Appendix 1

Executive Board 9th March 2011 Architectural Design Services Review – Report Back on Options.

Legal Advice

1. In relation to option 5 (NPS proposal), the report provides that "NPS JV's have so far been excluded from EU requirements for procurement on the basis of the tested Teckal exemption, which covers activity where there is no outside finance, the Council is on the board, and the majority (75%+) of work is for the Council. If this position can be established, the Leeds proposal could be exempt and on this basis, the Council would not need to specify or guarantee a specific work level or type as it would in a full procurement exercise".

2. Where a public body performs a service using its own resources there is no contract and the Public Contracts Regulations 2006 do not apply. In addition, the Regulations do not apply to arrangements between organisations who, although legally separate are so closely connected that it would be inappropriate to make their dealings subject to the Regulations, and are, for procurement purposes, considered to be indistinguishable. This is known as the "in-house exception" which was first established in the European Court of Justice case of Teckal Srl v Comune di Viano(Case C-107/98).

3. The 2 elements of the exception are first, the contracting authority must exercise over the person concerned a control which is similar to that which it exercises over its own departments and second, at the same time, that person must carry out the essential part of its activities with the controlling authority or authorities. This exception has been the subject of a number of other European Court of Justice cases.

4. The exception was considered recently in a case involving a mutual insurance company set up by a number of the London Boroughs. This case is worthy of particular consideration, as a number of NPS subsidiary arrangements will have been established before this case came to Court. To summarise, the High Court decided
    - The exception is part of English law, but is to be strictly interpreted.
    - It is for the public authority to prove that it applies.
    - The assessment of the control of a company for the purposes of the first condition must take account of all the legislative provisions, and relevant circumstances.
    - The public authority must have a power of decisive influence over both strategic objectives and significant decisions of the company.
    - The fact that the controlling authority holds, alone or together with other public authorities all of the share capital in the company tends to indicate, without being decisive, that the authority exercises over the company a control similar to that which it exercises over its own departments.

- It was not necessary for Brent to show that it alone had the power of decisive influence over the strategic objectives and significant decisions of the company.

5. On appeal in Brent London Borough Council v Risk Management Partners Limited [2009], the Court of Appeal decided broadly,
    - The Regulations are subject to the exception.
    - Powers arising from the relevant documents provide the starting point, but the circumstances in which the arrangements will operate, including how the authorities are likely to exercise their powers should also be considered.
    - A body which is controlled by a group of public authorities will satisfy the exception if the authorities jointly exercise the necessary degree of control over it, and it carries out its essential functions for them.
    - The presence of private capital and participation in commercial activities with third parties, are each likely to exclude the operation of the exception.
    - The authorities could pass special resolutions by a 75% majority, but the powers of the board were extensive, and they had a substantial amount of discretionary control over the way in which the company was run. It was clear the board rather than the members was intended to exercise control over the company, so this did not amount to sufficient control for the exception.
    - The fact a contractor's constitution allows the entry of private capital was not significant if there were no private shareholders at the time the contract was awarded, and the second condition would have been satisfied as the provision for affiliates was marginal.

6. On appeal, by its judgment dated 9 February 2011, the Supreme Court decided
    - The Teckal exemption does apply to the Regulations.
    - Collective control by public authorities is enough.
    - Public authorities do not require to follow any particular legal form in order to take advantage of the Teckal exemption.
    - As long as no private interests are involved, authorities are acting solely in the public interest in the carrying out of their public service tasks, and they are not contriving to circumvent the rules on public procurement, the Teckal conditions are likely to be satisfied.
    - The decisive influence that a public authority must exercise can be present even if it is exercisable only in conjunction with the other participating public authorities.
    - The board was subject to direction by the participating members in general meeting by a 75% majority, and 100% of the voting rights at general meetings lay with the participating members.
    - There were limitations on the insurance that might be offered, and collective control over strategic objectives and significant decisions was with the participating members at all times. The Teckal control test was satisfied.

- There was no private involvement in the company's affairs, other than a minority of independent directors on the board, and the company had no external or private capital.
- The main objects of the company were to provide insurance to the London Boroughs, and bodies associated with them. The second Teckal condition was satisfied.
- The Directive applies unless, in substance, the body concerned only trades with the local authority, or authorities. The body must remain within the public authority sphere and could not go out and compete with other suppliers for other primary insurance business on the open market.

7. NPS has provided a draft form of Articles of Association for a subsidiary trading company limited by shares. These provide for a holding company (presumably the NPS "parent" company) to hold 51%, (with the Council presumably holding the remaining 49% of the shares). The Articles also refer to the holding company itself being under the control of Norse Group Limited. However, NPS's solicitor has confirmed the "standard model" for NPS subsidiary companies is 80%/20% share ownership in favour of NPS and the local authority respectively.

8. In relation to the board of the proposed subsidiary, NPS's solicitor has confirmed the proposal is for 6 directors, being 1 managing director, 3 appointed by Norfolk County Council (NCC), and 2 appointed by the Council.

9. NPS's solicitor has confirmed that NPS is 100% owned by Norse Group Ltd, and that Norse Group Ltd is itself owned 100% by NCC. Therefore, although the Council will not itself exercise control over the subsidiary similar to that which it exercises over its own departments, in effect the subsidiary will be wholly owned and controlled by the Council and NCC acting collectively. The Council could not, by virtue of its shareholding in the subsidiary, prevent an element of private sector ownership being introduced into either NPS or Norse. However, it could seek a separate contractual commitment from NPS and/or Norse to the effect that the Council must be notified of any proposed company resolution to introduce private capital or ownership into NPS or Norse, with suitable exit provisions in the services contract with the subsidiary. The Council should also seek a limitation in the constitution of the subsidiary to the effect that a proposed resolution to introduce private capital or ownership into the subsidiary itself, must first receive the separate written consent of the Council.

10. The presence of private capital or ownership is clearly significant. In the case of Mehilainen and Terveystalo Healthcare [2010], concerning the setting up of a joint venture company on an equal share basis both in terms of ownership and of power of control, the ECJ decided that "the holding, even a minority holding, of a private undertaking in the capital of a company in which the contracting authority in question also has a holding too means that, on any view, it is impossible for that contracting authority to exercise over that company control similar to that which it exercises over its own departments".

11. It seems unlikely that the participation of NCC in the subsidiary through NPS and Norse, rather than directly in its capacity as a local authority, would be significant for these purposes. In the case of Commission v Germany [2009], when deciding whether a process of inter-municipal cooperation required the creation of a separate body, the ECJ decided that "Community law does not require public authorities to use any particular legal form in order to carry out jointly their public service tasks", and that such cooperation did not undermine the objectives of the Community rules on public procurement. This case was referred to by the Supreme Court in its judgment mentioned above, and it seems clear that so long as no private interests are involved, and authorities are acting solely in the public interest in the carrying out of their public service tasks, the form of their collaboration will not be regarded as significant for the purposes of the Teckal exemption.

12. It is not yet clear whether, or to what extent it is intended the subsidiary would carry on commercial activities by providing services to the private, as well as the public sector. Plainly, any proposal for the subsidiary to carry on such activities would need to be carefully considered in the light of the Supreme Court judgment mentioned above. In any event, it would be appropriate to place restrictions in the Articles in this respect, either prohibiting such activities or limiting these activities to no more than a specified percentage of turnover. It appears that neither NPS nor Norse engage in any commercial activities at present, but again a separate contractual commitment could be sought to notify the Council of any proposal to this effect, with suitable exit provisions in the services agreement with the subsidiary.

13. The draft Articles provide that a number of actions or decisions by the subsidiary company require the separate written consent of NCC. These include activities which would fall outside the scope of an approved business plan, the giving of guarantees, creating new shares etc. These restrictions have been included to reduce the discretionary control by the board, and to demonstrate that there is a decisive influence over the strategic objectives of the subsidiary company, and its significant decisions, by the public sector. These provisions also serve to provide a control over the potential consequences for NCC (and the Council) arising from capital finance transactions undertaken by the subsidiary company. It will be necessary to review this list, to consider whether it is adequate for these purposes, and to determine the extent to which the Council would wish to control such matters. It may be appropriate to include a "catch-all" provision to the effect that separate written consent would also be required for any decision which NCC or the Council reasonably considered was likely to affect the company's strategic objectives, or which NCC or the Council reasonably regarded as being significant.

14. A draft Business Case provided by Hull City Council (HCC) provides details of a different model, namely a joint venture company (JV) between HCC and NPS whereby HCC took only a minority interest in the JV. It appears HCC proceeded on the basis that because of the wholly owned status of NPS, they could rely upon an exemption in an earlier EU Directive which provided that

the Directive did not apply to a public services contract awarded to an entity which was in itself a contracting authority under that Directive, and HCC considered NPS to be a contracting authority for those purposes at that time. However, it appears that the relevant general exclusion in the Regulations is limited to where services are provided by a contracting authority which has "an exclusive right to provide the services" or such a right is "necessary for the provision of the services", neither of which conditions is relevant in these circumstances. It is recommended therefore, that in the current circumstances this model should be disregarded.

15. Overall, it is considered the subsidiary model proposed by NPS will be compliant with the Teckal exemption, provided there is no private sector activity carried on by NPS or Norse, and that no private sector activity is proposed for the subsidiary. If any private sector activity is proposed in relation to any of these bodies, there would need to be further consideration whether the second Teckal condition could be satisfied in the light of the Supreme Court judgment referred to above. It is also considered that the risks of private capital being introduced into any of these companies, to the extent that the Teckal exemption would be lost, can be mitigated by taking the necessary separate contractual commitments, backed up by appropriate exit provisions for the Council in the services contract with the subsidiary.

16. In relation to the Council's powers to participate in the subsidiary company and to enter into the service agreement, under Section 3 of the Local Government Act 1999, the Council is under a general duty "to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness".

17. If the Council identifies the proposals from NPS as being ones which will deliver improved, (in the sense of more economic, efficient or effective) services, it is considered that the totality of the proposals, including participating in the subsidiary company by way of share ownership, board appointments etc. can reasonably be regarded as securing continuous improvement, or as part and parcel of the Council's "arrangements" for so doing under Section 3.

18. In addition, under Section 111 of the Local Government Act 1972 the Council has the power to "do anything… which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions", and this includes obtaining professional and technical services which are incidental to its primary functions.

19. In the "Brent" case mentioned above, the Court of Appeal decided that mutual insurance arrangements, and the arrangements for participating in a mutual insurance company, were not covered by Section 111. It is to be noted that the question of the Council's powers was not considered by the Supreme Court in the Brent case, as a specific statutory power to enter into mutual insurance arrangements had been given to local authorities since the decision of the Court of Appeal.

20. The Court of Appeal found the local authority was not merely making an arrangement with other local authorities as a different way of obtaining insurance. The Court of Appeal found that Brent was going further, and was insuring other authorities and exposing the authority to a risk which insurance with a commercial insurance company did not, that is, a direct exposure to the losses of others. On that basis the arrangements could not be regarded as incidental to the functions of a local authority.

21. The Court of Appeal also found that when a local authority enters into arrangements to obtain property, goods or services necessary for or incidental to its primary functions, the farther those arrangements departed from the simple acquisition of the benefits in question, the greater the likelihood they would fall outside its powers. More elaborate arrangements were likely to involve elements which although they may form an integral part of what may be regarded as a beneficial scheme, were not necessary for the achievement of the objective and could less easily be regarded as incidental to the performance of the authority's function.

22. However, whilst the NPS proposals will involve what might be regarded as the distinct elements of acquiring shares in the subsidiary, and making appointments to the board, there will be no obligation to fund the company or to bear losses incurred by the company or by its other members. In addition, if the Council wishes to continue with an "in-house" service but in collaboration with other authorities, it is difficult to see how this could be achieved without creating a limited liability company if the Council wishes at the same time to insulate itself from the usual risks and liabilities concomitant with directly employing such a service.

23. As a result, it is considered there is a much stronger argument that these elements are "necessary" for the achievement of these objectives. In addition, it is considered that it would be reasonable for the Council to take the view that these arrangements do not depart to a significant extent from the simple acquisition of professional services either by contract alone, or by employing an in-house service, given that participating in the new company will not apparently give rise to any financial risk or obligation on the Council's part, beyond acquiring the shareholding, and given also that the Council will thereby have a continuing responsibility for the delivery of these services, albeit in conjunction with NCC.

24. Therefore, it is considered that even if Section 3 of the 1999 Act is not sufficient in itself for these purposes, the Council can rely on Section 3 in conjunction with the powers in Section 111, in relation to these matters.

Risk of Challenge

25. If the Council decide to create a joint venture company with NPS and seek to rely upon the Teckal exemption as detailed above consideration has to

be given as to whether there is a potential challenge from any third party, by the Council doing so.

26. Any challenge brought would have to be based on the fact that the Council had made a decision that was unreasonable (i.e. that no reasonable authority could have made such a decision) or is not within its powers to decide on such matters. It could not be on the ground that the Council has failed to comply with the Public Contracts Regulations 2006.

27. It is up to the authority to decide how best it wishes to provide its services and there is no requirement to go out to tender if it decides it wishes to keep this service “in-house”, even if this means doing so by reliance upon the Teckal exemption.

28. In order to mitigate against this the Council should be as open and transparent as possible about its intentions. For example, it could soft market test a JV by making it clear that the Council is considering the NPS option but is looking at the market to see if there are any other viable options that are worth considering. If a market testing exercise were to be carried out, there is no requirement to then go to the market if the Council decides not to. The information obtained from that exercise would enable the Council to come to an informed decision as to whether forming a JV is the best route for it to take or not.

29. In conclusion, provided the Council makes a reasonable decision which is justifiable in terms of administrative law, it is considered that the risk of challenge by a third party is low.

Do the Leeds Local Education Partnership (“LEP”) have exclusivity?

30. The LEP has advised the Council that the work carried out by Architectural Design Services can be carried out by it under its current contract with the Council, and if the Council chooses to continue as detailed above, it may decide to challenge the Council on the ground that it has exclusivity in relation to the works covered under the contract.

25. Advice provided from the Public Private Partnership Unit has indicated that the Strategic Partnering Agreement provides that exclusivity is granted to the LEP to carry out " Partnering Services", and "Major Projects". There is also the power (but no obligation) to grant the LEP “Additional Services”.

"Partnering Services”, includes (in the OJEU) the development and implementation of a strategic investment programme for (a) educational facilities consisting of new and refurbished secondary schools and (subject to funding approval and performance of the LEP); primary school accommodation, and accommodation for the provision of SEN partnership bases, other associated facilities as appropriate (e.g. Early Years, Community, Youth, Further Education) under the BSF Programme; and (b) leisure facilities (only within the OJEU which is limited to certain

facilities). Schedule 12 contains the “Partnering Services” specification, which contains considerable detail but is linked wholly to educational objectives principally for the “Major Projects”.

“Major Projects” are defined as Capital Projects over £100k in relation to "Relevant Facilities". A "Relevant Facility" is either construction of the secondary school estate (generally) or other facilities "funded under the BSF programme".

The "BSF programme" is only defined generally as the "Building Schools for the Future programme managed by Partnerships for Schools".

So in relation to design the LEP has the exclusive right to provide design and commissioning services in relation to Major Projects.

28. In conclusion, the LEP do have exclusivity in relation to “Major Projects” set out above and so care needs to be taken to ensure that any Architectural Design Services carried out by NPS do not impact upon such projects otherwise the LEP may seek to challenge the Council on exclusivity grounds.