# public matters newsletter

August 2013

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law, less ordinary

# public matters newsletter - August 2013

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### talk to us...


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**For those eagerly awaiting further news regarding the progress of the new EU public procurement directive, you might be interested in reading the Cabinet Office's recent update on the progress of the directive.**

The note helpfully summarises the main changes that will be introduced, in particular the following:

- there will be a much simpler process for assessing bidders' credentials, involving greater use of supplier self-declarations
- constraints on using the negotiated procedure have been relaxed, so that procedure is available for any requirements that go beyond 'off the shelf' purchasing
- it will be possible to exclude bidders on the grounds of poor performance under previous contracts
- the distinction between Part A and Part B services has been removed, and a new light-touch regime introduced for social and health and some other services
- it will be possible to reserve the award of certain service contracts to mutuals / social enterprises for a time limited period
- electronic marketplaces for public procurement are expressly permitted, removing any doubt as to their legality
- the statutory minimum time limits by which suppliers have to respond to advertised procurements and submit tender documents have been reduced by about a third
- although the current thresholds for application of the directives are not changed, the Commission will be bound to review, within three years, the economic effects on the internal market as a result of the application of thresholds, which could lead to an increase in the thresholds
- it has been clarified that buyers can take into account the relevant skills and experience of individuals at the award stage where relevant (for example consultants, lawyers and architects)
- there are improved rules on social and environmental aspects, making it clear that social aspects can now also be taken into account in certain circumstances (in addition to environmental aspects which had previously been allowed)
- electronic communication / e-procurement will become mandatory 4.5 years after the adoption of the new directives
- the new directives include various improved safeguards from corruption, including specific safeguards against conflicts of interest and illicit behaviour by candidates and tenderers
- buyers will be encouraged to break contracts into lots to facilitate Small and Medium Enterprise (SME) participation, but there is discretion not to do so where appropriate. In addition, a turnover cap has

been introduced to facilitate SME participation. Buyers will not be able to set company turnover requirements at more than two times contract value

- the new rules encourage and allow preliminary market consultation between buyers and suppliers, which should facilitate better specifications, better outcomes and shorter procurement times
- a new procedure has been introduced: the Innovation Partnership procedure. This is intended to allow scope for more innovative ideas. The supplier essentially bids to enter into a partnership with the authority, to develop a new product or service
- the full life-cycle of costings can be taken into account when awarding contracts in order to encourage more sustainable and/or better value procurements which may save money over the long term but appear more costly on the initial purchase price
- public authorities will no longer have to submit detailed annual statistics on their procurement activities but the Commission will collect this information directly from the online system
- E-certis will be a central, on-line point where suppliers can find out the type of documents which they may be asked to provide in any EU country, even before they decide to bid. This should be of particular help when suppliers wish to bid cross-border, as they may be unfamiliar with the detailed requirements of other EU member states.

It is expected that the new directive will be adopted in the autumn and the Cabinet Office is planning a very ambitious implementation timetable. Watch this space…

talk to us…

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## Guidance on the 'date of knowledge' test

In the recent Nationwide Gritting Services case[1], the Scottish Court of Session had to consider when the time limit started to run for the purposes of bringing a public procurement claim against a contracting authority. Just to recap, the legislation currently in force provides that a claimant must commence proceedings within 30 days of the date upon which the claimant first knew or ought to have known that the grounds for bringing proceedings had arisen. The key question that has been left to be interpreted by the courts is when this date of actual or constructive knowledge arises. Whilst the facts in this case were governed by the previously applicable regulations that provided for a three month time limit for bringing proceedings, the case is still directly relevant to applying the date of knowledge test.

**Background facts**

In 2010 and 2011, Transport Scotland (the 'defendant') purchased de-icing salt from several suppliers to cover the extensive gritting requirements of the roads during that period.

During the course of 2010 and 2011, Nationwide Gritting Services Ltd (the 'claimant') contacted the defendant by telephone and email to try to secure business for the claimant. It informed the defendant that it could provide de-icing salt together with storage facilities and invited the defendant to send a representative to view its facilities in Southampton.

Two separate reports were published in August 2010 and December 2010 which both indicated that the defendant had purchased emergency supplies of salt during this period. The claimant was also informed by one of its customers that the defendant had purchased and was storing supplies of de-icing salt. The claimant followed this up with an email to the defendant querying what tender process was carried out to procure this salt and the associated storage services. On 30 May 2012 the defendant responded to the claimant stating that it had obtained quantities of salt in 2009/10 and 2010/11 directly. It stated that although it did not normally procure salt directly:

> *"given the extreme urgency of the situation a derogation from the 2006 Regulations was granted to allow the procurement to proceed immediately".*

[1] **Nationwide Gritting Services Limited v The Scottish Ministers 2013 Scots CS CSOH_19**

**Basis of claim**

The claimant brought a claim on 28 August 2012 on the basis that the defendant infringed the Public Contracts (Scotland) Regulations 2006[2] by failing to publish either a contract notice or a contract award notice for its procurement of salt supplies. It argued that the weather conditions were foreseeable and that the defendant should have arranged to procure the supplies at an earlier date.

Whilst the defendant admitted to the failure to publish a contract award notice in breach of the regulations, it maintained that it was entitled to enter into contracts for the supply of salt supplies without running a competitive tender process because of the extreme urgency of the situation. The defendant submitted that the claim was time-barred in any event.

**Judgment**

The court considered the recent case law stemming from the Uniplex[3] case in which the Court of Justice of the European Union held that the relevant date for assessing when time starts to run was the one on which the claimant knew or ought to have known of the alleged infringement. This proposition was applied by the Court of Appeal in Sita[4] where Elias LJ stated that:

> *"Once the prospective claimant has sufficient knowledge to put him in a position to take an informed view as to whether there has been an infringement in the way the process has been conducted, and concludes that there has, time starts to run."*

This was expanded upon in the Mermec[5] case in which it was held that:

> *"The fact that [the claimant] could not be certain about all the facts or that it definitely had an unchallengeable case does not mean that time does not start running. All that is needed is a knowledge of the basic facts which would lead to a reasonable belief that there is a claim."*

Finally, in considering the definition of 'knowledge' the court referred to the Haward[6] case in which it was stated that knowledge *"does not mean knowing for certain and beyond possibility of contradiction"* but that *"reasonable belief will normally suffice"*. It also referred to the older Comer[7] case in which it was stated that knowledge *is "a question of degree"* and *"involves something approximating more to certainty than mere suspicion or guess"*.

[2] Now replaced by the Public Contracts (Scotland) Regulations 2012
[3] Uniplex (UK) Ltd v NHS Business Services Authority [2010] 2 CMLR 47
[4] Sita UK Limited v Greater Manchester Waste Disposal Authority [2011] 2 CMLR 32
[5] Mermec UK Limited v Network Rail Infrastructure Limited [2011] EWHC 1847 (TCC)
[6] Haward and others v Fawcetts (a firm) [2006] 1 WLR 68
[7] Comer v James Scott & Co (Electrical Engineers) Limited 1978 SLT 235

In the circumstances, the court considered the following three circumstances to be crucial:

- the absence of any business relationship between the parties and the failure of the defendant to respond to the claimant's overtures in 2010 and 2011. Furthermore, the defendant's principal function was to plan and coordinate the road network and the purchase of de-icing salt was usually made by other bodies
- the defendant could have acquired the salt supplies in accordance with the regulations by, for example, under an existing contract. There was no reason for the claimant to assume that the defendant had acted in breach of the procurement legislation
- the failure by the defendant to publish a contract award notice was significant as it subverted the transparency envisaged by the legislation. If the notice had been published then the claimant would have had the knowledge required to bring proceedings.

The court therefore concluded that although the claimant might have had suspicions in 2010 and 2011 that the defendant had obtained supplies of salt from elsewhere, this was just hearsay evidence and it had no hard information to that effect. The court considered that the claimant had acted correctly in enquiring with the defendant whether that information was correct and the defendant failed to respond swiftly.

**Thoughts…**

This case offers useful guidance in particular where a contracting authority has made a direct contract award without running a tender process. The court clearly frowned upon the fact that the defendant in this case was not forthcoming with the information being sought by the claimant. In the absence of a pre-existing business relationship between the parties, the court was not prepared to impute knowledge on behalf of the claimant where suspicions had not been confirmed.

The question often arises in practice whether there is any real risk in not publishing a contract award notice in accordance with the regulations. This case highlights the importance of publishing such a notice for the purpose of triggering the date of knowledge for the purposes of assessing the time limit for bringing a claim.

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## Successful management of outsourced service contracts

The recent Court of Appeal decision[1] in favour of the London Borough of Barnet regarding their 'One Barnet' contract with Capita has once again brought the issue of large, long-term outsourcing relationships into the media spotlight. This decision comes in the wake of several other local authorities recently deciding to bring outsourced services back in-house.

The main reason for bringing services back in-house is the lack of long-term savings or a wish to have more control over delivery. While is some cases this will be because of a lack of clarity in the figures that were submitted by the successful bidder, in others it is, at least in part, because once the contract is up and running, the management of it doesn't allow the local authority to spot potential problems and manage them. So what can be done to ensure good, consistent, costs-effective contract management by the recipient local authority?

1. Long-term service contracts with the private sector can be complex. The best contracts are often those which, once signed, rarely need to be looked at in detail. The detail of a payment mechanism, for example, can be challenging and it is those who manage the contract on the ground who really make it work. In the largest contracts, we would advise that the local authority have a 'user's/plain English guide' to the document, indicating clearly the roles and responsibilities of the parties. This should be drafted by the lawyers responsible for advising the local authority on the agreement when it is entered into.

2. In a well-drafted contract the provider should be obliged to attend contract management meetings and to make positive proposals for change. Are these obligations actually being carried out? There will often be obligations in a contract for the provider to alert the local authority to ways in which further savings can be made, even if it is not in the financial interest of the provider. The local authority needs to understand what these obligations are and ask questions of the provider to understand whether these are really being looked at and acted upon.

3. Linked to this, is performance always up to scratch? Performance regimes are often complex to operate. Indeed, the level of active management required to enforce them can often exceed the compensation available for more minor failures by the provider. However, in the long term, it is worth considering whether value can be gained by more rigorous monitoring of the contract. Review of the contract will indicate the strength of the remedies available for breach or poor performance. No performance mechanism is likely to be detailed enough to include all relevant failures by the provider. Therefore, a

1 Nash, R (on the application of) v Barnet London Borough Council [2013] EWCA Civ 1004

local authority should be aware of the other remedies available under the contract – for example (and in the worst case scenario), termination for persistent breach. It is worth noting that even the threat of issuing a default or warning notice can have a serious impact on a private sector contractor as these matters may need to be disclosed as part of any corporate due diligence. In capital projects, external funders will be made nervous by any sign of contractual difficulties and this could have serious implications for the contractor under its financing documents, thereby leading them to respond positively to the local authority's requests.

4. In a long-term contract there will often be benchmarking provisions dealing with the need to change. The provisions can take a number of forms, but will generally include a mechanism for comparing what is happening under the contract to what should be happening. If a local authority is looking to increase value, careful review of the benchmarking and market-testing provisions is crucial. Any attempt to operate benchmarking or market-testing processes is likely to require financial advice and will take time. But detailed knowledge of these provisions, and an understanding of the ways in which they might improve the local authority's position, can be one of the key drivers of value in long-term contracts.

5. Along with benchmarking/market testing, a variation protocol is one of the most vital tools for a local authority to drive value in a long-term arrangement. Before approaching the contractor to discuss any variation, the precise mechanics of this should be understood. A contract can always be changed by agreement but before considering any change to the contract, the detailed variation formalities should be clearly understood. For example, it is likely that changes must be in writing, or approved by the parties' representatives under the contract. In addition to this, there is likely to be a specific variation process under any long-term contract. If this is operated in accordance with its terms, this is not technically a change to the contract but local authorities need to keep in mind the procurement risk of varying the terms of a contract that has been procured under the EU regime to ensure that it is not perceived to be the award of a new contract. Every case must be looked at on its merits. Change mechanisms can be complex, and provided they are properly documented, negotiating changes outside of the formal mechanism on a partnering basis can be an effective way of proceeding. However, understanding the formal process, even as a backstop, can be to the advantage of a local authority seeking to drive value in a long-term contract. Pre-agreed changes, and options to extend, should of course be included in the OJEU notice to reduce any risk of challenge which may otherwise arise from making changes. This illustrates the importance of trying to anticipate the local authority's requirements at project inception.

Approaching the contract in this way may often be seen as ‘overly legal’, and not conducive to a good relationship with the contractor. Obviously the first step in a discussion about better value should be a spirit of partnership – but a sound grasp of the backstop legal position, is an invaluable aid to constructive discussions.


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# specific barriers to general powers

## A view from in-house

***"Gone are the days when you'd have to look for legal advice to even do the simplest of things. These days you can just crack on with it."***
Eric Pickles, July 2013

Speaking at the recent joint Local Government Association (LGA) and National Association of Local Councils (NALC) conference, the Secretary of State for the Department for Communities and Local Government reiterated that the General Power of Competence, introduced by section 1 of the Localism Act 2011, turned the old system of local government powers 'on its head'. Simultaneously making every local authority lawyer in earshot feeling that they were about to become somewhat redundant.

Unfortunately, the level of enthusiasm for using the General Power of Competence has not equalled or exceeded the level of enthusiasm with which Mr Pickles has promoted it (perhaps because officers have been speaking to the lawyers after all?). At the same conference, the LGA called on Mr Pickles to remove restrictions which acted as a barrier to exploiting the power, including in relation to charging and trading. Local authorities are under increasing pressure to make savings and generate income. The General Power of Competence's potential to contribute to these savings is unfortunately not unbridled.

Before February 2012, when the General Power of Competence was hurriedly brought into force, following the outcome of the Bideford Town Council case (R on the application of the National Secular Society, Mr Clive Bone v Bideford Town Council [2012] EWHC 175 (Admin)), local authorities relied on the power of 'wellbeing'. This allowed authorities to do anything considered likely to promote or improve their area's economic, environmental or social wellbeing – the Localism Act has restricted wellbeing to Wales.

The General Power of Competence is a power to do anything that an individual generally may do provided it is not expressly prohibited by legislation. It does not come with wellbeing's geographic and purpose-led restraints. The General Power of Competence was clearly envisaged to be used, in part at least, to assist authorities in these financially restrained times: the Localism Act specifically refers to charging and trading for activities conducted using the power. Unfortunately, these references take the form of restrictions.

Where a local authority provides a discretionary service to a person and no other legislative provision authorises them to impose a charge for that service, the authority is able to charge the cost of providing the service. This is not a profit or surplus making power, but simply cost recovery. This is broadly similar to the existing charging powers in section 93 of the Local Government Act 2003.

The Localism Act goes on to state that where an activity under the General Power of Competence is for a commercial purpose, an authority may not trade in something it is required by statute to provide. Furthermore, any trading activity must be through the medium of a company – to level the playing field between the private and public sectors in a particular marketplace. There is one distinct difference between the existing trading power under section 95 of the 2003 Act and the new power under section 4 of the 2011 Act: the section 95 power is restricted to function-related activities whereas the General Power of Competence allows for something to be done commercially if it can be done under section 1 of the 2011 Act. This means that while a local authority will still have to check that there are no specific restrictions regarding acting commercially in a particular situation, there is more scope for commercial activity.

Perhaps then the General Power of Competence does not reflect that much of a departure from the existing law? Although it is a power to do anything individuals generally may do, it is reasonable to conclude that unlawful exercise of the General Power of Competence by a local authority will be subject to the principles of public law, including the sanctions of judicial review. It will be interesting to see if the previous, restrictive case law applied to wellbeing and other analogous powers, will be applied to the General Power of Competence. The answer will only be found by local authorities testing the boundaries by being increasingly creative with their use of the General Power of Competence.

What should lawyers have in mind when considering the General Power of Competence? Some considerations when examining an innovative proposal include:

- can any other powers be used? It is important to identify the power that represents the 'best fit' for a proposal. Examine existing powers first, but if the proposal is truly innovative, the General Power of Competence is there to be explored
- are there any express restrictions on the activity involved in the proposal? The General Power of Competence is subject to pre-commencement limitations and post-commencement limitations expressed to restrict the power
- will you be competing with the private sector? If so, there is strong likelihood that you will need to do so through a trading company.
- is there a robust business case for the proposal? Will the proposal stand up to financial and political scrutiny, as well as legal – will members and electors support the proposal?

The LGA did take time to praise examples of good practice, as did Mr Pickles. For example, Newark and Sherwood District Council has used New Homes Bonus financing to create a Think Business Investment in Growth fund to provide loans to help local businesses grow. Such examples are to be admired and followed, but maybe after a short conversation with the lawyers...

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With the recent realignment of funding streams and a focus on more locally controlled growth through Local Enterprise Partnerships (LEPS) and City Deals, state aid is becoming more of a concern to both providers and recipients of funding. This is particularly the case given the Government's focus on achieving growth by supporting or commissioning from the private sector rather than having the public sector use the funds directly. Below, we have answered some common questions on how to identify and address state aid risks.

### What is state aid?

State aid refers to any assistance or subsidy given by an EU member state which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods. A 'member state' includes all public bodies in the EU and this can capture aid passed down through other organisations if the original source of the aid is public. For example, the European Regional Development Fund (ERDF) originates from EU public bodies but can be passed through a number of organisations before reaching the final beneficiary. The fact that the funds will pass through these other bodies does not mean that it will no longer represent state aid.

### Why is state aid illegal?

The European Commission has made state aid illegal as it distorts competition between member states and disrupts the common market. If member states subsidise private undertakings in their own states this can disadvantage competing undertakings in other states and so distort the common market, which can in turn limit innovation and discourage new market entrants.

### How can we identify illegal state aid?

Aid will be illegal state aid if:

- the aid is granted by the State or through State resources;
- the aid confers an advantage on the recipient undertaking;
- the aid is selective, favouring only certain undertakings or the production of certain goods;
- it distorts or threatens to distort competition; and
- it affects, or has the potential to affect trade between Member States.

If all of the above are satisfied and no exemption, approved scheme or framework can be identified the aid will be illegal unless it is notified to, and approved in advance by, the European Commission.

## What happens if state aid is illegal?

The granting of unauthorised state aid is illegal, and with extremely serious consequences:

- aid payments can be suspended
- recipients will almost always have to repay the state with interest (even if aid funding has already been spent)
- policies may have to be altered
- legislation may need to be amended
- the relevant public body and recipients could be sued by competitors for damages.

In recent years the Commission has taken a very dim view of unauthorised state aid and has given increasing priority to applying state aid rules more rigorously.

It is therefore crucial to establish whether proposals or projects constitute state aid. If they do, it is extremely important to determine how they can be carried out in compliance with the state aid rules.

## Are we an undertaking?

- an undertaking is an entity which is engaged in an economic activity
- economic activity means an activity which consists of offering goods or services on a given market and which could, at least in principle, be carried out by a private operator in order to make profits
- the important thing is what the entity does, not its status. Thus a charity, a not for profit company or a government department can all be undertakings if they are involved in commercial activities.

## What exemptions or approved schemes can we rely on?

The UK government has notified a number of schemes to the European Commission which have been approved for use. This means that if proposed aid fits within the scope of one of these schemes it will not be illegal as it has been pre-approved by the Commission as 'legal' state aid.

Examples of approved schemes are:

- English Property Development Scheme
- English Environmental Scheme
- English Risk Capital Investment Scheme
- English Research Development and Innovation Scheme
- Business Support Scheme

The schemes have been published by the Department for Communities and Local Government and are available on the UK government website.

## What is the General Block Exemption Regulation?

The General Block Exemption Regulation sets out several types of aid which are deemed to be legal if certain conditions (set out in the Regulation) are met. The types of aid include aid for training employees, supporting SMEs, recruiting disadvantaged workers and supporting research and development. A common condition is that the recipient of the aid will need to demonstrate that they have contributed a certain percentage of the costs of the activity which the aid is supporting. These percentages are known as 'aid intensity' levels. Often small and medium enterprises will be treated more favourably (i.e. required to contribute less) than larger enterprises.

## How does de minimis work?

The De Minimis Regulation permits small amounts of otherwise illegal aid. In simple terms, the limit is €200,000 over a rolling three year (fiscal) period and loan guarantees up to €1.5 million. The aid allowed is per recipient and not per project. This means that recipient undertakings must keep track of all aid received which is not covered by another exemption or approved scheme and ensure that any new aid does not result in this limit being breached. Where the de minimis exemption is relied upon recipient undertakings will usually be required to provide written confirmation that aid will not result in the threshold being exceeded.

## What is the market economy investor principle?

If aid is granted on terms which would be acceptable to a comparable private sector investor (or guarantor or lender) then the aid will not constitute state aid as this will not distort competition. This is because the recipient should (in theory) be able to obtain the aid from elsewhere in the market. The market economy investor principle will be particularly relevant where public bodies enter into joint ventures or partnerships with the private sector. If a public body and private sector partner invest in a special purpose vehicle (for example, a company limited by shares) then the public body should invest on terms which are equivalent to the private sector partner, i.e. the risk and reward ratios should be the same for both partners. It should be noted that benefits to public bodies which would not be benefits to private sector investors (for example considering the social and economic benefits to a local authorities' residents) should not be taken into account when assessing the risk/reward ratios.

## What happens if we can't rely on any exemption?

As set out above, if the aid would otherwise be illegal because other exemptions cannot be relied upon the parties involved should notify the aid to the European Commission. The Commission will usually take between six and nine months to make a decision on whether the aid is permissible and there is no guarantee that aid will be approved. Notification is a lengthy and expensive process and so should usually only be used a last resort.

## Are there any changes to state aid on the horizon?

As part of the Commission's 'state aid modernisation' programme the law on state aid is undergoing reform with the General Block Exemption Regulation, the Assisted Areas (geographical areas in which undertakings can be granted increased levels of state aid under certain exemptions) and the de minimis threshold being revised. The Commission is also amending its own procedural rules on state aid with a view to clarifying and improving the Commission's processes for handling complaints of state aid.


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