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Competing with the Private Sector

- 2.301 We receive a steady stream of enquiries about authority business units competing with private sector providers for contracts inside and outside the authority's district. Some business units competed in those areas to test the market before being established as LATEs.
- 2.302 The enquirers tend to be contractors who have missed out on contracts given to local authority business units, or organisations representing particular groups. Their concern is about the local authority effectively competing with its own ratepayers and other constituents, and they question the legality of the authority's actions.
- 2.303 This article summarises the legal framework applying to local authority contracts with external parties and discusses a recent example.

The Doctrine of *Ultra Vires*

- 2.304 Local authorities are statutory corporations, and the Local Government Act 1974 and other relevant legislation limit their powers. The common law doctrine of *ultra vires* is well established and, in the case of a local authority, requires that any activity undertaken must be expressly or impliedly authorised by statute.



2.305 The scope of local authorities' implied or incidental powers can be unclear. The courts have considered the line between what is and what is not permissible for local authority business units in numerous cases. In the case of trading activities, Palmer notes in *Local Government Law in New Zealand* that –

*the courts tend to require clear statutory authorisation for a distinct trading activity, having regard to taxation exemption and ratepayer subsidies which councils may enjoy.*⁴

The Purposes of Local Government

2.306 Parliament has spelled out the purposes of local government in section 37K of the Local Government Act (enacted in 1989). One of those purposes is to provide [f]or the efficient and effective exercise of the functions, duties, and powers of the components of local government.⁵

2.307 However, the requirement to operate efficiently does not justify an activity if it is outside the local authority's power. As an example, an English court found that a local authority's power to provide washing facilities did not extend to running a full collection and laundry service for ratepayers, as doing so was not reasonably incidental to the provision of washing facilities.⁶

2.308 Local authority business units sometimes do other work to utilise spare capacity in the interests of efficiency. However, the courts have held that the existence of spare capacity is not sufficient justification for unauthorised activity. For example, the use of spare council ferries for excursions has been held to be *ultra vires*.⁷

Competitive Neutrality

2.309 Another purpose of local government is to provide [f]or the operation of trading undertakings of local authorities on a competitively neutral basis.⁸

4 K A Palmer, *Local Government Law in New Zealand*, 2nd ed., 1993, page 51.

5 Section 37K(h).

6 *Attorney-General v Fulham Corp* [1921] 1 Ch 440.

7 *Dundee Harbour Trustees v D & J Nichol* [1951] AC 550 at 561.

8 Section 37K(e), Local Government Act 1974.

- 2.310 Parliament also enacted in 1989:
- section 247C, giving local authorities a general power to be involved in business and other ventures; and
 - Part XXXIVA, allowing local authorities to establish trading enterprises and divest undertakings to them.
- 2.311 The purpose quoted in paragraph 2.309 above does not impose any positive duty on local authorities. Nevertheless, it illustrates Parliament's intention – that trading activities of LATEs, or authority business units, should not affect competition (for better or worse) in their districts. It is clear that an authority business unit competing with ratepayers for private sector contracts is unlikely to be operating on a competitively neutral basis, because authorities are largely exempt from income tax.

Broad Enabling Provisions

- 2.312 A local authority may be able to justify the activities of a business unit by one of the broad enabling sections in the Local Government Act or by a specific section of the Act that concerns the particular activity.
- 2.313 Sections 247B, 247C, and 247D of the Local Government Act concern the powers of local authorities to carry out works and contracts and to be involved in business and other ventures.

Undertaking Work Inside or Outside the District

- 2.314 Section 247B(1) gives every territorial authority:

... the power to undertake the planning, implementation, and maintenance of any work that, in the opinion of the territorial authority, is necessary or beneficial to the district, whether inside or outside the district.⁹

9 Regional councils have the same power but the work must be necessary to the performance of the regional council's functions and duties, (section 247B(2), Local Government Act 1974).

2.315 “Work” is not defined in the Local Government Act, but the words “planning, implementation and maintenance” in section 247B(1) indicate that the power relates to physical works, rather than the operation of services. Therefore, in our view, the section does not authorise a local authority to perform *services* for external parties inside or outside its district.

2.316 When undertaking the work the territorial authority must consider it to be “necessary or beneficial to the district” (unless the work is explicitly authorised by a section of the Local Government Act other than section 247B). This means that any physical work carried out by a territorial authority *outside* the district is permitted only if it is necessary or beneficial to that authority’s district. Work will be beneficial to a district if it benefits the people living in the district.

2.317 Work that may be of benefit to people living in a territorial authority’s district could include:

- “Public” works – such as roading carried out in the authority’s own district.
- Work carried out in public amenities – such as school playgrounds or public hospitals.
- Efficient use of the authority’s resources (both staff and plant). If a business unit has spare capacity, earning additional income from work for external parties inside or outside the district should decrease the cost to the authority of work inside the district.¹⁰

2.318 In considering whether a local authority may carry out works for other parties, it is clear that an authority may perform works or functions for another local authority (paragraphs 2.319 and 2.320). An authority may also perform works for other public bodies or persons, so long as doing so is “necessary or beneficial” to its own district. In each case, the authority must ensure that there is no cost or detriment that outweighs the benefits accruing to the district.

¹⁰ Subject to the *ultra vires* rule.

Performing Works or Services for Other Authorities

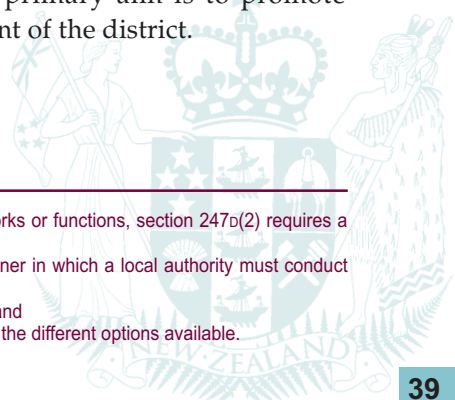
- 2.319 Section 247D allows a local authority to choose whether to carry out its works or perform its functions using its own staff or by contracting with another party, including any local authority.
- 2.320 Section 247D(1) authorises a local authority to perform services for another authority if the latter authority has met the requirements of section 247D(2).¹¹ However, as with section 247B, section 247D does not authorise an authority to perform *services* for external parties inside or outside the district.

Other Broad Empowering Provisions

- 2.321 The Local Government Act 1974 contains various broad empowering provisions that authorise local authorities to provide services in particular areas. For example:
- section 598, which authorises territorial authorities to *undertake, promote, and encourage the development of such services and facilities as it considers necessary to maintain and promote the general well being of the public...*;
 - section 601, which gives any territorial authority similar powers in the area of *recreation, amusement, and instruction of the public*, and provision or improvement of public amenities; and
 - section 602 – under which territorial authorities may provide “information services”, including the power to fund organisations whose primary aim is to promote development or advancement of the district.

¹¹ In deciding how to carry out any of its works or functions, section 247D(2) requires a local authority to have regard to:

- section 223c, which sets out the manner in which a local authority must conduct its affairs;
- the objects stated in its Annual Plan; and
- the advantages and disadvantages of the different options available.



2.322 These sections may be particularly relevant in cases where a local authority is providing a service to the community that the private sector is not prepared to provide or is unwilling to provide at a reasonable price.

Example of the Issue

2.323 A person was concerned that a local authority business unit was “competing with ratepayers” (i.e. with private sector suppliers) for work unconnected with the authority. The contract in question was for maintaining gardens, and providing cleaning and rubbish removal services, at an education institution in the authority’s district. The work was similar to that which the business unit carried out in maintaining public spaces in the authority’s district.

2.324 The annual value of the contract was around \$13,000 and did not constitute significant revenue for the business unit. However, for some time the business unit had faced an uncertain future. The council had considered over a long period whether to divest the business unit’s activities to a LATE. This uncertainty provided an incentive for the business unit to expand its activities and seek new customers.

2.325 The activities under the contract were in the nature of services rather than “works”, so a “benefit to the district” approach based on section 247B was not possible. The council obtained legal advice that various sections of the Local Government Act expressly authorised the activities covered by the contract – in particular:

- Rubbish removal – a local authority may contract for waste management, provided that to do so is in accordance with its waste management plan.¹²
- Cleaning services – a local authority may, with the agreement of the owner, carry out any works in respect of drainage or sanitation on the owner’s premises.¹³
- Gardening/lawn mowing – a local authority may *lay out and maintain gardens, shrubberies, and lawns on any private land or public place within the district* for payment.¹⁴

¹² Sections 538 and 540.

¹³ Section 673.

¹⁴ Section 621.

- 2.326 The council's legal advice also referred to sections 601 or 605 of the Act as possible justification for aspects of the contract. As already noted (paragraph 2.321), section 601 authorises a territorial authority to undertake such services as it considers necessary to provide for the instruction of the public or improvement or development or maintenance of amenities for the public. Section 605 authorises an authority to provide community centres in its district and a community centre can have an educational purpose.
- 2.327 We agreed with the legal advice on the authority for the rubbish removal part of the contract, but had a different view on the authority for the other parts. We did not think the cleaning part of the contract was authorised. In our view, the other provisions referred to had an element of public benefit – for example, through beautification of a public place or provision of services necessary for public instruction. It was not clear to us how the contract met those purposes, or why the council would consider it necessary to assist another public body with routine maintenance. Doing so would be of direct benefit to ratepayers only if no other contractor would provide such services.
- 2.328 We noted that the council was entitled to rely on its own legal advice but asked that our comments be considered. We understand that the future of the business unit concerned has been resolved and the incentives to seek other work no longer apply.

Conclusion

- 2.329 The line is not easily drawn between what is and what is not permissible when it comes to local authorities competing with the private sector to provide works and services. However, the issue is important and it is not surprising that members of the public who find themselves in direct competition with a local authority operation challenge the right to compete with them.
- 2.330 While it may be efficient for the staff of a local authority business unit to be fully employed, that may not be sufficient in itself to justify a contract – especially as local authorities that operate trading activities are intended to do so on a competitively neutral basis.

- 2.331 The *ultra vires* rule requires that a local authority acting in competition with the private sector carefully considers the statutory authority for doing so. In our view, the council should in each case closely consider the purpose in engaging in the activity, particularly as the broad empowering provisions in the Local Government Act tend to require a benefit to the public. The council should obtain legal advice in cases of uncertainty.
- 2.332 The mixture of the older prescriptive provisions and more recent broad enabling provisions in the Local Government Act creates a complex legal framework for councils to have to deal with. We hope that a new Local Government Act may provide some clarity in this area. We encourage councils with experience and views to comment on the issue during the review of the current Act.

