Review

Pensions – a focus on the public sector

Value is determined by a very simple equation:

$$\text{value} = \frac{\text{quality}}{\text{price}}$$

However, getting the balance of those two elements right is far from simple. A year ago the Government commissioned John Hutton to review public sector pension provision and provide recommendations on how to make it sustainable, affordable and fair. His Commission's report was issued four months ago and broadly accepted by the Government in full but the precise details of how the Government intends to act upon its recommendations are still not known. What is becoming increasingly clear, with trades unions organising strikes and high profile financial difficulties within local authorities and private organisations contracting with them, is that, although time is of the essence, the implementation of any major changes will be even less simple.

In this Review we focus on some of the implications of the Hutton Commission's recommendations within the public sector and for those private sector organisations that contract with it, and we consider the possible effects of the outcome of the current review of the Fair Deal policy. An article contributed by Tim Lunn and Christine Rice of Aon Hewitt looks specifically at possible cost implications of both. Lastly, but not at all least, recognising that while the consideration of strategic changes goes on, business as usual must continue at the day to day level, we consider the possibility for Local Government Pension Scheme funds to get better value through changes to their procurement processes.

The Government is not alone in seeking the best value for money. Many people are under financial strain as a result of the struggling economy. On any trip to the supermarket it is apparent that the cost of everyday items such as bread and milk (and hair nets...) has escalated dramatically. We have therefore decided to share some tips on how our readers might make their money go further by taking economy measures in the home. The quotations in the margins are submissions made to the Manchester Evening News in the 1940s and published in their 'Take a Tip' booklet. We do not necessarily recommend that our readers try all of these tips (and in fact any of them should be attempted entirely at your own risk!).

> "A Nightcap
>
> Here is a good tip for a 'hair net'. Cut the top off an old nylon stocking – about nine inches – wear it like a cap and it will keep hair in place beautifully. It is very comfortable to wear at night."

HUTTON MAY CARE BUT WHAT WILL HIS RECOMMENDATIONS ACHIEVE?

The final version of the Hutton report was issued on 10 March 2011. This article looks at what Hutton was asked to consider, his key recommendations and whether these are practicable in terms of both their implementation and the actual likely cost savings that they might achieve.

Background

Lord Hutton headed up the Independent Public Service Pension Commission which was established by the Government in June 2010 to undertake a review of public service pensions. The objectives set for the review were difficult to bring together, since they had to result in significantly better affordability for tax payers in relation to the costs of public sector pension plans without dramatically reducing the standard of living in retirement for public sector workers.

A fair and balanced deal?

The broad consensus within the pensions industry seems to be that Hutton's basic guiding principle of looking to achieve a fair and balanced deal has led to some sensible recommendations. He advocates keeping a defined benefit based pension for public sector workers, with a good pension in retirement, protection of the benefits that have been accrued to date and a fair process of change. The proposals intend to make the provision of these benefits more affordable by bringing in fixed costs, "future-proofing" (ie making provision to automatically contain costs in the future – for example, linking normal pension age to the State Pension Age) and making workers take a fairer share of the cost implications associated with longevity improvements.

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> “Smooth Complexion
>
> No need to spend money on an ‘improved’ complexion. After using eggs in cooking, just smear the white remaining in the shell on your face, let it dry, then rinse off with cold water and pat dry. Your skin will glow!”

Hutton also wants to move to greater simplicity, and has made 27 recommendations in total to achieve this aim. There is not space here to examine every one, but the key recommendations and their consequences are considered below.

CARE in the public sector community

The most sweeping change proposed by Hutton is to move public sector pension plans to a Career Average Revalued Earnings (‘CARE’) basis, rather than the traditional final salary model. This defined benefit model entitles a member to a tranche of pension in each year of pensionable service, linked to their salary in that year. At normal pension age, each year’s worth of benefit would be revalued in line with average earnings to give a final pension.

As benefits are based on salary on a year-on-year basis, this would generally result in a lower overall benefit than under a traditional final salary model. The biggest impact would be on workers who expect to achieve a jump to a significantly higher salary at least once during their career. However, those workers whose salaries increase broadly in line with inflation over their working lifetime would see a comparatively smaller change in their pension expectations.

CARE plans are tried and tested in the private sector and, although they can be more complicated to administer than traditional final salary pension plans, there are existing systems in place. A key point to note, however, is that Hutton recommends a single framework to be established for all public sector workers for the future, with consistent controls and governance. There is clearly much potential for greater efficiencies across the public sector pensions landscape. However, this will be difficult to achieve given that implementation of the Hutton reforms has been devolved to a number of relevant Government departments and due to the sheer scale of the systems that would be involved.

Increasing Normal Pension Age

Hutton noted the cost implications of increasing longevity on pension provision. He has recommended that for most public sector pensions, normal pension age should be linked to State Pension Age. There are certain exceptions for uniformed workers based on their unique working circumstances.

Increasing normal pension age should rebalance the proportion of working life to retired life for public sector workers, making retirement costs more affordable. In practical terms, the question boils down to when you get a benefit vs. how you calculate a benefit. Will each “tranche” of CARE benefit have a fixed normal pension age set at the point it is accrued (with an adjustment up or down depending on when it is actually paid), or simply be payable at the appropriate State Pension Age whenever the member reaches it? Whilst the latter seems more logical and would be easier to communicate to members, it would be more difficult to price. This would have implications for the cost ceiling mechanism discussed below.

Preserving historic rights

Hutton recommends an “honour in full” approach to benefits accrued prior to the implementation of the changes (anticipated to be in 2015). Whilst it is not clear whether this principle would continue to apply to post-2015 benefits, meaning that any future changes would also only affect future service, we suspect that this would be Hutton’s preference.

It is interesting to contrast this with alternative approaches that have been taken in both the private sector and elsewhere. A few brave organisations (including the Government of the Isle of Man) have attempted to convert past service benefits onto the new basis by means of an “actuarial equivalence” calculation. Whilst this may well be unpopular with members and bring further outcry from the trade unions (the Isle of Man has offered workers the opportunity of maintaining the higher benefit accrual based on the previous benefit structure – but at a higher contribution rate), it would have the merits of moving to a truly simpler system, as there would not be different tranches of benefit to be calculated in years to come.

Just one of several significant knock-on effects of this can be seen in questions over how the calculation of transfer payments (both between public sector pension plans and following a public-to-private outsourcing) is to be carried out. Different benefits and normal pension ages, the impact of the proposed cost ceiling (see below) and the need for agreement of actuarial assumptions will make such calculations more complex rather than less.

Introduction of a cost ceiling

Hutton is hoping to future proof the cost of public sector pension plans and avoid a need for further changes in the future. A key mechanism to achieve this is his proposal to introduce a cost ceiling. The level of the cap is likely to be a percentage of salary rather than a percentage of GDP. It will have to strike the balance between being meaningful but not triggering too often. In addition, there will need to be certainty around the actuarial assumptions used.

Unlike the cost sharing mechanisms already in place for the Local Government Pension Scheme, Hutton is proposing an automatic default (presumably, increased member contributions and/or reduced benefits) in the event that the cost ceiling is triggered and changes to the pension plan cannot be agreed. Whilst this would technically be feasible to write into the pension plan from a legal perspective, such an arrangement is likely to be controversial. In recent weeks there have already been trade union press releases claiming that the existing mechanisms, if implemented, would have achieved the same cost savings that Hutton's report is envisaging.

Another article in this Review focuses on Fair Deal and private sector outsourcers, but it is worth noting here that there will be particular legal difficulties with mirroring any application of the cost ceiling – not least the pension plan's amendment power, section 67 of the Pensions Act 1995 and employer consultation requirements.

Looking ahead

The Government has committed to implement the Hutton recommendations in full rather than cherry-picking, although this will be left to individual departments responsible for the various pension plans. The aim is to implement the changes by the end of this Parliament in 2015. Is this target date realistic? There remains a lot of detail still to work out. However, Hutton's interim report had a great deal of analysis about accrual levels etc, which will have been shared with Government, so hopefully some of the 'thinking' has already progressed.

It should also be borne in mind that, whilst the Commission, the Government, much of the pensions industry and a large proportion of the general public agree with the need to make public sector pension plans more affordable, the members of those pension plans are not all as convinced. There has already been some outcry against the recommendations, with many trade unions having balloted members to take coordinated action and with the first pensions strike already having taken place. Whether or not the threatened "winter of discontent" materialises, given the timescale and the level of detail yet to be decided, the prospect of multiple protests and strike action can only make the process of change yet more protracted and difficult.

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"Sugary Setting

No need to panic should you run out of setting lotion and the shops are closed. A tablespoonful of sugar dissolved in a cup of hot water and used when cool proves adequate."

“Stool Tops

Make use of discarded coloured berets by fitting them on the round wooden tops of kitchen stools. This makes them more comfortable and warmer on chilly winter mornings.”

FAIR DEAL: THE BEGINNING OF THE END?

Introduction to Fair Deal

Public sector pensions are under the spotlight, following Lord Hutton’s final report on their future. The key message of Hutton’s report (considered elsewhere in this Review) is “cost reduction” through various means, but the report also looked at the implications of Fair Deal.

Fair Deal is a (non-statutory) policy introduced by the Government in 1999 to protect public sector employees’ retirement benefits (both past and future) on compulsory transfers of employees to the private sector, where a public service is outsourced. It requires a new (private sector) service provider to give transferring public sector employees benefits which are ‘broadly comparable’ to the benefits they enjoyed immediately before the transfer, for the duration of the service contract. This will usually involve setting up a pension plan which is certified by the Government Actuary’s Department (‘GAD’) for this purpose. (GAD has issued over 70 valid current ‘passports’ for plans in the UK.) Alternatively, for local government employees, the new employer may be admitted to participate in the Local Government Pension Scheme (‘LGPS’).

Fair Deal – why the need for change?

Fair Deal has been the subject of an increasing amount of criticism from the private sector and its lobby groups, due to the significant, and often unpredictable, cost of providing public sector final salary benefits, particularly during shorter term outsourcing contracts. GAD’s approach to measuring broad comparability effectively requires a mirror image benefit structure. This results not only in significant ongoing future service costs – 45% contribution rates are not uncommon, compared with just 19% in some public sector plans – but also funding risks and volatility associated with past service benefits, whether due to insufficiently generous bulk transfer terms or an exit debt on leaving the LGPS.

The requirement under Fair Deal to protect transferring employees’ pension benefits at the time they first transfer out of the public sector means it is hard for the private sector pension plan to keep pace with subsequent changes in public sector pension arrangements. Some contractors end up operating passported plans with multiple benefit categories, increasing the cost and complexity of administration. In comparison, the Best Value Authorities Staff Transfers (Pensions) Direction 2007 applies similar requirements to Fair Deal on transfers from “best value authorities”.[1] However, there is no obligation to provide the same level of benefits during the life of the contract or on a susequent transfer, which means that it is easier to change benefits during the life of the contract. This difference of approach and the relative inflexibility of Fair Deal are in the spotlight given the prospect of significant changes to public sector pension benefits contemplated by the Hutton report.

Consultation

Hutton mentioned Fair Deal and the barrier it represents for some would-be contractors in his interim report. In response to these comments and industry concerns, the Government duly launched a separate consultation on Fair Deal on 3 March 2011, which closed on 15 June 2011.

The consultation outlined the Government’s key future policy objectives, including:

- delivering value for money for the taxpayer;
- providing an appropriate level of protection to public sector employees;
- removing barriers to the plurality of public service provision; and
- allocating the costs and risks of pension provision appropriately.

Options considered in consultation

The consultation paper considers various options to achieve these policy objectives, including reforming Fair Deal, abolishing Fair Deal entirely, or preserving the status quo. The consultation also asks for submissions on the potential withdrawal of admitted body status (‘ABS’) in the LGPS.

1. Preserving status quo

The Government has broadly ruled out preserving the status quo, due to Fair Deal’s reported complexity, expense, and what it feels is probably an unacceptably high level of risk for private sector bodies. The consultation suggests that enabling more bodies to be admitted to public sector arrangements is likely to result in greater deficits in those plans, which will eventually have to be met by the taxpayer. There is little in-depth analysis of whether this would actually be the case, however. The consultation argues that Fair Deal perpetuates the ‘two-tier’ public sector workforce, because some staff benefits are effectively entrenched under Fair Deal, with the benefits of colleagues left behind in the public sector potentially being subject to future change.

The consultation does consider retaining Fair Deal for existing contracts, to ensure adequate protection

1 These are listed in section 1 of the Local Government Act 1999 and essentially comprise English local authorities plus some other organisations such as emergency services bodies and waste disposal entities.

for staff who have already been outsourced. Similarly, it also considers the merit of preserving Fair Deal on transfers back into the public sector. This would at least offer stability for existing contracts – but would perpetuate the difficulties already outlined. We are awaiting further detail but it is difficult to see how tranches of employees can effectively be carved out from the reforms without significantly reducing their effect and/or cost savings.

2. Abolition of Fair Deal

Similarly, the consultation raises a concern that abolition of Fair Deal could significantly reduce the value of transferring employees' future pension provision. Although this may encourage independent service providers to enter into public sector outsourcing arrangements, it is likely to mean that in-house public sector bids could be less competitive. It is likely, however, that any such significant reduction in future pension provision would result in widespread protests from the public sector unions and workforce, and could even bring an end to the particular procurement process if a satisfactory compromise cannot be reached.

3. Reform of Fair Deal

The third option – reforming Fair Deal – seems the most likely outcome. Although the consultation considers this option in outline, the details are hazy. It is difficult to see any clear reform options which will make it easier for smaller contractors to compete for outsourcing contracts, without conflicting with the original aim of Fair Deal, ie the protection of pension benefits on transfer.

The consultation concentrates on the following key areas:

- **protection of future service benefits** - ie replacing the requirement to provide broadly comparable benefits with something else, such as a minimum contribution into a defined contribution arrangement (perhaps similar to the protections under the Pensions Act 2004 applying to TUPE transfers, or on a more generous defined contribution basis); and
- **protection of past service benefits** - ie changing the basis on which bulk transfer values must be paid, by moving away from a 'day for day' service credit and towards a 'cash equivalent' model.

The reform option is likely to require compromises from both sides of the table, and is also likely to involve a lengthy and politically sensitive process.

Implications of consultation

The thorny question of second and subsequent transfers (including transfers back to the public sector) remains. Will Fair Deal continue to apply or will it fall away on future transfers, or immediately following any reform or withdrawal of Fair Deal? How should any resulting cost savings be shared between outsourcers and the public sector procurer of services? Much is unclear, although one thing is certain: change is likely to be messy and slow to achieve.

The consultation refers to the complexities involved in changing contractual terms, which are likely to be a significant hurdle to overcome. Add into the mix the recent legal challenge to the Government's changes to the basis of indexation and revaluation of public sector pensions (from RPI to CPI) and the strikes called in protest to proposals to reform public sector pensions in line with the Hutton Report's recommendations, and the task ahead seems onerous. Public law issues are also likely to arise and will need to be carefully handled.

The consultation fails to acknowledge the Best Value Directions, which would require secondary legislation to change. We can only hope that when it comes to implementation the Government will take a more coordinated approach than was the case with the recent withdrawal of the Two Tier Code and its equivalent policies.

As for the future of ABS – this seems uncertain. It is unlikely to be extended beyond the LGPS. We also understand that some local authorities are already refusing to offer contractors participation in their funds for new contracts. The very long duration of some existing ABS contracts will need to be considered as part of the implementation of any policy changes in this area.

Finally, a note about timing. We do not know when the Government will announce the outcome of the consultation (or, indeed, whether further consultation will be required). The non-statutory nature of Fair Deal means that, technically, it could be amended or withdrawn with very little notice. This could have serious implications for contracts in the final stages of negotiation at the time of any change. Contractors and public sector procurers may wish to anticipate any future changes to Fair Deal in contracts currently undergoing negotiation, so that at the very least there will be an acknowledged framework for changing the pension obligation and, consequently, the contract price if the Fair Deal requirements are substantially altered.

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"For Sleepy-Heads

If, as is usually the case, a pillowcase wears thin in the centre, stitch a pretty full-sized handkerchief corner-wise over the thin part and the case will have a second life."

“Clean Baths

Here’s a good tip for cleaning all stains off your bath. Use peroxide and cream of tartar, mix into a smooth paste, put on with either a 2 in. paint brush or a soft cloth and leave overnight. Then wash off.”

A LOOK AT THE POSSIBLE COST IMPACT OF THE HUTTON PROPOSALS

This article has been written for our Review by Tim Lunn and Christine Rice of Aon Hewitt.

Background

When it comes to public sector pension plans, and for private sector contractors trying to comply with Fair Deal, change is certainly in the air. As if the review of Fair Deal itself were not enough, multiple changes to the public service pension plans themselves are proposed. The result for contractors could be a heady brew of new challenges. In this article we consider briefly some of the possible changes arising from the Independent Public Service Pensions Commission chaired by Lord Hutton and what the cost implications of these might be.

The basics

As mentioned in the previous article, Fair Deal requires contractors to provide broadly comparable benefits for transferring staff. This generally means provision of a final salary pension plan, broadly similar in nature to that provided by the public sector employer. For local government staff, this might be through the Local Government Pension Scheme (‘LGPS’) if the contractor becomes an employer in that scheme, in respect of the relevant contract, via an admission agreement (known as having ‘Admitted Body Status’).

Fair Deal itself is currently under review and the Government’s consultation ended on 15 June. Outcomes may range between retention of the current framework, through limited protections for transferring staff, through to complete abolition of Fair Deal. If it remains in place, however, what are the implications of Lord Hutton’s proposals? We look at some of the key changes proposed below.

Increase member contributions

Following Lord Hutton’s Interim Report, the Chancellor announced that member contribution rates in the public service pension plans would be increased by, on average, 3% of pay over the next 3 years. At its simplest, and ignoring any other changes, an increase in member contributions of 3% of pay reduces the employer’s costs by the same amount. However, member contributions tiered by salary level or other features mean that the overall saving for a particular contract or group of employees will depend heavily on the profile of the employees concerned, and could be very different from the average 3% of pay targeted.

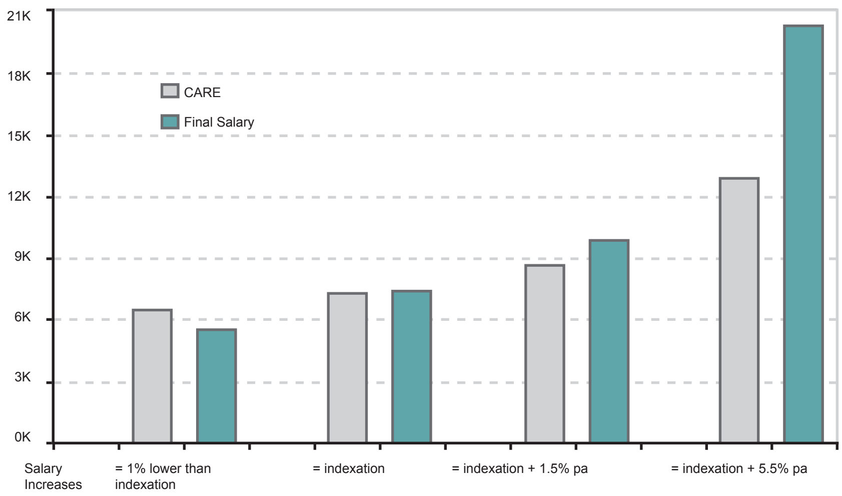
Furthermore much coverage has been given to the impact on membership take up rates – with warnings from the LGPS community that relatively large numbers may opt out of LGPS membership. This will also be a concern for other public sector pension plans. This must raise issues for the Government as regards its wider objective of lifting future pensioners out of poverty, and the impact on the Government deficit of an increasing gap in the unfunded pension plans between contributions paid in and benefits paid out. However contractors and other LGPS employers may see a reduction in overall costs as membership falls (though in the immediate future, for existing employers in the LGPS, this may be masked by the relatively high deficiency reduction contributions being paid by some employers).

A move to CARE

Lord Hutton has proposed a move from final salary (where pensions are linked to pay close to retirement) onto a Career Average Revalued Earnings (‘CARE’) framework (where pensions are based on average pay increased in line with a set index). The pension built up under a CARE framework compared to a final salary framework will depend on:

- Members’ pay increases compared with the indexation used (an average earnings index is proposed).
- The accrual rate. In the current public sector final salary pension plans, this is typically broadly equivalent to a sixtieth.

The chart below compares CARE (grey) and final pay (green) pensions for the same individual, varying the level of actual pay increases whilst a member, retaining the same accrual rate under each. You can see that if the person's pay increases at less than the average earnings index, the CARE pension is higher (and will result in higher overall costs to the employer). If pay increases are higher than the index then the CARE pension is less. This shows that for individual members there will be winners and losers from this change, depending on their future salary progression compared to the index used. The impact on employer costs will therefore depend on the profile of the group of employees involved. For groups of employees with pedestrian pay progression, costs may be about the same, or even higher under a CARE framework. For groups which are predominantly high flyers, CARE may give rise to significantly lower costs.



Based on: Salary at start = £14K. Total service = 20 years. Employee stays to retirement

“Shoe-shine with a Banana Skin

To give brown leather shoes and boots an extra shine, rub them with the inside of a banana skin before polishing them in the usual way. Do the same for black leather by adding a few drops of orange juice to the polish.”

However the comparative costs depend crucially on whether the existing accrual rate is retained under the CARE framework. If a higher accrual rate is used under CARE, this will reduce, or potentially eliminate, potential savings.

Link normal pension age to State Pension Age

Lord Hutton proposed that normal pension age for public sector pension plans be linked to State Pension Age, so that it will increase when the State Pension Age increases. Currently State Pension Age is set to increase to 66 by 2020. Further increases are planned and the Government consultation on wider State Pension Reform, which ended on 24 June 2011, includes mechanisms to link future changes to increases in life expectation.

For a given amount of pension, the later it is paid, the less it costs. This is in part because it will be paid for a shorter period of time, and also because the value of money diminishes over time. Delaying a pension by a year could reduce the cost by over 5%, if no adjustment for later payment is made. Where the current pension age is 60, the savings from an increase to age 66 could be significant. The devil is in the detail. It is unclear whether increases in the Normal Pension Age for the public sector pension plans would apply to all benefits, or just future benefits building up after the change, although the Government appears in recent speeches to be leaning towards the latter at least for benefits built up before the Hutton recommendations are implemented. The latter may be perceived as fairer by members, and may be more manageable for pricing contracts, but will not be simple to explain to members or to administer. Also there may be pressure from unions to have long transition periods which will dilute any savings.

Abolishing Admitted Body Status in the LGPS

This will affect contractors who choose, at present, to provide broadly comparable benefits through the LGPS for local authority contracts. Options will be more limited and the outcome of the Fair Deal review takes on more importance. Generally speaking, loss of this option, with no dilution to Fair Deal, would be likely to increase contract prices as the risk sharing that can accompany admitted body status can reduce costs markedly. It appears to be unclear whether this would apply to existing admitted bodies, or simply prevent new admitted bodies joining. If existing admission agreements are to be terminated early, then this raises headaches (and adviser and administrative costs) for contractors about how to continue to meet Fair Deal for current contracts. It may also expose them to significant termination costs.

“A Pot of Ivy

Do not discard a teapot if the spout gets knocked off. Just fill it with soil and plant one of the trailing varieties of plants and you have a decorative pot which can be lifted by the handle and sufficiently watered down the spout.”

Do we need to do anything now?

Although much remains to be decided, it can be seen that cost savings from the potential member contribution and benefit changes proposed by Lord Hutton could be meaningful. Until the detailed changes are known it is difficult to say with certainty what the eventual cost impact might be. The eventual look of the public sector pension plans is likely to be affected by the outcome of state pension reform; whilst the proposed cost sharing mechanism, and cap on employer costs, will affect how the costs develop in the longer term.

Keep an eye on developments. As member rates go up, so contractors bidding for new public sector contracts should look to adjust broadly comparable pension plans which are offered in bids for new contracts (this will tend to reduce contract prices all other things being equal). Existing contracts should also be reviewed to see if corresponding member contribution changes can be made for existing employees in broadly comparable pension plans. If you have admitted body status this would happen automatically as the regulations applying to the LGPS alter. However, care is required to ensure that any accompanying risk sharing mechanism doesn’t have unintended consequences.

Beyond that, as and when the various changes to benefit structures come into being, the nature of broadly comparable offerings will need to change accordingly. That does assume that Fair Deal survives in a form similar to at present and, to the extent that Fair Deal might be diluted, the degree of flexibility for contractors may increase. Particular care should be taken to anticipate the impact of future changes, such as any increases in pension age, and over the interaction with any cost sharing mechanisms. Outsourcing contracts and contracts of employment need to be constructed with suitable flexibility.

Summary

Change is coming, but the question is what and when? Stay alert: build in flexibility, and take advice from your lawyer and actuary when appropriate, and as firm details emerge.

SHARED SERVICES AND ECONOMIES OF SCALE IN PROCUREMENT

Introduction

Readers of Lord Hutton’s review of public sector pensions will need no reminding that one of his less controversial recommendations was to promote the possibility of achieving greater economies of scale in the procurement of public services:

“Central and local government should closely monitor the benefits associated with the current co-operative projects within the LGPS with a view to encouraging the extension of this approach, if appropriate, across all local authorities (Recommendation 23a).”

Examples of collaborative projects Lord Hutton was referring to are the common procurement of actuarial, investment advisory and legal services in the South West of England (coordinated by the Environment Agency), a similar exercise for London boroughs to procure actuarial and investment services by the London Borough of Croydon under a framework agreement, and the Scottish Pensions Pathfinder project which considered rationalisation of services beyond the Scottish LGPS funds and looked at the police and fire-fighters’ pension plans.

There is no one size fits all solution as authorities will have different needs and resources but it is also clear that the legal complexities of procurement rules create confusion. In a recent survey carried out by the Local Government Association[2], 64% of respondents said that there was legal uncertainty about whether competition to tender was required when “sharing, trading or pooling” services with another council.

So what are the options available and what issues do these raise?

Can the services be provided in-house?

If a contracting authority has the capabilities and resources to provide the necessary goods or services in-house, there is no obligation on that authority to outsource. Obtaining services in this way is not deemed to be a contract and the authority is exempt from having to enter into a full public procurement process.

It remains to be seen whether the introduction of a statutory right by local community bodies to challenge the provision of services by local authorities under the Localism Bill will impede in-house service provision.

If the required services cannot be sourced in-house, there are a number of possible ways to structure the procurement in order that the contracting authority may benefit from significant efficiency savings.

2 *The impact of EU procurement legislation on councils*, December 2010

1. Central procurement on behalf of other LGPS funds

Under the public procurement rules, there are specific provisions which allow for a contracting authority to act as a Central Purchasing Body ('CPB') and to award public contracts or conclude framework agreements intended also for other contracting authorities.

The benefit of this approach is that, provided the contracting authority acting as a CPB has complied with the Public Contracts Regulations 2006 (the '2006 Regulations') and has sufficiently identified the class of authorities it intends to procure on behalf of (for example, naming the other relevant LGPS funds), any such other contracting authority which procures from or through the CPB is also deemed to have complied with the 2006 Regulations. Therefore, it does not need to go through a full public procurement procedure, saving both time and money.

The use of a CPB can also be an effective tool in procuring goods or services in combination with framework agreements, which can then be accessed by other contracting authorities provided that the class of potential users has been adequately described in the original public procurement notice.

2. Framework agreements

A framework agreement is an agreement or arrangement between a contracting authority and one or more suppliers which sets out the terms on which the contracting authority will purchase in the future, for example, as to price and, where appropriate, quantity.

Frameworks can present significant efficiency savings to LGPS funds by removing the need to enter into full procurement procedures for individual future contracts. Instead, the terms of the contract (the "call-off" contract) have already been established. They can be set up for four year periods and in some cases longer periods may be permitted. They can be structured in a way so as not to include any obligation on the contracting authority to buy nor the supplier to sell.

3. Shared services and the 'Teckal exemption'

The 2006 Regulations do not apply to contracts awarded by one or more contracting authorities to another legal entity, such as a subsidiary or a special purpose vehicle (SPV) where the substance of the arrangement would be similar to an in-house arrangement. This exemption has been developed judicially and is often referred to as the 'Teckal exemption' (after the name of a case decided by the European Court of Justice more than a decade ago).

There are two tests for determining whether the Teckal exemption applies to a particular arrangement:

1. the "control" test – whether the LGPS fund "exercises over the person concerned a control which is similar to that which it exercises over its own departments"; and
2. the "essential part of its activities" test – whether that person "carries out the essential part of its activities" with the controlling LGPS fund.

The recent judgment of *Brent London Borough Council v Risk Management Partners Ltd* provides helpful guidance on the breadth of the Teckal exemption and on the interpretation of the two conditions above in the context of shared services.

In particular, if several authorities (here LGPS funds) were to combine to procure certain services from an SPV, the "control" test can be satisfied even if control is exercisable only in conjunction with the other funds that are participating members in the SPV (and provided that no private interests are involved in the SPV). It is not necessary that each fund individually exercises a level of control similar to that which it exercises over its own departments.

Similarly, in relation to the "essential part of its activities" test, it has been established that as long as the SPV does not compete with other bodies on the open market, this condition will be met if the SPV carries out the essential part of its activities with all of them together (and not exclusively with the particular participating fund that is seeking to rely on the exemption).

The Teckal conditions are not concerned with the separate question of whether a local authority has the power or competence to provide a particular service as this is a matter of general constitutional law. The Localism Bill, when enacted, should shed more light on the separate question of statutory powers.

"Rubber Bands

Do not throw away your rubber gloves when they are no longer watertight. Cut across in suitable widths and you will have a splendid selection of good rubber bands of different sizes – most useful in any household."

"In the Shade

If you have a wide lampshade frame, why not cover it with fine muslin and make a meat safe? Believe me, it can be very useful in this hot weather for keeping the flies off."

Overall, the *Brent* case makes it easier for LGPS funds to pool and share services between themselves and without having to conduct a full public procurement exercise for each contract individually.

A full public procurement procedure can also be avoided where two or more authorities decide to cooperate by pooling capabilities and resources as long as in doing so they are governed solely by the pursuit of legitimate public interests. Such public-public-partnerships do not require the establishment of a separate SPV. Provided that the principle of equal treatment is respected, no other private third party body is placed at a competitive disadvantage, and the arrangement is not used as a way of circumventing the Regulations, it will not constitute a 'public contract' and no public procurement procedure would be required.

Conclusion

It is becoming increasingly important for contracting authorities to maximise efficiency savings where possible. There is more than one way to achieve this goal, and recent developments in case law make it easier to share, trade or pool services with other contracting authorities with a view to creating efficiency savings. Case law in this area is still evolving, and each agreement and situation should be assessed on its own merits. Legal advice should be sought in every case as to whether a full public procurement exercise is required or whether a robust exemption is applicable.

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FURTHER INFORMATION

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EDITOR'S CLOSE

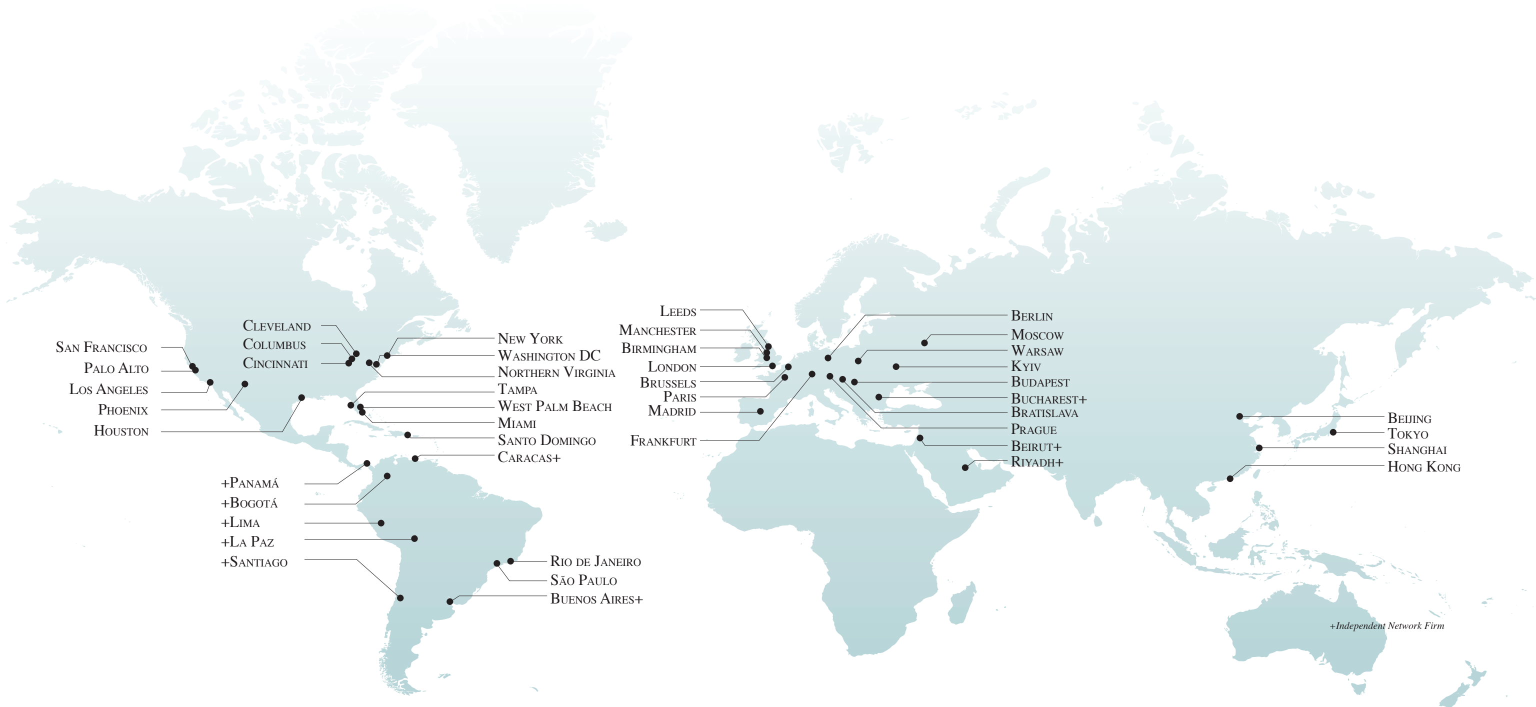
We hope that the tips in the margins have given our readers some good ideas for frugality in the home. Finally, although this is not technically a money saving tip, we could not resist sharing the following advice, taken from the same source:

> *"This Tonic Will Go To His Head!*
>
> *For men only.*
>
> *Anyone who has just had his hair cut and rubs castor oil on the scalp will find it a good tonic. It prevents the hair from falling out.*
>
> *They say what is good for inside is also good for outside!"*

"Cushion Apron

Do not throw away that faded old cushion cover. Sew tapes on the corners, by each side of the openings, and tie it around your waist. On wash days pop the pegs in it."

Squire Sanders Hammonds | Legal Counsel Worldwide



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