



EUROPEAN COMMISSION

Brussels, 30-05-2007

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**Subject: State Aid N 46/2007 – United Kingdom
Welsh Public Sector Network Scheme**

Dear Foreign Secretary,

1. SUMMARY

- (1) I am pleased to be able to inform you that the European Commission has assessed the referred Welsh Public Network Scheme and decided to consider that the notified measure does not constitute State aid within the meaning of Article 87 (1) of the EC Treaty.

2. PROCEDURE

- (2) Following a pre-notification meeting held on 25 October 2006, the authorities of the United Kingdom (hereafter "UK"), pursuant to Article 88 (3) of the EC Treaty, notified to the Commission the planned "Welsh Public Sector Network Scheme" by letter registered on 22 January 2007. The Commission requested additional information on the proposed measure by letter on 28 February 2007, to which the UK authorities replied by letter registered on 30 March 2007.

3. DESCRIPTION OF THE PROJECT

- (3) **Objectives.** The aim of the notified measure is to provide public sector organisations in Wales with high availability, high bandwidth managed network services. The procurement will ensure common standards of service, increased interoperability and extended service reach throughout Wales. Thereby, it will allow public sector organisations to work more effectively together and improve the delivery of public sector services to the citizens. By aggregating the needs of the individual contracting authorities and conducting a centralized procurement, the measure also aims at avoiding duplications and realizing economies of scale.

The Rt Hon Margaret Beckett
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Current situation. Currently, public organisations have their own networks in Wales which were procured separately resulting, according to the UK authorities, in higher costs, lack of sufficient connectivity and duplication of resources. The authorities assert further that the fragmentation and lack of interconnectivity, interoperability and common network standards hamper the improvement and reduce the efficiency of public services.

- (4) **Legal basis.** The measure is based on Education Act 1996 (c.56) Section 10 & 485; Education Act 2002 (c.32) Section 14, 15 & 16; Housing Grants, Construction and Regeneration Act 1996 (c.53) Section 126 and Section 128(l)-(3); National Health Service Act 1977 (c.49) Section 1, Section 2 and Section 23(1); and Section 1 Welsh Development Agency Act 1975; all in conjunction with Sections 40 and 85 of the Government of Wales Act 1998.
- (5) **Subject matter of the procurement.** The procurement aims at the award of a public service contract for the provision of consolidated network services. In particular, the service contract includes (i) a collective electronic communications network service consisting of a range of core infrastructure services, (ii) an initial connection of selected public sector organisations (around 1000 connections shared between the Health Service, local government and the Higher Education / Further Education Sectors).¹
- (6) **Infrastructure.** At present, the existing networks of private operators already reach out to 98% of all public buildings in Wales. Tenderers are expected to build upon this infrastructure and the UK authorities believe that there will be no need for significant new infrastructure provision. Even if there was a need for some new infrastructure in order to link further sites, this would necessarily be localised and small scale. It follows that the contract will not give rise to additional spare capacities which could be commercially exploited, either by providing services to the wider market, or by granting wholesale access beyond the relevant regulatory requirements².
- (7) **Procurement procedure.** In view of the particular complexity³ of the contract, the Welsh Assembly Government follows the competitive dialogue procedure in compliance with Directive 2004/18/EC.⁴
- (8) **Award criteria.** In compliance with Article 29 (1) of the referred directive, the award criterion is the most economically advantageous tender. For the application of this complex award criterion, the following criteria are used in a descending order of importance: quality of commercial proposal (pricing structure and financial model, overall value for money); quality of technical proposal (review

¹ In addition to the initial connectivity services provided by the contract, public sector organisations in Wales will be able to buy further connections into the collective service during the life of the contract.

² For example: if a telecommunications operator is deemed to have significant market power in the relevant market, it may be required to provide wholesale access to its network.

³ The Welsh authorities consider the procurement particularly complex, since there are a large number of various users with different service requirements and needs (for instance in case of security, bandwidth or managed services) and these differences have to be dealt with in the implementation of a single managed network. Moreover, the best technical means for achieving the new network were not known.

⁴ The competitive dialogue procedure was introduced by the 2004 procurement directives. By way of difference to the negotiated procedure, in this type of procedure, negotiations are confined to a particular phase in the procedure. Recital 31 of Directive 2004/18/EC refers to large computer networks as a typical example for the use of this procedure.

of technical proposals and assessment of appropriateness to deliver required services); quality of service proposal (confirmation that the services offered match the requirements of the recipient organisations); risk retained (a weighted evaluation of the risk retained by the Welsh Assembly Government under each proposal); contractual compliance (a weighted evaluation of any departure from the issued contract documentation, developed during dialogue and shared across each participant).

- (9) **Choice of technology.** The procurement will be technology neutral, allowing tenderers to propose any suitable technological solution. Of course, in view of the existing infrastructure, tenderers are expected to make proposals which use existing telecommunications infrastructure where this is feasible.
- (10) **End users of the network.** The users of the network will be organisations which receive funding from, deliver services on behalf of, or form a constituent part of the National Assembly for Wales (such as National Health Service Wales, local authorities, fire services, police, national parks authorities, Welsh Assembly Government and National Assembly for Wales, higher and further education, and assembly sponsored public bodies⁵).
- (11) **Budget and duration.** The maximum budget of the procurement is GBP 200 million (approximately EUR 295 million) and the contract duration will be up to 7 years. The vast majority (more than 90%) of the funding comes either from the Welsh Assembly Government directly or through funds allocated by it to public sector organisations for their own spending on network connectivity. The remainder will be funded by the recipient public sector organisations from their locally managed overall spending budgets.
- (12) **Mechanisms to ensure cost effectiveness.** Taking into account the rapid and continuous change of the ICT⁶ industry, the Welsh authorities have foreseen appropriate mechanisms to ensure that the price paid remains “best value for money” not only now but also in the years to come. Accordingly, the contract specification requirements foresee price and service reviews which include market testing, benchmarking and other mechanisms, following the same logic as market operators would pursue in case of a mid or long term ICT service contract:
- A "gain sharing" mechanism is to cover situations where market prices for networking services fall during the life of the contract. In such circumstances, the difference between the reduced costs to the Service Provider and the fees paid by the Welsh authorities will be shared between the parties. This mechanism prevents increased return for the Service Provider, but at the same time would continue to provide an incentive for the Service Provider to reduce (overall) costs.

⁵ Some examples for assembly sponsored public bodies are the "Welsh language board" (its aim is to promote and facilitate the use of the Welsh language) or "Countryside Council for Wales" (which is the Government's statutory advisor for natural beauty, wildlife, etc.).

⁶ Information and Communication Technology

- A "benchmarking" requirement will ensure regular independent reviews of tariffs and service performance to guarantee that services remain cost effective and efficient compared with other network services and service providers within the industry.
- Price control for connectivity services through a "system of mini-competitions" will be introduced. This mechanism would allow the individual Welsh public bodies to tender the subcontractors of the Service Provider in case they plan to purchase a new connectivity service. This system will enable to test the market continuously and ensure delivery of the best value service for a particular service or services.

(13) **State of play.** The contract notice launching the public procurement procedure was published in July 2006⁷ in the EU Official Journal. The dialogue phase was concluded on 19 March 2007 and the participants were requested to submit a final tender by 23 April 2007. The target date for the award of the contract is mid June 2007.

(14) **Purpose of the notification.** In the notification, the UK authorities emphasised that they consider the procurement of the network not to constitute a measure containing State aid within the meaning of Article 87 (1) EC Treaty and have only notified the scheme for reasons of legal certainty.

4. STATE AID ASSESSMENT

State aid in the sense of Article 87 (1) of the EC Treaty

(15) According to Article 87 (1) of the EC Treaty, "*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market*". It follows that in order to be qualified as State aid, the following cumulative conditions have to be met: 1) the measure has to be granted out of State resources, 2) it has to confer an economic advantage to undertakings, 3) the advantage has to be selective and distort or threaten to distort competition, 4) the measure has to affect intra-Community trade.

(16) **State resources.** The notified measure is mainly financed out of the central budget of the Welsh Assembly Government and partly out of the budgets of other State-financed public organizations. Hence, State resources are involved.

(17) **Economic advantage to the end users.** The end users of the network services procured by the Welsh Assembly Government are all part of the public administration and exercise public functions in the territory of Wales. These organisations provide public sector services (administration, education, healthcare, fire and police service, heritage conservation, environmental

⁷ 2006/S 132-141782 published on 14 July 2006.

protection, etc.) which do not have a commercial character. Therefore, the end users are not considered to exercise an economic activity and hence do not qualify as undertakings⁸ under Article 87 (1) EC Treaty.

(18) ***Economic advantage to the selected service provider.*** By means of the notified measure, the UK authorities aim at awarding a public service contract to the service provider selected as a result of the procurement procedure. The Commission considers that the award of the contract will not lead to an economic advantage that the service provider would not receive under normal market conditions, taking into account the following considerations:

- ***The award of the contract is a pure procurement transaction.*** The UK authorities are purchasing services from the market in order to satisfy a clearly defined public sector need.
- ***The procurement procedure is compliant with the public procurement directives and suitable for achieving best value for money.*** The award is made in line with the national legislation transposing the EU procurement directives, using a competitive procurement procedure with prior publication at EU level in which any economic operator may request to participate under equal conditions. In compliance with the requirements of Directive 2004/18/EC, the award will be made to the economically most advantageous tender, using criteria which correspond to the objective of achieving best value for money. Cost effectiveness is ensured over the entire duration of the contract via implementing appropriate mechanisms (such as gain sharing, benchmarking, system of mini-competitions, for details see paragraph (12)). Furthermore, there is no extra advantage resulting from the contract for the service provider. Beyond the initial order fixed in the public service contract, there will be no obligation for the public service organisations to use the connectivity services provided by the service provider. The provision of the network services would also not result in additional spare capacities which could be commercially exploited.

(19) ***Economic advantage to third party operators.*** As any eventual new infrastructure that might be required would be localised and small-scale, granting wholesale access on these parts is not envisaged beyond potentially existing regulatory requirements.⁹ Therefore, third party operators will not benefit from the present measure.

5. CONCLUSION

(20) In the view of the above, the Commission has come to the conclusion that the Welsh Public Sector Network Scheme does not constitute State aid within the meaning of Article 87 (1) EC Treaty. First, the end users of the measure are public sector organisations which do not carry out economic activities. Secondly, with respect to the service provider, the award of the contract will not confer any

⁸ The concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed. See for instance judgment of the Court of 23 April 1991 in Case C-41/90 "Klaus Höfner and Fritz Elser v Macrotron GmbH".

⁹ For instance, there may be a regulatory obligation to provide wholesale access if the selected provider was deemed to have significant market power.

economic advantage which would go beyond normal market conditions. Thirdly, the measure does not give rise to benefits for third party operators.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the internet site: http://ec.europa.eu/comm/competition/state_aid/register/ii/.

Your request should be sent by encrypted e-mail to stateaidgreffe@ec.europa.eu or, alternatively, by registered letter or fax to:

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Yours faithfully,

For the Commission

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Member of the Commission