

# public matters newsletter

January 2014

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talk to us...

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## *new procurement directive: subcontracting*

As the avid Europe watchers amongst you will know, 15 January 2014 saw the European Parliament pass Resolution (COM(2011)0896 - C7-0006/2012 - 2011/0438(COD)). This snappily titled resolution is one that procurement lawyers have been awaiting for some time, as it saw the European Parliament approve the text of the new public procurement directive. Although there are some final administrative hurdles to overcome, it seems that this is now the final text (fingers crossed). It will take some time for commentators to analyse all 591 pages of the text. However, for the final article in my series (for the moment) I take a look at Article 71 on subcontracting. This is something that the Cabinet Office is currently seeking views upon in one of its discussion papers. It is another article which allows member states the discretion to implement part or all of the requirements of the Article.

As we are all aware, both the UK government and the Commission are concerned about the role of SMEs in public procurement. It is however recognised that SME participation in large scale public contracts is normally in the role of sub contractor rather than primary contractor. From a commission perspective, there are two levels of concern. Firstly, transparency over these sub contractors, their working practices and their adherence to environmental, social and labour laws and secondly, the treatment of sub contractors by primary contractors in relation to payment. The Directive tries to answer the often cited concern that sub contractors are not paid in a timely manner even when the primary contractor has been paid on time by the public sector body.

The Article splits itself into a number of key issues for the UK (and other member states) to consider and this is what the Cabinet Office are seeking views upon.

Article 71(3) provides that the national regulations could require, where the nature of the contract allows:

- the provision for direct payment of subcontractors; and
- sub contractors to receive direct payments without it being necessary for them to request direct payment from the contracting authority.

In principle, this is potentially a good thing for sub contractors in a market where sub contractors are being squeezed and are sometimes going out of business as a result of cash flow difficulties. However, these provisions would need to include mechanisms for the contractor to object to payments (for example, where there was a dispute over performance or delivery). The mechanism would need to be set out in the tender documents and accordingly, if the UK decides to adopt these measures, one imagines that these types of provisions will be very carefully scrutinised by bidders. For example, bidders are likely to be concerned about how the quantum of these payments would be calculated and how the primary contractor's overheads

will be built in? Will we see scenarios where, notwithstanding direct payment, sub contractors will be required to make repayments or rebates back to the primary contractor to cover off risk for them? It is perhaps worth making clear that Article 71(4) reiterates that these direct payments will be without prejudice to the main contractor's liability.

Article 71(5) provides that the national regulations could make it compulsory for contracting authorities to ask bidders to indicate in their proposals any share of the contract they may intend to subcontract to third parties and the details of any proposed subcontractors. It also provides that regulations could directly oblige the main contractor to provide information about its subcontractors and supply chain. This seems largely a positive transparency point, although an added burden for those involved in the process. It may be for this reason that this requirement is restricted to certain types of procurement and to contracts over particular thresholds.

Article 71(6) provides that the national regulations could make it compulsory for contracting authorities to verify whether there are mandatory or discretionary grounds for exclusion of any subcontractors and, where the response shows that there are discretionary grounds for exclusion, require that the main contractor find a replacement subcontractor. This comes from the Commission's desire to ensure that those providing services to the public sector (and indeed further than this) maintain proper standards and do not employ exploitative behaviours (whether in terms of environmental or human cost) in the delivery of those contracts. One would hope that this is something which is adopted by the UK although, even if it is, time will tell how much it will be utilised by contracting authorities in the UK (if it merely constitutes a voluntary obligation). Although all public sector bodies would wish to ensure that sub contractors comply with such obligations, the resources and finances to evaluate all sub contractors is going to be a challenge, especially where such action is necessarily going to involve greater cost and potential delay. It will also be interesting to trace through what is to happen if a sub contractor is to be replaced, especially if they are already contracted to provide the services. Who is going to be responsible for costs associated with bringing such sub contracts to an end? Presumably, contracting authorities will have to set out these requirements in their tender documents, making it clear that where a sub contractor is found to have failed such tests, the bidder will bear the costs and risks of finding another? Would such a new exercise have to be on the basis of criteria put forward by the contracting authority? If so what obligations would it owe? All questions which will need some further thought.

The provisions in Article 71 are largely positive but there are a number of questions that need to be answered. I would recommend that you look at the Cabinet Office discussion paper and respond if you get a chance, you have until 17 February, so get reading! Once we have the draft text for the UK regulations Browne Jacobson will prepare a guide and run a seminar series. If you would like to receive a copy of this or attend a seminar in one of our offices please do let us know.

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# conflicts of interests in joint-authority management

## Background

Many local authorities are considering the benefits of shared services and management in response to the austerity climate. There are savings to be derived from such arrangements, but this article explores the importance of being prepared to respond to conflicts of interest. In effect, there is a duty to avoid conflicts of interest, and in joint-authority management, such conflicts can and do arise. It is necessary for protocols to be put in place, to ensure a safe legal approach.

## Legal Issues

There is an administrative law principle, 'the rule against bias', which is one of the rules of natural justice. This principle applies in relation to public bodies and their actions can be declared unlawful if they offend the rule against bias. The principle can be summarised as a person with a conflict of interest should not participate in public decision taking, i.e. justice must not only be done but be seen to be done and the poacher cannot also be the gamekeeper.

The courts have been prepared to recognise the special position particularly of councillors who represent their ward and, as a result, may have a predisposition towards a certain decision, but so long as they do not predetermine that decision and keep an open mind as to their decision, then they will not generally contravene the principle. This has been codified to some extent in section 25 of the Localism Act 2011.

It is relevant to note that company directors have a duty to avoid conflicts of interest as set out in sections 175 and 177 of the Companies Act 2006. These sections include four separate provisions dealing with conflicts and their disclosure distinguishing (i) interests in transactions and arrangements with the company (which must be disclosed but need not be approved) and (ii) all other conflicts (which will normally require approval). As for all employees, this requires that directors state any potential conflicts of interest before they arise, and make known any conflicts of interest in existing transactions or arrangements. A similar approach ought to be adopted by local authority officers and particularly those in joint-authority management.

It is important that officers recognise that this principle could be relied upon by a party aggrieved by local authority decision-taking in circumstances where there is joint authority management and yet the positions of the two (or more) Councils differ. This risk needs to be identified early in relation to any given project or decision taking and steps taken to eliminate the conflict of interest of individuals so far as possible. It is common to prevent employees from working on projects where they might be seen to have conflicting

interests, but this presents practical difficulties for joint authority managers. For example they will have direct accountability to the councillors of each of the two (or more) authorities concerned.

It is important, therefore, to have protocols in place from the outset, whereby the joint authority manager can take a safe legal approach to carrying out their duties. Some potential solutions are outlined below.

## Solutions

- where a conflict of interest arises for a joint-authority manager, it may be possible for a deputy to be responsible for one interest, whilst the director is responsible for the other interest
- in a situation where there are more than two authorities involved in the conflict of interest, the joint-authority manager should be empowered to bring in further suitably qualified individuals to represent the interests of each such affected authority
- where the director needs or wishes to rise above the conflict, or does not feel able to participate in its solution, he or she must be empowered to appoint suitably qualified individuals to represent each of the relevant interests.

Whichever of the options is selected the crucial element is that there is an absolute division between those representing or working for one authority with one interest and those representing or working for the other service area or authority with the conflicting interest(s). This is classically known as the establishment of a chinese wall. There are bound to be resource implications of involving the separate management arrangements, but this is a cost which has to be accepted as part of the overall consequences of joint authority management. The cost to the authorities of following a process and then having it successfully judicially reviewed will surely be greater than the cost of separating the decision-taking.

It is important that those appointed as deputies to the joint-authority manager, or brought in as representatives, must only be associated with or connected to one of the relevant interests.

We recommend that a document is produced which sets out the separation arrangements for dealing with the conflict of interest. This should then be shared with all of those concerned with the project or decision-taking. It will be very valuable if any aggrieved party seeks to challenge an authority's decision-taking to be able to refer to or produce this document to demonstrate that a transparent and fair approach has been adopted.

If you would like assistance in developing your own authority's protocol for dealing with conflicts of interest, do not hesitate to contact us and we'll be pleased to help.

*talk to us...*

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## 2014 - what's on the agenda?

If you're like me you will already have failed in a number of your fitness related new year resolutions, so it's time to get ourselves into real shape by taking a look at what are some of the big legal signposts for the first half of 2014 and how they are likely to affect the role of in-house public sector lawyers. This overview has a particular emphasis on the commercial and contractual side of things.

### Draft procurement directives

The story to start with is, of course, the new EU public procurement directives which will, according to Cabinet Office, be implemented in England and Wales before the middle of 2014. MEPs agreed to the final version of the directive on 15 January 2014. It will now have to go back to the European Council for final sign off and is not likely to be officially in final form until early March 2014. We believe that work is going on apace behind the scenes at the Cabinet Office to have draft regulations for consultation almost as soon as the directives are adopted.

As we have commented previously, the Cabinet Office is not planning to treat the new draft directives in the same way as the previous and past directives. Instead of a lengthy interpretation and transposition into an 'anglicised' version of the classic directive, we understand that they will transport the majority of the wording of the draft directive directly into regulations for England and Wales and will only add in additional regulations where the draft directive requires Member States to build upon the bricks laid by the Commission's wording. While this will help with a quick implementation process in England and Wales, it has left some of us slightly concerned as to the effect this will have on interpretation of the new regulations at a later date. The current Public Contracts Regulations 2006 (as amended) were drafted to sit comfortably with UK legislative practices and to take into account differences between the UK and EU legal systems. Some language and phraseology used in the English translation of the draft directive will need to be carefully considered to ensure that it has been understood as the Commission meant rather than what we would naturally assume.

### State aid

In May 2012 the Commission launched a modernisation programme of the state aid enforcement regime. This has been undertaken by a series of consultations on the various exemptions and guidance documents issued by the Commission in its role as regulator of the state aid regime in the EU. A number of the current pieces of guidance and the exemptions were due to expire on 31

December 2013 but these have been extended until 30 June 2014 to allow for the consultations to be completed and the final form regulations and guidance to be drafted.

Therefore, for both the state aid and procurement regimes, when advising client departments who wish to start projects around or after the middle of 2014 you will need to take into account the new legislation as well. Clients may wish to be encouraged to think about starting projects sooner rather than later if possible to give certainty to the legislation that will apply. Obviously, it is the legislation that is in force at the time that the project formally begins (admittedly sometimes that needs to be thought about carefully) that will be applicable throughout the life of the project.

### TUPE and pensions

2014 will see the implementation of major parts of the overhaul programme of the Local Government Pension Scheme (LGPS) under the Public Service Pensions Act 2013. It is anticipated that the new LGPS will be introduced in April 2014. While the changes will obviously impact the advice that a local authority lawyer gives on a number of levels, of particular interest to us are the changes to the Fair Deal 2013 rules for most public bodies except local authorities. Currently the Best Value Authorities Staff Transfers (Pensions) Direction 2007 continues to apply but it is possible that the requirements of the Fair Deal 2013 may impact on any changes to the 2007 Direction. Under the new Fair Deal regime, employees have the right to choose on both the first and any subsequent transfers whether they would prefer to stay with their current pension plan or move to one proposed by the employer. When undertaking outsourcing procurements, this would need to be taken into account as part of the pre-tender engagement with the cohort of staff likely to transfer so as to be able to give the bidders as much information as possible about the likely route that they will have to plan for.

### Mutuals

The mutuals agenda will continue apace. The Cabinet Office remains committed to supporting cohorts of employees and their employers in all parts of the public sector to consider whether services could be provided to the public body in question by a public sector mutual. We will shortly be publishing a mutuals clarity guide which looks at some of the big questions that local authorities in particular will need to answer. It is always going to be a delicate balance between supporting employees who are keen to operate in a way which could provide better quality services and taking too many risks with service provision.

## Health and social care

The use of pooled budgets for public health will continue with the next tranche of £2.79 billion being available in April 2014. Local authorities and their health care partners will need to look at how to come up with effective and efficient decision-making and governance arrangements to allow for the local priorities for public health to be developed and approved with appropriate sign off. There will be a need to understand the decision-making processes for CCGs, local authorities and Health and Wellbeing Boards and how they can fit together. This will link into effective monitoring of spend, in particular how CCGs and local authorities will work together to ensure that pooled budgets are being spent effectively and that the results can be used to develop further improvements.

The Care Bill will come into force this year and the latest suggestions made by Norman Lamb MP that local authorities should become commissioning bodies for adult social care, similar to the role of clinical commissioning groups (CCGs) for health care, without providing any services themselves, will raise a few eyebrows in town and county halls. This comment was made during a parliamentary debate on the Care Bill so whether it has any real impact on the legislation remains to be seen. In any event, the thinking of government is definitely along those lines and the establishment of a market for adult social care services to allow choice of provision will, in many areas, be encouraged.

## Local growth

The funding for economic development will continue to focus on plans made in partnership with local enterprise partnerships (LEPs) and other regional partners. Local authorities and their partners in the LEP should now have their growth plans drafted and be looking forward to discussions with BIS and/or DCLG before final submission. While the funds will not be available until 2015/16, 2014 will be the year to prepare for the additional funding coming through the single pot and to cement the partnership arrangements necessary for managing the funds.

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# state aid de minimis - new regulation, same threshold

The European Commission has adopted a final version of the new de minimis regulation which came into force 1 January 2014. Many authorities and potential aid recipients will be disappointed to learn that the €200,000 threshold has been retained.

## Threshold

The Commission's press release IP/13/1293 states that there is no evidence to suggest that a higher threshold is required because *"for the vast majority of undertakings this ceiling is not reached"*. It is arguable that this may be because aid payments are always going to be structured so as not to reach the threshold (whatever the threshold may be) in order to permit further aid over the three year rolling period. However, the Commission has taken the view that a higher threshold would risk distorting the market.

The Commission also rejected calls to increase the threshold due to inflation on the basis that inflation between 2007 and 2013 has been lower than originally expected but it is not clear whether the Commission considered future inflation. By the time the threshold is reviewed again (the regulation will be replaced on 1 January 2021) it will have been in place for 14 years.

## Exceptions

The de €200,000 minimis exemption does not apply to the following sectors and activities:

1. Fishery and aquaculture sector.
2. Primary production of agricultural products.
3. Export-related activities.
4. Activities for which the aid is contingent upon the use of domestic products.
5. Acquisition of road freight vehicles.

However, undertakings in the fishery and aquaculture sector which have other activities outside the sector can receive aid under the exemption in respect of those activities. A separate de minimis regulation (€15,000) has been published in respect of agricultural activities.

It is also worth noting that aid to undertakings in difficulty can now fall within the de minimis exemption.

## Central register

The Commission has also sought to simplify the application of de minimis. Many will be relieved to learn that the plans for a mandatory central register were abandoned and aid recipients in the UK can continue to self-declare.

## Loans and guarantees

The new regulation includes specific provisions for relying on the exemption in respect of loans and guarantees which will be deemed to be de minimis. This should make life simpler for authorities looking to provide strategic loans or guarantees into joint vehicles or companies owned by public bodies.

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## forthcoming events

### Engaging with public service: driving value from PFI/PPP seminars

Tuesday 4 March 2014, Exeter

Thursday 6 March 2014, Nottingham

Tuesday 11 March 2014, Birmingham

2.00pm - 4.00pm

The pipeline of new PFI projects may have slowed to a trickle, but authorities remain responsible for managing high-value, long-term contracts. The coalition government signalled its intention to drive savings in existing PFI/PPP arrangements, and authorities facing unprecedented financial constraints will in any event be seeking the most effective way to manage existing contracts or reduce costs.

This workshop explores the key legal and commercial issues facing authorities managing these contracts - specifically:

- those aspects of PFI/PPP contracts which authorities may wish to review. For example insurance, benchmarking, market testing, change, change in law, indexation
- best use of existing provisions including transparency provisions and the pay and performance mechanism
- other ways in which savings might be made. For example through change to avoid 'gold-plating', and the legal issues flowing from this (such as whether funder consent is required)
- linked to this, the extent to which concepts from the new PF2 model (such as separating hard and soft FM, or retaining a larger share of insurance risk) might be introduced into existing arrangements as a tool to drive value
- whether PF2 suggests any new approaches that can be taken by authorities when procuring new PPP arrangements.

The session will have a practical focus, and allow the opportunity for discussion of case studies and real life issues faced by delegates.

This session is free of charge and 1.75 CPD points can be claimed. [Please click here to register your place.](#)

### **In-house lawyers seminars**

**Wednesday 5 March 2014 - Birmingham**

**Wednesday 12 March 2014 - London**

**Wednesday 19 March 2014 - Nottingham**

**Wednesday 26 March 2014 - Manchester**

**2.30pm to 5.30pm**

Topics for discussion will include an update on various areas of law including developments in contract and IT law; the practical changes required as a result of the revisions to consumer law happening over the next six months and any significant changes to public sector contracting, competition law and employment law.

2.5 CPD points will be awarded to those who attend and there will be wine, nibbles and an opportunity to network for those who want to catch up afterwards. [Please contact us here to register your interest.](#)

### **Local government conference**

**Tuesday 25 March 2014 - Mercure Southgate Hotel, Exeter**

We will cover a range of topical subjects relevant to local authorities in the South West in our free all day conference. Areas we will cover include:

- prosecution and defence aspects of criminal regulatory law for local authorities
- key areas in the mutuals agenda, including vires, state aid and procurement
- Environmental Impact Assessment and Appropriate Assessment - bats out of hell?

[Please contact us here to register your interest and receive further details.](#)