public matters newsletter

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index

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shared services and public to public cooperation

As you will recall from last month we are doing a series of articles on the new draft public sector Directive, which hopefully is now in final form. This month I am going to look at the codification of the 'Teckal' line of case law which will be of critical importance for any public bodies which are looking to put in place shared services arrangements with other public bodies.

I think it is first worth having a look at the existing position under the public procurement regime. As a matter of principle, the European Procurement Directives (which have been incorporated into UK law by the Public Contracts Regulations 2006 (the 'Regulations')) potentially apply whenever a contracting authority awards a contract for goods, works or services to a party which is legally distinct from it and the value of the contract is over the relevant EU financial threshold.

Accordingly, a separate body, prima facie, should not be awarded a contract to provide services without the public body having gone through a fair and open procurement procedure in accordance with the Regulations.

However, a number of decided cases in the European Court of Justice ('ECJ') have provided to contracting authorities an exemption from the scope of the EU procurement rules when contracting authorities are awarding contracts to 'in house entities'. This entity is likely to be a company but could possibly be an LLP (subject to general powers issues with local authorities participating in LLPs).

The principle case which gave scope for this type of exemption was Teckal SRL v Commune DI Vialmo (case C-107/98) ('Teckal'). The test set out in Teckal is that whenever a contracting authority awards a public contract (as defined in the Regulations) to a body which is legally distinct from it, the procurement rules apply, unless:

- the contracting authority exercises over the contractor a degree of control which is similar to that which it exercises over its own internal departments
- the contractor carries out the essential part of its activities with the controlling authority or authorities.

Moving on from this, the European courts have also recognised the possibility of public to public cooperation without the establishment of a separate 'controlled' entity in Commission v Germany (case C-480/06) (Hamburg Waste). The court in this case held that there was no procurable contract between two or more public bodies where such arrangements were:

- to facilitate genuine cooperation to perform a public task
- not to advantage any particular private entity
- to reimburse the costs of carrying out the tasks
- with a distribution of tasks (not necessarily equally) between the authorities
- with no private sector involvement in the agreement.

In the new directive the European Commission has looked to try and codify the position of the courts from both the Teckal line of cases and the decision in Hamburg Waste. These can be found in Article 11 which concerns contracts between entities within the public sector.

The article has been essentially split into 3 parts. Part one deals with a Teckal type arrangement where the controlled body is controlled by a single contracting authority. In order for the contract to fall outside the scope of the directive the following conditions must be fulfilled:

- it must be controlled in a similar way to the contracting authority's control over its internal departments
- the separate body must carry out 80% of its activities with its controlling public body
- there is no direct (with very limited exceptions unlikely to be relevant often in the UK) private capital participation.

You will of course note that, the first condition is largely what is required under the existing Teckal exemption. In relation to the second point, it has been accepted for some time that some form of external activity is permitted for Teckal vehicles. The introduction of a 20% figure for that activity is in excess of the figures previously understood to be acceptable and is therefore a broadly welcome clarification. The third condition is something which seemed to have been critical in the failure of claims for the exemption in more recent cases. Accordingly, it was inevitable that something like this was going to be included in the directive. However, this is something that will need to be carefully thought about when considering how best to capitalise any separate vehicle where funding is difficult to obtain from the controlling bodies.

The second part of the article provides that the conditions can be fulfilled by two or more contracting authorities who jointly control and own the vehicle. It goes on to explain how the control must be demonstrated, in particular:

- the decision making body (for example the board of directors) are composed of representatives of all the controlling bodies, although a representative may be a representative of more than one body
- the controlling bodies are able to jointly exert decisive influence over the strategic objectives and significant decisions of the vehicle
- the vehicle does not pursue any interests which are contrary to those of the controlling bodies.

The first condition although perhaps understandable does not obviously come from the case law. However, its drafting does not make it clear whether this means that it must be exclusively made up of such representatives or whether there could be other non representative board members. The second condition is largely reflective of the current case law position. However, the third point is new and it is unclear why this is needed (in that by definition this body will be controlled by the contracting bodies and so why would it do anything contrary to their interests). Furthermore what would happen if a controlled body was found to be acting in such a way? This seems dangerously superfluous and could be utilised to second guess what the interests of the contracting bodies actually are.

Finally Article 11 endeavours to establish a Hamburg Waste type principle of public to public cooperation without the establishment of a separate vehicle. Such an arrangement will fall outside of the regime where:

- the contract establishes or implements a cooperation between the participating contracting authorities with the aim of ensuring that public services they have to perform are provided with a view to achieving objectives they have in common
- the implementation of that cooperation is governed solely by considerations relating to the public interest
- the participating contracting authorities perform on the open market less than 20% of the activities concerned by the cooperation.

To some extent these conditions are less onerous than the existing case law position. The introduction of the market orientation in the third condition is something new and not something immediately apparent from the Hamburg Waste case itself. It is not clear why there was the change in emphasis from the first two parts i.e. concentrating on the 20% market orientation rather than the 80% activity with the contracting authorities, however the end result should not in itself be different. This codification is important as the Hamburg Waste case did stand on its own somewhat and having this put into the directive will give a firmer footing for this type of arrangement.

Finally, the article also confirms that the percentages referred to are based on an average turnover over a three year period and it also makes it clear that the Teckal exemption works both ways i.e. the controlled body can award contracts to its controlling bodies without competition.

As a number of commentators have pointed out, Article 11 (and the other articles which attempt to codify existing case law) only really codifies the position (to the extent it truly codifies the position) at a fixed point of time. It is not feasible to take on all of the nuances which have come out of the case law in one article of a directive. Accordingly, although useful to have this starting point in the directive, it will not of course mean the end of case law in the area. Future cases will no doubt be used to interpret the meaning of various aspects of Article 11 and new cases will undoubtedly come along.

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Hydraulic fracturing or fracking is an unconventional hydro-carbon extraction method which is strongly supported by the UK Government, who views it as key to meeting the UK's energy needs and boosting the economy.

However it has not been a smooth introduction, with a number of high-profile protests and in 2011 fracking was briefly suspended following seismic tremors.

It now appears that fracking may soon be a reality for many, with the government confirming this month that people in southern England should prepare for fracking in their areas. In addition, a report by UK Water Industry Research is also set to be released by the end of 2013. The Government has indicated that it will conclude that the water used in the fracking process will not contaminate water supplies, thus addressing a key environmental concern.

It seems inevitable that fracking will take place on a large scale in the UK. Therefore it is essential that mineral planning authorities understand the planning process and their role within it. To assist in this, the government released planning practice guidance for onshore oil and gas in July this year.

The process

In relation to offshore hydrocarbon extraction there are three distinct phases. These are exploration, appraisal (testing) and production.

Each phase requires planning permission as well as other permits and approvals. The relevant mineral planning authorities will be the county council in two tier areas, the unitary authority, or the national park authority.

The exploratory phase is likely to include seismic surveys as well as exploratory drilling.

The appraisal phase occurs where further information is required about the extent of the deposit or its characteristics.

The production phase normally involves the drilling of a number of wells. The production life of the wells can be up to 20 years.

Minerals planning authorities should note that when considering whether to grant planning permission, the authority should not take into account the impacts of future phases. Moreover, when the subsequent phases come forward for approval, the fact that exploratory drilling has already taken place is only relevant to the extent that it establishes the presence of hydrocarbon resources. It does not mean that the site is suitable for extraction approval.

Although the granting of permission for the exploratory phase does not inevitably lead to the grant of permission for extraction, local residents are likely to believe that once exploratory permission has been granted that this will lead to extraction. Strong local resistance should therefore be expected even at the exploratory stage.

Fracking and the National Planning Policy Framework (NPPF)

It is trite law that planning applications are to be determined in accordance with the development plan unless material considerations indicate otherwise. In the context of fracking, that directs the decision maker to the minerals local plan (or core strategy) for the area concerned.

However, most plans do not currently address unconventional gas exploitation due to its relative novelty.

The NPPF will be a material planning consideration when considering applications. Additionally, in the absence of a minerals local plan which addresses unconventional gas extraction or if the plan imposes policies which appear to be purely ones of resistance, then the plan will be accorded little weight by the Secretary of State on appeal. In this situation the NPPF would gain increased significance.

The NPPF states that great weight is to be given to the benefits of mineral extraction, suggesting that applications are likely to be approved if considered solely with reference to the NPPF. Recent case law confirms that even green belt land is not safe from fracking.

Where next for minerals planning authorities?

- minerals planning authorities will have to develop their local plans to reflect the opportunities for fracking. The potential for such developments in their areas must be engaged with and planned for rather than simply resisted

- additionally, certain authorities will lose the right to determine fracking applications over the coming months, and direct applications will be made to the planning Inspectorate under s62A TCPA 1990, where the authority is designated as failing

- the government has stated that it will keep under review the question of whether fracking should be the subject of the Planning Act 2008 regime. If it decides that it should, expect to see the early publication of a National Policy Statement recognising a national need for unconventional gas extraction.

Overall, there is a pressing need for minerals planning authorities to plan positively for fracking or face having the power to decide taken away from them.

Fracking and the EIA

Environmental Impact Assessments (EIA) are likely to be a key element of applications made for fracking licenses, considering the potential significant impact on the environment.

Developers may wish to avoid the cost and time associated with EIAs by structuring their activities so as to avoid the relevant threshold tests.

Whilst this may be attractive in the short term, it is likely to be in all parties interests to address environmental concerns at an early stage. Potential legal challenges to decisions made by minerals planning authorities are most likely to come from those concerned about the effect on the local environment. Being able to demonstrate that environmental issues have been fully considered will assist in successfully defeating any challenge. It may also provide the justification for refusing an application. Therefore pressure should be put on developers by minerals planning authorities to undertake EIAs in relation to fracking in their area. Authorities should beware of applications being 'salami sliced' in an attempt to come under the EIA thresholds.

It should also be remembered that authorities which traditionally did not have to consider onshore hydrocarbon extraction may now find themselves in a position whereby shale gas deposits are located in their area.

The amount of applications for fracking licences is on the increase. Strong government support and the comments on the expected UK Water Industry Research Report are set to encourage development of further fracking. Minerals planning authorities should ensure that they are prepared to fully engage in the process in order to maximise any possible rewards, whilst also remaining in control of the process in their area.

The UK Water Industry Research report is expected by the end of the year. It may be this which helps kick off the fracking 'boom' which the government is aiming for. Only time will tell on whether this is the case, but as all the indications are that fracking is only going to increase, no harm can come of getting your house in order in the meantime.

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ECJ ruling on ability of contractors to rely on capacity of third parties at PQQ stage

Contracting authorities are often faced with difficulties when applying their selection criteria at the pre-qualification stage of a tender process. When drafting the pre-qualification questionnaire (PQQ), care always needs to be taken to ensure that any minimum criteria used is compliant with the EU public procurement rules. One question that often arises is to what extent a contractor can rely on the capacities of other entities for the purposes of satisfying these criteria?

Article 47(2) of the Public Sector Directive 2004/18 provides that:

"an economic operator may, where appropriate and for a particular contract, rely on the capacities of other entities, regardless of the legal nature of the links which it has with them. It must in that case prove to the contracting authority that it will have at its disposal the resources necessary, for example, by producing an undertaking by those entities to that effect."

Regulations 24(4) and 25(3) of the Public Contracts Regulation 2006 implement this provision in the UK.

On 10 October 2013, the European Court of Justice (ECJ) ruled on a reference from an Italian court on whether a national law can impose restrictions on the right of a contractor to rely on the capacity of third parties to meet selection criteria relating to its economic and financial standing or technical and/or professional ability[1].

The Italian law established a national certification system for public works contractors whereby public works contracts over a certain value could only be performed by undertakings in possession of an 'SOA' certificate from certain certification bodies. It provided that a bidder may usually only rely on the capacities of only one 'auxilary undertaking' for such contracts.

In the procurement at issue, bidders were required to demonstrate their technical and professional ability by presenting an appropriate SOA certificate. A member of an ad hoc consortium participating in the tender sought to rely on the certificates of two third party undertakings and was excluded from the tender under the Italian law.

The ECJ held that the Italian law was incompatible with the Public Sector Directive. It considered that the combining of the capacities of more than one economic operator is permissible under the Directive provided it can be demonstrated that the resources of those entities would be at the disposal of the bidder for the

[1] Case C-94/12 *Swm Costruzioni 2 SpA*

execution of the contract. The provisions in the Directive on consortium and sub-contractors actually imply that reliance on the capacities of more than one third party is permissible and previous case law supports this also[2]. The ECJ noted that in certain circumstances, where works with special requirements are involved, a requirement that limits the number of third parties that can be relied upon may be appropriate. However, the requirement must be exceptional and not made a general rule such as under the Italian law at issue. It must also be related and proportionate to the subject matter of the contract.

The ECJ also noted that the objective of public procurement is actually to open up public contracts to competition, including by facilitating the involvement of SMEs (Small and medium enterprises). This last point raises a very topical issue in public procurement as it is one of the main objectives of the new public procurement directive due to be adopted shortly by the European legislature. The new directive contains a number of provisions designed to make public procurement more accessible to SMEs. The Cabinet Office has also been leading a drive to encourage SME participation in public procurement and is currently considering responses to a consultation it issued on the matter. The question of how to deal with consortium bids and the legal parameters around evaluating a bidder's supply chain is clearly in the legal spotlight at the moment. It is crucial to ensure that you are considering SME issues therefore when designing your procurements, especially in relation to the selection criteria you set at the pre-qualification stage.

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[2] See, for example, case C-314/01 Siemens AG Osterriech and ARGE Telekom

For rescuing and restructuring undertakings in difficulty

As part of its state aid modernisation drive, the European Commission is consulting on new draft guidelines on state aid for rescuing and restructuring 'non-financial' undertakings in difficulty (financial undertakings such as banks are subject to separate rules).

Current guidelines

The current guidelines distinguish between temporary support to an undertaking in difficulty such as loans or loan guarantees ('rescue aid') and aid intended to restore the long-term viability of an undertaking on the basis of a restructuring plan ('restructuring aid') and were originally published in 2004.

Proposed new guidelines

The Commission's proposed guidelines include four main changes:

Temporary restructuring support

The proposed guidelines include a new temporary restructuring measure available only to SMEs, designed to *"simplify the granting of state aid for restructuring SMEs while reducing distortions of competition"*. The maximum duration of such aid is shorter (the Commission proposes either 12 or 18 months) than for the standard restructuring support and can only be in the form of loans or loan guarantees. The recipient would also only be required to provide a simplified version of the restructuring plan usually required in respect of restructuring support. This new approach appears to be intended to bridge the gap between rescue aid (which has a maximum duration of 6 months) and the more complex restructuring aid where the recipient is an SME. This may be on the basis that the size of SMEs means any market distortion is likely to be less severe than where a larger undertaking is involved.

Better 'filters' ensuring aid is in the public interest

Any aid under the new guidelines must pursue an *"objective of common interest"* but simply preventing an undertaking from exiting the market will not be, in of itself, an objective of common interest. The aid must aim to *"prevent social hardship or address market failures by restoring the long-term viability of the undertaking."* Examples of how this will be demonstrated are set out in the guidelines and include high unemployment in the affected regions, disruption to an important service where it would be difficult for a competitor to simply step in or even where the exit of the undertaking would lead to an irremediable loss of important technical knowledge or expertise.

'Burden sharing' with the undertaking's investors

The concept of burden sharing requires the undertaking's investors to share the burden of the aid with the rescuing body. This concept has been developed through the rescue of financial institutions and the Commission believes it could successfully be applied to other non-financial undertakings. Two potential options are set out. The first requires reasonable contributions from an undertaking's shareholders and creditors which are (i) based on the losses they would likely suffer in the event of insolvency and (ii) at least match the level of aid provided. The second requires that shareholders bear past losses and then subordinating creditors also contribute if anything further is required. Again the contributions must usually match the level of aid provided.

Definition of 'undertakings in difficulty'

In order to benefit from rescuing or restructuring aid undertakings must be 'in difficulty' and the new guidelines seek to develop this requirement by making the definition more objective and precise. Specific objective criteria apply and more subjective criteria can only be used 'exceptionally'. The application of these more objective criteria should make it easier for public bodies to determine whether an undertaking is eligible for this class of aid, but also carries the risk of limiting the availability of the aid if the criteria are drafted too tightly.

The consultation is open until 31 December 2013 and comments are invited from any stakeholders, but particularly public bodies who may provide aid to undertakings in difficulty. The draft guidelines are available on the European Commission website here.

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PF2 – a toolkit for local authorities?

We recently held a roundtable session for local authorities to discuss the implications and opportunities of the new PF2 model for local authorities.

PF2 could be of relevance to local authorities (or indeed any public body) by:

1. Undertaking new ‘PF 2 projects’ with the benefit of central government funding.
2. Using the PF2 documentation to exercise existing powers to make a direct investment into a scheme.
3. Using the changes made under PF2 to inform and scope new projects which are not ‘badged’ as official PF2 schemes.
4. Using PF2 concepts as tools with which to renegotiate or otherwise drive efficiencies from existing contracts.

In our first roundtable session, it was felt that options 3 and 4 were more likely to be immediately relevant to local authorities. We have produced a short ‘toolkit’ of the main PF2 concepts, with commentary on the ways in which PF2 might be used.

For example, PF2 introduces greater flexibility in respect of maintenance obligations and ensures that any savings which result a shared with the authority. This is a concept which could be explored with contractors in an attempt to reduce any ‘gold-plating’ of existing arrangements.

We are also launching a PPP review product, designed to assist authorities in reviewing their PFI arrangements. Recognising the financial constraints our public sector clients are working under, our fees will be linked to any savings actually generated.

If you would be interested in receiving a copy of our toolkit document, or discussing our PPP review service, please get in touch.

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PF2 equity participation

Will the Treasury invest in local authority projects?

The government recently announced its response to the consultation on the proposed terms for equity participation in PF2.

PF2, the much heralded heir to the now demised PFI programme, has been in the public domain for around a year. The response sought to clarify one of its key features – equity participation in projects by the public sector. This means that the government – in this case a newly established arm of the Treasury – will become a shareholder as well as a customer in the new arrangement.

The major scheme to use PF2 to date is the Priority Schools Building Programme, the replacement to the now defunct Building Schools for the Future (BSF) programme. But there is nothing to suggest that the Treasury will not invest in local authority schemes which:

- are sufficiently robust, with a business case that stacks up
- are large enough to warrant the ancillary costs involved in this type of arrangement (for example, advisers fees)
- meet the 'eligibility criteria' (yet to be detailed).

Presumably, projects which support the core policies of economic growth – for example, transport infrastructure – are more likely to attract the attention of government equity investors. Until a pipeline of PF2 schemes develop, some uncertainty does remain around the process of government equity participation. For example, will government equity support go some way to unlocking a new line of private finance? However, with investment decisions made on a commercial basis, a local authority with a sound proposition is free to make its case.

Additionally, time will tell whether local authorities will follow the templates provided by central government and seek to invest directly in their future projects without recourse to Treasury funding.

We are hosting sessions on local authority involvement in PF2 at our offices in Nottingham and Birmingham. The sessions are free of charge. Do contact us here if you would like to attend.

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The best of recent developments

Extension of the FOIA to public sector joint venture companies

Arguably the most significant Freedom of Information Act 2000 (FOIA) related development in recent months has been the implementation of section 103 of the Protection of Freedoms Act 2012. This followed the making of the relevant Commencement Order (No. 8) on 31 July 2013.

This relatively little publicised amendment to the FOIA tidied up the (distinctly untidy) definition of a public authority – which included companies wholly owned by one public sector body – but not those wholly owned by more than one public sector body. The change got a mention in the Information Commissioner's Office (ICO) e-newsletter for August, which also mentioned the consequential tweaks that had been made to ICO guidance and guides, but wasn't otherwise heralded with trumpets.

So, public sector joint venture companies have been subject to the FOIA since 1st September and will no longer be able to say *"sorry, we're not bound by it"* when they receive an FOIA request.

What does this mean in the short term for anyone with governance responsibilities for these joint venture companies (JVC)?

First of all, each JVC will have to publish a publication scheme on its website (which is fairly short and a model version is provided by the ICO). This sets out a high-level commitment to publish information proactively. It consists of seven commitments and seven classes of information. It will also specify how the JVC should make the information available, what it can charge and what it needs to tell members of the public about the scheme. This does mean it will have to publish various types of information on the website going forward. Please click here to see the ICO's guidance on what wholly owned public companies should publish.

The most difficult part is likely to be deciding what board minutes should be made available as part of the JVC's publication scheme. A JVC is likely to be operating in a more commercial environment than its parent bodies and there is likely to be genuinely commercially confidential information contained in the minutes. The ICO does recognise this and its guidance acknowledges that disclosure requirements exclude information which is *"properly regarded as private to the meeting"* – in line with FOIA commercial confidentiality exclusions.

Extension of the FOIA to require publication of datasets

The ICO got rather more excited by the dataset amendments to the FOIA, which were also made by the Protection of Freedoms Act 2012 and also came into force on 1 September 2013.

In fairness, this does have the effect that members of the public now have rights not only to receive datasets in a form capable of re-use but also the right to re-use them for commercial or other purposes, under the terms of a specified licence. Public authorities are also now required to publish any datasets which have been requested as part of their publication scheme.

The previously existing exemptions which apply to FOIA requests will still apply – so excessive costs or vexatious requests will justify refusal. The Freedom of Information (Release of Datasets for Re-use) (Fees) Regulations 2013 set out legitimate charges for making a dataset available for re-use. The authority can recover its costs and a reasonable return on investment.

Disclosure of historical information under the FOIA

There have been two interesting developments in this area over the last few weeks.

In The Cabinet Office v The Information Commissioner and Gavin Aitchison [2013], the Upper Tribunal upheld the decision of the First-tier Tribunal that information about the take-over of Rowntree Mackintosh by the Nestlé group of companies in 1988 should be disclosed.

Cabinet minutes and ministerial communications are exempt from disclosure unless the public interest in disclosure outweighs the public interest in maintaining the exemption. Generally speaking, the exemption will apply, to ensure that ministers are free to discuss matters and to maintain the convention of collective responsibility of cabinet government.

However, the Upper Tribunal found that, when balancing the public interest, it was right to take into account changing government policy towards disclosure of historical records, which will enable the public to access records 20 years after their creation instead of 30 years. This change came into effect on 1 January 2013. In this case, 22 years had elapsed between the decision and the request for disclosure was made and the Rowntree takeover was still an issue of interest in York. These factors were decisive in determining that the public interest lay in disclosure.

It is clearly open season on historical records, as this month the Scottish Government published its response to consultation on reducing the protected period for historical records under the Scottish FOIA. The Scottish Government will introduce an order to reduce the period from 30 to 15 years, which is a significant reduction. The change will not require Scottish public authorities to publish newly historical information proactively on their publication schemes but the 15 year period will apply to requests. Where Scotland leads, will England and Wales follow?

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