Recyclables and Sorting Plants on the Market – Special Aspects of Antitrust Law, Public Procurement Law and Fiscal Law

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Abstract

This article presents a survey on questions arising in the fields of antitrust law, public procurement law, and fiscal law, when contracts of recyclables (incl. sorting) are drafted.

Keywords

Recyclables, sorting plants, antitrust law, public procurement law, fiscal law

1 Introduction

Waste disposal services often constitute challenges for public contracting authorities and private waste management enterprises with regard to antitrust law, public procurement law and fiscal law. In particular, this also applies to the disposal of recyclables and the sorting thereof.

In accordance with antitrust case law, a (tender) market is not declared open before a public contracting authority calls in a third party for the provision of a service (cf. e.g. Federal Cartel Office, decision of 16 May 2007, file no. B 4 – 90003 – Fa – 8/07, margin no. 61). This is especially important for Germany, where waste disposal is a sovereign function. Owners and producers of waste can only dispose of waste within certain limits. In principle, private owners of both waste for disposal as well as waste for recycling are obliged to hand over waste to public waste managers (the so-called *Überlassungspflicht*), while owners of other kinds of waste have to meet that obligation only for waste for disposal (for a detailed examination see KUNIG/PAETOW/VERSTEYL, 2003, § 13 margin no. 1 et seq.). Defining these categories in a given case is highly controversial – considering the economic interest of the "service providers" – and shall not be discussed in detail here (for a detailed examination see WENZEL 2008). However, it should be pointed out that, within the framework of pending appeal proceedings, a fundamental decision of the Federal Administrative Court is expected concerning some important issues, notably on § 13 (1) sentence 1 German Waste Avoidance, Recycling and Disposal Act [KrW-/AbfG, *Kreislaufwirtschafts- und Abfallgesetz*] (on the issue of individual recovery of waste) and possibly also on § 13 (3) sentence 1 no. 3 German Waste Avoidance, Recycling and Disposal Act [KrW-/AbfG, *Kreislaufwirtschafts- und Abfallge-*

setz] (on the issue of commercial collections) (file no. 7 C 16.08; following OVG Schleswig-Holstein [Administrative Appeals Tribunal of Schleswig-Holstein], ruling of 22 April 2008, file no. 4 LB 7/06].

To the extent that the waste is handed over to public waste managers, the latter has to fulfil its waste management duties pursuant to § 15 (1) KrW-/AbfG. The public waste managers may exercise general discretion concerning organisation, meaning that they can decide whether they want to provide the relevant waste disposal services themselves or appoint third parties in accordance with § 16 (1) sentence 1 KrW-/AbfG (for a detailed examination of the assets and drawbacks as well as the prerequisites of the different organisational structures see GAßNER/SIEDERER 2003, margin no. 393 et seq.) In the event that the public waste manager provides the entire waste disposal services itself, three consequences apply: firstly, no public procurement procedure is required, secondly, the (tender) market as object of regulation required for the application of antitrust law is missing and thirdly, no fiscal issues arise, as the sovereign function is (as yet!) tax-exempt. From the state and municipal viewpoints respectively, the following issues arise only if a third party is called in and appointed for waste service provision.

The following paragraphs therefore deal with special aspects of public procurement law as well as antitrust law and fiscal law. Antitrust legislation and public procurement law, which, as legal fields, are now anchored firmly within the Act Against Restraints of Competition (cf. §§ 1 et seq. and §§ 97 et seq. GWB *[Gesetz gegen Wettbewerbsbeschränkungen]*) are supposed to guarantee and result in competition free from discrimination. Antitrust law is supposed to prevent or restrict monopolies and oligopolies and to provide the Federal Cartel Office with strong powers of intervention and regulatory powers, whereas public procurement law regulates that invitations to tender are competitive and include basic duties of the public contracting authorities. Both main protagonists are subject to judicial or quasi-judicial control (cf. §§ 63 et seq. and §§ 107 et seq. GWB respectively).

2 Public Procurement Law

The public contracting authority is obliged to call for tenders for disposal services pursuant to § 98 GWB as it is either the original owner or producer of the waste or is legally obliged to dispose of recyclables of third parties and does not provide the service itself (for a more detailed discussion see BYOK/BORMANN 2008, 843). With respect to public procurement law, the contracting authority is de facto faced with the following issues that regularly lead to arguments with tenderers in the process of inviting tenders for recyclables and sorting services.

2.1 Special Aspects concerning Recyclables

§ 8 no. 1 of Award Rules for Services, part A [VOL/A, *Verdingungsordnung für Leistungen/Teil A*,] defines a set of requirements which need to be considered in the specifications for tenders, which in turn constitute the centrepiece of the so-called CADO (Contract Award Documents). To this end, the service shall be described “precisely and exhaustively” so as to guarantee an equal appreciation of all tenderers and thus comparability of the tenders (paragraph 1). Additionally, all conditions relevant to price calculation have to be indicated (paragraph 2) and the contractor shall not be burdened with any “rare venture” (paragraph 3). This is why special importance is attached to the quantitative and qualitative description of the recyclables in inviting tenders for disposal services of recyclable material. Quantities, for instance, can be erratic and influenced by conditions over which the contracting authority has no influence. The contracting authority is, however, expected to draw up authoritative quantity forecasts. By establishing quantity frames of +/- 10 %, the tenderers can calculate and indicate their fees based on that quantity information. The qualitative description of the recyclables is particularly important if further recovery is carried out in plants that must observe a certain quality. If the invitation to tender concerns quantities at transfer points that have already been recorded and/or have been pre-treated, the interfaces between the respective partial performances also have to be clearly defined, as, on the one hand, unsuccessful or delayed transfers or acceptances of quantities of recyclables may result in follow-up costs (especially incidental damages) and, on the other, there is no direct contractual relationship with the respective contractor of the partial service to the effect that the contracting authority must solve any respective problems.

To the extent that the recyclables have a positive market value at the time of the transfer to the contractor or as a result of the invitation to tender for waste disposal services, tender prices must be retrieved and assessed carefully, as problems concerning the comparability of the prices may arise from offsetting the proceeds with the fees. With respect to fiscal issues, this may even lead to incomparable tenders and thus to a breach of the above-mentioned requirements pursuant to § 8 no. 1 (1) sentence 2 VOL/A (see chapter 4.2; see also decision of the Public Procurement Chamber of Brandenburg at the Economics Ministry of 28 January 2008, file no. VK 59/07). The provisions pursuant to § 15 VOLA shall also be examined very carefully, determining whether the services are to be assigned at fixed prices or allowing for potential price adjustments.

To the extent that proceeds can be generated from recyclables and that their acquisition is not an exclusive sovereign function, the question of how competitive activities by the contractor may be prevented in order not to alter quantity or provoke a loss of proceeds

may arise for the public contracting authority. Pursuant to a recent decision of the Higher Regional Court of Rostock [OLG, *Oberlandesgericht*], any universal non-competition clause aimed at banning the contractor (or a business connected to it) from competing for the same object of service in the field of waste disposal is illegal for the duration of the contract (decision of 6 March 2009, file no. 17 alloc. 1/09). According to this legal opinion, the contracting authority should at least ask to contractor to supply information on how the latter plans to rule out the aforementioned negative consequences of a commercial waste collection, if necessary.

2.2 Special Aspects concerning Sorting Plants

As far as waste management issues are concerned, the sorting is carried out with the aim of achieving a superior quality of waste disposal and/or with the business interest of gaining an economic advantage from this process. This advantage can, however, only be realised if the sum of the proceeds from the partial fractions minus the sorting costs does not exceed the proceeds of the unsorted total fraction (in the past this was not regularly the case with waste paper). Using sorting plants can be an obligatory or optional object of service. If the use of sorting pants is an obligatory component of the total service, the question arises whether the procurement may be carried out by lots pursuant to § 5 VOL/A. In this case, the definition of the interfaces (transfers before and after sorting) must be especially precise.

If the sorting plant is itself the subject of a call for tender, a distinction must be made between construction (Award Rules for Public Works Contracts, Part A – VOB/A, *Verdingungsordnung für Bauleistungen, Teil A*) and service (VOL/A) with respect to public procurement law. Public-private partnerships are only possible following a call for tender, and are only of limited economic interest with respect to follow-up and additional orders, this since the amendment of ECJ jurisdiction for want of in-house capabilities (cf. judgement of 11 January 2005, file no. case C-26/03, “City of Halle”).

3 Antitrust Law

Firstly, the concept of market definition shall be discussed, as the definition of the relevant market legally precedes all further examination with respect to antitrust law. A basic distinction has to be made between the so-called merger control (§§ 35 et seq. GWB), which is more and more frequently the case due to the increasing concentration in waste management, and the general antitrust regulations banning anti-competitive agreements, collusive behaviour, anti-competitive behaviour etc. (cf. Federal Cartel Office, decision of 6 May 2004, file no. 10 B 97/02 – “Waste Paper Disposal”).

3.1 The Legal Market Definition Concept

An antitrust test is de facto especially important with co-operations, be it on a simple contract basis, or as a consortium / joint bidders, or institutionalised (e.g. within the scope of a public-private partnership).

An antitrust market definition is generally made on two, occasionally also on three levels: as a relevant product market, a geographical market and a temporal market (if the market is not permanent).

The so-called demand market concept has been developed to define relevant product markets. It is based on the possibility to substitute products from a functional perspective from the supplier's point of view. The relevant product market comprises all goods that are so close to each other in terms of their characteristics, their economic purpose and their price range that a sensible consumer regards them as being interchangeable to satisfy a certain demand and thus weighs them against each other (cf. Federal Supreme Court [BGH, *Bundesgerichtshof*], judgement of 14 October 1995, file no. KVR 17/94, "Oven Market").

The geographical market is defined by a geographical description that is based either on political borders (federal states, administrative districts, towns, or municipalities) or on specific radii around points of reference (e.g. plant location), established on the basis of regular analysis of municipal tenders (see also LOTZE/MAGER 2007, 244).

3.2 Markets for Recyclables and the Sorting of Recyclables

While analysing Federal Cartel Office case law concerning antitrust issues in waste management, it can be pointed out that the product market definition generally contains two points of view: On the one hand, the fraction serves as a characteristic (e.g. waste paper, packaging, pre-treated municipal waste etc.), and, on the other, individual waste disposal processes are considered (e.g. collection, transport, sorting etc.). Based on the demand market concept set out under paragraph 3.1, the waste disposal services for the product market definition in question are subject to thorough analysis. In practice, the following aspects are of particular importance: term of the contracts, quality and quantity of the waste, purity of variety, removal intervals, vehicles used, other equipment and personnel (cf. e.g. Federal Cartel Office, decision of 16 May 2007, loc.cit.). Notably, the following product market definitions have been made with respect to antitrust case law: collection and transport of light packaging, sorting of light packaging, recycling of pre-treated municipal waste, sorting and recycling of waste paper, collection

and transport of waste glass. In some cases, there have been divergent decisions of the Federal Cartel Office and the OLG Düsseldorf, which is in charge of judicial control. The Higher Regional Court Düsseldorf questioned, for instance, the inclusion of waste incineration plants and mechanical-biological treatment within the same product market (cf. decision of 4 September 2002, file no. Kart 26/02 (V)), whereas the Federal Cartel Office proceeded on that very assumption (cf. decision of 17 March 2006, file no. B 10-141/05).

The geographical market definition requires a case-by-case review. Whereas general nationwide markets could be found on rare occasions only, a geographical market regularly spreads up to 100 km around one plant or municipality, including a federal state or a number of federal states (cf. e.g. “Northern New Länder”, Federal Cartel Office decision of 17 March 2007, file no. loc.cit., margin no. 90).

Sorting services and sorting plants also face special challenges. Technically, the interchangeability of sorting services is most relevant for product market definition, i.e. whether the respective sorting plant is only capable of treating particular waste fractions (cf. Federal Cartel Office decision of 22 June 2006, file no. B 10-90003-FA-155/05). As regards the geographical market definition, there is a direct link between the catchment area of a sorting plant and transport costs, which in turn depend on the weight or density of the material to be sorted and also on the specific transport costs (especially fuels and tolls).

As a rule of thumb the following conclusion can be drawn: the smaller the geographical market, the higher the probability that an antitrust issue will arise, as, in terms of the relevant product and geographical market, more importance is attached to the order or enterprise subject of the antitrust test, which thus leads to an increased market share.

4 Fiscal Law

There are two basic issues with respect to fiscal law: privileging sovereign functions, while its legitimacy is doubted with respect to competition law, as well as the turnover tax base when offsetting the proceeds and the fees. Other issues, such as provision of reserves, cannot be discussed in great detail here (cf. Federal Fiscal Court judgement of 21 September 2005, file no. X R 29/03).

4.1 Privileges of Sovereign Enterprises

Sovereign enterprises are not subject to corporate tax pursuant to § 4 (5) sentence 1 Corporation Tax Law [KStG, *Körperschaftsteuergesetz*]. As the Federal Fiscal Court [BFH, *Bundesfinanzhof*] recently pointed out, this provision is to be construed narrowly

(cf. BFH judgement of 29 October 2008, file no. I R 51/07). Distinguishing between a sovereign enterprise and a commercial enterprise is also difficult with respect to waste management practice (cf. e.g. BFH decision of 6 November 2007, file no. I R 72/06, concerning waste disposal within the framework of the so-called Dual System in accordance with § 6 (3) Regulation on Packaging [VerpackV, *Verpackungsverordnung*]. Here, at least domestic waste disposal is acknowledged as a sovereign enterprise (BFH judgement of 23 October 1996, file no. I R 1-2/94). This is basically justified by the obligation to hand over waste to public waste managers (and "obligation to accept", respectively), as the definition of a sovereign enterprise (the decisive factor being the exercise of a sovereign function) indicates that "functions that are peculiar to and reserved to legal persons governed by public law. This is characterised by the exercise of public functions that derive from state authority, serve public purposes, and that a beneficiary has to accept based on legal or official order" (BFH loc.cit.). If exertion of public authority under federal state regulation is reserved to individual federal states, a sovereign enterprise pursuant to § 4 (5) sentence 1 KStG can only be presumed "if the market is regionally limited with respect to the provided service in a way that excludes restraints of competition on taxable enterprises in other federal states or EU member states."

Trade tax (§ 2 (1) GewStG, *Gewerbesteuergesetz*), real estate tax (§ 3 (1) GrStG, *Grundsteuergesetz*), as well as the turnover tax privilege all follow this classification (cf. § 1 (1) no. 1 in conjunction with § 2 (1) sentence 1, (3) sentence 1, Turnover Tax Law [UStG, *Umsatzsteuergesetz*]), so that waste management services provided in practice by an owner-operated municipal enterprise are, for instance, tax-free, whereas if a private waste management enterprise is appointed as a third party, 19 % turnover tax applies (cf. also BFH judgement of 15 December 2007, file no. V R 63/05). When comparing (re-)municipalisation and privatisation models, this leads to a de facto cost advantage for municipal enterprises which may (partly) compensate the private model's cost advantages due to e.g. sub-minimum wages paid to the personnel.

Associations of the private waste management industry criticise this form of privilege on a political level and have attempted to make this the subject of a European Commission appeal procedure with reference to ECJ jurisprudence (judgement of 16 September 2008, case C-288/07) – parallel to the unsuccessful motions of the FDP [German Free Democratic Party] in the German parliament (of 21 September 2006, printed matter of the Bundestag no. 16/2657 and of 19 June 2007, printed matter of the Bundestag no. 16/5728). The Commission has issued an intermediate information indicating doubts about this legal opinion (of 8 January 2009, the European Parliament, file no. E-6246/08). A final decision is pending.

4.2 Turnover Tax and Turnover Resembling a Barter Transaction

Outside of the sovereign realm (see chap. 4.1), waste disposal services are subject to turnover taxation. Determining the tax base (cf. § 10 UStG) can become a difficult issue if proceeds can be generated from the recycling material (for a detailed examination see: THIMM 2008). An example: a waste disposal service generates costs of 100 €; proceeds to the amount of 50 € can be generated from the recycling material left in charge of the service provider. If the fee reduced by the amount of the proceeds is taken as the tax base, the bid price is reduced by 9.50 € (100 ./. 50 = 50 x 1.19 = 59.50 €). A different result is reached when the costs are taken as tax base and the proceeds are only deducted from the gross amount (100 x 1.19 = 119 - 50 = 69.00 €). Against this problematic backdrop, the Federal Ministry of Finance issued a statement on 1 December 2008 (ref. no. IV B 8-S 7203/07/10002) commenting on the application of the principles of turnover resembling a barter transaction [*tauschähnlicher Umsatz*] and explaining the individual requirements (including the minimum limits). To determine the tax base you generally take the economic value of the recyclable material. In case of barter transactions with additional payment, this payment then has to be added. So if a waste owner pays 5 € for a waste disposal service and the economic value of the waste left in charge of the service provider is 20 €, a turnover of 25 € is chargeable (5 + 20 = 25 x 1.9 = 29.75 €). The statement urges the fiscal authorities not to object to parties to a contract entered into before the 1 July 2009 who assume that there is no turnover resembling a barter transaction for a transitional period until 31 December 2010.

5 Summary and Outlook

Without knowledge of public procurement law, antitrust law and fiscal law, any contracting parties risk concluding a contract on the disposal of recyclable material which is not legally compliant. Considering the increasing deregulation of recyclable disposal services and the decreasing participation of public contracting authorities associated with it, the importance of public procurement law certainly decreases. At the same time, an increasingly complex public procurement law that is more risky for the contracting authority, “motivates” them to return to providing waste disposal services (for which a call for tender had as yet been obligatory) themselves. Admittedly, an amendment of public procurement law, supposed to strengthen the legal certainty in that matter, will come into force very soon (for a more detailed discussion see V. BECHTOLSHEIM 2009). It remains to be seen whether this goal can be reached in practice. At the same time, antitrust law gains in importance in deregulated markets in order to maintain material competition. In this, antitrust case law tends to adopt regional markets that generally increase the probability of the relevance of co-operations or mergers for competition law based on a market share that is increasing correspondingly. However, an analysis of

municipal calls for tender to define relevant markets is far too short-sighted, as here (especially concerning waste paper management and scrap metal recycling services provided in so-called commercial collections) market shares have been won back by competitors with direct contact to waste owners. These market shares are not taken into account in the assessment, thereby encouraging the formation of oligopolies in the waste disposal management industry. Fiscal law poses bigger legal problems in the case of the positive market value of recyclables and therefore also poses bigger economic risks in case of wrong decisions if the tax rates exceed the usual profit margins. Considering the increasing deregulation of recyclable waste disposal services, the issue of tax equity has gained in importance, no doubt resulting in yet another cost item for the owner of waste. It is worth considering whether fiscal law should, in particular, privilege recycling and therefore contribute to the fulfilment of (true) waste management objectives – thereby regaining the true meaning of "fiscal law".

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