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Charging and Trading: The Local Government Act 2003

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INTRODUCTION

The issue of Charging and Trading has been of relevance to local authorities since the late 1980s. Although the law originally developed rather slowly, it entered an important new phase with the publication of Sections 93 to 98 of the Local Government Act 2003. That Act sought to create a statutory framework for trading for the first time.

This note traces briefly the history of municipal trading from the 1980s to the present day, analyses and comments upon the provisions introduced in the Local Government Act 2003 and considers developments since the passing of that Act.

BACKGROUND

Three decades ago, local authorities entering into arrangements with one another (and potentially the private sector) rarely proved problematic. Specific powers were given in s1 of the Local Authorities (Goods and Services) Act 1970 for entering arrangements for specified purposes between local authorities and with other public bodies; any remaining activities were swept up by s111 of the Local Government Act 1972 which provided that local authorities could do anything which facilitated or was conducive or incidental to the performance of their functions.

It has to be said, though, at this time there was very little pressure on local authorities for income generation outside of the normal channels, such as rates; this resulted in a low level of interaction between the private sector and local authorities, except in the incidence of normal contracts for goods and services being made and performed.

This situation was changed by the introduction of the Compulsory Competitive Tendering regime by the former Conservative Government. Originally introduced in 1980, CCT was extended by way of the Local Government Act 1988 to a whole range of blue collar services. With the legal duty to tender such services, came the potential for one local authority to bid for the services of another and the rise of so-called "cross boundary tendering". This was predictable, bearing in mind the new pressure to make a return on capital on in house services and a greater pressure to be competitive. Cross boundary tendering brought into sharp focus whether the local authorities did have the power to undertake large service contracts for each other, involving commercial risk, or not.

The practice of cross boundary tendering was seized on by external auditors and a long legal debate commenced over the true extent of local authority powers. The position of the Audit Commission and Government was spearheaded by Tony Child, as solicitor to the Audit Commission, supported by a particularly restrictive Counsel's opinion from John Howell QC in 1989. This indicated that the practice of cross boundary tendering in particular and much trading in general was unlawful and would leave local authorities open to challenge from their external auditors.

There followed a period of uncertainty in relation to the full extent of local authority powers and many local authorities were dissuaded from entering any form of arrangement that could be described as trading, for fear of challenge. Other local authorities who were more confident in their interpretation of powers did enter agreements during this period and achieved outcomes which are now hailed as exemplary to other local authorities. This is one example of the irony of how the trading debate has twisted and turned.

In 1989 the Local Government and Housing Act was passed and included at s150 a specific provision empowering the Secretary of State to make regulations to permit charging by local authorities for a number of services. The power is widely drawn and covers activities where there was no current power or duty to impose a charge. Regulations may impose minimum or maximum charges, specify types of activities which may be covered and a multiplicity of other matters. The power has to-date only been used on a few occasions, for example to produce the Local Authorities (Recovery of Costs for Public Path Orders) Regulations 1993 (SI 1993 No 407). These enable authorities to charge for the making of public path orders. As with many other modern legislative provisions, the law may be changed by regulation via a positive resolution from each House of Parliament.

Whilst this was a useful power, it was unlikely at the time it was made that the Government had anticipated that introducing regulations on all matters previously accommodated by use of s111 of the Local Government Act 1972 would place a significant burden on the Department and would not be a sensible way forward.

The issue of charging had also come to the fore in municipal trading case law. The case of McCarthy and Stone Developments Limited -v- London Borough of Richmond Upon Thames (1991) is perhaps the best example of this. In this case the Council as local planning authority had sought to levy a charge for pre-planning enquiries of £25 but this had been challenged by developers McCarthy and Stone. After a long fight through the courts, the House of Lords held that as the holding of pre-planning enquiries was calculated to facilitate, or be conducive or incidental to the function of determining planning applications (under s111 of the Local Government Act 1972), the levying of the charge was not. This meant that the charge itself was incidental to the activity, with the activity being itself incidental to the core function. Accordingly, the House of Lords held that levying the charge was ultra vires. This case drew legal powers to levy charges into the same uncertainty as had existed for some years in respect of general municipal trading.

The outlook for trading by local authorities brightened in the mid-1990s for two reasons. The first was that for the first time in many years, a case before the Courts had come to a positive outcome in terms of the interpretation of powers (the YPO case); and secondly a Counsel's opinion was obtained of equal standing to that rendered by John Howell QC, but reaching a different, and opposing, conclusion.

In February 1995 Stephen Richards, then Treasury Counsel, had been asked by the Department of the Environment (DoE) to advise on the extent of the Local Authorities (Goods and Services) Act 1970, following further uncertainty in relation to the position of educational institutions following further decentralisation.

In a considered and lengthy opinion of 19 February 1995, Stephen Richards QC indicated that the 1970 Act was to be broadly construed and would permit local authorities to engage in trading for profit and to take on staff for the purposes of their trading activities. The DoE was taken aback by the answer (it can only be assumed that this was not the answer it had anticipated or necessarily wanted) and it provided Stephen Richards with voluminous new material and asked him to re-consider. In a second opinion, of the 12th June 1995, he refused to change his opinion and confirmed that the 1970 Act should be construed purposefully.

This was followed in December 1996 by the YPO case (R -v- Yorkshire Purchasing Organisation and British Educational Suppliers Association - the Times 10 July 1997) in this case the BES had questioned the legality of the activities carried on by the YPO under the Local Authorities (Goods and Services) Act 1970. Whilst starting from humble origins, by the time of the case, the YPO employed 373 full-time staff, had an annual turnover of £130m and sold to non-members more than £2m worth of goods a year. It also had a full array of catalogues and undertook its activities in a normal trading way.

The Court in the YPO case also took a wide view of the 1970 Act powers. This was in contrast to a long line of cases that had come before, where the Court of Appeal and House of Lords had taken a more restrictive line. Here, the Court of Appeal said that the 1970 Act empowered local authorities to trade for profit and that they could purchase supplies necessary for those trading operations. It even confirmed that speculative trading was permissible under that legislation. However, it should be noted that the Act only applies to a limited number of parties with which a local authority can so trade.

Together with the Counsel's opinion by Stephen Richards, these two factors were instrumental in providing a brighter future for municipal trading.

However, some legal uncertainty still existed and as a result Gordon Prentice, a Labour MP and former local authority leader, introduced a Private Members Bill in 1996 which would have had the effect of clarifying the legal powers of local authorities. The Local Authorities Trading and Competition Bill passed its first reading on the 1st May but did not survive the subsequent Parliamentary process. Interestingly enough, the bill was backed by all political parties except for the Conservatives.

The legal situation in respect of trading by local authorities did not therefore change to any great degree. Local authorities towards the end of the 1990s would have to take detailed legal advice on whether the 1970 Act, s111 or any other legal power could be relied upon to pursue a given course of activity. If the authority relied on proper legal advice, entered into arrangements and there was no challenge, then no problems arose. However, often what would happen is that when a local authority proposed to enter into an activity, someone would raise the spectre of the arrangements being unlawful and the mere risk of ultra vires was enough to scupper many a proposal. In many ways, the former Conservative Government was less concerned about this than the new Government that entered power in May 1997 after a crushing election victory.

THE LABOUR GOVERNMENT REFORMS

The new Labour Government set about implementing a major reform programme for local authorities. This included improving central/local relations and seeking to encourage and develop a mixed economy of service provision. The twin pillars on which the modernisation agenda were based were Best Value and the governance changes to the decision making process of local authorities. Its plans were set out in the White Paper *Modern Local Government - In Touch With the People*, published in 1998.

The Best Value provisions were introduced by way of the Local Government Act 1999 and it soon became clear that the issue of local authority powers and duties would be problematic. Whilst the former Government had enjoyed legal uncertainties dissuading local authorities from municipal trading activities, the new Government realised that it would also hamper local authorities entering into innovative partnership arrangements with the private and voluntary sectors, which would be necessary to achieve Best Value.

Accordingly, the issue of powers and duties was thrust back to the forefront of the political agenda by Best Value. Included in the Local Government Act 1999 was s16, which was intended to ensure that any pre-existing statutory provisions which prevented Best Value being achieved could be swept aside by order of the Secretary of State; and secondly that if a local authority could identify that it needed the power in order to achieve Best Value, but did not have that power, then the Secretary of State could by order bestow that power on the local authority. Local authorities immediately raised issues in relation to formation of companies, joint arrangements with other local authorities and undertaking work for the private sector as areas where powers were required. The Government made it clear that it would consult local authorities before using these powers (see below).

In implementing the second main pillar of the reform agenda, the Government forwarded the Local Government Act 2000. Principally for the purpose of amending legislation on governance, in Part I of the Act, the much vaunted powers of economic, social, and environmental wellbeing were included. These mirrored the wide drafting of s16 of the 1999 Act and gave local authorities an important *general* power to promote or improve the wellbeing of their areas. The power of community wellbeing is contained within Part I of the Local Government Act 2000. The main provisions are contained in s2, which sets down the powers to promote or improve the economic, social or environmental wellbeing of the area. The provisions are so wide that it became immediately apparent to local authorities that they could be used to authorise activities that might be described as trading.

Section 2(1) provides:

“Every local authority are to have power to do anything which they consider is likely to achieve any one or more of the following objects:

- (a) the promotion or improvement of the economic well-being of their area,
- (b) the promotion or improvement of the social well-being of their area,
- (c) the promotion or improvement of the environmental well-being of their area.”

Section 2(4) provides examples of how the power may be used, for example “to enter into arrangements or agreements with any person” (s.2(4)(c)), or “to provide staff, goods, services or accommodation to any person” (s.2(4)(f)). It is the very breadth of the provisions, which clearly permit a local authority to enter contracts with the private sector which has excited interest from those wishing to pursue income generation activities.

Section 3 of the Act contains specific limits on the exercise of the power. The first is a limitation on using this power to circumvent other restrictions placed on local authorities in other pieces of legislation (s3(1)). The second clarifies the fact that the power does not enable the raising of money (“whether by precepts, borrowing or otherwise”) in s3(2). This confirms that the wellbeing powers cannot be used as a form of indirect taxation and has a particular relevance to the issue of charging for services in the context of municipal trading. The third limitation is that s3(3) gives the Secretary of State power to make an order which prevents local authorities from using the wellbeing powers for certain activities. This limitation was described in Parliament as a “reserve power”.

Local authorities also have to have regard to guidance which is itself a form of limitation, albeit a mild one. The exercise of the power has to be undertaken within the concept of a sustainable community strategy. This is triggered by s4 which confers a duty on every local authority to prepare a strategy for promoting or improving the economic, social and environmental wellbeing of its area, and contributing to the achievement of sustainable development.

The breadth of the provisions included in this Act raised the spectre of local authority trading during the Parliamentary stage of the Bill. The Government Minister sought to scotch this talk immediately and said, “nothing in the Bill would change authorities’ ability to trade goods and services, as defined by the Local Authorities (Goods and Services) Act 1970.” This was a reaction to taunts from the opposition that the wellbeing powers are so wide that they would provide a charter for increased local authority trading.

The powers conferred by s2 of the Act are very wide, although subject to the specific limitations provided by s3. Whilst there is no express limitation on charging for the provision of services to third parties, the Minister mentioned in Parliament that this would be covered by the limitation in s3, namely a prohibition on raising money (“whether by precepts, borrowing or otherwise”). She made clear that it was the Government’s view that “or otherwise” included charging. This is, in fact, inconsistent with what was said by Baroness Farrington in the House of Lords. She said on January 25, 2000 at col. 1467:

“Let me make it absolutely clear that the well-being power does not prevent local authorities from charging for services. They simply cannot use the power itself as a means for doing so. Under s150 of the Local Government and Housing Act 1989 the government can make regulations to allow authorities to charge for services that they provide, although that power cannot be used in respect of some specified functions, including education in schools and fire-fighting. Local authorities can continue to

use their powers under the Local Authorities (Goods and Services) Act 1970 to charge for services that they provide to other public sector bodies.”

It is arguable that the issue of charging is not limited by the provisions of s3(2), bearing in mind the *ejusdem generis* rule, which requires general words following specific words to be interpreted in a manner consistent with the words that are followed. Furthermore, in circumstances of uncertainty or ambiguity a court is able to look at statements made in Parliament; although here it might refuse to conclude any such ambiguity exists (see *Pepper v Hart*). This being the case, the current law relating to charging would apply, namely that power has to be found to levy a charge. There are two principal ways in which this would happen, namely a specific power being included (eg, s19 of the Local Government (Miscellaneous Provisions) Act 1976) or s111 of the Local Government Act 1972 ie where it facilitates or is conducive or incidental to the performance of a function to make a charge. This is one of the most important areas underpinning the wellbeing powers, which has yet to be determined by a court of law. If local authorities are prevented from levying charges, this would seriously weaken the use of the wellbeing powers and limit the circumstances in which they would be available.

In some ways, therefore, the well-being powers created as many questions as they answered and uncertainty continued, this time over whether the local authority could charge for the services involved, rather than whether the well-being powers authorised the activity in the first place.

CONSULTATION ON FURTHER REFORM

In April 2001 the DETR issued a Consultation Paper entitled *Working with Others to Achieve Best Value - Section 16 of the Local Government Act 1999 - a Consultation Paper on Changes to the Legal Framework to facilitate partnership working*. The purpose of the consultation was to seek views on changes necessary to the law to promote partnership between Best Value authorities and other organisations in the public, private and voluntary sectors. It canvassed issues such as performing and participation in local authority companies, providing a wider range of goods and services to partners, whether public or private, providing financial assistance to other bodies, pooling budgets and joint commissioning. Many of these proposals were particularly relevant to municipal trading.

The Consultation Paper was criticised as being vague on some key points and confused in its thinking. Nonetheless, it did demonstrate that the Government was willing to tackle these important issues and to sort out once and for all the issues relating to municipal trading. In over a year following the publication of the paper, no action was taken by the Government in relation to publishing the proposed s16 regulations.

In the end the proposed changes in the Consultation Paper were overtaken by the 2001 White Paper and the launching of the second phase of the Modernisation Agenda, following the Labour Government's further election victory in 2001. The latest proposals contained in the White Paper are featured below.

THE WHITE PAPER

In December 2001 the DLTR published the paper *Strong Local Leadership - Quality Public Services*. The publication of this document followed its return to Government for a second term. The White Paper set out a fine tuning of the Modernisation Agenda originally introduced in 1997, often referred to as phase II of that Modernisation Agenda. It dealt with a wide variety of further reforms, but for these purposes also included provisions in relation to trading.

The main thrust of the White Paper was to introduce a clearly defined “comprehensive and integrated performance framework to help councils deliver better services for their community”. The framework would include:

- Clearly defined priorities and exacting performance standards;
- A framework for performance assessment and proportionate and co-ordinated inspection including regular comprehensive assessments of each councils overall performance;

- *Extra freedoms and flexibilities for councils which are able to use them to make a real difference for their communities, over and above the universal de-regulation described in Chapter 4; (emphasis added)*
- Local PSAs to deliver accelerated improvements in priority services supported by additional freedoms; and
- a streamlined and reformed Best Value framework to help councils manage improvement across all services.

In effect, the Government had introduced the Best Value framework, underpinned by the Local Government Act 1999, but this required reviews of functions and it had subsequently been determined that a corporate review of each authority's corporate governance was required to get a clear picture of overall local authority performance across the country.

If the comprehensive performance assessment (CPA) process was the stick, then additional freedoms and flexibilities represents the carrot. In many ways a traditional government approach. However, here, the proposal was that the extra freedoms and flexibilities depend on the performance of the Council. As paragraph 3.4 of the White Paper indicated, "information from comprehensive performance assessments combined with clear priorities as standards will lead to targeting of additional freedoms to councils with the capacity and track record to make best use of them for their communities". In other words, only the better performing councils would get the extra freedoms and not the poorly performing councils.

The White Paper originally suggested 4 categories of performance, though ultimately 5 were chosen namely: *excellent, good, fair, weak* and *poor* and in 2005 these were changed to categories of 0 to 4 stars. Local authorities would be put into one of these classifications, following a full CPA assessment by the Audit Commission.

So far as trading was concerned, the highest performing councils would have "Freedom to trade more widely across the range of their services" whilst those whose performance was good would "be free to trade in areas where their performance is strong" Naturally, the White Paper did not mention any further powers for poor performing councils, from which could be derived the conclusion that trading would not be permissible in such authorities, where there is a failure to perform their own services to an adequate standard.

Chapter 4 of the White Paper gave a little more detail as to the Government's thoughts in relation to the greater freedoms to trade and charge. Paragraphs 4.13 to 4.15 covered this area. Two elements were included: namely the power to trade with others and the power to charge for the provision of discretionary services. So far as discretionary services are concerned, para 4.15 made clear that the Government intended to give authorities the power to charge, "an appropriate fee for providing discretionary services". This would get over all of the previous problems in relation to charging, including the lacuna left by the fact that the Local Government Act 2000 powers could not be used for charging and problematic cases such as the *McCarthy and Stone* case referred to above.

As far as general trading was concerned, para 4.13 made it clear that the Government wanted to see a "dynamic and entrepreneurial public sector which will increase the diversity and choice in the delivery of public services". This confirmed the very definite link between Best Value and trading. Reference was then made to the Consultation Paper mentioned above which proposed to use the powers in s16 of the Local Government Act 1999 to introduce further flexibility.

The White Paper, however, indicated that the Government now intended to "go further than the proposals in the Consultation Paper and provide wider powers to trade for all authorities, where this helps achieve Best Value and delivery of public services" other matters of note were that councils would only be allowed to trade where they have a record of strong performance on delivery (see above) and that the Government did not propose to impose any "centrally imposed financial limit or be limited to the exploitation of existing assets". Local authorities welcomed these comments and with the inclusion of new provisions in the draft Local Government Bill, as mentioned below, their passage towards legal force has become appreciably closer.

THE CONSULTATION PROCESS AND PASSING OF THE LOCAL GOVERNMENT ACT 2003

A draft Local Government Bill was published by the Office of the Deputy Prime Minister in July 2002, for the purposes of consultation. Following this consultation, the Government published the Local Government Bill on 26 November 2002. The Act was passed on 18 September 2003 and an order under s.95 was made on 5 July 2004 to authorise some best value authorities in England to trade. (Two further orders were made later in 2004 to amend this).

THE PROVISIONS OF THE LOCAL GOVERNMENT ACT 2003

Distinction Between Powers to Charge for Discretionary Services and Commercial Trading

The genesis of the distinction between powers to charge for discretionary services and commercial trading is to be found in the consultation paper mentioned above issued in April 2001, namely *Working With Others To Achieve Best Value*.

There is a fundamental distinction between charging for a discretionary service (which is available, theoretically, to all local authorities) and commercial trading (which is only available to the higher echelon CPA authorities and by way of a separate trading company).

The purpose of charging for discretionary services is to allow local authorities to perform those services and to be able to recover the costs of so doing. In other words, local authorities would not be prevented from providing discretionary services because they cannot fund them themselves. By contrast, commercial trading is - as the name suggests - risk based trading in the private sector. It is for that reason that this will only be available to some local authorities and is subject to tighter restrictions, principally the establishment of a company.

Powers to Charge for Discretionary Services

Sections 93 and 94 (which came into force on 18 November 2003) deal with this issue. In short, s93 gives the power to charge for discretionary services, with s94 allowing the Secretary of State to disapply s93, where appropriate. Clearly then, the power is there to control charging for discretionary services in accordance with CPA classifications, although this is not the Government's intention according to the ODPM (see below).

Section 93 links the provision to a "Best Value Authority" as defined in the Local Government Act 1999. A discretionary service is defined in s93(1)(a) as a service which the authority is *authorised* but not *required* to provide. The Government has added the extra element of agreement by the party who is to be charged for the service in question (s93 (1)(b)).

Sub-section (2) makes clear that this is a new power which does not affect pre-existing statutes giving *express power* to levy a charge or where there is a statute expressly *prohibiting* the levying of a charge. An example of the former would be s19 of the Local Government (Miscellaneous Provisions) Act 1976 to provide leisure facilities or s1 of the Local Authorities (Goods and Services) Act 1970; and of the latter the prohibition in the Education Act 1944 to charge for basic schooling.

The sensitive nature of charging for discretionary services is underlined by subs (3) which confirms that the Government only wants local authorities to recover their costs for such activities. Previously, in the draft Bill for consultation, there was provision for the Secretary of State to make regulations and the amount of any charge to be controlled by those regulations. The fact that the Government has decided to drop a clause seeking to set out in detail how such charges should be calculated is to be welcomed.

Instead, the Act now goes for a general duty expressed in these terms: "taking one financial year with another, the income from charges under that subsection does not exceed the costs of provision."

What is not clear, of course, is whether the "costs of provision" can include an element of surplus. Many local authorities undertaking discretionary activities and wishing to charge for them would wish to include its full administrative costs and / or some form of contingency element and this would be perfectly acceptable in commercial terms.

The ODPM issued guidance in November 2003 entitled *General Power for Best Value Authorities to Charge for Discretionary Services - Guidance on the Power in the Local Government Act 2003*. This was an interesting paper that confirmed a number of points about charging, including the fact that there is no *requirement* to charge for discretionary services, it is up to the local authority; that these provisions are not intended to be subject to the CPA regime; and the aim of the Government here is to encourage this type of activity, rather than create a new form of income stream.

So far as the calculation of charges is concerned, the provisions have been drawn up quite widely. There is a measure of discretion allowed to local authorities, including the fact that they can choose their own methodology for assessing costs, that costs are likely to be comprehensive and that there is also flexibility in the period for calculation.

Taking the first of those points, the methodology with which charges are set and costs calculated would be a matter for the local authority concerned. Accordingly, a local authority may decide to offer discretionary services free to some parts of the community (for example pensioners); levy a nominal charge to others (for example students); whilst charging the remainder of the community the full amount. Provided that "taking one year with another" the income and expenditure tally, this is not a problem; save for other legal controls such as competition law and the public law requirement to act reasonably.

So far as the calculation of exact costs is concerned, the guidance refers to the CIPFA Best Value Accounting Code of Practice and offers two options: namely *total cost* or *total cost plus*. The total cost includes employee costs, expenditure relating to premises and transport, supplies and services, third party payments, support services and capital charges but excludes central establishment charges. The total costs plus option includes all the foregoing and a share of central establishment charges. Either way, the full costs of provision are included and "profit" is not mentioned. There is nothing in the guidance regarding a local authority charging a contingency as part of its budget planning.

So far as the period for calculation is concerned, the guidance suggests a period of one to three years, although it permits a longer period and confirms that the period is at the authority's discretion. A longer period might be required where capital investment is higher but the local authority simply has to determine this and ensure that its decision is recorded.

There can be no doubt that these provisions are very flexible indeed. A local authority choosing a five year period for the calculation of the charges and taking into account all of the costs permitted, will be able to ensure that the provisions are observed.

Subsection (7) indicates that a number of important provisions shall be disregarded for the purposes of the exercise of the power to charge for discretionary services, including s111 of the Local Government Act 1972 (incidental powers) and s3 of the Local Government Act 2000 (prohibitions on use of the well-being provisions). At first blush, this is not easy to understand. The government proposes in the Act to *disapply* the prohibitions in those Acts where trading within the boundaries of this Act is concerned. These provisions prevent local authorities raising money using those particular powers and therein lies the answer. The official government view on charging for services is that this is prohibited under, for example, the wellbeing provisions due to the wording of s3 and the interpretation that raising money "whether by precepts, borrowing or otherwise..." covers charging. The proposal is therefore to avoid this problem - but only where trading takes place within the controlled environment provided by this Act. This was clarified in a recent letter by Nick Raynsford, the Local Government Minister, to the Association of Public Service Excellence as follows:

"As you note, certain specific powers in other legislation preventing authorities from raising money, including in relation to the wellbeing provisions in the 2000 Act, are specifically disapplied in relation to Orders made under this provision. Thus, if a local authority wished to use powers set out in any Order made under the new provisions and undertake trading under its well being function, there will be no potential conflict with the 2000 Act prohibition on raising money.... indeed, by disapplying the restriction on raising money, the (Act) would actually pave the way to extending the power's scope."

This means that if a local authority is operating under these new provisions, it can charge for the discretionary services, even if this might be prohibited under other

circumstances, as being, for example raising money under the wellbeing provisions.

It can therefore be seen that the whole premise of the new Act is founded on the notion that local authorities are unable to charge for either discretionary services or much trading activity. However, the early law provides a more flexible background for interpretation.

Section 94 is an important provision, giving the Secretary of State power to disapply s93 in relation to particular types of Best Value Authority, particularly "descriptions" of Best Value Authority or particular services offered by Best Value Authorities. In short, this means that the Secretary of State has the authority to take away the power to charge for discretionary services.

In this way, the Secretary of State has a further hold over poorly performing authorities. Whilst he would not have the power to prevent them from engaging in the performance of discretionary services, if he can remove the express power to charge for them, thereby preventing charging for them, this would be a severe disincentive to any local authority proposing such a course of action. However, the removal of the s93 express power would simply re engage the former legal position, namely that a local authority would be able to charge if it could identify a power to do so. The problem is that it would also be impossible for an authority to argue that it would facilitate or be conducive or incidental to levy a charge (under s111 of the 1972 Act), as this Act would constitute Parliament's intentions and therefore provide a statutory code.

However, it might still be arguable that any local authority, even a poorly performing authority can charge where a specific charging power exists (such as s19 of the 1976 Act as mentioned above) as such provisions are specifically excluded from these sections. However, this is where the sting in the tail comes, as these provisions can still be excluded by s97(2), as discussed below. If this reading of the Act's provisions is correct, that would leave a local authority completely powerless, with no way that could be arguably lawful to levy a charge for a discretionary service. This would indeed constitute the "fencing off" legally of charging for discretionary services.

It is curious as to why the Government has chosen to put in such potentially draconian measures, particularly in the light of its claim that the CPA performance of local authorities will be irrelevant to their powers to charge for discretionary services. However, the guidance in relation to charging mentioned above offers some insight as to why the Government might wish to act. At paras 18 to 20, it mentions that the powers may be removed from local authorities for a variety of reasons including the practising of unfair competition (for example undercutting private sector suppliers); where an authority is found to be making a commercial return on the service; or where it might be "deemed in the public interest" to do so.

General Trading Activities

Sections 95 and 96 concern more general trading activities. Generally the provisions allow the Secretary of State to authorise, by subordinate legislation, trading activity which is defined as allowing them to "do for a commercial purpose anything which they are authorised to do for the purposes of carrying on any of their ordinary functions". Regrettably, this has no definition and we believe that this may well cause problems in future. The parties with whom a council may engage are also controlled. The subordinate legislation - The Local Government (Best Value Authorities) (Power to Trade) (England) Order SI. 2004 No. 1705 was made on 5 July 2004 and came into force on 29 July 2004. The Government also issued guidance entitled *General Power for Local Authorities to Trade in Function Related Activities Through a Company* in July 2004, which was updated in November 2004.

Naturally, this power does not permit a local authority to trade where it is under a *duty* to do something under its functions eg education (s95(2)) and is without prejudice to other pre-existing provisions, permitting commercial trading in a functional area, for example s38 of the Local Government (Miscellaneous Provisions) Act 1976, which authorises the sale of spare computer capacity commercially.

Again, there are provisions in relation to who the power might apply to. Section 95(3) includes the phrase "particular descriptions" of local authorities which permit the trading powers to be related to an authority's performance under the CPA. The latest categorisation order is The Local Authorities (Categorisation) (England) Order 2006 SI 2006/3096 which was made on 17 November 2006 and

came into force on 24 November 2006. For Fire and Rescue authorities there are specific provisions contained in SI Nos 2004/2307 and 2004/2573.

The CPA is being replaced by the Comprehensive Area Assessment from April 2008.

The link between the CPA categories and the power to trade can cause difficulty if the legislation on this does not keep pace with amendments made to the CPA system. As stated previously, in 2005 the CPA categories for single tier and county councils were changed to categories of 0 to 4 stars. This meant that there would need to be amendments to the legislation permitting trading to reflect this, as well as the making of a new categorisation order as usual. Although CPA ratings for single tier and county councils were published in December 2005, it was not until January 2006 that the ODPM published consultation proposals on amending the legislation and the consultation period was to last until March. Although local authorities were able to use existing freedoms in the meantime, authorities which had been in the lower categories but which had improved their rating significantly in 2005 were faced with a considerable delay before the trading power would be available to them. Also the provision at s.95 of the Local Government Act 2003 for the Secretary of State to authorise authorities to trade applies to best value authorities which would include more than councils. However, the orders made under s.95 have a more restrictive application and would prevent the use of the trading power by some organisations even though they might have expected s.95 to apply to them.

Subs (4) contains the wholly new provision that such commercial trading can only be done via a company regulated by both the Companies Acts and Part V of the Local Government and Housing Act 1989. This was not part of the draft Bill circulated for consultation and the decision appears to have been taken post consultation to make this a specific requirement.

There are a number of reasons why the Government has included the requirement to trade via a company. One is to make it a level playing field, as most competitors will usually be companies; another is for tax reasons, as local authorities would otherwise have a tax advantage over the competition; a third reason might be EU Competition Rules - if there is a requirement for a company it is easier to keep it all separate; and finally state aid rules will apply and this will mean that matters are more transparent through the company route.

There are no *de minimis* provisions so any level of trading activity for a commercial purpose must be by the company vehicle. Will this mean that local authorities set up general trading companies for this purpose?

The provisions are linked to Part V of the Local Government and Housing Act 1989 which are difficult and complex provisions, introduced for the different purpose, of regulating local authority involvement in companies. The Government changed the practical impact of Part V with the introduction of the new Prudential Borrowing regime in April 2004. Previously the capital finance transactions of a "regulated controlled or influenced" company under the Act had to be amalgamated with the authority's own financial position to determine credit limits and borrowing capability - the result was many authorities tried to avoid these categories by having involvement of less than 20%. Now local authorities only need to account for potential liabilities from their direct transactions with the company ie the amount of unpaid share capital and loans or guarantees. The propriety controls remain however, so there is a need to establish the extent of control or influence to determine whether the ownership of the company needs to be placed on letterhead etc. Part V of the Local Government and Housing Act 1989 is to be completely repealed by the Local Government and Public Involvement in Health Act 2007 but the repeal is not yet in force.

There is no doubt that making a company a requirement complicates matters and this may explain why so few local authorities have decided to engage in commercial trading through this route.

It is also worth pointing out, that local authorities can still trade using existing powers. As an example, if a local authority sets up a company for the purpose of promoting or improving its economic, social or environmental wellbeing, then that company would not be established for the purpose of commercial trading and would not be covered by the Local Government Act 2003. If that company then traded, it would not be the local authority trading but the company.

In the draft Bill, there was included a sub-clause confirming that where trading is engaged in accordance with this power, the agreement may contain such terms as to payment or otherwise as the parties consider appropriate. It was considered

important that there was no control by the government on what a local authority could charge in respect of its trading activities. However, the Select Committee mentioned above commented at paragraph 48:

“While we welcome the intention to give trading powers to local authorities, we would wish to see safeguards against authorities trading unfairly, particularly by using an unfair competitive advantage to undercut small local firms. We recommend that the framework for trading should make it impossible for local authorities to cross-subsidise the cost of providing the traded service from other areas of council activity.”

This point has been strongly argued by the CBI for some considerable period of time. It was interesting that the Government had reserved powers to control the charges that local authorities may levy for discretionary services (see s93(2) above), but had not done so here. However, this point seems to have been taken on board in the consultation process as this clause was omitted from the Act as passed. Instead, s96 gives the Secretary of State power to make regulations on such matters, thereby reserving to the Government complete flexibility in this matter.

Bearing in mind the requirement to have a company to undertake trading, the disapplication of the same three key functions (including s111 of the Local Government Act 1972 and s3 of the Local Government Act 2000, as mentioned above) - which appeared in the draft Bill - were deemed not to be required. This is because the government has accepted for some time that having an interest in a company falls outside of current regulation (see for example para 40 of the Wellbeing circular).

Power to Modify Trading Enactments

Section 97 is an extremely important provision and now goes further than might have been anticipated. This is because the new clause covers not just the powers given by this Act, but has the potential to relate to other legislation which is already in existence.

The first provision in s97 gives the Secretary of State power to sweep aside any prior enactment which seems to prevent or obstruct charge of the discretionary services (as covered by s93) or general trading (as covered by s95). The drafting of this provision has been widened following consultation.

It is subs (2) that is the most important provision. This gives the Secretary of State power to make an order which would have the effect of amending, repealing, revoking or disapplying the application to Best Value Authorities of an enactment, other than s93, which makes provision for “power to charge for the provision of a discretionary service”. So far as charging for discretionary services were concerned, the Explanatory Notes on the Draft Bill were not particularly clear in relation to this. They stated:

“The clause also permits the Secretary of State to modify or exclude the application of any enactment that confers power on a Best Value Authority to charge for a discretionary service. The effect of excluding such a power would be to substitute for the specific provision in question the general power to charge under s93.”

In effect this means that a pre-existing power, such as s19 of the Local Government (Miscellaneous Provisions) Act 1976, or s1 of the Goods and Services Act 1970, as mentioned above, can be excluded by order of the Secretary of State. He could therefore exclude the s19 power from being used by a local authority, based on its CPA assessment. According to the Explanatory Notes, the net effect of this would be to leave the authority with only the general charging power under s93. What has to be borne in mind, however, is that the s93 power can *itself* be removed by s94. This would leave an authority without any specific or general power to charge for discretionary services.

So far as commercial trading generally is concerned, only the general provision in s97 (1) applies, not subs(2), and the effect of this should be largely positive.

As is the case in the clauses mentioned above, the powers are flexible and may be used in relation to different categories of authority; they may also be used in relation to whole functions, or activities within functions.

Subsection (6) is a safeguard to reassure those who might see these provisions as turning local authorities into purely commercial entities. The power to sweep away an obstruction to trading cannot be used to allow a local authority to trade in an area where it has a legal obligation under its ordinary functions to perform a service.

Procedural Issues

Section 98 sets down the procedure for orders under s97. Basically, the Secretary of State is under a duty to consult appropriate persons before making his proposals and the procedure is very similar to that contained in the Local Government Act 1999 in relation to Best Value.

In effect, the Secretary of State has to lay before each House of Parliament a paper which explains his proposals, encloses a draft Order and gives details of the consultation he has adopted. The provisions must be formally approved in a positive resolution and no order can be laid until 60 days after the explanatory document has been put before Parliament.

THE POSITION IN WALES, SCOTLAND AND NORTHERN IRELAND

In Wales the Local Government Act 2003 will apply, though the position of the Secretary of State is assumed by the Welsh Assembly Government for some functions. An Order was made on 29 March 2006 under section 95 of the Local Government Act 2005 to authorise some best value authorities in Wales to trade.

In Scotland, the position is entirely different. The Local Government in Scotland Act 2003 governs trading, not the Local Government Act 2003 which does not apply in Scotland. There, the trading provisions have been introduced via an amendment to the Local Authorities (Goods and Services) Act 1970 and a widening of its scope by replacing the public bodies with whom deals can be entered with any person and widening the categories for agreement. However, a financial limit may be set by ministers and there is a specific and mandatory link to the wellbeing function.

In summary, there is no financial limit in England but there is in Scotland; England divides into charging and trading whereas Scotland does not; England requires a company to be established for commercial trading but Scotland does not; in England the power is free standing, whereas in Scotland it is linked to wellbeing.

In Northern Ireland there are no wellbeing powers as none have been introduced. Whilst Best Value does exist, it was introduced via a separate piece of legislation and is much narrower than the Best Value applicable to England and Wales. The Local Government Act 2003 does not apply either, so any trading must be conducted using the old legal position, for example using the Local Authorities (Goods and Services) Act 1970.

PUBLIC PROCUREMENT

Local authorities which set up companies to carry out commercial trading activities should note that the award of contracts by the local authorities will be subject to the Public Contracts Regulations 2006. This would mean that such contracts would need to be procured competitively, rather than simply being awarded to a trading company associated with the procuring local authority. There was a time when it was thought that companies which were similar to a contracting authority's in-house department would be able to take on a contract without competition. This was on the basis of the judgement in the case of *Teckal Srl v Comune di Viano and Azienda Gas- Acqua Consorziale (AGAC) di Reggio Emilia* Case C-107/98, which acknowledged that public procurement legislation would not apply to an arrangement between a contracting authority and a person providing services to it if the contracting authority exercised over that person a level of control similar to that which it exercised over its own departments and the person carried out the essential part of its activities with the contracting authority. Other case law has confirmed these requirements. Therefore if a local authority establishes a company which either is not subject to sufficient control by a local authority or undertakes a significant amount of work for customers other than the local authority, the company will not be regarded as an in-house company and so will need to compete with other applicants for the local authority's contracts.

CONCLUSIONS

The Local Government Act 2003 has, for the first time ever, sought to provide a statutory framework for trading activities by local authorities. It will therefore take some time to fully analyse how the provisions might work and further detail will be needed from the Government as to how the Secretary of State intends to use the powers of subordinate legislation.

The charging powers came into effect in November 2003 and the trading powers July 2004. Guidance has been issued by the Secretary of State on both areas and is useful; it repays careful reading.

We view these provisions positively and believe they are a significant step forward for local authorities, currently hampered by significant legal uncertainty as to what they can and cannot do. However, there can be no doubt that the slogan "use it or lose it" will apply here. In other words, if local authorities do not take the powers and utilise them fully, then the Government will be vindicated in seeking to restrict the trading activities of local authorities in due course.

Trading practice will clarify over time and we very much hope that local authorities will give active consideration in the near future to what purpose they may be put to for the benefit of local communities.

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