THE TROUBLED LIFE OF COMPETITION IN LOCAL PUBLIC SERVICES

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Abstract

After providing a systematic picture of the state of the art in the regulation of local public services pursuant to the laws that came into being in the 2008/2009 period, this papers moves on to illustrate what the management system of local public services ought to be in light of the special implementing regulation. Finally the author points out that various elements lead to the opinion that the regulation of local public services has yet to find its true basis.

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1. Competition in local public services. Competition for the market instead of the relevant competitive market.

Much ink has been spilled, and not always favourably, over the series of laws that came into being in the short period 2008/2009 to regulate local public services.

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It may therefore be appropriate to provide a systematic picture of the state of the art before moving on to illustrate what the management system of local public services ought to be, in the light of the special implementing regulation which, after a lengthy gestation, finally came into being.

It all began when the European Community, following the example of the United Kingdom, decided to introduce the practice of competition in public services into the various Member States. For the European Community, of course, extending competition to all the possible actors within the Community is a means of achieving European unity at the roots by the Members of the Community, now the Union, thanks to the "mix" of all possible competitors, a unity so difficult to achieve at the top.

The public services competition model naturally consists in identifying a relevant market in the public services, in dissociating State ownership and management of services, creating artificial competition implemented by administrative measures, in management, gradually encouraging the emergence of more competing firms until competition between operators becomes natural, while regulation is entrusted to a neutral entity, an independent authority, through administrative measures (so-called "artificial" competition).

The application of these rules to the major national public services has seen both success and failure, and to date has produced the most diverse results, but they were still applied, or are still being applied, to services for which it has been possible to identify a relevant market, first at home and then abroad.

The model came unstuck when it came to *local* public services, for which it was impossible, except in exceptional cases, to identify a relevant market in which to introduce simulated competition and, later, *true* competition[1]. There are many reasons for this failure, but, in essence, they are due to the fragmentation of local authorities and their consequent inability to identify a market in the operational area of a service if local.

This phenomenon is particularly apparent in Italy, where the subjective configuration of local powers, at municipal level, has remained unchanged, or has undergone only marginal

[1] See F. Merusi, *Le leggi del mercato. Innovazione comunitaria e autarchia nazionale* (2002), at 76.

changes, since the 1859 Rattazzi Law, which legitimated the local communities as they were, without attempting to rationalise the administrative powers of local communities[2]. This "temporary" solution was consolidated by an 1865 law on administrative unification for the whole of Italy, and has come down to this day with only minor alterations, reflecting the changing Constitutional order over time. After World War II, almost all the other European countries rationalized their local authorities, but, as before, there was barely any attempt to make the provision of services fit in with a market that could be described as relevant from the point of view of introducing a competitive system[3].

Faced with this state of affairs, the EU decided not to introduce the simulation of competition into markets that appeared to be of no great relevance and resorted to a lesser form of competition: competition for the market. This involves periodically submitting the management of local services for tender on the assumption that occasional competition for the market would guarantee efficient services.

A system of this kind obviously means that the local authorities themselves, or other public entities which simulate competition for the market through a holding company, cannot allocate the provision of services to subsidiaries in which they have a substantial share or through subsidiaries which essentially constitute a veiled provider along the lines of the old in-house providers.

There are endless problems, and not only in Italy, connected with alleged circumvention of EU legislation, and there have been countless cases before domestic administrative courts as well as the Court of Justice, often involving Italy.

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[2] For an overview of the situation at the time of the Rattazzi law see the reconstruction and documentation of A. Petracchi, *Le origini dell'ordinamento comunale e provinciale italiano*, vol. 3 (1962), and on the situation of the southern municipalities after the unification of Italy, see the authoritative study P. Manfredi, *I comuni meridionali prima e dopo le leggi eversive della feudalità*, vol. 2. (1910-16). On the reasons for the 'confirmation' of 1865, see G. Vesperini, *I poteri locali*, vol. 1 (1999) and the literature cited there.

[3] See for example Y. Meny, *Profili di Amministrazione locale. La riforma francese* (1983) and A. Alexander, *L'amministrazione locale in Gran Bretagna. Una riforma alla prova* (1984). For a description of the current state of local autonomy in practically every part of the globe see G. Pavani & L Pegoraro (eds.), *Municipi d'Occidente. Il governo locale in Europa e nelle Americhe* (2006).

The first legal measure, the legislative decree of 2008, an addition to the string of legislative changes whereby the Italian government sought to remedy up to 14 Community infringements, also regulates what the competition for the local public services market ought to be by specifying the kinds of local services to be regularly put to tender and the type of entity to be entrusted with managing the service.

It begins with the exceptions for services of national relevance, or at any rate of a relevance reaching beyond municipality level, i.e., the distribution of natural gas, electricity and rail transport (the latter transferred only to regional control). But thanks to a parliamentary sleight of hand, the exempted services were extended to include community municipal pharmacies, which certainly cannot be said to have any kind of large-scale relevant market. Here, if anything, problems arise relating to the privatization of pharmacies, and not competition for the market concerning the service to be provided[4].

The normal rules refer to services of economic relevance. The problem that clearly arises is that of distinguishing between financially important services and those of social importance. This is not always easy, and not only in the marginal cases, but also because of the different possible meanings of the concept of public service into which economics can blur when providing socially relevant services. The question of interpretation seems to have been resolved by the Italian Competition Authority which, in a communication referring to the article in question states that "*the public services are defined as those of economic relevance relating to the production of goods and activities designed to achieve social purposes and to promote the economic and social development of local communities with the exception of social services of a non-entrepreneurial nature.*" It follows that according to the Authority, the notion of an economically relevant local public service should, in principle, be reconstructed in terms of the difference between it and other activities related to the normal function of public administration, i.e., administration, and providing services which cannot be handled in such as way as to be economically relevant, including all the activities instrumental to the workings of the

[4] For associated problems see D. De Pretis (ed.), *La gestione delle farmacie comunali: modelli e problemi giuridici* (2006).

public administration, but which cannot be run on business lines. Of course there will always be cases where it is uncertain whether or not an instrumental activity can actually be run along business lines. From this perspective, in the end it should become relevant whether they are run as enterprises or not, considering their actual nature rather than the way the service is provided.

Under normal circumstances, i.e., in the relatively near future and after the transitional adjustment procedures which may not actually turn out to be as "ephemeral" as one might wish, those assigned a local public service through a public selection process in conformity with all the rules laid down by the EU should be: 1) entrepreneurs or established companies of some kind, and 2) public/private joint venture companies, provided however, that the private partner is selected through a competitive selection process, i.e. shifting the tender onto involving a private sector partner who should take on a specific practical role in the management of the service and who should in any case acquire a stake of at least 40% of the capital.

2. The *in-house* companies exception.

This is how it should normally be in a more or less distant future. But not for everyone. The long shadow of the Rattazzi solution still falls over the Italian municipal authorities. These municipalities are not all homogeneous. For many, "the territorial criterion of reference" – to cite the wording of the Act - not only does not make it possible to identify a relevant market, but it also fails to allow recourse to a management policy envisaging regular competition for a place on the market. For this reason, the law provides for an exception through the use of so-called *in-house* companies, that is, a company wholly owned by the public partner (or by several public bodies joined in a consortium) and dominated by the shareholder as if it were one of its own (i.e. without any concession to autonomy made possible by statutory regulation): "in exceptional situations, because of the particular economic, social, environmental and geographical features of the territory, which do not permit an effective and beneficial use of the market, a fully public-held company owned by the local authority can be called upon to provide the service if it satisfies EU requirements for the so-called *in-house management,* if it at any

rate complies with the principles of the guidelines on the control of companies and especially its activity with the authority or authorities that control it."

As can be seen here, there were two problems to solve: 1) to determine when and why the conditions for exemption might arise, and 2) the legal form that could legitimise the exemption.

An answer has been proposed for the first question. As for the second, an *idolum* in EU case law has provided an answer, probably without asking the reason for such a response.

3. Control by the Italian Authority on Fair Competition. Constitutional doubts and problems concerning the system.

The answer to the first question is found in procedure: it relies on a neutral authority, independent of the central administration, to determine whether the "economic" reasons that a local authority is obliged to set out are valid.

In fact, under Art. 15 and Regulation 4 of the regulation, an entity wishing to avail itself of an *in-house* company to manage a public economic service must give "adequate publicity to its choice, based on a systematic market analysis" and then submit it to the "opinion", in reality the approval, of the Authority on Fair Competition.

The reason for turning to the Authority on Fair Competition is easily comprehensible: no-one wanted to return to the days of the hated government controls, and the Authority has technical expertise while being independent of the government. There is one detail that everyone seems to have forgotten: the reform of Title V of the Constitution repealed Art. 130 requiring controls which provided for legal and technical specifications by a governmental agency which also would take a neutral stance towards the administration: regional monitoring committees. If this abrogation makes any sense from the legal point of view, it is because any control over the acts of local government, legitimacy, and, even more so, merits, should be considered unconstitutional – even when attributed to an equally "neutral" authority with respect to government policy, like the Antitrust Authority. The emphasis placed on municipal and provincial autonomy in the new art. 114 of the Constitution clearly states that the deletion of Art. 130 of the Constitution is meant to provide for the prohibition

of new *ex lege* controls, hence the doubts concerning the constitutionality of this provision.

But whatever the doubts about the constitutionality of this legislation, there remain issues including the choice of the Italian Authority on Fair Competition. The role of the Antitrust Authority is to guarantee competition and to dissuade from abuse. In the so-called competition for the market in public procurement and public services, there is naturally no competition, and the appearance of one must be created, a one-off, by means of administrative procedure: the call for tender. Artificial competition brought about by means of administrative acts.

But creating artificial administrative competition measures is defined as "regulation" and so far it has been considered appropriate to distinguish between regulatory and supervisory authorities so that competition exists and does not degenerate into an attack on itself. Briefly, it is claimed that the antitrust authorities intervene *ex post* and the supervisory bodies *ex ante*, with the Competition Authority defending the market and the regulatory authorities creating it. There is usually a problem of the powers of regulatory authorities '"overflowing" into those of the Antitrust authority: just as the regulatory authorities manage to create effective and natural competition in a market, they end up competing with the Antitrust authorities in protecting the competition that already exists. The case of the relations between the Antitrust Authority and the Authority for the Regulation of Communications (AGCOM) is, at least in the Italian system, paradigmatic.

Here, the opposite happens: the Antitrust Authority is attributed a regulatory function which will naturally remain such and will never take on the function of an authority protecting competition. In fact, competition for the market will never result in competition in the market, to be defended, once created, by antitrust authorities.

And there is another asystematic peculiarity: at least for the moment, this consists in a national jurisdiction extra to the general EU competence which has recently seen the "unification" of the jurisdiction of domestic antitrust authorities and the European Commission by means of a "single jurisdiction" spread over several agencies which are also “part of the community”. After being joined together into a single community administrative

system, can the antitrust authorities still be used in special national regulation?

But beyond the doubts concerning constitutionality, and perplexities on altering the antitrust system there is the "waiver" benefiting so-called *in-house* companies, which, having been provided for in this way, raises a number of questions.

The *in-house* company is not an institution envisaged by EU law, as the law on the "exception" allowed for local authorities would have us believe.

The *in-house* company is an invention of the Court of Justice which, in several successive rulings on the subject, not only for Italian cases, has pursued a dual purpose: 1) to submit to EU legislation, characterized by the typifying (and therefore unifying) effect of administrative law, "substantial" administration assessed as such using identification parameters, as had been done with the analogous institution, also a Community invention, for the other administrations, of the public law agency, and 2) to exclude from the regulation of public services the phenomenon of "administrative self-production, i.e. administrations which use the company's means to provide services for themselves, not for the end users.

Neither of these cases has anything to do with the exemption proposed by the law; here the idea is one of a service, which in itself could be described as being of an economic nature, and therefore amenable to competition for the market, cannot be run as a business due to local economic reasons. But if this is the case, there is no reason to run it as a joint-stock company, since the quoted company is, by definition, an organisational instrument to manage a business.

If the service cannot be organised as a business and as such is not subject to competition for the market, the service management organization model can only be direct delivery or the attenuated form of company management known as the in-house provider.

Paradoxically, this was demonstrated by the provision introduced when the Legislative Decree was converted, stating that services below a certain threshold to be defined by government regulation do not require the opinion/approval of the Italian Authority on Fair Competition. The provision established a threshold of €200,000 for the economic value of a service below

which the prior approval of the Authority is not required and, consequently, it is possible to freely set up an *in-house* company. But what is the point of setting up a service company with an economic value of less than 200,000 euros? The organisation here appears to be clearly disproportionate to the function it is meant to perform. The use of the form of the joint-stock company was envisaged to get round the domestic norm imposed by the EU on the acquisition of goods and services and the domestic law on the employment of State workers through competitive examinations required by the Italian Constitution (Article 97).

But after the case law and the national parliament (as confirmed by law and regulation) have clarified that the administrative rules on purchasing goods and services and on the employment of State employees[5] also apply to *in-house* companies and companies with majority State ownership, being "substantive administrations," what is the point of setting up companies to carry out activities by their very nature devoid of entrepreneurial "attraction"?

Adding then the obligation to respect, on the part of the *in-house* companies and holding companies dominated by public shareholders, the internal agreements on financial stability, the only possible conclusion is that the law and the regulation, in codifying the hypothesis of the *in-house* company, envisaged its disappearance, prohibiting the pursuit of those ends which had been so felicitous in the Italian and other systems.

4. Competition for the market in normal conditions and for joint ventures. The rules of tender.

But let us return to normality: competition for the market - to a tender to select the private service provider which will be a qualified minority shareholder (at least 40%), with "specific" functions that should be "... in accordance with the principles of the Treaty establishing the European Community and the general principles relating to public contracts and, in particular, the

[5] Albeit with some mitigation and an exception for quoted companies, the fruit of the strenuous resistance of local administrations involved in the question ("In house companies and mixed public/private companies providing local public services, apply provisions of Legislative Decree 163 and subsequent amendments, of 12 April 2006, for the procurement of goods and services").

principles of economy, effectiveness, impartiality, transparency, adequate publicity, non-discrimination, equal treatment, mutual recognition and proportionality".

Principles that Art. 3 of the Regulation has tried to adapt to the complex reality of local public services, but with some difficulty arising from the *de facto* and legal ambiguity that are still present even after the legislation.

First, there is the problem of sources. The Constitutional Court has legitimized the intervention of parliament in the name of competition which, after being mentioned in Title V of the Constitution, in the Court's view "horizontally" legitimates any intervention by the State legislator to the detriment of the regional legislators (see Corte Cost. November 3, 2010, No. 326). This is tantamount to saying that in economic matters, after the Community competition option, Title V was reformed to eliminate any regional legislative powers on economic matters in the broadest sense. A kind of euthanasia for the 'Republic of Autonomy' formally proclaimed in Art. 114. One of the many adjustments that the Court was forced to make to clean up the the mess created by the reform of Title V of the Constitution, an area which now constitutes a large part of the activity of that same Court.

At best, regional parliaments may retain a residual power over the type and *standards* of service being provided. The regional legislature, in all truth, has in some cases intervened to add some alteration to what the Community Treaties, the EU directives and the legislature had determined by taking away some of the original power from local authorities (for example, in Lombardy, on which the Constitutional Court also expressed an opinion in Judgment 2009/307).

Then there are the authorities regulating the sector which may affect directly, or through interference, the regulation of local public services, drawing them into an important national market, leaving only decisions on the territory for the provision of the service under the control of local authorities [6].

Finally, if anything is left, it is the grantor which must establish the "law of the tender", including the *standards* for

[6] For a more complete description, see F. Merusi & M. Passaro, *Le autorità independenti* (2011).

providing the service in the call for tender[7].

To ensure competition for the market, i.e. the tender that the regulation improperly calls the "competitive structure of the relevant markets", the Regulation requires tenders to comply with 1) the dissociation between the network and management, without giving any advantage, in fact or in law, for the availability, for any reason, of the network, then 2) the link between the requirements of the competitors and the service to be provided in order to avoid the economically unfavourable participation of mere "business hunters" as often happened in public tenders, and 3) an impartial definition of the object of the tender in order to prevent the service being artificially tailored to a few competitors favoured by the grantor, and at the same time favouring any economies of scale and scope available from multiple providers of similar services.

This is a theory that could give rise to agreements restricting competition with regard to applications for participation and, as such, must also be evaluated, thanks to the Regulations, by the grantor agencies, which are thus invited to relax their autonomy and to extend their assessments to the whole universe of bids to provide a service, with the necessary effects on the preparation of the call to tender.

It seems clear that if two or more large utility companies are associated in any form, they could counteract or reduce the possible positive effects of competition for the market. Thus, also competition for the market is a form of competition, and as such it should be approached by the grantor for which it is envisaged.

But the truly thorny question concerning competition for the market is time. How often does the tender need to be held for the service to be delivered efficiently and for any initial efficiency not to decline over time?[8]

The Regulation (Article 3) requires a link to be established between the investment required to manage the service and its

[7] As well as drawing up the rules for providing the service through the stipulation of a service contract with the grantor. On this see A. Mozzatti, *Contributo allo studio del contratto di servizio. La contrattualizzazione dei rapporti tra le amministrazioni e i gestori di servizi pubblici* (2010).

[8] A time for competition for the market to add to the examples of the relevance of "time" examined recently by L. Cuocolo, *Tempo e potere nel diritto costituzionale* (2009).

amortization in order to calculate the duration of the service, if and when investment is necessary, of course. And this is what happens in the case of almost all services.

But to call a new tender it is not enough to calculate the amortization of the investment. It should be borne in mind that the company leaving the service has to "transfer" operations to the new operator, which, to avoid the risk of litigation hanging like a sword of Damocles over the costs of the service, means determining beforehand, in the call for tender, at the very least, the criteria for calculating the value of what is passed on to the new assignee. The same, *mutatis mutandis,* must be said for private sector share when the public service has been granted by tender to identify the minority shareholder of the public body. Again, if the criteria and procedures for the liquidation of the share are not defined, not only would litigation be inevitable, but it may prove difficult to find a successor at the end of the established period.

But when there is a private shareholder, at least two other problems arise regarding the call for tender: 1) to define the specific responsibilities to be allocated to the private partner in the management of the service (and not as in the original version of the legislative decree in the outright management so as to *totally* remove the political component of the majority shareholder) and make it effective by stating that the assignment of responsibilities is a condition leading to the forfeit of the assignment should they not be honoured, for any reason, during the provision of the service, and 2) to ensure that a tender based on the price of the shares to be purchased by private bodies interested in becoming partners in the joint enterprise does not jeopardise the quality and cost of the service to be provided, which must be suitably defined in the call for tender.

These are largely obvious criteria of what local authority calls for tender should anyway provide for, applying the general principles relating to public tenders set out in law, but setting them out in a government regulation means transforming the obvious, inferred from general principles which can only be ascertained through case law, into a means of legitimating calls for tender, for whose omission prospective partners or prospective grantees could take action. It would also be a way of ensuring that local authorities do not deviate from the "correct way" through calculated omissions. It would be a form of regulatory

government protection to replace the one repealed by the reform of Title V of the Constitution.

It could of course be argued that the original law already provided for a regulation on municipalisation, albeit issued after more than half a century, and on the point of death, to try to adapt Giolitti's 'municipal' firms to later entrepreneurial needs, but it would be just as easy to reply that at that time the relationship between the State and the local authorities was not on an equal footing as required by the new Title V of the Constitution[9]. But perhaps this goes to show once more that Article. 114 of the Constitution is a showcase norm with no practical implications, and is considered as such not only by the legislator, but also by the Constitutional Court.

5. The search for competition in the market without first identifying the relevant market.

But where the rule seems to have been left in mid-stream is not the question of competition for the market, but competition in the market.

It may well be that a local public service, initially considered to be a monopoly, i.e. provided and able to be provided by a single entity, finds that it has a substantial market and may thus be subject to competition. Among local public services, the phenomenon of city tours in competition with traditional means of transport such as buses and trams is a common experience, not to mention alternative airport links rather than normal public services.

It is widely known how the European Community addresses the problem of transition from competition for the market to competition in the market, i.e., universal service. As competition between firms anyway favours the provision of services at the lowest cost, the social cost of certain services established on a case by case basis is covered by public finance, directly or through a procedure of apportionment of the burden across the competition. The application of this principle is also set

[9] For past events regarding the localisation of public services, see F. Merusi, *Cent'anni di municipalizzazione dal monopolio alla ricerca della concorrenza*, Dir. Amm. 37 (2004).

out in Art. 2 of the Regulation, the so-called "liberalisation measures": "... providing for any economic compensation to the firms providing the services, taking into account income from charges within the limitations of the funds set aside for this purpose."

A local public service may evolve towards the identification of a significant market. But in this case, it is no longer an issue of competition for the market, but of the regulation of competition in the market which has been identified as relevant.

And it is in this light that Article. 2 of the Regulation envisages a complex procedure to determine whether the conditions exist for competition with local public services in the market and, consequently, for eliminating the exclusive monopoly clause favouring the local authority. This would be with the intervention, in this case perfectly congruent, but apparently passive, of the Italian Authority on Fair Competition, which has only to account to Parliament in the annual report.

But even here the text of the regulation, following the suggestions in the opinion prepared by the *Consiglio di Stato*[10], raises some questions.

In the surveys that individual local authorities ought to carry out after the entry into force of the Regulation, and thereafter at regular intervals, there is no mention of the pre-condition of establishing the existence of a relevant market.

In the majority of municipalities, an expensive economic analysis on the possibility of liberalising services is useless because, in terms of size, it is immediately clear that a relevant market does not exist.

And, secondly, is it certain that the addition of the monopoly clause is still legitimate?

The exclusivity clause in the provision of public services is a dubious hypothesis of the original reservation enforceable under Art. 43 of the Constitution. But is Art. 43 of the Constitution still valid or was it not perhaps repealed, as some authorities have

[10] The norm was suggested by the Consiglio di Stato with its opinion of 24 May, 2010 based on what had been set out previously in Art 113, para. 11 of the legislative decree of 18th August 2000, nr. 267 and the EU principles on public services of an economic nature. The issue of the relevant market does not however seem to have come to the attention of those drawing up the opinion.

already claimed after the incorporation of Italian law in EU law[11]?

But even if Art. 43 of the Constitution were still effective, is the law on the municipalisation of public services still in place? This law which made it possible to include the exclusivity clause, that is, the original reservation, when a local authority set up a public service. Or, if it is still in force, is it not now in conflict with community competition law?

Perhaps there is still a monopoly, because no relevant market can be identified.

Elements which lead to the opinion that the regulation of local public services has yet to find its true basis[12].

Post scriptum

The subject covered in this article had lapsed as a result of the referendum which abrogated Art. 23bis of Law 25 of June 2008, Nr. 112 and subsequent amendments, causing to lapse with it the regulation which had implemented it, to which the comments contained in this text referred. However, the norm on local public services (except the integrated water service... despite the judgment of the Constitutional Court, 26 January, 2011, nr 24, which, when approving the referendum, had stated that the reason for holding it, as far as the water question was concerned, was irrelevant) was immediately "resurrected" by the legislative decree of 13 August, 2011, Nr. 138, which became law on 14th September, 2011 as Nr. 148, which proposed again, and practically to the letter, the norm contained within the regulation. The only difference is that what in the text referred to regulatory norms implementing a general disposition of the law, now refers to statutory provisions which directly govern local public services of economic relevance.

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[11] On the debate in question of the consequence of the "Community Constitutionalisation" of a competitive market, see N. Irti (ed.) *Il dibattito sull'ordine giuridico del mercato* (1999), where the idea of a "breakdown of the Italian Constitution" emerges, also with reference to art. 43.

[12] For some ideas based on criteria of economic sociology on the reform envisaged even before its approval, see G. Bargero - G. Fornengo, *Mercato, concorrenza e governance nei servizi pubblici locali*, Economia Pubblica 5 (2008), and more in general on the reform of the public services R. Pedersini, *La riforma dei servizi pubblici: oltre le istitutzioni in Stato e mercato* (2009), at 95.