

PROCUREMENT LAW

SUPREME COURT PAVES THE WAY FOR INCREASED USE OF SHARED SERVICES OUTSIDE OF THE PROCUREMENT REGULATIONS

BRENT LONDON BOROUGH COUNCIL AND OTHERS (HARROW LONDON BOROUGH COUNCIL) v RISK MANAGEMENT PARTNERS LIMITED [2011] UKSC 7 (9 FEBRUARY 2011)

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The Supreme Court has overturned the Court of Appeal ([2009] EWCA Civ 490) and High Court ([2008] EWHC 1094 (Admin)) judgments in holding that a group of local authorities who awarded insurance contracts to a mutual insurance company set up by them for that purpose, without putting the contracts out to competitive tender, had not acted contrary to the Public Contracts Regulations 2006.

BACKGROUND

In reaching that conclusion, the Supreme Court considered in detail the European jurisprudence in relation to the application of the so called “Teckal exemption” (which relates to the provision of services in-house) and provided further guidance.

The Appellant local authority, Harrow, appealed against the decision of Stanley Burnton LJ that the Respondent (Risk Management Partners Ltd “RMP”) was entitled to damages for breach of the Regulations in circumstances where contracts of insurance had been awarded to London Authorities Mutual Limited (“LAML”). LAML had been established by a number of London local authorities, including Brent and Harrow, and participation in the company involved, inter alia, subscription to the memorandum and articles of association and payment of a capital contribution. Brent abandoned a procurement process it had initiated in which RMP submitted

a tender in order to award the contract for insurance to LAML, which had not taken part in the procurement. Following a successful challenge in the High Court and an unsuccessful appeal on the part of Brent, the proceedings between Brent and RMP settled. Harrow continued with an appeal to the Supreme Court.

THE "TECKAL EXEMPTION"

The European Court of Justice in *Teckal Srl v Comune di Viano (Reggio Emilia)* (C-107/98) (1999) ECR I-8121 provided for an exemption from the requirements of the public procurement Directives where a public body enters into a contract with an entity over which that public body exercised a degree of control similar to that which it exercised over its own departments (referred to by the Supreme Court as "the control test"), and, at the same time, the entity carried out the essential part of its activities with the controlling public body (referred to as "the function test").

In this case, the Supreme Court considered six issues:

1. Whether the *Teckal* exemption applied to the UK Regulations;
2. Whether the exemption was applicable where the contract is for insurance;
3. Whether, to satisfy the control test, the contracting authority were required to exercise a control over the legally distinct entity which was similar to that which it exercised over its own departments, or whether it was sufficient that control was exercised by the contracting authorities collectively;
4. Whether the control requirement was satisfied on the facts of this case;
5. Whether the function test was satisfied on the facts of this case;
6. Whether a reference to the Court of Justice was required in this case.

IS THERE A TECKAL EXEMPTION IN THE REGULATIONS?

Lord Hope, delivering the main judgment of the Court, held that the basis for implying the *Teckal* exemption into the 2006 Regulations is to be found in their underlying purpose, which was to give effect to the Directive. The absence of any reference to the exemption in the Regulations is of no more significance than the absence of any reference to it in the Directive that was being transposed. The exemption in favour of contracts which satisfy its conditions was read into the Directive by the European Court in *Teckal* because it was thought to be undesirable for contracts of that kind to be opened up for public procurement. The purpose

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of the Directive is to open up public procurement to competition across the EU. This was not a mere technicality but was a considered policy of EU law and it would conflict with the harmonising aim of the Directive if a significant and policy-based exemption were to apply in some member states and not others. Having regard to the background of EU law against which the Regulations were enacted therefore, the definitions of "public contract", "public works contract" and "public services contract" in the Regulations can be taken to express the same idea as those in the Directive and something which amounts to a contract in domestic law can nevertheless be held, without doing undue violence to the words of the Regulations, not to be a relevant contract for the purpose of the public procurement rules. The Regulations do not therefore apply to contracts between a public authority and a person which is legally distinct from it if, but only if, the control and function tests identified in *Teckal* are both satisfied.

CAN THE TECKAL EXEMPTION APPLY TO INSURANCE CONTRACTS?

RMP advanced the proposition that the *Teckal* exemption applies only where there was in substance no agreement between two separate persons. A contract of insurance, which by its very nature transferred the insured risk from one person to another, could not meet that requirement as it was by its very nature necessarily a contract between two different people.

The Court dealt with that argument swiftly and held that it was of course necessary that there be a contract for pecuniary interest concluded in writing between one or more economic operators for the Directive to be applicable but the entire point of the *Teckal* exemption is to build on that premise and to define the circumstances in which the position can be otherwise. It assumes that there is a contract between two separate entities. So the mere fact that the nature of the relationship between an insured and his insurer is of necessity one between two independent parties does not, of itself, make the exemption inapplicable.

Although it was a necessary consequence of the nature of that relationship that the transfer of risk from one person to another is not a service that a local authority can provide for itself there is nothing in *Teckal* which suggests that that is at all important. All that matters is whether the arrangement satisfies the control test. If it does, an insurance contract is as just as eligible for exemption under *Teckal* as a contract for the collection and disposal of waste.

WHAT WAS THE APPLICABLE “CONTROL TEST”?

In determining the most significant aspect of this appeal, Lord Hope reviewed the entire development of the *Teckal* caselaw and concluded that the Court of Justice control test could be encapsulated in the following key points:

- (i) the individual control by a single public body is not necessary;
- (ii) the policy objective of the Directive permits public authorities to participate in the collective procurement of goods and services, so long as no private interests are involved and they are acting solely in the public interest in the carrying out of their public service tasks;
- (iii) in that regard though they are presumed to be so acting where the contracting authority holds, alone or together with other public authorities, all of the share capital in a successful tenderer; the fact that two or more public authorities have collaborated to secure a service which is designed exclusively for the performance of their public functions, where they did not hold any share capital in the successful tenderer carries at least as much weight in assessing whether the control test is satisfied overall;
- (iv) the decisive influence that a contracting public authority must exercise over the contractor in order for the test to be satisfied may be present even if it is exercisable only in conjunction with the other public authorities; and
- (v) where such a body takes its decisions collectively, the procedure used for the taking of those decisions is immaterial.

WHAT WAS THE APPLICABLE “FUNCTION TEST”?

As for the function test, the Supreme Court held, essentially, that:

- (i) where several public authorities control an undertaking the question is whether that undertaking carries out the essential part of its activities with all of the public authorities together in the consortium;
- (ii) this does not necessarily have to be with any one of those authorities individually. It is enough that it is with the same authorities collectively as exercise control over it;
- (iii) this is because, if this test is satisfied, it shows that implementation of the cooperation between the public authorities is governed solely by considerations and requirements relating to the pursuit of objectives in the public interest by

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those authorities. The absence of private capital and private customers is another important indication that the cooperation is for that purpose only, and that there is no risk of putting any private undertaking at a disadvantage vis-à-vis its competitors.

APPLICATION TO THE FACTS

The Supreme Court departed radically from the Courts below in relation to the application of the control test to the facts of this case. The Court did not agree with Stanley Burnton LJ that the general picture given by the articles of association and operational rules attached thereto is of a business the administration of which was relatively independent. Nor could it agree with the Court of Appeal that the nature of LAML's business and the possibly differing interests of different authorities were factors militating against finding the necessary local authority control. Though the nature of the relationship between each participating member and LAML was essentially one between independent third parties, individual control is not required. Collective control over strategic objectives and significant decisions was with the participating members at all times. They controlled a service which was designed exclusively for the performance of their public functions. No private interests were involved. Thus, the Court held that the *Teckal* control test was satisfied.

Similarly, the function test was also satisfied. There was no private involvement in the affairs of LAML, which had no external or private capital, other than the presence on the Board of a minority of independent directors (as required by the Financial Services Authority as a condition of its authorisation of LAML as an insurer). The main objects of the company were to provide insurance to participating members and affiliates. Since all members were public authorities and insurance could be provided to affiliates only if arranged and paid for by the members, LAML essentially existed only to serve the insurance needs of its members. Thus the function test was satisfied.

Lord Rodger reached the same conclusions as Lord Hope marshalling similar policy and legal arguments. In applying the control test to the facts of the case, he considered it decisive that a 75% majority of participating members present and voting at a general meeting may issue any direction to the board by special resolution. The authorities who contract with LAML therefore have a power of decisive influence over both the strategic objectives and significant decisions of LAML. That, he considered, was sufficient to satisfy the first *Teckal* criterion. He added that far from removing primary insurance from the ambit of the responsibilities of the

local authorities, the whole purpose of the scheme is to keep it within that ambit and not to transfer it to an outside body. Accordingly, he was satisfied that in the circumstances of this case both of the *Teckal* criteria are satisfied and that, since the local authorities are not to be regarded as contracting with an outside body, Community legislation which is designed to secure the free movement of services and the opening-up to undistorted competition had no application.