73] may select based on the quality of the suppliers' policies on social and environmental issues. The directive requires utilities to make its selection based on "objective" rules and criteria[74]; and thus,

[71] The final provision differs on this point from the original proposal on the issue.

[72] On the UK position, for example, see S. Arrowsmith, 'Implementation of the New EC Procurement Directives and the *Alcatel* Ruling in England and Wales and Northern Ireland: a Review of the New Legislation and Guidance' (2006) 15 *Public Procurement Law Review* 86, section 8.6.

[73] This applies only in restricted or negotiated procedures. It is expressly permitted by Article 54(3).

[74] Article 54(3), referring back to Article 52(1) and (2), which require use of objective criteria.

in principle the same range of criteria apply to selection as to exclusions [75] (although this does not mean that exactly the same criteria must be applied at each stage in each individual procurement). This means that the possibility for considering such policies at the selection stage depends on the scope of the power to exclude. For example, if a utility can exclude for non-compliance with special conditions, then it would appear that the capability of suppliers to meet applicable secondary conditions can be considered at the selection stage, alongside technical and financial capabilities. For example, a utility buying protective clothing that includes in the contract special conditions that the clothing must not be made using child labour or slave labour could then, in choosing whom to invite, consider not merely suppliers' experience and reliability in meeting supply contracts of this size, but also their experience in monitoring for compliance with such special conditions. As we have seen at 4.2.2., however, the scope for this is far from clear.

Utilities might also wish to reserve some of their contracts exclusively for limited groups of suppliers, such as firms owned by certain ethnic groups or small businesses. Whether there is any scope for this depends on whether excluding firms outside the targeted group is considered to be based on "objective" criteria. If utilities may not, in general, lay down conditions for suppliers that do not relate to contract performance, then *a fortiori* it seems that they may not reserve contracts for limited groups. (See the discussion at xx above). If (as seems less likely), they *are* able to do so, it is possible that

[75] In the context of the Public Sector Directive the ECJ has expressly clarified that the same criteria apply to deciding who meets the qualification criteria and selection between qualified suppliers: Case C-360/89, *Commission v Italy* [1992] ECR I-3401.

in justified cases utilities may also be able to set aside contracts for limited groups – although even in that case, set asides might only rarely be justified under the EC Treaty or equal treatment principle. Regardless of the general position, however, as is discussed in chapter xx, the 2004 Utilities Directive, in Article 28 (and also the 2004 Public Sector Directive, Article 19) now provides expressly for reserving contracts for sheltered workshops or sheltered employment programmes employing handicapped persons[76]. Even if programmes of this kind are allowed more generally under the Utilities Directive, it seems that any programme concerned with the employment of handicapped persons must now be carried out within the limitations of this explicit provision.

Finally, social and environmental policies are often implemented by the public sector by including social and environmental criteria as award criteria, to be weighed against price and other features of a supplier's offer in choosing the most advantageous tender (for example, by allowing a 10% price preference for tenders offering social benefits)[77]. This approach is valuable, in particular, to enable public bodies to balance price and other objectives, including to establish, and to set limits to, the amount paid for social or environmental benefits. It does not appear[78], however, to be common, at least in the UK, in the case of commercial utilities (or other commercial firms), whose concerns are largely limited to ensuring that their supply chains operate within minimum ethical standards that are not suitable for this kind of overt financial "trade off" (although such a

[76] See further chapter xx at xxx.

[77] See S. Arrowsmith, J. Linarelli and D. Wallace, *Regulating Public Procurement: National and International Perspectives* (London and The Hague: Kluwer Law International, 2000), Ch.5.

[78] This observation is based on the authors' experience.

trade off is almost inevitably in operation at the stage of monitoring and enforcing the standards set, limiting the resources devoted to this aspect). Should utilities wish to follow such an approach, it appears that the applicable principles are those applying in the public sector, since the rules on award criteria are formulated in the same way and – according to the ECJ in the *Concordia Buses* case - are thus to be interpreted in the same way[79]. As explained in chapter 2, these rules allow procuring entities to use award criteria relating to the subject matter of the contract, which certainly allows use of social and environmental criteria that could be included as part of the technical specification (for example, the noise or pollution level for buses purchased or used under a contract)[80]. It is less clear whether or not award criteria may include criteria relating to "workforce" issues – for example, the extent to which firms are able to provide employment for handicapped persons – but, as explained in chapter 2, the better view is that this is possible[81].

4.6. Evidence for proving compliance with CSR policies

We have so far examined the constraints in the Utilities Directive on substantive CSR requirements. Also important, however, are the Directive's rules on evidence that utilities

[79] Case C-513/99, *Concordia Bus Finland v Helsinki* [2002] ECR. I-7213. It might possibly be argued that the rules on award for utilities are different in certain respects, however, because of the differences in the rules on exclusion, that are relevant to the overall context of the provisions on award.

[80] *Concordia Buses*, above, concerning noise and pollution levels of buses in a contract for the provision of transport services.

[81] See further the discussion at xxxx.

may require from suppliers to demonstrate the ability to meet those requirements. One concern of the directives is to remove barriers to market access that result from procedural burdens on suppliers. To this end, the Utilities Directive provides that in the qualification and selection process[82] entities may not require tests or evidence that would duplicate objective evidence already available.[83] This means that utilities cannot require suppliers to provide evidence chosen by the utility to prove the supplier's compliance with the CSR requirements: suppliers must be permitted to offer any adequate evidence that the supplier has available (and the utility must probably also make it clear that it will accept such evidence as an alternative to any evidence that the utility suggests)[84].

The principle is also stated more specifically for environmental management measures and quality assurance measures: the directive states that entities cannot require suppliers to be certified by reference to EMAS or environmental management standards based on European or international standards, or to be certified in accordance with quality

[82] Article 52(1)(b). That does not expressly refer to open procedures but the same principle will apply by analogy. This requirement – like the rules on qualification criteria – is not as rigid as the comparable public sector rules which, in addition to this principle, also contains a detailed and limited list of evidence that can be even requested for proving certain aspects of technical and financial capability

[83] Article 52(1)(b).

[84] Such an argument could be made on the basis of the transparency principle – it cannot be expected that suppliers will know of their rights to supply alternative evidence so as to rely on this even when the contract documents seem to imply that only the specified evidence will be accepted.

assurance systems based on European standards, but must accept evidence of "equivalent" measures[85].

The same principle is also stated in the context of technical specifications. Utilities may set their specifications either by reference to certain recognised standards – such as those based on European standards – or by reference to the functional or performance characteristics of the product/works/services[86]. When the utility refers to recognized standards, it cannot reject a tender simply because the offer does not comply with the standard itself, but must accept any offer that meets the substantive requirements reflected in the standard "in an equivalent manner"[87]. The directive here states expressly that the tenderer must prove equivalence "to the satisfaction of the contracting entity, by whatever appropriate means"[88]. It seems likely that this same principle – that the burden is on tenderers to demonstrate compliance with requirements – also applies to other areas, including compliance with CSR requirements.

This general principle has important implications for CSR policies. Many private firms operate programmes that require suppliers to be certified under specific schemes, either based on international or European standards – such as those for environmental management – or set up by industry itself, as in the case of SA 8000. Suppliers that do

[85] Utilities Directive Article 52(2) and (3). These provisions also add to the general principles otherwise stated in the directive by requiring reference only to systems based on European standards when certifications are suggested as evidence – that is, the utility may not instead refer to other certification systems even as suggested evidence (although suppliers themselves could offer such certifications).

[86] Utilities Directive 34(3).

[87] Utilities Directive 34(3).

[88] Utilities Directive 34(3).

not obtain certification may be excluded from contracts. The Utilities Directive does not, however, allow this approach: a utility cannot require any such certification, but must allow a supplier to demonstrate by other means that it can meet the utility's requirements relating to labour conditions, environmental impact, or whatever. Such certifications are relevant only in that they provide one useful means for a supplier to show that it meets requirements, if the supplier chooses to become certified (and it may be helpful for utilities to indicate certain certificates that they will definitely accept as evidence).

From the point of view of maintaining a balance between its own interests in value for money, procedural efficiency and the effectiveness of CSR policies, an unregulated private firm may insist on certification: this limits the procedural burdens on the buyer itself, and can potentially provide a better guarantee of compliance than examining evidence presented on a case-by-case basis. From the utility's perspective, these advantages might outweigh any benefit from broadening the supply base to uncertified suppliers (especially if there are more than enough certified suppliers to ensure adequate competition). The Utilities Directive, however, constrains utilities' discretion in making this balance, in order to broaden access to utility markets and to limit discretion that could theoretically be abused to favour national suppliers. A rule that places the burden of proof on suppliers goes only part way to meeting these concerns: it is still procedurally more burdensome than a rule that permits a utility to insist on certification, as utilities must themselves examine the evidence in each case, and the risk of legal challenge may also make it difficult for utilities to insist on the level of proof that they would ideally like.

The Utilities Directive also states expressly that utilities may not impose administrative, technical and financial conditions on certain suppliers that are not imposed on others[89]. This appears to restate in this specific context the directive's general equal treatment principle. This principle, as elaborated by the ECJ in *Fabricom*[90] "…requires that comparable situations must not be treated differently and that different situations must not be treated in the same way, unless such treatment is objectively justified"[91]. One of the current authors has already highlighted the nebulous nature of this principle and the uncertainty that it creates for purchasers in making everyday decisions: it is difficult to anticipate how it will be applied by the courts in any individual case – that is, what they will consider to be a comparable situation and what reasons will justify different treatment[92]. It raises a specific concern for the utilities in the context of CSR: they may be nervous of imposing additional checks on some suppliers from high risk areas of the world which might be considered to contravene this principle (especially as even a supplier in an EU state may have a complex supply chain exposing the utility to significant risk), but equally nervous of a claim that they are imposing an unnecessary burden on suppliers from low-risk countries.

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[89] Utilities Directive Article 52(1)(a). Like Article 52(1)(b) this actually refers only to restricted and negotiated procedures, but the same rule will apply for open procedures.

[90] Joined Cases C21/03 and C-34/03, *Fabricom v État Belge* [2005] ECR I-1559.

[91] Para.27 of the judgment. See also Advocate General Mischo in *Concordia Buses*, above, point 149 of the Opinion.

[92] S. Arrowsmith, 'The Past and Future Evolution of EC Procurement Law: from Framework to Common Code?' (2006) 35 *Public Contracts Law Journal* 337.

Utilities probably also cannot demand information beyond that needed to show compliance with requirements for participating in procurements. Merely to require suppliers to *provide* such information may contravene the directive, as it involves an unnecessary burden; and requiring irrelevant information may also create a presumption that this information has been *taken into account*. This means that utilities that seek information on the supply chain for research purposes – for example, to help inform future standard-setting, or for other (non-regulated) parts of its business – probably needs to indicate that suppliers have an option whether or not to supply it. It may also be advisable to ensure that this additional information relating to identifiable suppliers is not available when making decisions in a regulated procedure, again to avoid any inference that the utility took irrelevant information into account.

4.7. Issues arising from the use of qualification systems

4.7.1. The use of qualification systems

The Utilities Directive – unlike the Public Sector Directive[93] - allows utilities to restrict access to contracts to suppliers registered in advance on lists maintained by the utility[94]. The directive calls these "qualification systems". Utilities may also use an advertisement of the list to satisfy the advertising requirements of the directive[95]: the list must be

[93] The Public Sector Directive does not allow this for suppliers from other Member States.

[94] See Article 53 of the Utilities Directive and for discussion Arrowsmith, note 3 above, at 16.141 *et seq*.

[95] Utilities Directive Article 42(1). Again, the position is different from that under the Public Sector Directive: authorities covered by that directive must publish a separate advertisement for each procurement.

advertised when first set up and, if its duration is more than three years, annually thereafter.

Although the directive calls these lists “qualification systems”, it does not require utilities actually to assess supplier qualifications as a condition of registration – the utility has discretion over how far it will do this at the time of registration, rather than when it actually uses the system to place contracts. Thus at one extreme the utility may choose to register any supplier interested in the type of contracts covered by the system, whilst at the other it may make a full assessment of qualifications prior to registration. In practice, many systems operate somewhere between these extremes. Thus a limited amount of pre-screening of suppliers (with exclusion of those that are unsuitable) can be carried out before registration, and this is then supplemented by assessments of the supplier’s ability to carry out specific contracts when these are awarded. A qualification system can also be set up which provides information on suppliers (which may or may not be verified at the time of registration), and which is not used as a basis for excluding them, but can later be used by the utility to select tenderers (and verified at that point if required). For example, suppliers are commonly asked to provide information needed to assess capability for most contracts - on financial turnover, past experience and criminal convictions – on registration, but this is not necessarily used to exclude suppliers or to make any assessment of capability. This information can then be used when specific procurement arise to choose whom to invite to tender, and the utility can then take further steps to assess capability for the specific project, as required. This avoids duplication in assessing information required for all contracts, whilst limiting detailed assessments to cases in which they are actually relevant.

The possibility for using qualification systems to advertise procurements and choose suppliers is one of the most important ways in which the Utilities Directive provides for greater flexibility than the public sector rules. Use of qualification systems allows utilities to streamline the procurement process, leading to more efficient management of information on the supply chain[96].

Utilities use qualification systems widely for several reasons. First, the nature of their work often requires technically and commercially complicated assessments that they cannot easily undertake at the last minute within a tendering process. Secondly, a particular need may be driven by events and a utility will not necessarily have time to qualify all suppliers from scratch. In this case using an advertised qualification system may significantly enhance the transparency and openness of the process, since the alternative might be a procedure without any call for competition. Thirdly, the costs of repetitive qualification are unproductive for the utility and supplier alike. There is scope for utilities to reduce these for both sides through using general systems to replace multiple qualifications, and also by sharing such systems with other organizations that draw from the same supplier pool. Whilst in practice co-operation on qualification started as a national or European regional development it is becoming increasingly global, as firms seek to extend their area of supply and wish to use a single set of data to make informed buying decisions. In the case of CSR this is particularly relevant as most organizations seek information on the same areas of activity, there is no agreed standard, and the weight that any one organization wields in terms of gaining supplier commitment

[96] For further discussion of such systems, and also the possible disadvantages and the ways of addressing these, see Arrowsmith, note 3 above, 12.45 *et seq*.

to answer truthfully and to comply with standards is clearly less than if the whole industry is seen to be working together to drive up standards and eliminate rogue suppliers.

In the same way that utilities sometimes limit invitations for a particular procurement to only a few of the qualified available suppliers, they may also wish to confine registration on a qualification system to a limited number of the most suitable suppliers – that is, to use the list as a form of selection to narrow the participants for later procurements. This seems possible in principle, since the same requirement to use "objective" rules and criteria applies under the Utilities Directive to both the process of excluding suppliers as unqualified, and the process of selecting a limited number from those that are qualified[97]. So far as commercial procurement objectives are concerned, this can be useful, for example, to develop cooperation with a limited group of suppliers on issues such as product development (although subject to the scope for excluding and selecting suppliers for reasons going beyond the specific procurement: see 4.2. above).

4.7.2. Legal issues

Several legal issues arise in relation to the use of qualification systems in the context of CSR.

[97] Thus the same obligations in Article 52(4) to use objective rules and criteria in restricted and negotiated procedures applies to both aspects, and Article 54(3), setting out further rules for the process of limiting suppliers to some of those qualified, merely elaborates on the general statement in Article 54(2), confirming that that statement covers both aspects.

One concern arises from the fact that individual qualification systems cover a range of contracts, and may cover contracts for different products, works and services. Further, systems may cover both contracts regulated by the directives and contracts that are not regulated by the directives - such as below-threshold contracts - or even by the Treaty, as in the case of below-threshold contracts awarded by private utilities not covered by the Treaty. This is common in practice given the importance of shared qualification systems, as just discussed, and also the increasing diversity of activities carried on within individual utilities, as discussed in section 6 below. This raises two related questions.

The first is how substantive exclusions operate under qualification systems. We have seen that utilities can exclude suppliers for anticipated failure to fulfil certain CSR requirements that are relevant for the contracts covered by a qualification system, and can also use these criteria to narrow down registered suppliers to a "preferred list", although it is not clear how far this is so for requirements that the directive classifies as "special conditions" (see section 4.2. above). Clearly, if a utility *can* exclude for anticipated failure to comply with special conditions, it can exclude a supplier from registering for – say - works contracts, where all works contracts awarded under the qualification system will include special conditions relating to working conditions. However, if the system covers *some* contracts for which such conditions are – or may not be - not relevant, it is not clear how far suppliers can be selected for the list on the basis of their performance in the area of working conditions. This could arise, for example, where a utility decides on a case-by-case basis whether or not to include such conditions, depending on the precise scope and nature of the work, and the pool of potential suppliers. The same issue arises

with a system used by several different utilities that have different policies for the same type of contract. At one extreme, it seems unlikely that utilities can operate a single system for, say, works and supply contracts, and exclude suppliers totally for reasons that are only relevant for works contracts. On the other hand, to allow utilities only to exclude suppliers on the basis of criteria that are relevant for *every* contract on the system could undermine the value of a qualification system. By its very nature, such a system is designed to cover a range of contracts that are not identical. Thus it seems that utilities are allowed some leeway to set criteria that are not necessarily relevant for every covered contract. Quite how much, however, is unclear at present.

It is likely to be most practical to implement exclusions based on CSR considerations for cases in which these need not be tied to future contract performance. Thus, for example, utilities may wish to exclude from qualification systems suppliers that have certain types of criminal convictions, or have been guilty of certain grave misconduct. Using qualification systems to deal with these exclusions can help to ensure that a utility adopts a consistent policy. It also avoids the need to deal with it in each procurement – and helps to avoid some of the pitfalls that this may involve, as a result of the need to follow bureaucratic procedures for exclusions[98].

The second question that arises from the fact that qualification systems cover a range of contracts relates to the provision of information by suppliers. To the extent that doubts exist over excluding suppliers for reasons that are not relevant to every contract,

[98] See, in particular, Joined Cases C-226/04 and C-228/04, *La Cascina v Ministero della Difesa* [2006] ECR I-1347 indicating that entities must set out in detail how such exclusions are to apply; and see the discussion at xxx.

to reduce the risks that exclusion might create, or simply for convenience, as discussed above, it might sometimes be provided simply that registered firms should *supply information* on the relevant CSR matters, without this being used to exclude the supplier automatically from any contracts at the time of registration. The question of exclusion could then be determined on a contract-by-contract basis in the context of each award procedure.

Can suppliers be *required* to provide such information or to submit to such assessments at the time of registration, as a condition of registration?

As discussed at 4.5, in general it does not seem possible to require suppliers to provide information that is not relevant for the contract to be awarded. In the context of qualification systems, it would appear that a parallel rule applies to that which governs exclusions – suppliers may not be required to provide information that is not relevant for registration on the system (or in a particular classification within the system). However, as with exclusions, given the nature of qualification systems it does not seem that such information would need to be relevant for *every* contract before it can be required as a condition of registration.

Suppliers could also possibly be given a choice over whether to provide certain information or undertake certain assessments, but on the basis that without that information or assessments they cannot be considered for later specific contracts for which the information/assessments are relevant. For example, a supplier could be given a choice over whether to provide information relevant for assessing working conditions (assuming that non-compliance with special conditions is indeed a ground for exclusion),

on the basis that if it does not it will not be considered for contracts for which ability to comply with the special condition is a selection criterion.

5. Utilities' procurement outside the Utilities Directive

Activities of the regulated utilities – as well as activities of other state companies – may also be affected by the EC Treaty rules. These are important for contracts that fall outside the directives, including those below the directives' financial thresholds (which are relatively high for utilities) and works and services concession contracts, which are expressly excluded from the directive[99]. Such contracts are still in principle subject to the EC Treaty rules on free movement[100], and the Treaty rules are also important for certain services contracts, to which most of the directives' procedures do not apply. The free movement rules have become potentially more important as a result of the ECJ's ruling in *Telaustria*[101] that they imply a positive obligation of transparency, which involves at least an obligation to advertise procurements.

Quite apart from the points already discussed above, notably the impact of the Treaty on measures of CSR directed at conduct outside the Member State concerned, the significance of the Treaty rules for the CSR policies of utilities is not yet clear for two main reasons.

[99] Article 18. The directive is silent on supply concessions leaving the position unclear.

[100] Case C-324/98 *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria AG* [2000] ECR. I-10745.

[101] Above. On this see further xxx.

First, as discussed in chapter 2, the exact requirements of the transparency obligation are unclear: it is not yet known how far the ECJ will take inspiration from the directives in setting the requirements of transparency, and how more flexible – if at all - the transparency procedures of the Treaty on issues such as exclusion and award criteria[102]. Secondly, the ECJ has yet to clarify whether the free movement provisions apply to utilities that are public undertakings[103]. Whilst the Community legislator has provided for a broad application of internal market rules in certain secondary legislation, including under the Utilities Directive, by including all companies subject to dominant government influence as defined by ownership or control, it is not clear that the Treaty has such a broad application. Jurisprudence on state aids suggests that, in fact, this might not be the case, and that only actual intervention in decision-making by government, or a real likelihood of this, will attract the application of the Treaty[104]. Applying the Treaty broadly to state companies – particularly outside the sectors identified in the directive as giving rise to problems in terms of market access - seems particularly problematic in procurement, given the ruling that transparency obligations apply under the Treaty, since these can interfere with the ability of commercial undertakings to procure in an effective manner. However, the position is unclear. It seems unlikely, though, that the Treaty's free movement rules will apply to private entities merely because they enjoy special or exclusive rights. There may, however, be a violation of Article 86 when a Member State itself encourages utilities that are public undertakings or have special or exclusive rights

[102] See xxx.

[103] See Arrowsmith, note 3 above, at 4.23.

[104] See, in particular, Case C-482/99, *France v Commission* ('*Stardust Marine*') [2002] ECR I-4397.

to act in a way that would violate the free movement rules if carried out by a Member State itself – for example, by limiting its procurements to national suppliers, or *requiring* them to include social clauses that would violate the Treaty if applied by the State[105].

6. The problem of divergent regulatory regimes

A final important issue is the growing problem for modern utilities' procurement strategies that is caused by the proliferation of regulatory regimes. Since the original Utilities Directive in 1990, both the nature of the utility industries and the nature of procurement have undergone great changes, as many utilities have been privatized and deregulated. For many years utilities were protected from major transformational change by state ownership or state control and/or an absence of competitive market conditions. However, privatisation and liberalization at Member State and EC level has meant takeover and merger activity has completely changed the landscape. In particular, there have emerged a smaller number of much larger utilities with clear international aspirations. This consolidation has been most apparent in the energy sector, although there has been some similar movement in other areas, such as transport and water. Consolidation has not been limited to private companies, with some of the most

[105] It has been suggested that there may be a violation of Article 86 whenever a public undertaking or entity with special or exclusive rights acts in a way that would violate the Treaty if a Member State acted in the same way (J.L. Buendia Sierra, *Exclusive Rights and EC Monopolies under EC Law* (Oxford: Oxford University Press, 1999), pp.192-193 and the works cited there). However, the authors reject this view: see Arrowsmith, *The Law of Public and Utilities Procurement*, 2nd edn (London: Sweet & Maxwell, 2005), at 4.54-55.

aggressive acquirers being state owned energy companies such as EdF of France, which now owns utility assets in several European countries. These changes have had a major, and increasing, impact on procurement.

First, within individual utility groups the new trans-national utilities are seeking to use their greater leverage and market position to improve their overall supply arrangements and are becoming large enough to enter into genuine global sourcing arrangements in the same way as the multi-national oil and gas industry has long done. These arrangements are generally taking three forms - direct contracts with an individual user utility within the utility group, global sourcing arrangements awarded by the Head Office with call-offs by individual subsidiaries within a group, and shared agreements with several subsidiaries taking part.

Secondly, another substantial issue for the utilities is that the growth of the companies has led to them diversifying out of their traditional activities, operating both in the EU and outside, and acting both in regulated areas and in non-regulated areas. As a result they are increasingly engaged in varying activities that are subject to different procurement rules. Thus, for example, a major German utility has found itself subject to the public sector regime for a public-private partnership deal, the utilities sector for its electricity network business, and potentially one of the Utilities Directive's derogations for its upstream gas business[106], as well as operating several completely unregulated businesses, such as supply of consumer products and activities outside the EU.

Finally, as mentioned above in looking at qualification systems, utilities are increasingly engaging in co-operative arrangements in their procurement, both in order to

[106] Under Article 3 of the previous Utilities Directive 93/38, an exemption preserved by the new directive.

drive down costs and – more recently – to ensure effective implementation of CSR policies. This co-operation is carried on to a large extent with others within the regulated utilities sectors, but also with both private and public bodies outside those sectors.

By imposing regulatory constraints on utilities in the EC, the Utilities Directive, and to a more limited extent the EC Treaty, may have the effect of inhibiting effective initiatives that span more than one country or more than one sector, or which involve cooperation with organizations that are not subject to the EC's regulatory regime. For example, a qualification system set up to cover both regulated and non-regulated activity, will need to be set up to comply with the directive, potentially limiting the value of the system for organizations that are not subject to the same constraints. The fact that individual utilities may carry out a diverse range of activities and operate in different regions that are subject to different regulatory regimes also creates confusion within the utility about which rules to follow - especially in the case of activities such as IT purchasing which may cover a variety of different projects - as well as confusion amongst suppliers.

This problem barely exists for entities covered by the Public Sector Directive, since cooperation is largely limited to entities within the same Member State covered by the same regulatory regimes. These entities may be affected, though, by the application of different regimes to the public and the utility sectors, which create obstacles to cooperation across these sectors**.** This has occurred in the UK, for example, both because utility and public sector bodies have sometimes wished to use combined supplier databases. In addition, individual public authorities are sometimes covered by different directives for different activities.

7. Issues for the future

The discussion above has highlighted the legal position encountered by the regulated utilities that wish to implement CSR strategies relating to the supply chain.

It is apparent, first, that, however the EC procurement rules are interpreted, they place significant restrictions on regulated utilities' freedom of action, in comparison with that of their non-regulated counterparts. This is more clearly so than it was prior to 2004, as the 2004 directive – particular Article 38 on special conditions - has cast greater doubt on some of the previous possibilities for a flexible interpretation. Secondly, it was shown that the limits of discretion are not at all clear, and there is very limited guidance from official sources, which have focused on the public sector rules. Utilities engaging in this area must carefully balance their interests in CSR against the legal risks involved.

Given the impact that the directive has in this area, and the fact that it has not previously been much discussed in the public and institutional debates on CSR, there is clearly a need for further debate and further research. A number of questions and concerns need to be considered in any such debate.

A first issue is whether there is a sufficient case for regulating utilities at all, at least those in the private sector. Is there sufficient recent evidence of the fact that utilities behaviour in procurement operates as a barrier to trade to justify regulating such procurement (which is not generally regulated under other national and international procurement regimes)? It is pertinent that the study of the economic impact of the internal market rules completed for the Commission in the late 1990s indicated that firms in the telecommunications industry were engaging in commercial procurement for reasons other

than the influence of the directives, even though that industry was not yet fully competitive[107] (in the sense currently required for an exemption under Article 30 of the current Utilities Directive). It is possible that for some sectors, at least, the problem no longer meets the threshold that justifies regulatory measures. However, in the recent reform of the directives a decision was taken to exclude only entities operating in fully competitive markets (under the Article 30 exemption and by a total exclusion of the previously-regulated telecommunication industry), and some utilities previously caught under the concept of special or excusive rights (by narrowing the definition of that concept). It seems unlikely that this decision will be revisited in the short term, but research on this issue comparable to that undertaken in the 1990s would be useful for ensuring that decisions on regulatory strategy in the longer term are made on the basis of full information. Assuming that regulation does continue, research on the extent of discrimination and other barriers to trade, and whether the Utilities Directive is material here, would be equally useful for deciding precisely how to balance the competing concerns involved, as discussed below.

Assuming that the EC continues to regulate the procurement of private utilities and those that are public undertakings, the question is how the rules on CSR should be developed, whether through legislation, judicial interpretation or soft law, including guidance from the Commission and national governments. To some extent the issues are the same as with the public sector. Key issues are the value of the directives' transparency rules for removing barriers to trade, and – assuming that they are of some

[107] European Commission *The Single Market Review* subseries III, *Dismantling of Barriers*, Volume 2, Public Procurement (1997).

value – how the internal market interests with which these rules are concerned should be balanced against the impact that they may have on the interests of both the Member States and the EC itself – since some of the CSR policies involved are EC policies[108]. As chapter 1 emphasises[109], the directives do not themselves seek to determine the proper balance between social and environmental concerns and other procurement objectives – matters such as value for money and implementation of social and environmental policies in procurement remain in principle a matter for Member States. These policies can only be implemented within the framework of rules laid down to achieve the EC's single market objectives, which may, of course, affect the discretion of Member States to implement such policies. However, the EC must take into account the adverse impact that its internal market rules may have on Member States' interests, and it must also take account of the EC's own policies in these fields. As elaborated in chapter 2, a number of commentators, and the European Parliament, have criticised the EC's current approach for the public sector as giving undue weight to the interests of the internal market, but in the recent reform process the same approach was eventually maintained.

Irrespective of these criticisms of the public sector rules, are there reasons why utilities might anyway be treated differently from the public sector? A number of possible reasons can be identified. Some of these influenced the original decision to provide a more flexible regime for utilities in general than for the public sector, but some also did not exist at that time – or not to such a great extent – and/or are particularly relevant for CSR policies.

[108] See chapter 1 of this book.

[109] See xxxx.

One is simply that the problem of procurement as a barrier to trade is not so great with the utilities - at least for some utilities – as with most entities covered by the Public Sector Directive. Thus, the same degree of regulation may not be required to open up markets, and this could justify allowing utilities more discretion – for example, to exclude suppliers. As already mentioned, utilities very clearly enjoy more discretion in some areas – such as in using the negotiated procedure that allows extensive dialogue with suppliers – even when buying simple products, and greater flexibility may possibly be justified also in the context of CSR. However, this argument is less relevant to the question of allowing policies that go beyond the contract, which is based less on the desire to limit discretion rather than on the limiting effect of such policies on trade.

It can also be argued that, to the extent that CSR policies are part of the utility's commercial strategy, they are more important for many utilities than for many other regulated entities, since they relate to what in many cases is the utility's core objective, namely commercial success. This is in contrast with some of the policies implemented by public sector bodies, which involve minimizing the impact of the body's policies on unrelated areas of policy, or supporting policies unrelated to the entity's own mission. This argument may be less relevant if the public sector is regarded as a whole, rather than as a number of constituent parts. However, here it is also relevant to note that there are alternative methods for implementing many of the policies that are promoted through procurement and that these methods may be more efficient. This is one consideration that may have led the EC legislature and courts to the conclusion that a strict approach is needed for the public sector: the adverse impact on Member States interests and Community interests in these fields is limited when entities can use alternative means that

have less impact on trade (although this consideration has not been articulated). This is not, however, a consideration for utilities whose commercial interests may be adversely affected if they are not able to take account of CSR concerns in managing their supply chains.

Another similar consideration also arises from the fact that CSR policies may be driven by commercial motives. This is that, irrespective of whether alternatives are available, the Community's tolerance for adverse impact in the internal market may be influenced by the fact that the costs of implementing social or environmental policies through procurement may outweigh the substantive benefits, or even be counterproductive (as, for example, where policies to support a particular disadvantaged group lead that group to become dependent on government contracts and unable to compete in the broader economy); and the decision to implement them in Member States may be driven more by political concerns than a genuine assessment of the other costs and benefits of the policy. Again, this may result in less weight being placed on Member States interests. The same concerns may arise with utilities' policies, also – for example, where the immediate effect of prohibiting child labour has the effect of pushing the children concerned into even more unsatisfactory occupations. However, it can be questioned whether this is so relevant for utilities, where the success of the policy is from the perspective of the utility to be measured not at all (or, at least, not only) by its practical effects, but by its impact on the utility's business. If this can affect the utility's competitiveness, is it a concern that should be given more weight than the political concerns of a Member State? Should policy makers then be less concerned – or not

concerned at all - with the actual social or environmental impact of the policy when balancing the competing interests involved?

The fact that the drivers for CSR policies are often commercial, also raises another question: how are policy makers to deal with the fact that it is difficult to prove or disprove actual commercial benefits from CSR policies? Is this something that the courts, legislature or other policy makers should take into account and seek to judge, or is it something that should be left to the utilities themselves? In this respect, it can be pointed out that the EC itself has placed increasing weight on the commercial reasons for CSR policies to justify its own intervention in the field, although this does not mean that there are not also other reasons for Community action[110].

Finally, it is relevant that the strictures of the directive are likely to have a greater adverse impact on utilities than on most of the public sector because of the increasingly international and collaborative nature of utility activity, and because of the problems of subjecting individual entities or different entities in corporate groups to divergent regulatory regimes, as discussed above. This is relevant both because it means that utilities may need to compete (for example, in global markets) against firms that are not regulated in the same way, and also the directive may prevent utilities from using efficient collaborative strategies, pushing up the costs of internal market regulation.

All these issues are relevant to any future debate and policy-making relating to CSR in the utility sectors. It is hoped that this chapter will serve to stimulate debate on the subject and to provide at least part of the legal and policy framework for conducting such a debate.

[110] See the Communication cited in note 1 above.