



ROYAL NORWEGIAN MINISTRY OF
TRADE, INDUSTRY AND FISHERIES

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Your ref
84264-1112240

Our ref
19/6536-36

Date
28 October 2020

Reply to letter of formal notice to Norway concerning restrictions on subcontracting in the field of public procurement in Norway

1. Introductory remarks

Reference is made to the letter of formal notice of 10 June 2020, where the EFTA Surveillance Authority ("the Authority") concludes that Norway has failed to fulfil its obligations arising from Directives 2014/24/EU and 2014/25/EU, as adapted to the EEA Agreement by Annex XVI and Protocol 1 thereto, by maintaining in force national legislation, in the form of Section 19-3 of Regulation No. 974 of 12 August 2016 on Public Procurement and Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors, which, in the Authority's opinion, is not compliant with those directives.

Furthermore, the Authority concludes that Norway has failed to fulfil its obligations arising from Articles 31 and 36 of the EEA Agreement by maintaining in force national legislation, in the form of Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors, which, in the Authority's opinion, is not compliant with those articles.

The Authority requests that the Norwegian Government submits its observations on the content of their letter within four months of its receipt. The letter from the Authority was received on 10 June 2020. The deadline for submitting observations has been extended to 30 October 2020.

The Government recalls that the purpose of the pre-litigation procedure is to give the State concerned an opportunity to comply with its obligations under EEA law or to avail itself of its right to defend itself against the complaints made by the Authority. More specifically, the purpose of the letter of formal notice in the pre-litigation procedure is to delimit the subject-matter of the dispute and to indicate to the State, the factors enabling it to prepare its

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defence (cf. case C-145/01, Commission v Italy, para. 17, Case C 476/98 Commission v Germany para. 46, case C-20/09, Commission v Portuguese Republic, paras 17-18). This is important in order to ensure that any contentious procedure will have a clearly defined dispute as its subject-matter.

In the letter of formal notice, the Authority concludes that “Norway has failed to fulfil its obligations arising from Directives 2014/24/EU and 2014/25/EU”. The Authority does not identify which provisions in these Directives the Norwegian rules allegedly fails to fulfil. The failure to specify which provisions in the Directives Norway has, allegedly, failed to adhere to makes it difficult for Norway to prepare its defence. Moreover, we question whether the subject-matter of the case is sufficiently clearly defined by this general conclusion. Thus, we ask the Authority to clearly define and substantiate the alleged breaches of these Directives.

However, it is our understanding that the question under EEA-law is whether Section 19-3 of Regulation No. 974 of 12 August 2016 on Public Procurement and Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors, which aim is to combat work related crime, *comply with the principle of proportionality*, which is explicitly referred to in Article 18(1) of Directive 2014/24/EU and Article 36(1) of Directive 2014/25/EU.

The Norwegian Government does not share the Authority's view that the Norwegian provisions mentioned above are not compliant with Directives 2014/24/EU and 2014/25/EU. Further, the Norwegian Government does not share the Authority's view that Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors, is not compliant with Articles 31 and 36 of the EEA Agreement.

In the following, the Norwegian Government will therefore submit arguments in support of Section 19-3 of Regulation No. 974 of 12 August 2016 on Public Procurement and Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors, being compliant with EEA law.

In this letter, the Norwegian Government will, in item 2, first outline the Government's firm policy on the combat against work-related crime. Moving on to the assessment of proportionality, in item 3, we will show that the Norwegian rules are both suitable and necessary in order to attain the legitimate objective. In this context, we will explain the history and the rationale behind the provisions, including the limitation of the provisions to specific sectors i.e. public works contracts and contracts related to cleaning services and their positive effects on SME participation in public procurement. Further, the Government will address the Authority's arguments on competition and explain why the Norwegian provisions do not deter competition. We will also comment on the Authority's assertions that a case-by-case assessment would be feasible in this area.

2. The legitimate aim to combat work related crime

The Norwegian Government's strategy for combating work related crime was first adopted in 2015-2016 and has been revised several times, lastly in 2019. The strategy underlines the importance of public procurement rules as an important area to combat work related crime.¹ This was also underlined in the Norwegian Prime Minister's report to the European Commission on Strengthening European cooperation for combating work-related crime.²

Through its procurement, the public sector has both an opportunity, and a certain responsibility to prevent work-related crime, and private enterprises are responsible for combating work-related crime in their deliveries. Thus, the procurement rules contain provisions that are intended to contribute to preventing work-related crime and unacceptable working conditions and social dumping in public procurements. The Government aims to reduce the market share available to the criminal actors, *inter alia* by making it easier to identify the serious parties, and making it more difficult for the irresponsible parties to offer their services.

Despite many efforts to combat work related crime it continues to be a significant problem with serious consequences that affect workers, enterprises and the society in general. Work-related crime can lead to reduced economic growth and can thus undermine the foundation for the Norwegian welfare state. Norway is a country characterised by a high level of trust. Work-related crime contributes to undermine the trust and confidence in working life and it is important that the Norwegian Government has a certain discretion for the purpose of adopting measures intended to combat work-related crime.

As a follow-up to the Government's strategy, a number of measures have been initiated to combat work-related crime. However, the Norwegian Tax Administration, the Norwegian Labour Inspection Authority, the Norwegian Labour and Welfare Service and other public agencies report that the criminal actors have become more adaptable to avoid detection, and that they increasingly camouflage their activity behind a seemingly law-abiding facade. This means that it has become more challenging to combat criminal actors than before. The Government wants to reinforce its efforts to prevent and combat work-related crime. Heightened focus on prevention, a better basis of knowledge building and more targeted information will contribute to reduce the market access for criminal actors.³

The Norwegian Government welcomes that the Authority does not dispute that ensuring working conditions by combatting and preventing work related crime is a legitimate objective capable of justifying a restriction.⁴ However, we are not convinced that the Authority fully appreciates the scope and the gravity of the situation, and the challenging circumstances

¹ Reference is also made to the letter from the Norwegian Government of 11 December 2019 (point 3) where the government carefully explains the background for the Norwegian provisions.

² [Norwegian Prime Minister's report to the European Commission on Strengthening European cooperation for combating work-related crime](#), 2017, section 4.6, page 17.

³ [The Norwegian Government's revised strategy for combating work-related crime. 5 February 2019, page 5.](#)

⁴ Also confirmed by the CJEU in Case C-63/18 *Vitali*, paragraph 37.

that many Norwegian contracting authorities find themselves in when facing criminal actors of this nature.

In order to understand even better the background for the desire to combat work related crime, the Norwegian Government would like to point out that the presence of one or more of the following elements is characteristic of work-related crime: crime related to taxes and government fees, gross violations of accounting and bookkeeping practices (incorrect and deficient accounting and use of fictitious/incorrect documentation), corruption, bankruptcy crime, money laundering, currency smuggling, social security fraud, providing incorrect or false information and documentation to public authorities (false identity and recording of incorrect data in public registers), gross violations of rules on health, security and environment, exploitation of labour in violation of statutes or agreements and use of illegal workers.⁵

Further, the Norwegian media have documented that work related crime is also linked to forms of forced labour like for example human trafficking and prostitution.⁶ Indications of forced labour are humans living under shameful conditions lacking control over their own work and life circumstances.

In 2020, the National Inter-Agency Centre for Analysis and Intelligence (NTAES) prepared a situational description on work-related crime. The report confirms that work-related crime is systematic and organised and that enterprises increasingly camouflage their violations of the law behind a seemingly law-abiding façade.⁷ This illustrates that work-related crime is a complex challenge that demands work along various lines for both prevention and measures to combat and counteract the situation.

3. The provisions are suitable and necessary in order to achieve the objective pursued

3.1 Introductory remarks

The Norwegian Government maintains that the restrictions on subcontracting in public procurement are suitable and necessary in order to attain the objective of combatting work related crime. We will demonstrate this in the following.

The suitability assessment is, in essence, an assessment of whether the restrictions contribute to combatting and preventing work related crime. In order to ensure that the Authority fully appreciates the thorough considerations that support the Norwegian rules, we will in the following give a broad run-through of the rationale behind the rules and their scope, as well as their effect. Moreover, the line of arguments will demonstrate that the restrictions are necessary in order to obtain the legitimate goal. However, first we turn to the recent case law of the CJEU and its implications for this case.

⁵ [The Norwegian Government's revised strategy for combating work-related crime, 5 February 2019](#), page 7.

⁶ Reference is made to a case in [Dagbladet](#), dated 11 September 2012.

⁷ [The situational description on work-related crime from 2020](#), NTAES (National Inter-Agency Center for Analysis and Intelligence), page 10.

3.2 States have the discretion to adopt measures that promote transparency and compliance with labour law

The Norwegian Government would like start by pointing out that the judgement of the Court of Justice of the European Union ("CJEU") in C-63/18 *Vitali* highlights that:

" recitals 41 and 105 of Directive 2014/24 and certain provisions thereof, such as Article 71(7), explicitly state that Member States remain free to provide for rules in their national legislation that in some respects are more stringent than those provided for by the directive as regards subcontracting, provided that those rules are compatible with EU law."⁸ (our underlining)

Accordingly, the Directive clearly leaves discretions to the States to regulate public procurement on the national level. This includes setting more stringent rules than the Directive provides for, as long as these are in line with general EEA law.

Moreover, the Norwegian government would like to point out that in *Vitali*, the CJEU recognised that EEA States have a certain discretion for the purpose of adopting measures intended to ensure observance of the principle of transparency, which is binding on contracting authorities in any procedure for the award of a public contract. Also, the Court states that each State is best placed to identify, in the light of historical, legal, economic or social considerations specific to it, situations propitious to conduct liable to bring about breaches of that principle.⁹

Correspondingly, the Norwegian Government underlines that the provisions in the case at hand were also adopted in order to ensure observance of the principle of transparency. Particularly, in order to make it easier for the contracting authority, the contractors at the upper level of the supply chain and the Labour Inspection Authority to control, detect and combat work related crime. As explained in our letter dated 11 December 2019, shorter supply chains are easier to follow, more readily understood and the subcontractors are closer to the main contractor, which in turn makes communication between an entity in the supply chain and the contracting entity easier.

The importance of socially responsible public procurement, including complying with social and labour law, has been further enhanced by the Court in a the recent judgment from the CJEU in Case C 395/18 *Tim SpA*. As the Court states in para 38:

"In this respect, it should be noted that Article 18 of Directive 2014/24, entitled 'Principles of procurement', is the first article of Chapter II of that directive devoted to 'general rules' on public procurement procedures. Accordingly, by providing in paragraph 2 of that article that economic operators must comply, in the performance

⁸ Paragraph 33

⁹ Paragraph 36

of the contract, with obligations relating to environmental, social and labour law, the Union legislature sought to establish that requirement as a principle, like the other principles referred to in paragraph 1 of that article, namely the principles of equal treatment, non-discrimination, transparency, proportionality and prohibiting the exclusion of a contract from the scope of Directive 2014/24 or artificially narrowing competition. It follows that such a requirement constitutes, in the general scheme of that directive, a cardinal value with which the Member States must ensure compliance pursuant to the wording of Article 18(2) of that directive." (our underlining)

Here the Court clearly classifies the obligations relating to environmental, social and labour law as "a cardinal value", on pair with the general principles of equal treatment, non-discrimination, transparency and proportionality. This is a vital clarification from the Court and one that is of great importance when assessing the Norwegian provisions, which aim is exactly to protect social and labour values in Norway by combatting work related crime. It is the Government's view that the importance the CJEU has attached to the social and labour law considerations in Article 18(2) must be interpreted to the effect that the Norwegian rules concerning restrictions on subcontracting are indeed in line with EEA law.

3.3 The provisions – the rationale

Section 19-3 of Regulation No. 974 of 12 August 2016 on Public Procurement and Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors (for hereafter "the provisions" or "the measures") on limitation on the number of links in the supply chain, were introduced into the Norwegian public procurement legislation as preventive measures in order to detect and combat work related crime.

As explained in the letter of the Norwegian Government of 11 December 2019 (page 3), the provisions were suggested by a minority of the members of the government appointed committee in the Norwegian official report, NOU 2014:4¹⁰. After a public hearing in 2016, the provisions were introduced into the Norwegian legislation in 2017.

Nevertheless, it is important to note that before the entry into the Norwegian legislation, large contracting authorities, such as Statens vegvesen and Statsbygg and private entrepreneurs such as Skanska Norge AS, were already using a provision on limitations on the number of links (max two) in the supply chain in their own contracts clauses. The background was that these actors had experienced, sometimes subsequent to media disclosure, the negative development regarding respect for health, environment and safety-measures and social dumping in their projects.¹¹

¹⁰ [NOU 2014:4, on the simplification of rules relating to public procurement under the EEA-thresholds](#)

¹¹ The Fafo Paper, *Kortere kjeder – mindre sosial dumping? Om begrensninger i antall ledd i kontraktskjedene i bygg og anlegg*, Fafo-notat 2014:09, is available on [Fafo's home page](#). See pages 10-14 describing cases from Norwegian contracting authorities and private entrepreneurs.

Their experience was that the longer the supply-chains were, and the further down in the chain they were assessing, the higher were the risk of work related crime. They also found that it was considerably more difficult to carry out effective control in long supply chains.¹² The restriction on maximum two sub-contractors in the supply chain was therefore introduced by the actors in order to balance, on the one side, the need of the private entities to organise their work in the most effective manner by using sub-contractors, and on the other side, the need for the contracting authority and the main contractors to be able to carry out effective control. Before being introduced into the legislation in 2017, the measure had therefore been developed and tested out in Norway for a number of years.

The experience of the Norwegian Labour Inspection Authority, after carrying out field-control on different sites, is that in practice it is problematic that the further down in the supply-chain, the more unclear it is to the employees which sub-contractor they are actually working for. This has consequences for their working conditions. Moreover, long supply-chains are one of the prerequisite for carrying out fictitious invoices and to cover up for violation of VAT-rules. Further, according to the experience of the Norwegian Labour Inspection Authority, long supply chains often camouflage ownership which again camouflages work related crimes like bankruptcy crime.

3.4 Work related crime in the specific sectors

The Norwegian provisions are limited to two specific sectors, i.e. public works contracts and contracts related to cleaning services. The reasons behind is that it is primarily in these sectors that the Norwegian Labour Inspection Authority has uncovered a substantial and considerable challenge with work related crime.¹³ The provisions are therefore limited to prevent challenges in these specific sectors.

The construction industry is more burdened with undeclared work than many other industries. It is characterized by a high proportion of foreign workers, low education and limited skills in the Norwegian language. One of three employees state that they earn less than the statutory minimum rate for unskilled.¹⁴ It has been estimated that up to 40 per cent of the total number of undeclared work hours in the Norwegian economy can be linked to the construction industry.¹⁵ This sector faces also specific challenges when it comes to employment due to the large volume of projects. Construction sites might also be geographically difficult to reach for the Norwegian Labour Inspection Authority.

Also the Norwegian Labour Inspection Authority has pointed out that the construction industry has the highest risk of having problems connected to work related crimes.¹⁶ Many of the users who visit the Norwegian Labour Inspection Authority's counter for guidance at The

¹² Ibid. pages 11

¹³ [The Government's Consultation paper of 7 December 2015](#), page 3.

¹⁴ Fafo, *Privatmarkedet i byggenæringen*, Report 2014:14, is available on [Fafo's home page](#).

¹⁵ Ibid.

¹⁶ [The situational description on work-related crime from 2020](#), NTAES (National Inter-Agency Center for Analysis and Intelligence), page 8.

Service centres for foreign workers (SUA) work in the construction industry. They often lack knowledge of the rules of Norwegian working life. These workers have questions about employment contracts, working hours, dismissals and non-payment. They have often worked for a long time without an employment contract, they do not receive a salary, or they have experienced various problems in their employment relationship¹⁷.

The cleaning sector is also one of the vulnerable sectors when it comes to work related crime.¹⁸ The nature of the organisation in the sector is different from the construction sector. The cleaning sector is characterized by many foreign workers, few formal qualification requirements and low start-up costs. The union density rate is low.¹⁹ Work is often carried out after normal working hours rendering it more difficult for the Labour Inspection Authority to carry out control. Further, cleaning-services are often carried out by few persons in remote working places.

3.5 The provisions facilitate the participation of small and medium-sized enterprises (SMEs) in public procurement

Turning to the Authority's letter of 10 June, under point 4.1.1., the Authority points out that the aim of the Directives is to ensure that effect is given to principles of EEA law and to ensure that public procurement is *opened up to competition*. The Directives also explicitly recognise the right of economic operators to rely on the capacity of other entities and envisage the possibility of subcontracting by the successful tenderer. In the Authority's opinion, limitations on subcontracting restrict those rights since they restrict the freedom to provide services and freedom of establishment by limiting the possibility for economic operators to subcontract to third parties or to propose their services as subcontractors.

The Norwegian Government does not agree with the Authority that the provisions are in conflict with the aim of the Directives to open up to competition. Rather, the provisions have the effect that they stimulate competition between businesses, which comply with legislation aimed at combatting work related crime, and are operated in a serious manner.²⁰

It is important to note that the provisions do not limit the right of economic operators to rely on the capacity of other entities, as they do not restrict the number of horizontal links in each level of the supply chain, and therefore the use of subcontractors as such. This entails that the main-contractor can have as many subcontractors as needed, organised in an horizontal manner with a direct link to the main-contractor. Further, the subcontractors on the first level can also enter into as many contracts with their subcontractors as needed, as long as there is a direct link between the subcontractor at the first level and its subcontractors at the second level in the chain.

¹⁷ [SUA, Årsrapport, 2019](#)

¹⁸ [The Norwegian Government's revised strategy for combating work-related crime](#), 5 February 2019, page 17.

¹⁹ Fafo, *Til renholdets pris*, 2011 is available on [Fafo's home page](#).

²⁰ This is supported by the Confederation of Norwegian Enterprise (NHO) and Contractors Association - Building and Construction (EBA). The information was presented in a meeting with the Ministry of Trade, Industry and Fisheries.

By restricting the number of links in the supply chain to two levels, the main-contractor has ample opportunity to rely on the capacity of other entities where the main-contractor does not have, for instance, the technical or the professional ability themselves. In practice, this entails that large infrastructure projects can be structured in an efficient manner, with the use of subcontractors on the first and second level of the supply chain. In Norway, these are often small and medium sized enterprises (SMEs). Further, the provisions do not restrict the SMEs in participating in tenders as main-subcontractors since they may rely on subcontractors for large part of the contract volume.

Competition is one of the most effective measures to ensure the best quality to price ratio for public buyers, as well as a functioning private market. Thus, the Norwegian provisions also contain an important exemption stating that the contracting authority may accept additional links in the supply chain, if it is necessary in order to ensure adequate competition. This is a balancing measure, intended to limit possible restrictions related to competition.

Above, the Norwegian Government has submitted arguments to support the view that the provisions do *not* deter competition. However, if the Authority is still of the opinion that the provisions deter competition in any way, the Norwegian Government submits that the restriction falls, in any event, under the scope of measures, specifically listed in the Directives, that *can be taken in order to affect subcontracting*. That is:

- Article 18(2) of Directive 2014/24/EU and Article 36(2) of Directive 2014/25/EU, which oblige States to take measures to ensure contractors comply with obligations of, inter alia, social and labour law.
- Article 71(6) of Directive 2014/24/EU and Article 88(6) of Directive 2014/25/EU, provide that measures may be taken in the context of subcontracting with the aim of avoiding breaches of the obligations referred to in Article 18(2)/36(2).
- Recital 41 of Directive 2014/24/EU and Recital 56 of Directive 2014/25/EU, refer to the ability of states to take measures necessary to protect, inter alia, public policy, public morality and public security.

3.6 The provisions are neither general nor abstract

In the letter from the Authority of 10 June 2020, under point 4.1.2. and the assessment of the necessity condition, it is clear that the Authority strongly relies on the judgement of the CJEU in *Vitali* to conclude that the necessity condition is not met. In *Vitali*, the disputed provision limited subcontracting to 30% of the public contract. In reaching its conclusion, the Court relied on the fact that the provision was in *general and abstract terms*, so that the prohibition applied whatever the economic sector concerned by the contract at issue, *the nature of the works or the identity of the subcontractors*, and that it *did not allow for any assessment on a case-by-case basis* by the contracting entity. Therefore, the Court found that it was precluded by Directive 2014/24/EU on the basis that it went beyond what was necessary to achieve its objective in relation to organised crime.

The Norwegian Government refers to the letter of 11 December 2019, where the Government carefully draws a distinction between the provisions in the case at hand and the Italian provision in the Vitali case. The Government is not going to reiterate the arguments submitted in that letter but underlines that the Norwegian Government disagrees with the Authority that the Norwegian provisions are materially similar to the provisions in Vitali.

The Government welcomes that the Authority does not dispute that the Norwegian provisions are limited to specific sectors (construction and cleaning services) which the Norwegian Government considers to have particular problems of work related crime which arise from the length of supply chains. As the Authority states, in this respect, the provisions indeed do not suffer from the one of the shortcomings identified by the CJEU in Vitali.

However, the Authority continues by stating that the provisions are otherwise in *abstract terms* since they apply limitations on subcontracting based on the number of links in the chain without any further assessment of the nature of the works/services or the identity of the subcontractors. As regarding the nature of the works, the Norwegian Government point out that it is important to note that the provisions do not apply generally to all works contracts, but are limited to the execution of the works where the outcome is a building or a civil engineering works.²¹ That is, the provisions and the limitation of the number of the links in the supply chain is not applicable in the planning phase/engineering phase, consultation or other related services.

Moreover, the provisions do not limit subcontracting to a fixed percentage of the public contract (like the provision in Vitali). As stated above, the main-contractor may rely on subcontractors for large part of the contract volume.

3.7 A case-by-case assessment would undermine the legitimate aim of the provisions

The Authority states, under point 4.1.2. in the letter of 10 June 2020 and the assessment of the necessity condition, that it does not accept the position of the Norwegian Government that a case-by-case assessment of either the risk related to work related crime or the nature and complexity of the proposed supply chain could result in the measures not reaching their intended policy objective.

The Norwegian Government respectfully submits in that context that the provisions are *preventive* measure with the legitimate aim to avoid work related crime. They improve the possibility to carry out *effective control*. The control is carried out both by public buyers, tenderers themselves and the Labour Inspection Authority. The latter has pointed out that long supply-chains are extremely difficult to control. Thus, improved options for control deters criminal actors from participating in tenders thereby reducing their business opportunities.

²¹ [The Guidelines of the Norwegian Government](#), chapter 29 on the provisions restricting the number of subcontractors in the supply-chain, point 29.2.

Therefore, the Norwegian Government submits that a case-by-case assessment is not only difficult to carry out and burdensome for both the contracting authority and the economic operator, but it could also undermine the preventive nature of the provision.

The Authority's proposal for other means of control, for instance that *"a contracting authority could place the burden of proof on the economic operator to demonstrate that appropriate control to combat work related crime could be satisfactorily achieved by other means."* The Norwegian Government underlines that such a case-by-case assessment would render it nearly impossible for both the contracting authority and the economic operators at the upper level of the chain to control their sub-contractors further down. In that context, the Government recalls, with reference to point 1 above, that work-related crime is systematic and organised and that enterprises increasingly camouflage their violations of the law behind a seemingly law-abiding façade.²² In order to address these structures, general regulations are a prerequisite.

The current rules on limitation are preventive and transparent and can be applied at a minimum of administrative and financial cost. As concerns possible alternative measures, the Norwegian Government submits that it has not been able to find measures that are less restrictive, and at the same time are equally as suitable and effective as the rules that limit the number of links in the supply chain. In the view of the Norwegian Government, the alternative measures pointed out by the Authority would not satisfy the objective of the provisions.

4. Conclusion

The Norwegian Government submits that the provisions, that is Section 19-3 of Regulation No. 974 of 12 August 2016 on Public Procurement and Section 7-8 of Regulation No. 975 of 12 August 2016 on Procurement in the Utility Sectors, pursue the legitimate objective of preventing and combatting work related crime. They are suitable to meet the objectives and do not go beyond what is necessary in order to achieve the said objective.

If the Authority has any further questions, please do not hesitate to contact us.

Yours sincerely

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²² [The situational description on work-related crime from 2020](#), NTAES (National Inter-Agency Center for Analysis and Intelligence), page 10.

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