CLiNKS

supporting voluntary organisations that work with offenders and their families

RUSSELL-COOKE | SOLICITORS

Subcontracting

A guide to the legal implications of the Industry Standard Partnering Agreement for voluntary, community and social enterprise organisations

February 2014

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Introduction

The intention of this document is to support leaders of voluntary sector organisations and social enterprises who are thinking about subcontracting as a Tier 2 or Tier 3 organisation within the Transforming Rehabilitation Programme.

Part 1 of this document outlines the Transforming Rehabilitation Programme as it currently stands and the role of the Industry Standard Partnering Agreement (ISPA) within that.

Part 2 is a series of modules, which deal with a variety of legal and practical issues that arise from the prospect of entering into a contract as a Tier 2 or Tier 3 organisation.

The modules

This is not a comprehensive list of everything that needs to be considered and each organisation will need to carefully review any contract they are entering into and pinpoint the implications that it will have for their operation. Where the contract language doesn't make that clear, the organisation should get written clarification from the Tier 1 body. You are strongly advised to get specific legal advice before you enter into these types of contracts.

Feedback and Further Help

This is a document in progress. This version is based on the draft ISPA which is yet to be finalised. We intend to update the document, if possible, once the final version is available. We also intend to add or amend elements of the modules in response to questions that arise. We would welcome your feedback. If you have any questions or feedback, please email TRHelpline@clinks.org.

We are also running a TR Helpline until mid June when the Tier 1 bids are due to be submitted. Please call 020 3637 0155. The helpline is staffed 10am-2pm and you are welcome to leave messages or email TRHelpline@clinks.org at other times.

Free legal advice is also available through the Helpline for small or medium sized VCSE organisations around TR subcontracting issues, subject to demand.

Part 1

A brief overview of Transforming Rehabilitation

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a) An introduction to Transforming Rehabilitation

Transforming Rehabilitation (TR) is the Government's agenda for the future of rehabilitation services to adult offenders.

Sometimes characterised as the privatisation of the probation service, it also includes the roll-out of Payment by Results (PbR), a new approach to offenders completing custodial sentences of 12 months and significant changes in the role of prisons.

It will have a major impact on voluntary sector organisations working with offenders and their families.

In 2010, following negotiation between the two political parties, "The Coalition: our plan for government" was published. This included the following commitment:

"We will introduce a 'rehabilitation revolution' that will pay independent providers to reduce reoffending, paid for by the savings this new approach will generate within the criminal justice system."[1]

[1] HM Government (2010) 'The Coalition: our programme for government', Online, https://www.gov.uk/government/publications/the-coalition-documentation (last accessed 17.02.2013).

The current proposals were first consulted on in January 2013 in "Transforming Rehabilitation: A revolution in the way we manage offenders"[2]. The response to the consultation[3] was then published in May, and indicated the Government's intention to proceed as follows:

- The management of low and medium risk adult offenders in the community, both those on community orders or on license, and those leaving custody, would be opened out to competition.
- The new providers would also be incentivised to deliver reduced reoffending by a Payment by Results (PbR) scheme.
- A number of prisons would be redesignated as resettlement prisons, where prisoners from the area would start working with the new providers during the last three months of their sentence, to ensure continuity through the gate and in the community after release.
- For the first time, statutory rehabilitation services would also be available to those completing sentences of less than 12 months, who would serve all or most of their sentence within their local resettlement prison, and then be subject to supervision afterwards.
- The cost of extending rehabilitation to more offenders would be met by efficiencies driven by the new providers, and longer-term savings would be delivered by the projected reduction in reoffending.
- Meanwhile, high-risk offenders would be the responsibility of a newly-constituted National Probation Service, who would also undertake risk assessment, advise courts and the Parole Board and work closely in partnership with the new providers to ensure public protection.

More detail on the substance of the new services, and Clinks' views on the outstanding questions for the voluntary sector, can be found via the Transforming Rehabilitation page of the Clinks website www.clinks.org/criminal-justice/transforming-rehabilitation .

b) The key documents

As more information has emerged both within and following the Government's response, including the documents that have so far been released as part of the formal competition, the specifics of how the new arrangements will look have become clearer.

The most useful documents for those seeking more detail on TR, as opposed to the ISPA, are as follows:

- *A Strategy for Reform*[4]: this remains the primary iteration of the case for the reforms.
- The *Target Operating Model 2*[5]: this gives the most detailed publicly available outline of the new landscape. This is a revised version, published in February 2014

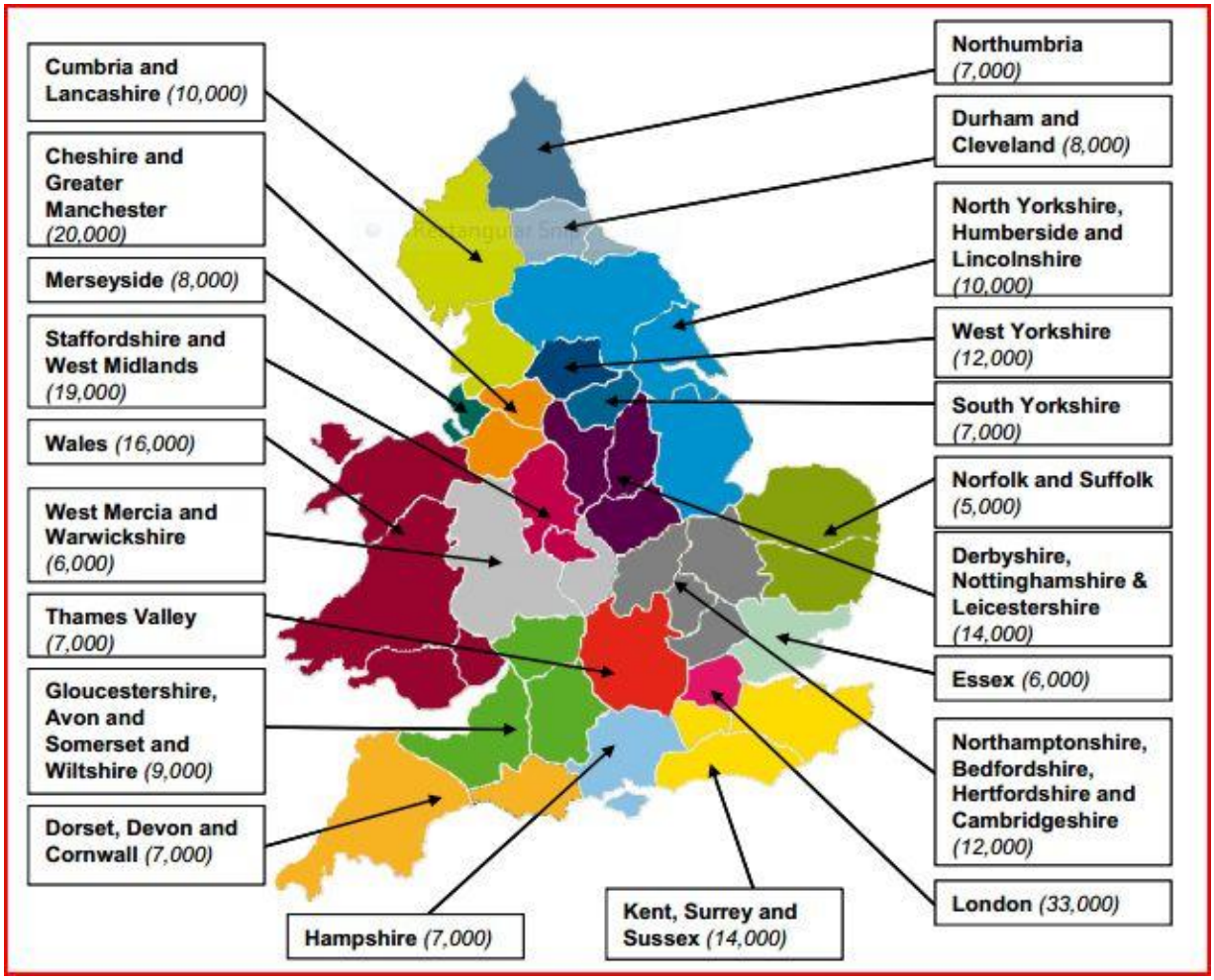
[2] Ministry of Justice (2013) 'Transforming Rehabilitation: A revolution in the way we manage offenders', Online, https://consult.justice.gov.uk/digital-communications/transforming-rehabilitation (last accessed 17.02.2014).
[3] Ministry of Justice (2013) 'Transforming Rehabilitation: A Strategy for Reform', Online, https://consult.justice.gov.uk/digital-communications/transforming-rehabilitation (last accessed 17.02.2013).
[4] Ministry of Justice (2013) 'Transforming Rehabilitation: A Strategy for Reform', Online, https://consult.justice.gov.uk/digital-communications/transforming-rehabilitation (last accessed 24.02.2013)

c) How will rehabilitation services be structured?

There will be 21 Contract Package Areas (CPAs) across England and Wales. CPAs are larger than police force areas; in some cases there are as many as four police force areas per CPA. See below for a map of the CPAs.

Community Rehabilitation Companies (CRCs) have been set up in each CPA. The CRCs will be responsible for the provision of services for low to medium risk offenders. The CRCs are currently owned by the MoJ and will be sold to the winning bidders (Tier 1s) following the completion of the competition. In the meantime, the allocation of probation staff to their new roles is expected to be complete by 1st April 2014. Caseloads will begin to be transferred from 1st April and it is expected that the CRCs will be fully operational by the beginning of June, when the old governance structures will cease.

Figure 1: Map of CPA areas and estimated annual starts [6]



[5] http://www.justice.gov.uk/downloads/rehab-prog/competition/target-operating-model-2.pdf

[6] From "A Strategy for Reform" – p 48
Ministry of Justice (2013) 'Transforming Rehabilitation: A Strategy for Reform', Online, https://consult.justice.gov.uk/digital-communications/transforming-rehabilitation (last accessed 24.02.2013)
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d) The new supply chains

The winning bidders for the CRCs are categorised as Tier 1 providers; their subcontractors are referred to as Tier 2 and Tier 3.

The distinction between Tier 2 and Tier 3 is yet to be formally defined by the Ministry of Justice, but in general it is expected that Tier 2s will be larger organisations, which will take on significant delivery of the reduction of reoffending outcomes. These may be private sector organisations, mutuals, social enterprises or voluntary sector organisations. Tier 3s are likely to be smaller organisations providing specialist services.

e) The timetable for contracting out

September 2013	➢ Pre-Qualification Questionnaires open for Tier 1s
December 2013	➢ Tier 1 bidders announced
February 2014	➢ Invitation to Negotiate Period for Tier 1 bidders starts
April - June 2014	➢ Existing contracts with Probation Trust move to new CRCs
June 2014	➢ New CRCs become fully operational
June 2014	➢ Tier 1 Bids to MoJ
October to December 2014	➢ Tier 1 Contracts awarded
April 2015 or before	➢ Contracts for Tier 1s begin *(Contract period 7,10 or 13 years)*
Beyond April 2015	➢ Contracts for Tier 2 and 3 continue to be awarded *(Minimum term currently recommended to be 3 years)*

The first stage of the TR competition opened in September 2013 with the Pre-Qualification Questionnaire to lead providers, or Tier 1s. The list of 30 potential Tier 1s who have made it through this stage was published in December, and can be found on the MoJ website Competition page[7]. A map of which Tier 1 has shown an interest in which CPA is available via the link below, though the MoJ have not formally confirmed it yet [8].

The Invitation to Negotiate stage commenced in February 2014. Tier 1 bidders will be expected to present to the MoJ a bid which will include details of their proposed supply chain on June 16th. They will be expected to understand the range of services available in the areas they are bidding for, and to have a supply chain in place. It is therefore expected that Tier 1s will be discussing their plans with potential partners in Tiers 2 and 3 during this period. At present, it is expected that the new Tier 1 contracts will be awarded before

[7] MoJ website page on Competition: http://www.justice.gov.uk/transforming-rehabilitation/competition
[8] A map of bidders by CPA is available here http://www.russellwebster.com/who-is-bidding-for-your-probation-area/

December 2014, and that delivery will start by April 2015 at the latest – and perhaps before this date.

f) Market stewardship and the voluntary sector

From the outset, the involvement of the VCSE sector has been an explicit priority in the MoJ's thinking. A Strategy for Reform made the following commitment:

"A large number of consultation respondents agreed that voluntary and community sector organisations could have a strong impact on reducing reoffending. We know that there are challenges for smaller organisations in all sectors in participating in delivery under 'payment by results' contracts and across large areas. We are determined to design a system which brings together the best of the public, private and voluntary and community sectors."[9]

To facilitate this, a set of market stewardship principles were developed as follows:

- Appropriate management of risk in the supply chain
- Alignment of ethos in the supply chain
- Visibility across the supply chain
- Reward and recognition of good performance
- Application of the principles of the Compact[10]

These can be found in the Principles of Competition[11] document released alongside the PQQ stage; Clinks has also produced a briefing on this[12].

The Principles of Competition document indicates that these would be embedded during the Invitation to Negotiate stage of the competition (which is currently underway), both through the main contracts to be awarded to Tier 1 organisations, and through the new Industry Standard Partnering Agreement (ISPA).

g) Payment by Results

Arguably the key underlying principle of the new contracted services is the large-scale introduction of PbR, which will apply to the 21 new contracts, and is designed to incentivise a focus on reducing reoffending.

Clinks is aware that some members will wish to explore the option of entering a PbR contract if they consider the attendant risks to be manageable; these are likely to be Tier 2 organisations within the new supply chains.

A brief summary of the proposed payment mechanism that will apply to the Tier 1 contracts is given below, though it should be remembered that any PbR element that is passed down the supply chain to subcontractors must be negotiated, and it may be agreed between the Tier 1s and their subcontractors that the specifics should work differently at this level.

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[9] *Transforming Rehabilitation: A strategy for reform*, as above, p.16.
[10] For more information on the Compact: http://www.compactvoice.org.uk/about-compact
[11] MoJ Principles of Competition document can be found here: http://www.justice.gov.uk/downloads/rehab-prog/competition/moj-principles-of-competition.pdf
[12] Clinks' Briefing on the Competition Stage: http://www.clinks.org/sites/default/files/basic/files-downloads/Members%20Briefing%20-%20Competition%20stage%20of%20the%20TR%20reforms%20FINAL.pdf

In our understanding, it is unlikely that potential Tier 3s would be able to take on a PbR contract, though there are other risks associated with subcontracting which this document goes on to consider.

Following a "straw man" version of the payment mechanism and a subsequent report on the market feedback, an overview of the payment mechanism, which sets out how PbR will work in practice, was published in February. It is available as part of the draft contract documentation on the Competition page of the MoJ website[13].

Providers potentially receive two types of payment: the Fee for Service (which covers the core activities of the contract, is worked out by predicted volume, and is paid monthly in arrears) and any PbR for which they're eligible.

To receive the maximum possible PbR amount, Tier 1 providers will need to achieve both a substantial reduction in the number of service users who go on to commit further offences (the "binary metric"), and a reduction in the number of further offences committed by each service user (the "frequency metric").

A significant addition to the previous versions is that there will now be a "bedding in period" before PbR begins; this will be between 6 and 9 months after the new contracts start. There will then be a significant gap before payments under the Payment by Results element are made, because of the need to form cohorts of service users, measure their reoffending and analyse the results. The binary metric will take 26 months to become measurable and the frequency metric will take 35 months. So the total time taken before a PbR payment or reduction is made, including the bedding in period, would be 32-35 months for the binary metric, and the time taken for both metrics to be in use would be 41-44 months.

More details on PbR metrics and timelines are available on pages 11-18 of the Payment Mechanism overview via the link below.

h) The National Probation Service Contracts

The new National Probation Service will also purchase rehabilitation services for high-risk offenders from the new providers, and we presume they will continue to do so directly from the voluntary sector too. These contracts will not include any PbR element. We await more detail on this aspect of the reforms.

i) The Industry Standard Partnering Agreement

The new Industry Standard Partnering Agreement (ISPA) is not specific to TR, and will in fact apply to all future Ministry of Justice (MoJ) subcontracting arrangements. In practice, however,it will be the key governing document through which MoJ monitors the relationships between organisations in the new supply chains.

Organisations who wish to be involved as subcontractors, whether they are from the voluntary sector or not, will be covered by its terms so long as they register with the MoJ (see below).

[13] MoJ website Competition page http://www.justice.gov.uk/transforming-rehabilitation/competition

j) Current position of the ISPA

The Industry Standard Partnership Agreement (ISPA) is currently in draft form. The consultation period for this discussion draft closed on February 20th. A final standard ISPA will be produced, but the MoJ have been unable to give a date for this.

The draft ISPA is available from the MoJ website[14]. It has a series of standard clauses and a number of areas – such as Service Levels – which will be individually negotiated with subcontractors. There is also an Explanatory Guide which explains more detail about the ISPA, but will not form part of the contract.

As outlined in the Explanatory Guide it is intended that the ISPA is the starting point for subcontracts with Tier 2s and most Tier 3s. It is expected that it will be negotiated and clauses will be removed or changed. There may be some clauses which are deemed mandatory and these will be identified by the Ministry of Justice, presumably in the final version.

It is a framework document, and there will be a good deal to be added in the case of individual contracts. These will include details of services and payments etc, but there is also room to negotiate, including to have standard clauses removed or changed.

The Ministry of Justice expects that Tier 1s to use the ISPA when contracting with Tier 2s that are registered with the MoJ. For Tier 3 organisations (smaller organisations that are more likely to be providing specialist services), it is less clear. The ISPA is held up as good practice and the principles of transparency and passing down appropriate levels of risk apply. This may meant that a shortened version of the ISPA is used for smaller contracts. It is possible that grant arrangements may be available.

In short, there is room for negotiation. How much can be negotiated is likely to depend on the level of service your organisation will be providing.

k) Registering with the MoJ

Registering with the MoJ will help you access the supply chain. The MoJ are also sending out information to registered organisations which may be useful. Registered organisations will also be covered by the Market Stewardship principles.

You can register by requesting a form via mas@justice.gsi.gov.uk. The deadline for registration has now been extended indefinitely.

[14] For Draft Industry Standard Partnering Agreement (ISPA) and Explanatory Document (Jan 2014) https://consult.justice.gov.uk/digital-communications/df97a7b1

Module 1

Moving from grants to contracts

Index

1.1 Introduction

1.1.1 The Industry Standard Partnering Agreement (ISPA) is a contract, not a grant agreement.

1.1.2 The Voluntary, Community and Social Enterprise Sector (VCSE) is aware of the general shift in government funding from grants to the award of contracts. However, many VCSE organisations remain unaware of the full implications of such change.

1.1.3 The distinction between a grant and a contract is not always clear. In entering into any sort of funding agreement you need to think carefully about what the true relationship is. It doesn't matter that an agreement states it is a grant or a contract throughout. It is the content of the agreement that will determine whether it is a grant or a contract. However, there is no question that the ISPA is a contract.

1.1.4 A key difference between a grant and a contract is that whilst grants can often contain provisions that allow the grant funding to be clawed back in certain instances, they are not perceived to carry the same risk profile as contracts. The potential "claw back" being liabilities or claims under a contract are far more wide ranging.

1.1.5 In this module we will explain the differences between a grant and a contract and the broad implications of taking on a contract such as the ISPA.

1.2 The key differences between a grant and a contract

Grant	**Contract**
Enforceability Grants will often contain "claw-back" provisions requiring grant funds to be re-paid if they are not used in accordance with a specific purpose. While the funder may be able to take action for misapplication of the funds, a grant generally carries a lower risk profile than a contract.	**Enforceability** Contracts are legally enforceable both by the client and supplier, and either party can seek a remedy from the courts, including injunctions and payment of damages.

A donation or gift The funder has no legal right to receive anything in return (although perhaps there is an acknowledgment of funds or a report on how funds were spent).	**Payment for services** One party pays the other in exchange for the other providing something. Note that this can trigger VAT liabilities.
No profit A grant should be spent for the purpose it was given. Unspent monies are usually returned to the funder.	**Possible profit** A payment is made for a service. If the service is provided any surplus funding not used to deliver the service can be kept.

1.3 Other features of a contract

1.3.1 Contracts cover a multiplicity of different issues. They can include provisions such as employment, leases of premises and insurance arrangements. There is no one size fits all and each contract will need to be tailored to fit the relationship and to comply with any necessary rules and regulations. The keys terms of the ISPA need careful negotiation and it is important that you do not accept "standard" terms wholesale. In each case the primary purpose of the ISPA is to ensure each party's responsibilities are clear and risk is appropriately apportioned between them. This point is emphasised in Part 1, Section 2 of the ISPA Explanatory Guide.

1.3.2 Contracts also need to be absolutely clear as to the terms of payment. What precisely is the trigger or outcome which creates a payment obligation? These sorts of obligations will need much more careful consideration than the somewhat more general obligations that are contained in grant agreements. Specific comments on the payments under ISPA are found at paragraph 1.5.5 below. Further information on payment mechanisms can be found in Module 2, paragraph 2.4.

1.4 Tax and VAT implications

1.4.1 Generally speaking, unlike grants, contracts might be considered to be business income for VAT purposes. Generally trading and income from contracts would count towards the VAT threshold, unless deemed to be "exempt". The rules on what constitutes something as VAT exempt are complex and specific to the particular case. You should get expert advice on this.

1.4.2 In general, if an organisation earns more than the VAT threshold as vatable business income in any 12 month period, it must register with HMRC for VAT. The current VAT threshold is £79,000 (2013/14).

1.4.3 Many charities that are used to receiving grants, which do not count towards the VAT threshold, are having to register for VAT as they move to contracts.

1.4.4 VAT laws are complex and the administration of VAT rules for charities is difficult. Registering for VAT will have implications across your organisation. Your organisation may be required to charge VAT for some types of services, but there may also be some advantages in being able to reclaim VAT on some of your expenditure.

1.4.5 If your organisation is not registered for VAT and the ISPA is likely to tip you over the VAT threshold, you should seek early advice from a VAT specialist. VAT is one of the most complicated taxes. It essential that you understand the VAT implications from the outset.

1.4.6 Any amounts due under the ISPA are exclusive of VAT i.e. any VAT charges will be paid as an additional amount (Clause 17 (a) of ISPA).

1.4.7 Corporation tax may also be payable if an organisation makes a surplus from grants or contracts. Generally charities are exempt from tax on surpluses provided the surplus arises from charitable trading (see Resources below). If a charity undertakes work which is not within its charitable objectives, it may be liable for tax on that surplus. There are rules which allow modest amounts of what is known as small trading without tax, but advice should be taken before relying on these exemptions. For larger amounts of non-charitable trading, the charity will need to use a trading subsidiary (see Module 3).

1.5 Liabilities associated with grants and contracts

1.5.1 As mentioned in the table above, in the context of a grant, a funder can usually only require repayment of funds that are misspent or unspent. However, under contract law, the principles relating to “losses” or “damages” when a party breaches its obligations under a contract are potentially far more wide ranging.

1.5.2 Under contract law damages principles, the aim is to put the claimant (the party who suffers as a result of a breach) in the position he would have been in had the contract been properly performed and had the breach not occurred. Therefore, a contractor who suffered the loss can not only recover the money paid for the services that were not performed but can also recover any “losses” it has suffered as a result of a breach of contract. For example, the cost of re-procuring the service and any additional costs incurred with a new supplier.

1.5.3 Often, however, a contractor will include an “indemnity” into a contract, so the subcontractor indemnifies the contractor. An indemnity is basically a promise from one party to another to be responsible for any loss or damage that they incur as a result of a breach of the contract. The advantage of relying on an indemnity is that the innocent party can seek to recover a specified sum under the indemnity and it will not need to bring a usual contractual claim through the courts nor have to demonstrate it has taken steps to lessen the loss incurred. Of course, it is possible to dispute the amount claimed.

1.5.4 Clause 7 of the ISPA sets out the liabilities of the parties. Module 2 explains the liabilities that arise under the ISPA in more detail. Crucially, the clauses set out the potential amount that a Subcontractor will be liable to pay should there be a breach. The amount needs to be set in each case. These clauses need particular care and attention when being agreed. Clause 7.2 of ISPA does exclude certain types of losses, meaning a party would not be liable should they arise, although please note that this clause can be amended and you should check any amendments to clause 7 to see if your exposure to liabilities have been widened. You should ensure that there are appropriate insurance policies and levels in place.

1.5.5 Additionally, unlike grants, contracts can expose you to the risks of a funding shortfall and/or additional internal costs if triggers for payments are not met. The ISPA allows the Contractor to set specific Service Levels (clause 1.2 ISPA) and the Contractor can require the Subcontractor to re-perform the Services if those Levels are not met

(clause 1.2 (b) ISPA). The cost of this re-performance must be borne by the Subcontractor. The ISPA also allows for Service Credits to be applied, which are a deduction of a portion of the Charges if Service Levels are not met (clause 1.3 ISPA). Currently, these key terms such as Schedules 5 and 6 ISPA are blank so we cannot comment on them and nor can you consider if they are acheiveable operationally. These clauses could have a material impact on the funding received, cashflow and commercial viability of the ISPA. As such Subcontractors need to be confident that they can meet the obligations and Service Levels under the ISPA.

1.5.6 Modules 2 and 7 comment further on the issues of risk and liabilities under ISPA.

1.6 Key action points

1.6.1 In summary, it is essential to understand that the exposure to both legal and financial risk under the ISPA is higher than if the funding was provided by way of a grant. This introductory module highlights core legal concepts and risks that permeate throughout the ISPA.

1.6.2 Key actions to be taken in relation to this module include:

- Undertaking a detailed review of the subsequent modules which expand and explain the different sections of the ISPA and considering the implications of each.
- Ensuring that the VAT risks have been assessed and advice taken.
- Ensuring you agree the liabilities in Clause 7 and are aware of exactly what indemnities and liabilities you are exposed to.
- Reviewing your insurance policies to ensure it covers all the activities and liabilities under the ISPA and the financial levels of the policies are adequate.

1.7 Resources

- HMRC Charities: http://www.hmrc.gov.uk/charities/guidance-notes/annex4/sectionb.htm
- Chapter 52, *Contracts and Service Agreements,* Russell-Cooke Voluntary Sector Legal Handbook
- *Charities and Public Service Delivery* (CC37) *,* Charity Commission.gov.uk
- *Grants and Contracts made Simple,* Sayer Vincent, http://www.sayervincent.co.uk/Asp/uploadedFiles/File/Publications/MadeSimpleGuides/Grants_Contracts_Made_Simple.pdf
- Russell-Cooke Website Briefings- http://www.russell-cooke.co.uk/articles.cfm?id=92&sub=

Module 2

Risk analysis and mitigation

Index

2.1 Introduction

2.1.1 As with any business activity you propose to engage in, you need to evaluate the potential risks and rewards of the particular activity. Some of these issues relate to specific parts of the ISPA, others are more generic issues.

2.2 Organisational skills and approach to risk

2.2.1 Your organisation will need to devote time and effort to considering the terms of the ISPA. You may feel, having reviewed the ISPA and this document, that you have suitable skills within your board and/or your staff team to carry out this "due diligence", or you may feel you should obtain some external help.

2.2.2 Your organisation may already have a policy or protocol in place for evaluating and analysing risks. If not, models are available from organisations such as the Charity Commission or Sayer Vincent (see Resources below). If you don't currently assess and record, in a formal way, the risks facing your organisation and steps you will take to mitigate or address risks, now would be a good time to start doing this, including in relation to the ISPA.

2.2.3 Assuming you do sign up to the ISPA, you will need to ensure that you have the skills and resources to deliver the Services to the Service Levels.

2.2.4 This module will look at risks from three view points: legal risk; financial risk; and contract compliance risk. However, do bear in mind that these concepts are all interrelated, so, for example, failing to deal properly with a legal risk or a contract compliance risk could create a financial risk.

2.3 Legal and tax risks

2.3.1 Legal Structure and Corporate Powers: A very broad risk management point is that a complex contract such as the ISPA should not be entered into by an organisation which is not incorporated. Unincorporated organisations include trusts and unincorporated associations. Use of unincorporated structures can lead to individuals (members and/or trustees) involved in the organisation being at risk of personal liability if there was a liability under a contract which the organisation could

not meet out of its own resources. This risk is substantially reduced by using an incorporated structure such as a company or an industrial and provident society.

2.3.2 Companies are either limited by shares or limited by guarantee. Some companies limited by guarantee are also registered charities. Some companies are what is known as a Community Interest Company (CIC), these can be either limited by guarantee or limited by shares. A further limited liability structure which is only available to charities is the Charitable Incorporated Organisation (CIO). Use of an incorporated structure will remove most risks of personal liability for individuals associated with the organisation, although in some cases, risks of personal liability can remain and some of these risks are mentioned below.

2.3.3 You will need to consider whether your organisation is legally able to enter into the ISPA. This will include a review of your governing document or constitution. You will need to review your governing document to ensure that activities under the ISPA are within your organisation's objects or purposes and powers. Charities in particular, often have quite specific objects limiting them to particular activities. If you are established as a charity but your objects do not appear to cover this sort of activity, it may be possible to amend your objects. This will require prior Charity Commission approval and you will also need to comply with any rules set out in your own governing document in relation to amending it. You will need to evaluate whether you will have sufficient time to go through all of these steps if indeed you do need to change your governing document. Please see Module 3 for more information on this issue. Note that clause 6.1 of the ISPA says that Subcontractors represent and warrant that they have the power to enter into the ISPA. This is in effect a legally binding promise that you do indeed have all necessary powers (including under your governing document) to enter into the ISPA.

2.3.4 If you are a charity, operating outside of your charitable objects can lead to risk of personal liability for trustees. This is a risk even if your charity is incorporated either as a company limited by guarantee or a CIO, as this is one of the few areas where operating through an incorporated organisation will not protect trustees from the risk of personal liability.

2.3.5 There is also a tax issue because if you are a charity operating outside its objects you would risk losing your main exemption from income tax, corporation tax and capital gains tax.

2.3.6 If entering into the ISPA would either be outside your powers or create unacceptable risks for your existing organisation, another possible way to deal with this would be to set up a trading subsidiary with very broad powers. That subsidiary company could then enter into the ISPA. See Module 3 for more information.

2.3.7 VAT may also be an issue. Your organisation may already be registered for VAT. If it is not currently registered for VAT the income under the ISPA may mean that it will need to register for VAT. You should ensure that you get suitable professional advice. See Module 1, paragraph 1.4 for more information about VAT implications.

2.3.8 There are a number of other issues which involve legal risk and, in some cases, a contract compliance risk, for example, data protection and employment/TUPE. Please see Modules 5 and 8 for further commentary on these issues.

2.3.9 Note that governance obligations, regarding the management of the contract, have not yet been included in the ISPA. This is referred to at clause 10 and Schedule 9 of ISPA.

2.3.10 Subcontracting – note that you are entitled to subcontract your obligations under the ISPA but you would be fully responsible for all actions and failures by any subcontractors. You would remain fully accountable for the Services set out in your ISPA. Subcontracting always involves a degree of management so you should not underestimate the time and cost which will be involved both in assessing and selecting possible subcontractors and in properly managing any subcontractors you engage.

2.4 **Financial risk**

2.4.1 There are a number of financial risks. A major financial risk is that there is no guarantee of the volume of work that will be provided under the ISPA, see clause 1.1(h). Unless this can be renegotiated, you will not have the certainty of knowing the exact level of income you will receive. This sort of uncertainty may mean that you are confronted either with a lower volume of work than you were expecting, or indeed, a higher volume of work. In either case you will need to respond appropriately to ensure that you are complying with your obligations under the ISPA and, so far as possible, avoiding being penalised through Service Credits or other default mechanisms in the ISPA. Please also see comments in relation to possible changes to Service Levels. In terms of the volume of work, if you were able to negotiate a fixed base volume of work, together with realistic notice periods for increase or decrease on that base volume of work, and, for example, limits on proportionate change in volume in a set period, this would enhance your ability to plan and manage providing the Services.

2.4.2 Lack of certainty around volume of work may also make it difficult for you to assess what levels of staffing you need. You may wish to consider whether you should have flexible staffing arrangements, so far as the ISPA allows you to do so.

2.4.3 Risk also arises in relation to the price that will be paid. Can your organisation deliver the required Services for the agreed price? You should ensure that when pricing the ISPA you do not only look at your direct costs attributable to staff delivering the Services but also include relevant related costs, such as training, supervision, financial oversight of the ISPA and complying with the numerous reporting requirements under the ISPA.

2.4.4 The ISPA refers to a minimum three-year Initial Term. You should consider negotiating a specific right to revise your prices based on a particular measure of inflation or a particular index of changes in salary costs and/or other factors outside your control which will increase your costs of providing the service. For example, it may be possible to agree that changes in legislation that impact on your costs of providing the Services should be reflected in the price. Any such rights would need to be explicitly stated within the ISPA.

2.5 The ISPA also includes a reference to Service Credits. These are a mechanism by which you can be penalised for failing to provide the Services in accordance with the Service Levels. Details of both Service Credits and Service Levels should be set out in Schedule 5 (it is currently blank). Note that under clause 1.2(a), with effect from the Effective Date (not defined), you must meet or exceed the Service Levels in your provision of the relevant Services. Under clause 1.2(b) if at any time after the Effective Date you fail to provide any of the Services in accordance with the Service Levels, you will need to take various steps in addition to any other requirements the Contractor may require. You will need to inform the Contractor of your failure and the steps you will take to address the failure; at no additional cost to the Contractor, you will need to perform or re-perform those parts of the Services; to

the extent practicable you will need to rectify all direct operational consequences resulting from your failure; and as soon as practicable, arrange all additional resources as are reasonably necessary to perform your obligations and ensure that the failure does not recur. Please note that some of the wording used, for example, reference to such resources as are "reasonably necessary", is not specifically defined.

2.6 **Contract compliance risks**

2.6.1 There are a number of detailed requirements on you in terms of compliance with ISPA. For example, in relation to data protection (Module 8), termination (Module 7), and employment/TUPE issues (Module 5).

2.6.2 A key issue will be compliance with Service Levels and the risk of being penalised by Service Credits. Please see comments in paragraph 2.4.5 above.

2.6.3 As is common in commercial contracts of this kind, there is reference to your potential maximum liability. Clause 7.1(b) is not yet completed, but states that either party can be liable to the greater of a fixed amount (not yet specified) or the total amounts paid or payable to you under the ISPA. Clearly, it will be important that you ensure an amount is inserted that you are comfortable with. The amount set will link to the insurance levels you will need to cover the Services. Clause 11 imposes a requirement on you to take out insurance. There is no specific limit of cover specified, but you are required to maintain a level of insurance that would be held by a reasonably prudent supplier of Services similar to the Services under the ISPA, in accordance with Good Industry Practice or as may be required by law. This is very broad, generic wording. As such, it could be difficult for the Contractor to say that your chosen level of insurance was inadequate. From a business planning perspective, you need to make sure you have all insurance that is legally required, such as employer's liability and that you also cover risks specific to your business, which might include professional indemnity insurance. A related issue is business continuity. You will need to comply with clause 8.3 and the obligations to be included in Schedule 8 (not yet completed). You may want to investigate the availability and cost of business continuity/interruption insurance. This can cover things like the cost of renting alternative premises if it was not possible to use your own property for a period of time. Please review this and other possible types of insurance with your insurance advisers.

2.6.4 Additionally, you may want to inform the Contractor of the insurance levels you are going to be covered by to ensure that the Contractor is aware and cannot at a later date attempt to assert that they are inadequate.

2.6.5 Clause 7.1 says that nothing in the ISPA excludes or limited any party's liability in relation to certain activities. These include fraud, death or personal injury caused by negligence and issues covered by clause 18 in relation to issues such as record keeping and data protection. Some of these categories reflect the position under general law. For example, it is not possible in a contract to limit liability for death or personal injury caused by one's own negligence.

2.6.6 Clause 1.1 sets out your key obligations to deliver the Services. Clause 1.2 requires you to meet the Service Levels and refers to the consequences if you do not do so. Please note, under clause 1.3 that if you fail to provide Services in accordance with the Service Levels – i.e. there is no "margin of error" – the Charges payable to you will automatically be reduced by the Service Credit determined in accordance with Schedule 5.

2.6.7 As mentioned above, Schedule 5 has not yet been completed. Please note that under clause 1.3(b) the amount of any Service Credits payable by you needs to be included in invoices. Clause 1.3 (c) says that the parties agree that Service Credits are a genuine pre-estimate of the minimum level of loss or damage that the Contractor is likely to suffer as a result of your failure to provide Services in accordance with clause 1.1 (a). This wording is included to try to prevent an argument that the Service Credits are invalid as a "penalty" under contract law. It is fairly common to include this sort of language in contracts, although only the courts can ultimately decide whether or not something is a "penalty". This wording in the ISPA would be relevant as part of the evidence if this was ever tested.

2.6.8 If you have concerns that the Service Credits are unreasonably severe, you should seek to renegotiate them before agreeing a clause such as at Clause 1.3 (c). Clause 1. 3(c) also emphasises that even if Service Credits are imposed, this does not limit the Contractor's other rights and remedies, so, for example, if your failure to reach Service Levels gave the Contractor certain rights to terminate the agreement, the Contractor would still have those rights. Please refer to Module 7 in relation to termination.

2.6.9 Please note also that the Contractor is entitled under clause 1.4 to give you not less than 3 months' prior notice at any time of changes to the Service Levels or applicable Service Credits, or the introduction of new Service Levels or Service Credits. Although the changes must reflect changes in the Contractor's Services Agreement (the agreement with the MoJ), there is potentially very wide flexibility for the Contactor to make changes. For example, there is no reference to the extent of any possible change, whether by percentage or proportion compared to the prior level of Service Credits or Service Levels. Nor are there any parameters as to any new Service Levels or Service Credits which may be introduced.

2.6.10 Clause 1.4 is drafted on the basis that these are changes that the Contractor can simply impose by giving the requisite period of notice, not allowing for a process of discussion or negotiation. The only limitations are that the principal purpose of a change to the Service Levels or Service Credits should be to reflect changes made to the Service Levels or Service Credits in the Services Agreement (the agreement between the Contractor and the MoJ). Although, those changes, if any, may potentially be draconian and each change will be made in accordance with the Change Protocol. The Change Protocol will be included at Schedule 7 although no information has yet been included in Schedule 7, so there is no guidance yet on how consensual a process that might be.

2.6.11 In an extreme case, if you felt any of these changes were unacceptable or unworkable, you may want to consider whether this would have a bearing on your decision to give notice of voluntary termination. The earliest you would currently be able to do this is at 2. 5 years into the ISPA, to end on the 3 year anniversary. Please see Module 7 for more on the implications of the termination provisions.

2.6.12 As a first stage, you will need to evaluate the Service Levels and Service Credits as initially set out in your ISPA and assess whether they are likely to give rise to significant problems in terms of whether you expect to be able to meet the Service Levels comfortably at all times or whether you feel there may sometimes be difficulties meeting the Service Levels and, if so, how you would deal with reduced payments and the need to put in additional resources to re-perform Services. If changes in relation to Service Credits or Service Levels meant you incurred costs, under clause 1.4 you may be able to be compensated for those costs.

2.6.13 Please note that you are required under clause 6.4 of the ISPA to confirm that you have fully considered and assessed the allocation of risk to your organisation under the ISPA and your ability to control that risk, and that you have not been allocated a disproportionate amount of risk in view of the nature of the Services and the charges that will be paid to you. Again, this is part of an approach in the ISPA of seeking to create an impression that the ISPA represents a reasonable sharing of risk and that risks do not fall disproportionately on you. If you feel this is inaccurate, you should seek to renegotiate this and other clauses.

2.7 Key actions points

2.7.1 No commercial activity is without risk. Risk mitigation is all about proper investigation and planning. What exactly you need to do by way of due diligence and risk assessment will depend on a number of factors including your organisation's experience of this sort of contract, the value of the contract in the context of your current income, whether you have existing skills to carry out this contract or would need to access additional skills / personnel and a number of other factors.

2.7.2 Key actions to be taken in relation to this module are:

- Check your legal structure and power to enter into the ISPA.
- Ensure that you will be able to provide the Services as specified in Schedule 4 to the Service Levels specified in Schedule 5.
- Ensure that you agree the charges to be included at Schedule 6 and that the charges will cover your full cost of providing the service. Details also need to be added of when you will invoice for charges and the extent, if any, to which you will be able to adjust the charges based on inflation or any other specified factor which increases your cost of providing the service.
- Complete Schedule 2 (ISPA Questionnaire) before entering into the ISPA.
- Carry out a detailed risk assessment to ensure that your board understands the level of risk the organisation is taking on and that this level of risk is appropriate for your organisation.
- Review with your insurance advisors the appropriate level of insurance you should take out.

2.8 Resources

- Chapter 22, *Risk and Liability,* Russell-Cooke Voluntary Sector Legal Handbook
- Chapter 23, *Insurance*, Russell-Cooke Voluntary Sector Legal Handbook
- *Charities and Risk Management* (CC26), Charity Commission www.charitycommission.gov.uk/publications/cc26.aspx
- *Risk Management Made Simple* Sayer Vincent www.sayervincent.co.uk/Asp/uploadedFiles/File/Publications/MadeSimpleGuides/RiskManagementMadeSimple.pdf

- *VAT Made Simple,* Sayer Vincent, www.sayervincent.co.uk/Asp/uploadedFiles/File/Publications/MadeSimpleGuides/VAT_made_simple_2012.pdf

Module 3

Governance implications and legal structures

Index

3.1 Introduction

3.1.1 Taking on a substantial contract means ensuring that the governance and legal structure of your organisation is fit for purpose. It is likely that the ISPA will bring with it greater risks and potential liabilities than previous grant funding and these risks have implications across a range of areas.

3.1.2 Governance is also used in another sense in the ISPA and Explanatory Guide to mean the system of planning, reporting, review and meeting referred to in Clause 2 and Schedule 9. See Paragraph 3.15 of this module.

3.2 Conflicts of interest

3.2.1 Prior to the consideration of proposals in connection with a contract, the board members must carefully consider whether the contract or any of the parties to the contract, or any other matter creates or might be perceived as creating a conflict of interest, either because of the interests of the trustee or board member or because of persons to whom that trustee or board member is connected. In the Community and Charitable Sector it is sensible to treat a very wide range of people as being connected to and therefore sharing the same interests as a trustee or board member and particularly anyone who shares what is often referred to as a “common purse”. Typically this would include children, step-children, spouses, partners, business partners, close relatives and clients of the trustee’s business.

3.2.2 In addition to conflicts of interest, which mainly refers to conflicts that arise out of transactions between the person and the organisation, there also needs to be careful consideration of whether any conflicts of duty arise. Boards of organisations are frequently made up of people who have many interests in the field, and these other roles or interests may give rise to conflicts of duty between the duties they owe in those other roles and those that they owe on the board. Typically examples would be board members who are also board members of other organisations operating in the field and perhaps competitors for this contract, board members who were employed by, or were councillors in any public authority involved, or board members involved in campaigning or representative bodies with an interest in the field. Again declarations of interest should cover not only the board member's direct personal conflicts of duty but those of people close to him or her in any way. The normal duty to manage conflicts of duty is reinforced by the contractual requirement in clause 20.3 of the ISPA.

3.3 Objects

3.3.1 Organisations that are charities have to ensure that only activities which are wholly and exclusively within the strict written definition of their objects as set out in their constitution are undertaken. Please see Module 2, paragraph 2.3 for more information.

3.3.2 Acting outside any restrictions in these objects will be ultra vires and could make the trustees personally liable to reimburse monies expended outside the strict objects. Examples of where organisations may face difficulties can arise from a geographical limitation of the area of benefit of the charity. Even if this allows work in adjoining boroughs or counties, it still doesn't allow work in counties which are quite near but not actually adjoining. Other restrictions which can create difficulties are limitations to particular age groups, a particular gender or sexual preference or race.

3.3.3 The contract you are offered may require you to offer a broader service than you have undertaken previously. You must be absolutely sure that you can do so within the objects.

3.3.4 If you cannot, it is quite likely that an application to the Charity Commission would result in consent being given to a broadening of those objects, but this can take time and would almost certainly need legal advice. Steps need to be taken urgently.

3.3.5 Community organisations, not for profits and mutuals which are not charities may be less restricted in the scope of their objects. However, that is not necessarily the case and objects need to be carefully considered to see whether any part of the contract transgresses the limitation. It is not enough to say that most of it falls within our objects. If you have limited objects, everything must fall within those objects.

3.3.6 If you don't have the authority within your objects to carry out the contract, ythe alternative is to create a trading subsidiary or community enterprise which is wholly owned by you through which you can undertake the contract. See paragraph 3.8 below.

3.4 Mission and values

3.4.1 Your mission and values are not enshrined in legal requirements. However, in the search for funding and for the preservation of the organisation and the jobs of staff within it, some organisations can find that they have been lured into providing a service which is at odds with their fundamental values. Technically it is the job of the board to safeguard those values. However, everyone concerned needs to be

completely comfortable that the nature of the service provided is not at odds with your values.

3.5 Conflicts with stakeholders

3.5.1 Most charitable and not for profit organisations depend for their success on a reputation which they have worked over many years to establish and on a network of relationships with key stakeholders based on trust and a clear picture of what the organisation is about. Falling out with those key stakeholders may have important long term consequences for the organisation. You need to consider to what degree they need to be consulted and involved in a contract which is in any way at odds with your normal method of operation.

3.6 Campaigning and advocacy

3.6.1 If your organisation has a strong commitment to campaigning, you are going to need to look very carefully at the implications of the confidentiality provisions in the contract and consider whether these provisions are going to constrain you in any way. See Module 8, paragraph 8.4 for commentary on confidentiality. Beyond the legal restrictions that will be imposed by the contract, you need to be realistic about the implicit pressures you will be in not to disturb relationships with your Tier 1 contractor or NOMs that arise from being in a contractual relationship where you receive significant sums of money from them. Are the board and key stakeholders comfortable about entering into this relationship and realistic about its impact on future behaviours?

3.7 Powers

3.7.1 A modern constitution in a form typically of a company limited by guarantee or a CIO (Charitable Incorporated Organisation) should have very broad powers and there should be no problem in undertaking this sort of activity. However, if you haven't reviewed your constitution in the last four or five years, you may need to get some advice on ensuring that you have adequate powers to undertake the work you are about to do.

3.8 Using a subsidiary

3.8.1 One of the issues to consider when taking on a contract, particularly one that is large or perceived as risky, is whether it would be sensible to ring-fence that risk through taking the contract on through a subsidiary.

3.8.2 As mentioned in paragraph 3.3.6 above, an organisation with objects which are more restricted than the objectives of a contract may need to use a subsidiary in order to escape the restrictions of its objects. Typically a charity will set up a commercial company limited by shares which is a wholly owned subsidiary to undertake work outside its objects. While this section looks mainly at the issues that arise if you want to use a trading subsidiary, it should be remembered that on occasions charities set up charitable subsidiaries with wider or different objects from their own and create what is effectively a group structure. Despite the additional complexity of setting up a charitable company, there are some advantages in that the subsidiary will share the same tax, regulatory, business rate and governance regime as its parent charity. Insofar as there is an overlap in the objectives, transfers, income or capital to the charity, it may be easier.

3.8.3 Setting up a company limited by shares is very simple and should be relatively low cost. However, the creation of a company is only the first step.

3.8.4 You will need to provide it with a board of directors. Some of those board members should not be on the board of your charity and vice versa, so that the conflicts of interest that arise between a charity and its subsidiary can be properly managed.

3.8.5 Because the trading subsidiary is a commercial company, an arms length relationship needs to be established. This will involve:

- Creating a cost recovery agreement where the subsidiary uses, as it almost inevitably does, assets, premises staff time or services from the parent charity;
- Controlling any use of intellectual property, particularly brand or trade mark;
- A clear business plan and monitoring arrangements and the achievement of that plan;
- Clarity about employment status of staff providing services both to the charity and the trading subsidiary or exclusively to one or the other;
- A decision will need to be made about VAT status and in particular whether to VAT group the subsidiary with the parent charity. That grouping means that inter-group transfers, for example by way of the parent charity making its staff available to the subsidiary, and charges, will not be VAT chargeable. However, that grouping can only be done between two corporate entities, and since the VAT grouping exposes the parent charity to the VAT debts of the subsidiary, the board needs to consider whether it is prudent for it to do so. If it does not do this, the Charity Commission will take the view that the board has not properly managed the risk arising from VAT grouping;
- Considering whether the trading subsidiary will require working capital and how this is to be provided. It may be that a simple loan document is appropriate. However, for larger sums, the question and particularly where permanent capital is required, it may be more prudent to provide the capital by means of an equity investment. The charity needs to obtain commercial rates of return on this investment in what is, after all, a relatively insecure high risk investment and should take advice on what those levels of return should be. The loan or capital should be properly documented and where the subsidiary has or is likely to have any assets, consideration should be given to whether these should be charged, either through a mortgage or a debenture;
- Setting up separate accounts and accounting processes;
- Checking insurance policies to ensure that they cover all the operations of the subsidiary as well as the parent; and
- If the subsidiary is to occupy premises owned or rented by the charity, a form of agreement should be put in place and market rent charged. Because the subsidiary is a connected person under the terms of the Charities Act, consent for the letting will need to be obtained from the Charity Commission.

3.8.6 Given the new status of the subsidiary, organisations dealing with it, including the prime contractor, may seek to get guarantees of its performance of obligations from the parent, voluntary organisation or charity. Considerable care should be given before agreeing to these and legal advice should be taken as to whether it is permissible.

3.9 Special purpose vehicles (SPVs)

3.9.1 SPVs are companies created specifically to deliver a project or enterprise. They may be wholly owned by one body or may be part of the mechanism by which several organisations collaborate in the delivery of the service (See Module 4).

3.9.2 Typically they will use the form of a company limited by shares and the same issues relating to a trading subsidiary are likely to arise. However, they may be a subsidiary charity, Community Interest Company or a range of other structures. In certain circumstances it may be prudent to use a limited liability partnership, particularly if some of the collaborating partners have a different tax status from other parties (See Module 5 for more information).

3.10 Implications for the board

3.10.1 Any board should consider whether its size, composition and the range of skills to be found within it continue to be appropriate for what the organisation is doing. Winning a major new contract may mean that the organisation steps into a higher level of complexity or risk, or needs new areas of skill. A board should carefully consider this when deciding to authorise bidding for a contract of this sort.

3.11 Board authorisation

3.11.1 The board needs to consider, right at the beginning of the process of bidding for any contract, how it is going to handle the consideration and approval of a process that may not fit within its normal timescales. Is it prepared to formally delegate to staff or staff and officers or will some special working group be set up to monitor and finally approve the process? Will these groups be entitled to sign off or will recommendations have to come back to the full board for approval? What is important here is real clarity as to the authorisation process.

3.11.2 If a board is going to delegate, it needs to indicate very clearly to those it delegates to, what its key concerns are and whether there are any deal-breaker points. Among the key risks that they may wish to give rulings on are a range of financial issues including:

- the minimum return or margin that they will tolerate;
- the degree to which they will allow funding from other sources to be applied to delivering the contract; and
- the extent to which reserves may be used either permanently or temporarily to meet holes in the cash flow created by delayed payments.

3.11.3 A board should in effect be asking its staff or a group of trustees, perhaps with professional help, to undertake a due diligence exercise so that all the risks arising from the contracts can be considered against prospective benefits.

3.11.4 Trustees may need to commission reports on issues, for example, the insurance costs arising from the new contract and how they are likely to move during the course of the contract period.

3.12 Delegation and staff

3.12.1 Responsibility of the organisation lies with the board. However, clearly in most cases substantial delegation to staff is a pre-requisite of delivering the contract. With luck the organisation already has in place clear guidance as to what is delegated to staff

and what must be approved by officers or sub-committees or the full board. However, entering into this contract may mean that these delegations need to be reviewed and updated to take account of the requirements of the contract.

3.13 Reporting

3.13.1 In approving any project, a board member should always consider what sort of reporting is appropriate. Organisations often use differing methods, including traffic light and similar systems, but it is important to establish from the outset a timetable of reporting and what will be required at each stage.

3.14 Trustee liability

3.14.1 If an organisation taking on a contract is properly constituted as a limited liability body, i.e. typically a company limited by shares or by guarantee, a charitable incorporated organisation, a community interest company, a limited liability partnership (LLP) or a community benefit society (formerly an industrial and provident society) registered with the Financial Conduct Authority, then in most circumstances liability for claims arising out of the contract should rest with the incorporated body and not put board members' assets at risk. The situation for Royal Charter Bodies is not entirely clear.

3.15 Contractual governance

3.15.1 Clause 2 of the ISPA contains a series of obligations and procedures for managing the delivery of the service. Ensuring close liaisons with the Tier 1 organisation is going to be very important. For example, if the MoJ is considering making proposals to change the service that you provide, you are certainly going to want to make representations under clause 2.6 to ensure that you can be at the Services Agreement Meetings in order to point out the implications of any service changes being proposed. Ideally this clause should be amended to ensure that the contractor notifies you in advance if any of the service agreement meetings are going to deal with any element relating to delivery of your service and give you a right to attend or receive full reports of what occurred. You should also be seeking to get a right to submit papers and to get copies of documentation that relate to your services.

3.15.2 Try and get early stage agreements about the structure of documents like the service report (see clause 2.2(d) ISPA), and continuous improvement report (see clause 2.3(b) ISPA), and seek to keep the work level generated by them to a reasonable minimum. It may be that you can agree their format at the time of negotiating the contract included in Schedule 9.

3.16 Key action points

- Review Code of Conduct for staff, trustees and volunteers to ensure that conflicts of interest are properly declared and that there is an appropriate process for recording staff and trustees in a register of interest.

- Review objects and ensure that all activities under the contract properly fall within those objects.

- Prepare assessment of any risks to mission, values or relationships with stakeholders.

- Consider whether you might wish to use a trading subsidiary or special purpose vehicle for delivery of the contract.

- Agree at board level the document authorisation process and key steps from the bidding process and subsequent monitoring arrangements.

- Consider what changes, if any, to your record keeping and IT systems will be required to meet the reporting requirements in the ISPA.

- Seek to include in the ISPAa requirement for the Contractor to notify you in advance of Service Agreement meetings about your services, and the right to submit papers, to attend, or to receive full reports of what occurred.

3.17 Resources

- Chapter 3, *Incorporated Organisations*, *charity law and regulation* Russell-Cooke Voluntary Sector Legal Handbook.

- Chapter 15, *Duties and Powers of the Governing Body,* Russell-Cooke Voluntary Sector Legal Handbook.

- *Conflicts of Interests in Charities,* Charity Commission- http://www.charitycommission.gov.uk/detailed-guidance/trustees-staff-and-volunteers/conflicts-of-interest-in-charities/

Module 4

Collaborative working, group structures and mergers

Index

4.1 Introduction: spectrum of collaboration

4.1.1 The ISPA does not require a Subcontractor to collaborate or merge in order to deliver the Services. However, in order to compete for these types of contracts, organisations are likely to have to deliver a broader range of services and/or cover a wider geographical area.

4.1.2 Due to this, some organisations will find that in order to deliver the Services, they need to explore the possibility of collaborating or merging. In our experience we have found that some organisations have underestimated the expense, both in terms of cost and time, of managing and delivering a contract of this nature. Once the size and scope of the contract is established, organisations often realise that a merger with a like minded charity is needed in order to scale up its facilities and resources to be able to deliver the Services.

4.1.3 Collaboration itself takes a wide variety of forms and involves different degrees of legal risk depending on the outcomes sought and the motivations of the partners. It is essential to identify who wants to achieve what in collaboration and to understand the resources they can bring. The arrangements then need to determine how the parties will work together to deliver the outcomes and in particular consider how the arrangements will be governed and decisions reached.

4.1.4 At the simplest end of the spectrum collaboration between organisations can involve sharing information and strategies to help provide better services to beneficiaries. However even this can involve risks where information involves identifiable individuals as this becomes subject to the Data Protection Act (see Module 8 for more information).

4.1.5 Depending on, amongst other things, the nature of the activities and the expected outcomes, the number of collaborators, the risks and rewards, reputation and branding, the permanence of the arrangements and the degree of integration required to deliver the relevant outputs, a wide variety of issues will need to be addressed and we cannot hope to cover all of them in this document. Decisions as to

the appropriate structures to use from a legal perspective are driven by a desire to manage and allocate risk between partners.

4.1.6 Lawyers use various legal structures which are usually contracts and/or limited liability vehicles to ensure clear allocation of responsibility amongst the partnering organisations. Where one organisation is providing services to another, it is often sufficient to put in place a contract much as in the current context of the ISPA. However in other circumstances organisations may want to create a "consortium" or a "joint venture" vehicle to lead the project delivery independent of the individual organisations. These "special purpose" vehicles usually have the benefit of isolating risk within them. In some circumstances collaboration can take the form of, or lead to, a merger.

4.2 Activities to be undertaken - Objects and Powers

4.2.1 In order to collaborate charities will have to ensure the activities being undertaken seek to achieve its legal objects. This is because a charity can only carry on activities within its charitable objects. Where the objects are not compatible with the provision of services this may constitute "non-primary purpose trading" in respect of which it must charge the full cost of any service. It may need to use a trading subsidiary. (See Module 3 for more information).

4.2.2 A charity will need to ensure it has powers to enter into the collaborative arrangement.

4.2.3 Other types of organisation, which are not registered charities, may have a power implied by the Companies Act to undertake any trade. However other regulations may also apply if the organisation is, for example, registered as a Community Interest Company.

4.3 Due diligence

4.3.1 Most organisations will want to understand the viability of their partner from a financial and operational perspective.

4.3.2 If successful any tender for services will result in the award of a contract which will impose obligations, and potentially, liabilities, on the contracting organisation. A clear understanding of these potential liabilities will be essential.

4.3.3 If by way of example there are existing services being retendered TUPE may apply with the effect that an organised group of employees engaged "wholly of mainly" in delivering the tendered services may transfer to the new service provider with their existing terms and conditions of employment (and potentially obligations to provide equivalent pension arrangements). These issues are touched on in Module 5.

4.3.4 There may also be a requirement to deliver services from particular premises and the contract may require you to enter into a lease of the premises. You will need to understand if the premises are fit for purpose and what obligations are imposed on you under the lease, for example to maintain in good condition.

4.3.5 Other factors will need to be considered depending on the partner, the activities, the legal structure and the contract.

4.4 Legal structures

4.4.1 Binding contractual arrangements

4.4.1.1 Legal contracts are used to apportion responsibility, and hence risk, amongst the contracting parties. A contract awarded under a tendering process is generally awarded to a lead, or accountable, body. That body then subcontracts all or some of the obligations to its collaborating partners to deliver the relevant parts of the services. However the lead body remains primarily liable for the entirety of the contracted services.

4.4.1.2 Where small organisations are involved the lead body will need to consider the implications of a smaller organisation failing to deliver especially where the smaller organisation has received all or part of the payment in advance for cash-flow reasons. This may include getting an alternative provider involved. Where the collaborators are both strong sophisticated organisations this might be less of a concern. However the failings of a subcontractor can still cause significant reputational issues.

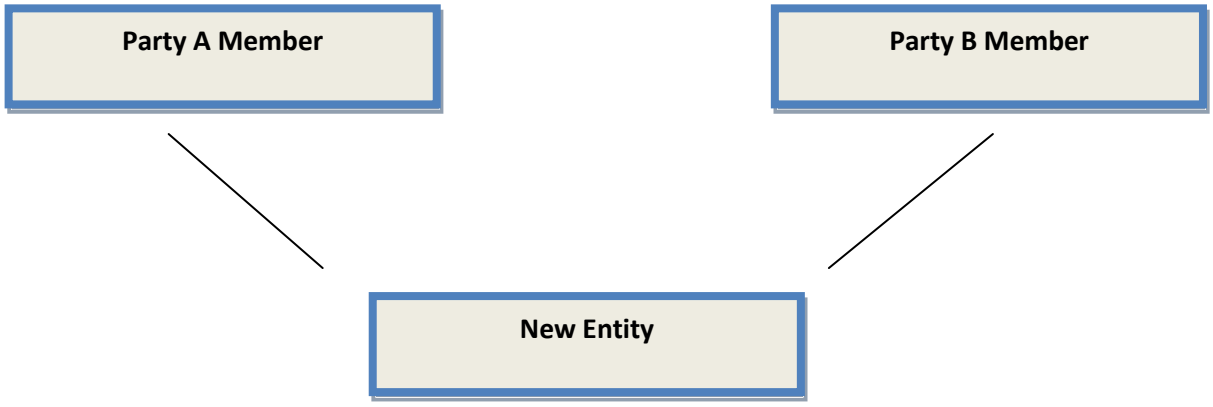
4.4.1.3 Although there are risks in contracts, and that they can sometimes be difficult or complex to enforce, they are generally the simplest approach to collaboration. A well drafted contract can specify what each party to it will be responsible for, can specify processes for making decisions and dealing with disputes and can allocate liability if things go wrong. They can also allow a flexible approach, for example by providing a high level framework within which to work, but specifying each party's responsibilities on a contract by contract basis.

4.4.2 New Entity or Special Purpose Vehicles

4.4.2.1 Often partners collaborating together do so through a new legal entity. These are sometimes referred to as joint ventures or special purpose vehicles or SPVs.

4.4.2.2 Some organisations work together through a new unincorporated organisation such as an association. These work by agreeing a new constitution or governance arrangement in relation to the collaboration but are usually unincorporated and are effectively just a contract between the members. They may have a steering group or management board which, in the absence of any other legal personality, enters into contracts on behalf of the association. Unless a new legal entity is created which has its own legal standing, the contracts are entered into by the management committee (which may be the collaborators themselves or designated employees) which can lead to direct obligations on the collaborators.

4.4.2.3 In order to insulate the collaborators from direct liability we usually recommend establishing a new legal entity with limited liability. This is usually a private limited company which might be limited by shares or limited by guarantee. Where a charity collaborates with a non charity and expects to receive a profit share there may be good reason to consider the use of a Limited Liability Partnership



4.4.2.4 Limited liability means the members or shareholders are only liable for a specified amount – usually a nominal £1. Directors of the new company have statutory duties to comply with under the Companies Act but do not enter into contracts themselves. It is the company that assumes the obligations and liabilities. As such the collaborating partners can insulate themselves from direct obligations incurred by the new entity.

4.4.3 There are other types of legal entity that can be used including:

4.4.3.1 A Community Benefit Society (also called an Industrial and Provident Society) – its drawbacks are the cost of establishment, their regulator is the Financial Conduct Authority, they are relative rare and the law surrounding them is old, leading to a less clear legal structure;

4.4.3.2 Company limited by shares. This cannot be a charity but does offer an additional benefit of equity financing;

4.4.3.3 A Community Interest Company – the same as a company but with a statutory asset lock and additional regulatory requirements. This cannot be a charity and any returns on equity investments are capped;

4.4.3.4 A Limited Liability Partnership – usually used for professional partnerships (such as accountants and lawyers) but can be adapted for collaborative use. This cannot be a charity;

4.4.3.5 A Charitable Incorporated Organisation (CIO) – a new legal structure for charities regulated just by the Charity Commission. The law and practice is untried and untested.

4.4.4 Where a new entity is established so that organisations can collaborate, there is usually a separate agreement put in place between the collaborating organisations specifying:

- how new members are admitted,
- the number of directors each organisation can appoint,
- whether any decisions are to be agreed by enhanced majority voting or whether members have veto's over certain decisions,

- the nature of the activities to be carried out,
- agreeing a strategy and business plan,
- the provision of information,
- exclusivity arrangements, and
- the use of surpluses.

Many of these provisions are also reflected in the articles of association.

4.4.5 The governance structure adopted will depend on a number of factors not least the number of collaborators.

4.4.6 There are a number of matters that should be borne in mind at this stage:

- If there are proposals to admit new members any governance arrangements will need to be revisited to reflect the changed balance of power (i.e. 2 members might vote against 1 on a critical issue);

- Directors have statutory duties to avoid conflicts of interest. This includes conflicts arising as a result of direct transactions with the company (such as service contracts) but also conflicts of loyalty. If one or both of the collaborators appoint their chief executive to the new organisation, that person faces a potential conflict of loyalty between his role as an employee of the collaborator but also as a director of the new entity. In certain instances this may prevent a director participating in a decision. While any technical issues can be addressed it is important potential conflicts are recognised and managed.

4.5 Operational structure

4.5.1 There are a number of ways in which any new entity can be used. This note focuses on two extremes.

4.5.2 Fully operational:

4.5.2.1 In this model the new entity is made fully operational by the member organisations breathing an independent life into the new entity. This would involve putting employees, assets, funding, contracts, premises etc into the new entity so that it operates independently of the members. The members would need to consider how they value their respective contributions. The new entity could then bid for contracts with the capacity to deliver on them without the need to resort to the resources of the member organisations albeit it may not have a trading record and this would need to be considered.

4.5.2.2 The advantage of this structure is that all risk from contract delivery is borne entirely by the new entity and the members are isolated from it.

4.5.2.3 The disadvantage is that it is likely to be more complex to establish and has a greater degree of permanence.

4.5.3 Shell structure

4.5.3.1 In this scenario the new entity is essentially empty. It bids for contracts and then subcontracts the entire contract out to third parties. These are usually the relevant members with the necessary service delivery capabilities. The members are likely to provide most of the bidding and contracting capacity or may second employees to work on the contracting process. They are also likely to underwrite any costs.

4.5.3.2 The advantage of this structure is that it is simple. Operational matters rest with the members and there is no need to establish an entirely new organisation with the complexity of employees, premises etc

4.5.3.3 The disadvantage is that if the new entity is to remain solvent it will need to pass all risk to the subcontractors while seeking to retain a small surplus. If the members are the subcontractors then they will assume the contractual risk that the new entity is, on the face of it, intended to isolate them from. There also remains the reputational risk that one member fails to deliver and the other member has to step in to make good.

4.5.3.4 There may also be an issue about VAT to be charged on the services (See Module 2 for information on potential VAT liabilities).

4.6 Charitable status

4.6.1 Charitable status obviously brings fiscal benefits. This may or may not be important depending on the activities carried on by any new entity. If the shell structure is used then it is unlikely that fiscal benefits will be significant as there will be little or no surplus (which would otherwise be subject to corporation tax), premises (rates) or donations (gift aid). If the operational structure is used the fiscal benefits could be much more significant.

4.6.2 Charitable status brings a certain brand or trust. While this is significant for the general public in their charitable giving it is not clear whether sophisticated commissioners will be swayed by the status.

4.6.3 As you will be aware charitable status brings a requirement for greater regulatory compliance. There are also restrictions on the payment of trustees. While this can be managed it adds to the complexity.

4.6.4 In contrast to a non charitable company limited by shares, which is established principally to seek to benefit its members or shareholders, charities and their trustees are meant to be independent and act independently of any outside body to seek to achieve the relevant objects. This does not prevent collaboration but the trustees of the new entity will need to be sure they do not merely act on the instructions of their members. They can of course work within a strategy agreed by the members and the new entity. Again this adds some complexity but it is manageable.

4.6.5 You would need to ensure that the objects of any new entity are sufficiently broad to enable the relevant activities to be conducted while remaining compatible with the objects of the members.

4.6.6 In practice we would assume this option is not necessary especially if the new entity can gift aid profits to charitable members as if it were a trading subsidiary

4.7 Merger

4.7.1 The drivers to merger that are not all necessarily driven entirely by shortages of government funding. Charities often want to increase geographic spread and reach of their services, expand their service provision, create a louder “voice” in campaigning, enhance employee retention, but also to increase the efficiency of service delivery, reduce overheads and generate cost savings, address concerns about the future funding uncertainty, increase brand profile and reduce the cost of fundraising. In some instances partners recognise that collaborating either via contract or a new entity creates significant work for senior management teams who have to communicate extensively and seek to reach a collaborative outcome.

4.7.2 Issues to consider at the outset:

4.7.2.1 Trustees considering a merger need to think of certain matters right at the outset. Trustees are obliged to seek to achieve the objects of the charity and make best use of charitable funds for the public benefit. They are not charged with continuing the operations of the charity regardless of their impact.

4.7.2.2 The Charity Commission encourages charities to consider whether merger might be a way achieving their objects more effectively. While merger might be considered, it is not going to be appropriate to every charity. Merging with another organisation may reduce a charity’s ability to raise funds.

4.7.2.3 Other charities however face a highly competitive environment competing for public donations or in tendering for government contracts and could be assisted by being larger and having more resources for brand development and fundraising or may be able to reduce their unit costs, and hence competitiveness, by combining back office functions.

4.7.2.4 Trustees need to be clear on where their charity stands and how a merger might improve its position. The strategic rationale must be clear.

4.7.2.5 No-one “owns” a charity. There is no “market” for charities. They are not “traded”. The first step therefore is to identify potential targets with whom a merger might be appropriate. This is not always easy. Most trustees and executives will have a working knowledge of what organisations work in similar fields and they are a natural starting point. Often such contacts are made through personal connections. However one of the difficulties is often making the connection with likeminded organisations and building a sense of trust and rapport. Many trustees, who give their time voluntarily, do not have the resource to set up an extensive search of compatible organisations.

4.7.2.6 There are numerous sensitivities in merger discussions which have the ability to derail merger proposals. In particular, there are often strong emotional ties to particular charitable organisations and their brands.

4.7.2.7 Many groups of trustees value the independence and unique characteristics of their particular charity and can often require convincing arguments to demonstrate the merger proposal is going to produce something more effective. Trustees need to be clear about where they stand in relation to their own roles and the impact that a merger may have

on other people involved in the organisation. Clearly seeking to achieve the objects in an effective manner should override any personal issues.

4.7.2.8 Members of the senior management team and other employees will be concerned that the merger, especially where it is justified on cost cutting grounds, will threaten their jobs.

4.7.2.9 Volunteers, sometimes critical in the work of a charity may be less inclined to assist a larger, less personal, organisation.

4.7.2.10 Other stakeholders, such as major donors or funders may also have a view.

4.7.2.11 It is therefore essential that future governance arrangements and executive roles are identified as early in the process as possible.

4.7.2.12 Communications between groups of trustees and, at the appropriate time, to staff and volunteers are vital to explain the process and anticipated benefits. Confidentiality of discussions in the initial stages is often important to ensure instability is not created as a result of rumours. Generally only where there is reasonable certainty that that merger will proceed should announcements be made.

4.7.3 Legal matters to consider:

4.7.3.1 Assuming a merger partner can be found and a feasibility report concludes there is merit in exploring the merger further, there are some basic matters of due diligence that must be undertaken. This is similar to a private sector merger but for the reasons set out in paragraph 4.7.6.3 the due diligence process is even more important in a charity merger.

4.7.3.2 **Objects**: The first key due diligence enquiry is to ensure that the objects of the respective organisations are compatible. A charity can only undertake activities within its charitable objects and as such if it is to merge its activities and transfer assets to another organisation, the objects must be compatible. One or both charities may need to seek to amend their objects to ensure the merger can proceed. This will require Charity Commission consent and a change to the constitution in accordance with whatever processes are set out in the constitution or by company law. For example, a general meeting of the members may be required in a company limited by guarantee. The Charity Commission will readily give consent to align objects to facilitate mergers but they cannot change objects entirely. So you cannot generally change a charity established to advance education into one that promotes health.

4.7.3.3 The parties will need to consider the structures of the existing organisations especially where they are unincorporated. Where organisations are unincorporated, consideration needs to be given to the position of individual trustees who can face personal liability in some circumstances.

4.7.3.4 The wider constitutional arrangements of both organisations will also need considering to establish whether any actions are required to effect a merger. This may lead to a decision on how the merger should be effected, for example, a general meeting may be necessary to authorise a transfer of

assets or to change the membership arrangements. Alternatively the transferring charity may be wound up (or be dissolved in accordance with its constitution) and distribute its assets to the other charity. Careful consideration of the constitutional arrangements will be required especially if one of the existing charities is to be used for the merged organisation.

4.7.4 Due Diligence

4.7.4.1 The merger parties will want to undertake a degree of due diligence on each other. Like a private sector merger this usually entails financial and legal due diligence. It can also include a "cultural audit" which tries to identify how the two organisations might fit in day to day working terms.

4.7.4.2 The usual due diligence exercise will need to be undertaken covering matters such as:

- constitutional requirements,
- property,
- employees and the potential impact of TUPE and the status of volunteers, consultants, workers and agency workers,
- contracts and funding arrangements,
- charitable trading, non-charitable trading and trading subsidiaries,
- intellectual property, trademarks and brand,
- information technology,
- health and safety and safeguarding matters,
- data protection,
- other operational matters such as banking arrangements,
- tax, VAT and gift aid
- disputes, and
- regulatory matters for Charity Commission, Companies House and others

  such as Care Quality Commission, Homes and Communities Agency etc.

4.7.4.3 **Pensions:** Of particular concern for many charities will be the pensions situation as some charities have contingent liabilities in relation to their membership of certain pension schemes. Some may be members of multi-employer defined benefit schemes (such as the Pensions Trust Growth Plan) or of other defined benefit schemes. On a merger a s75 Pensions Act cessation event may occur which, if not addressed, can trigger an obligation to make good their share of the deficit. Others may be admitted bodies under the local authority or national health service schemes.

4.7.4.4 **Permanent endowment**: Where charities have permanent endowment, which is capital given to the charity on the basis that only the income can be spent or where the asset such as a building must be used for a specific

purpose, the fund cannot be transferred as the corporate property of a charity. Special arrangements will need to be made to ensure the receiving charity is appointed as corporate trustee of the relevant permanent endowment fund. This may require a Charity Commission scheme.

4.7.4.5 **Restricted funds**: some funding may only be transferrable with the consent of the funder and may also only be applied to very specific purposes. You need to ensure the terms can be complied with.

4.7.4.6 **Standing orders and direct debits**: a charity will not want to ask its donors to provide new standing orders or direct debits in relation to regular donations as often apathy will mean they are not renewed. The bank may be prepared to novate the account to a new organisation. Alternatively the charity and account may need to be kept open to enable donations to continue and to be passed on to the merged organisation.

4.7.4.7 **Property**: s117 of the Charities Act 2011 will need to be complied with.

4.7.4.8 **OSCR**: Check whether the charity is also registered in Scotland with the Office of the Scottish Charity Regulator (OSCR) in which case consent to merge may be required.

4.7.4.9 **Sensitive personal information**: the charity may hold sensitive personal information for example medical records relating to a beneficiary with mental health issues. The Data Protection Act will need to be complied with.

4.7.5 Merger structures

4.7.5.1 Just like in the private sector, charity mergers can take a number of forms.

4.7.5.2 There are three main structures:

(a) the absorption of one charity by the other;

one charity becoming a subsidiary of the other; and

both charities joining in a group structure where the group was headed by a new charity.

4.7.5.3 Assuming the due diligence is completed there will need to be an agreement implementing the merger. The choice of structure will often depend on the results of the due diligence for example because one charity has a property that cannot be freely assigned. There is often considerable sensitivity about the structure and how it is presented. Charity trustees and employees are often sensitive to the concept of a “takeover” as somehow this implies a failing on their part to develop the organisation. Usually mergers are presented and a combining of equals even if one is in fact in need of rescue.

4.7.6 Business transfer - see 4.7.8 below:

4.7.6.1 Assuming a business transfer, then a deed of transfer (by whatever name called) will be required. The transfer is usually structured as a gift of assets from one organisation to another in pursuance of the charitable objects.

The transferring charity should ensure it has power to make such a transfer.

4.7.6.2 Trustees of the transferring charity could not give away all of their assets and retain any liabilities as this would render the organisation insolvent and would put the trustees in breach of their duties. So while no price is paid, consideration is given in the form of an indemnity in respect of the transferring charity's current and future liabilities.

4.7.6.3 **Apportionment of risk and liability:** The terms of the deed of transfer can be contentious if expectations are not managed at the outset.

- Often the recipient charity will look to the transferring charity to provide some warranties about the business being transferred, usually focussing on the adequacy of information that has been supplied.

- This can cause some concern amongst trustees about exposing the charity to potential claim for breach of warranty and hence liability. There is always concern that this will involve them personally facing liability. In most cases they are unpaid volunteers and are in a non-executive rather than executive role. They do not own the charity and are not selling it and receiving any form of benefit and do not want to risk any personal liability. In practice the risk of a claim is remote but it needs careful explanation.

- While in a corporate charity it would be the charity itself that gave any warranties, where a charity is established as a trust or an unincorporated association, it is the trustees that themselves face potential liability for the charity's activities as the charity does not have a separate legal personality. It would be the trustees that would give the warranties in the context of a merger. Even in a corporate situation concerns about potential claims for misrepresentation exist.

- After the transfer of assets, any claims under the warranties given by a corporate charity would essentially be made against a shell company; one does therefore question the value of any warranties were they to be given. One also has to ask what "loss" the recipient charity would have suffered given the transfer is made as a gift.

- However, an argument is often made that the giving of warranties requires the trustees to ask themselves the question about whether all relevant information has been appropriately disclosed.

- The counter proposition is that if a warranty claim were made, the transferring charity would become insolvent and this causes issues and concerns for the trustees. Were the transferring charity to be put into liquidation it might be possible for a liquidator to seek to unwind the transaction as a transfer at an undervalue. This is seldom, if ever, tested.

- Because generally there are no meaningful warranties that can be given, a recipient charity will need to rely on due diligence as effectively the recipient charity will have limited post merger remedies.

- From the perspective of the trustees of the transferring charity they will want to ensure no liabilities are retained (including potentially personal liability in an unincorporated situation) and ensure that they can wind up or strike off the remaining charity shell. They will therefore look for a full indemnity in respect of all liabilities from the recipient charity.

- However often the recipient charity looks to manage risk by capping the level of liability it assumes. Sometimes this is to the level of the net assets transferred or to some identified figure. This has the benefit of creating a firewall in the event some large unknown liability arises but it also potentially exposes the transferring charity (and its trustees if unincorporated) to risk. It is in the interests of both charities to ensure that charitable assets are preserved to be applied towards their charitable objects and therefore a limit on the indemnity should always be considered albeit it may not be acceptable.

4.7.7 Change in membership - see 4.7.9 and 4.7.10 below:

4.7.7.1 Where the merger is to be effected by means of a change in membership it will be essential to consider the structure of the existing organisations. In practice change of membership only really works in the context of an incorporated organisation.

4.7.7.2 Where one charity (A) wishes to take control of another charity (B) then this can be effected in two ways:

(a) Charity A is admitted into membership of charity B and the then current members of charity B resign. This only works where there are a limited number of members and their resignations can be ensured.

Alternatively charity B passes a resolution in accordance with its constitution amending its membership provisions to state that charity A is the sole member.

4.7.7.3 Generally speaking this is a much simpler approach to a merger as all contractual obligations remain in place within what becomes the subsidiary charity. So there is no need to transfer properties or contracts. TUPE will not apply in this scenario. There are sometimes concerns about whether the full benefits of integration can occur running two separate organisations in this way.

4.7.7.4 It is also common for a change in membership to occur, followed by a transfer of the business and assets as set out in paragraph 4.7.6. This is similar to an intra-group reorganisation and generally simpler that negotiating warranties and indemnities as mentioned in paragraph 4.7.6.3.

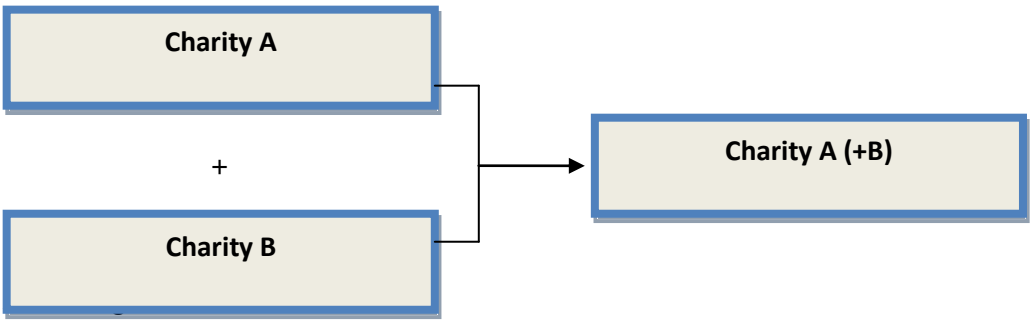
4.7.7.5 There are often ancillary agreements put in place for example dealing with future governance arrangements where charity B trustees are to be appointed to charity A.

4.7.8 One charity (Charity A) absorbs the other (Charity B)

4.7.8.1 In this structure, one of the charities (Charity B) transfers to Charity A all of its activities including assets, funding arrangements, cash, database etc. Usually this can only occur if the liabilities are also transferred. This is

effected by transferring contracts and staff from Charity B to Charity A and Charity A agreeing to "indemnify" Charity B against any other liabilities it may have. Following the transfer, Charity B is wound up (or for technical reasons retained as a dormant subsidiary). This results in one charity undertaking all the activities and functions of the two former charities.

4.7.8.2



- The advantages of this approach are the simplicity of the end structure. The existing corporate structure of one of the partners is used as the legal vehicle for the continuing operations. This reduces some of the costs of the transaction, however see disadvantages.

- The continuing charity has one single board of trustees resulting in clearer governance arrangement and reporting lines. The board may consist of trustee of both pre-existing organisations.

- A single brand may be used.

4.7.8.3 Disadvantages

- This form of model can be unattractive to the trustees of the transferring charity sometimes implying or giving the impression that there is a "takeover" of a potentially failing charity. While this is often not the case, many trustees feel strongly that the arrangements should clearly be presented as a merger of equals and this includes the legal structure that is adopted.

- Because a transfer such as this involves a transfer of the assets and more importantly, liabilities, both organisations, but particularly Charity A, will be keen to ensure they understand the full implications of taking over Charity B's operations and liabilities. This generally requires a significant amount of investigative work in particular legal and financial.

- There is also a need to liaise with all relevant third parties, including funders with whom the transferring charity has grants, other parties to certain contracts, landlords etc to ensure that all arrangements are properly transferred.

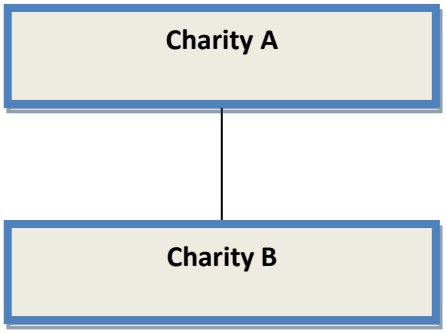
- A transfer of the entire undertaking will involve a TUPE transfer, whereby all staff transfer from Charity B to Charity A. As such, the application of the TUPE regulations will mean that the staff transfer with their terms and conditions intact and cannot easily be changed. Therefore making the terms of employment similar or the same is

more problematic. The transferring staff also transfer with any liability attached to them, for example claims, under the terms of the TUPE regulations.

- Both sets of trustees will want to be confident that the due diligence has been effective enough to reveal all material risks that can be reasonably discovered since the risks associated with either organisation will impact on the merged body.

4.7.9 <u>One charity (Charity B) becomes a subsidiary of the other (Charity A)</u>

4.7.9.1 In this structure one charity (Charity B) becomes the wholly owned subsidiary of the other, Charity A. Like all companies, corporate charities have members, akin to shareholders, who have the right to appoint and remove trustees and amend the constitution of the charity. Subsidiary status means that Charity B becomes controlled by Charity A. This is accomplished by all the members of the Charity B resigning and Charity A becoming the sole member of Charity B.



4.7.9.2 Advantages

- This is a straightforward and inexpensive method of achieving a merger.

- Charity A, as the member, is "insulated" from any potential problems in Charity B by Charity B's limited liability status. As such both boards may be content to undertake much more limited investigative work which reduces costs and means a merger can be put into effect more quickly (assuming the existing members vote in favour of merger).

- The subsidiary status means there is no need for any immediate transfer of staff and therefore the work associated with TUPE does not apply.

- There is no need to transfer assets, contracts or other arrangements and therefore the complexities of arranging transfers of contracts etc are avoided.

- If a VAT group is created it is possible to supply services between the two organisations without VAT leakage

- The separate brands of the two charities can be maintained if appropriate.

4.7.9.3 Disadvantages

- The key disadvantage is that this is often viewed as inappropriate by some boards of trustees given Charity B would be controlled (albeit within certain parameters) by Charity A and this can be perceived as a takeover.

- While a group is formed by this method Charity B needs to retain an independent Board (albeit appointed by Charity A) and this can means creating a unified strategy can be more difficult.

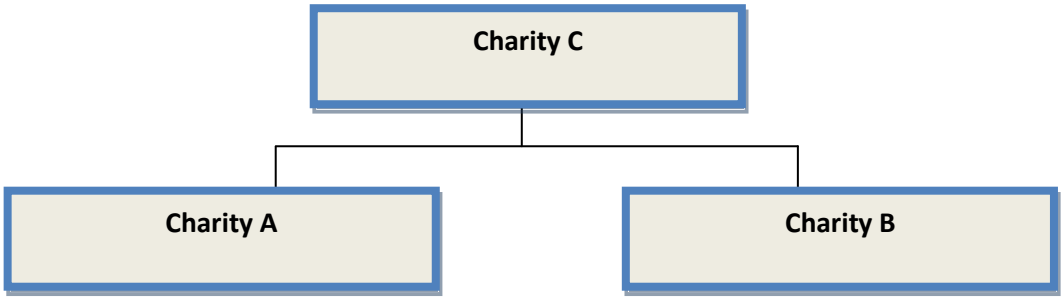
- It is generally perceived as being more difficult to generate cost savings while still in a group structure.

- Accounts will have to be consolidated.

4.7.9.4 A further variation is that both Charity A and Charity B transfer all their assets and liabilities to a new Charity C leaving a single new organisation in existing and conducting the activities of both Charity A and Charity B. This has the disadvantage of creating a new company, registering it as a charity, undertaking two sets of due diligence and transfers and the attendant costs. However its advantage is that it avoids the perception of a takeover and can enable complete integration.

4.7.10 <u>Group structure with new Holding Company</u>

4.7.10.1 In this model, both charities agree to the establishment of a new charitable company (Charity C) which will act as the parent or holding company for both charities. The board for the holding company will be made up typically with representatives from the boards or representatives of the boards from the existing charities. This structure has many of the features of the group structure arrangements referred to above.



4.7.10.2 Advantages

- This creates a structure in which the management team and core central services can be established within Charity C providing services to both subsidiaries Charity A and Charity B.

- Both Charity A and Charity B can retain their service delivery functions and therefore contractual and other relationships with third parties do not have to be re-agreed or transferred.

- Other than any senior, or core service staff transferring to Charity C, TUPE does not affect staff of either Charity A or Charity B and any adjustments to terms and conditions that need to be made can be made without the constraints of TUPE regulations albeit subject to other employment law issues.

- Both charities are clearly equal partners in the new structure.

- The structure is flexible and can be used to absorb other charities if the opportunities arise.

- The structure allows further developments and adjustments to take place over a period of time giving management a chance to balance restructuring with the need to continue to develop the work of both Charity A and Charity B.

4.7.10.3 Disadvantages

- This structure involves the creation of a new charitable company, however that is not unduly complex and can occur relatively swiftly.

- The group will then consist of three companies (plus any existing subsidiaries of Charity A and Charity B) and there will be a need to comply with the regulatory filings etc of an additional company.

- There will need to be a transfer of some contracts and other arrangements which relate to the core services being transferred.

- The boards of Charity A and Charity B need to continue to meet as mentioned in the previous example. However, subject to being able to manage conflicts of interest, it is possible for those boards, or the majority of those boards, to be made up of the board of the holding company.

- The group structure may appear less like a unitary organisation although how it appears is very much governed by the marketing and branding strategy adopted by the group.

4.7.11 Post merger matters

4.7.11.1 Following a merger, it is common for the transferring charity to be dissolved and for the merger to be registered on the Charity Commission's register of mergers.

4.7.11.2 The register of mergers was introduced under the Charities Act 2006 with the intent of ensuring that any gifts made to the transferring charity found their way to any new successor charity. However, in certain circumstances legacies may be worded such that the register of mergers does not have that effect. It therefore remains common for the transferring charity to be retained as a "shell" for a period of time, such that if it receives a legacy it can transfer that to the successor organisation.

4.8 Key action points

- Carry out a due diligence exercise as early as possible in order to identify any key risks that might affect a collaborative arrangement or merger.

- Check that your organisation's objects and powers allow you to enter into a merger or collaboration with the other organisations involved.

- Carefully consider what structure or vehicle is most appropriate for the collaboration or merger based on due diligence and the context of the particular arrangement.

- Engage employees, volunteers, funders and key stakeholders at the appropriate stage of the merger or collaboration and ensure that any TUPE obligations are considered and dealt with.

- Give careful consideration to the apportionment of risk and liability between the merger/ collaboration partners. This is a complex issue and further advice should be sought where necessary.

4.9 Resources

- Chapter 11, *Collaborative Working, partnerships and mergers*, Russell-Cooke Voluntary Sector Legal Handbook

- *Collaborative Working and Mergers: An Introduction* (CC34), www.CharityCommission.gov.uk

Module 5 and 6

HR implications including TUPE and pensions

Index

5.1 Introduction

5.1.1 When negotiating the terms of the ISPA for the provision of services, the legal implications in relation to staff should inform the commercial position of the parties from an early stage. If the contract creates a transfer under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (as amended by the 2014 Regulations)("TUPE") to transfer the employment of staff, this will have serious implications.

5.2 TUPE

5.2.1 TUPE is a complex piece of legislation and it is important for bidders to understand the operation and implications of TUPE when entering into contractual obligations. Failure to plan for the beginning and end of a service contract could leave you exposed to very large risk. This is because TUPE not only transfers the contracts of employment from the outgoing contractor to the incoming contractor but also all rights and liabilities associated with the employment including liability for redundancy payments if the contract is terminated.

5.2.2 The application of TUPE should be considered each time a service contract is won by a new contractor. Therefore TUPE will apply on the first transfer from NOMS via the Probation Trusts to NOMS via Tier 1 to Tier 2 and 3 contractors. TUPE will also apply on subsequent re-tendering exercises where a new Tier 2 or 3 contractor undertakes the services. Whether TUPE applies will vary from case to case. Very broadly and in practical terms it may be helpful to think about TUPE as "sticking" the services to the people who perform them. Therefore, if Tier 1 organisation staff will not undertake the services, probation trust staff will not transfer to them but will transfer to the Tier 2 or 3 organisations who are doing the work.

5.2.3 Where TUPE applies, it will take effect regardless of any assurance you have been given that it does not apply. However, parties should try to reach agreement about whether TUPE applies so you can apportion employment liabilities contractually through the terms in the ISPA.

5.3 Who is covered by TUPE?

5.3.1 The definition of "employees" for the purposes of TUPE is wider than the definition under the Employment Rights Act 1996 and may include workers who are engaged on casual contracts. It is also important to remember those who are absent due to sickness or on family leave or who work part time or on fixed term contracts will be covered by TUPE. Only genuinely self-employed contractors will not be covered by TUPE.

5.4 Relevant transfer

5.4.1 TUPE applies to business transfers and to service provision changes and both may be relevant to the contracting process. They are not mutually exclusive. A business transfer occurs when there is a transfer of a business or part of a business from one employer to another. Changes to the provision of services will take place when NOMS initially stops contracting with the Probation Trusts and instead contracts with a Tier 1 organisation. A service provision change will also occur when a contract is assigned to a new Tier 2 or 3 contractor and on subsequent retendering.

5.4.2 For TUPE to apply, the activities need not be identical following transfer but must be fundamentally or essentially the same. This will depend on the nature of the activities in question.

5.4.3 **Example -** Probation Trust A contracts with contractor B to assess offenders and provide pre-sentence reports within the London area. A new contract between a Tier 1 organisation and a Tier 2 organisation provides a new assessment service which incorporates pre-sentence reporting but also broader services and specifically for offenders under the age of 18 in London, Surrey and Kent. In this case, it might be possible to argue that Tier 2 is performing all the services carried out by its predecessor and is also providing additional services and therefore contractor B's

staff will transfer under TUPE. However, the new Tier 2 organisation may argue that they are providing a “wholly different operation” which is fundamentally or essentially different due to the geographical area, a more “holistic” approach and to offenders under the age of 18 such that TUPE does not apply.

5.4.4 You will need to form a view as to whether the activities are sufficiently similar and there is a breadth of case law which considers this question. You may be advised to take a pragmatic approach – minor difference between the nature of the tasks carried out or the way in which they are performed will not prevent a transfer and in general, an employment tribunal will attempt to define the activity as broadly as possible in order to give effect to the purpose of TUPE and to safeguard employees’ contracts of employment.

5.5 Organised grouping

5.5.1 If the activities of the outgoing contractor and incoming contractor are sufficiently similar, TUPE applies to employees who are “assigned” to an “organised grouping” delivering the service which is transferring. It is therefore vital to establish whether there is an organised grouping before you establish which individuals are assigned to that grouping.

5.5.2 An organised grouping means a team of employees who are dedicated to carrying out the activities that are to transfer. Although the employees do not need to work exclusively on those activities, carrying them out for the client does need to be their principal purpose. TUPE should therefore not apply where there is no identifiable grouping of employees or where it just so happens in practice that a group of employees works mostly for a particular client.

5.5.3 The amount of time that an employee spends working for a particular client is relevant to whether they are assigned to the organised grouping that is transferring. However, to constitute an "organised grouping", it is not enough that employees carry out the majority of their work for a particular client. Rather, employees must be organised by reference to the requirements of the client and be identifiable as members of that client's team. The organised element requires planning or intent in construction of a group to provide services to one client and therefore they must be connected in some sense by reference to the requirements of the client in question. The condition may not be met where employees provide their services to a number of different clients and where this is the case it can be difficult to identify who transfers on a change of contractor.

5.5.4 TUPE provides that a single employee can be an organised grouping. However, that does not necessarily mean that an employee who spends all of their time on work for a particular client is an organised grouping. Again, the employee must be deliberately organised by reference to the client's contract.

5.5.5 **Example -** Probation Trust C provide management of approved premises for ex-offenders in London. Probation Trust C engages Subcontractor D to undertake these services. Subcontractor D also contracts with a private organisation to undertake similar services in Surrey. 5 members of staff work on managing the premises. 1 member of staff spends 100% of their time working on managing premises for Probation Trust C and the remaining 4 employees spend their time equally between managing premises under the contract with Probation Trust C and the private organisation. A new ISPA provides that Contractor E will provide premises management services for ex-offenders in London.

5.5.6 The individual spending 100% of their time on the managing premises for Probation Trust C is likely to transfer to Contractor E but they may resist taking him or her if the work is undertaken without any deliberate planning or intent. Practically speaking you should consider whether job descriptions and work allocated in practice indicate that employees are allocated to tasks with reference to Probation Trust C.

5.6 Assignment

5.6.1 Assuming that there is an organised grouping, the employment of those assigned to that grouping automatically transfers to the new contractor on their existing employment terms. The regulations do not clearly define what is meant by "assigned". Therefore, you will need to make an assessment taking into account a number of factors, including but not limited to, the percentage of time spent working on the services being transferred. Contrary to popular belief, there is no specific percentage of time which an employee must devote to a service before being regarded as assigned to it although 50% or more is a good rule of thumb.

5.6.2 TUPE does not apply where an employee temporarily works on the services which are transferring. Whether an assignment is temporary will depend on a number of factors, including the length of the assignment and whether a date has been set for the employee's return or re-assignment to another part of the business.

5.6.3 Where an employee carries out a strategic role in an organisation and they are concerned with the running and maintenance of the business, rather than the direct provision of services, the employee may not be assigned to that service. There is a distinction to be drawn between employees essentially dedicated to the front-line provision of services for a client and those who form part of an organisation's infrastructure. Practically, where individuals are directors and are involved in organising and training staff, dealing with third parties, working on tenders and liaising with the board of trustees you should consider whether or not they will transfer under TUPE.

5.7 Information and consultation

5.7.1 There is a duty under TUPE to give the representatives of employees affected by the transfer certain basic information about the transfer. If no changes to their terms and conditions (including redundancy or restructure) are envisaged now or in the foreseeable future then you are simply required to provide information about the transfer. For example, where an organisation goes through the process of incorporation to become a company, there is a TUPE transfer because the employees will be employed by a different entity following incorporation i.e. from the unincorporated association to the newly established company. In such circumstances, it is unlikely that there will be any changes to terms and conditions so you would only be required to inform staff about the transfer.

5.7.2 The obligation to consult arises if the new contractor envisages it will be taking any "measures" in relation to any of the affected employees. "Measures" means any action, step or arrangement that the new organisation will take in connection with the transfer. Examples include a change to terms and conditions, potential redundancies or restructure. A change to workplace location would constitute a measure.

5.7.3 Both the current employer and new employer have a duty to inform and consult with their own affected staff and both the current and new employers are liable for awards of compensation for a failure to inform or consult. The duty to consult is with a view to seeking agreement to the intended measures. Both contractors would have to

consult with their own staff representatives with an open mind and be ready to consider and be persuaded by any arguments put forward.

5.7.4 The definition of “affected employees” extends beyond the employees who will actually be transferred from one employer to the other. You need to consider whether any other employees will be affected by the transfer or any measures taken in connection with the transfer. For example, following loss of staff on a TUPE transfer, you should consult with remaining staff if there will be a restructure because of the transfer.

5.7.5 If the affected employees are members of a recognised union, then representatives of the union will be the appropriate representatives for the purposes of giving information and consulting. Alternatively, there may be other existing staff representatives who have the authority of the affected employees to receive information on their behalf. Any employees who do not already have representatives should be invited to elect representatives. If the organisation recognises no trade union and employees fail to elect representatives, the individual employees must be directly informed/consulted. From May 2014 micro businesses i.e. those employing 10 or fewer staff will be able to consult with affected staff direct.

5.7.6 The representatives must be informed about the transfer and any measures associated with the transfer long enough before the transfer takes place to enable consultation to take place. The length of time should be decided upon with reference to the extent of the measures proposed and the number of staff affected. Where there are extensive measures, you will want to begin consultation early and you may wish to build in time for presentations to staff and separate consultation meetings with staff representatives.

5.8 Election of representatives

5.8.1 The rules for the election of representatives are that you must:-

- make such arrangements as practicable to ensure the election is fair;
- ensure all affected staff are allowed to stand for election and nominate candidates.
- determine the number of representatives so all types or “classes” of employees are represented;
- decide the term of office i.e. until transfer;

5.8.2 In addition:

- all affected employees are entitled to vote for as many candidates as there are representatives;
- the election must be conducted to ensure that voting is in secret and votes are accurately counted.

5.9 What information must be given to the affected employees?

5.9.1 The following information must be given to the representatives:

- the fact of the transfer, when it is to take place and the reasons for the transfer;

- the legal, economic and social implications of the transfer for the affected employees;

- the measures that the new contractor envisages it will take in connection with the transfer in relation to any affected employees. If no measures will be put into place then that fact should be stated.

5.9.2 If you are the outgoing contractor, the new contractor must notify you of the measures that they will take in relation to the transferring employees and if they are not planning to take any measures, then that fact should be confirmed.

5.9.3 If there is a failure to comply with the obligations to inform and consult then claims in an Employment Tribunal may be brought and compensation could be awarded of up to 13 weeks pay per affected employee.

5.10 Employee liability information

5.10.1 The outgoing contract is required to provide the new contractor with certain information about the transfer and employees before the relevant transfer takes place. Such information needs to be provided not less than 14 days before the transfer date. From 1 May 2014, the deadline for notification of employee liability information will be increased from 14 days to 28 days before the transfer. The required information includes:

- the identity and age of the employees who will transfer;

- the information set out in the transferring employees' written particulars of employment;

- information regarding any collective agreements in place;

- any disciplinary proceedings taken against an employee or grievance brought by an employee in the previous two years;

- Any legal action taken by those employees against you in the previous two years, and any potential legal actions.

5.10.2 The outgoing contractor will be under an obligation to provide written notification of any changes that may occur after the initial information was given.

5.10.3 Any failure to provide employee liability information would enable the new contractor to bring a claim in the Employment Tribunal within three months of the date of the transfer. The outgoing contractor may be ordered to pay the new contractor for any loss suffered because of the failure to provide the information.

5.11 Dismissals

5.11.1 A dismissal, including a constructive dismissal by either the outgoing contractor or new contractor is automatically unfair if the sole or principal reason is because of the transfer. This is subject to the normal rule that an employee must have 2 years' continuous service with an employer before they can claim unfair dismissal. If the employer can establish that the dismissal is because of an economic, technical or organisational reason requiring changes in the workforce or factors which are not connected with the transfer, it will have a defence against a claim of unfair dismissal.

5.11.2 The phrase, “changes in the workforce” has been interpreted as meaning a change in the number of employees or in the work done. As each case will depend on its facts, specialist advice should be sought if in doubt. Even where there is a fair or potentially fair reason for the dismissal, the employer must follow a fair dismissal procedure and give notice as required by statute or under the contract of employment.

5.11.3 In law, the outgoing contractor’s liability to the dismissed employee transfers with the services. Therefore you should agree contractually where the liability will lie if the claim is brought against the new contractor.

5.12 Redundancies

5.12.1 If, prior to transfer, it is clear that redundancies are likely, the need to undertake collective redundancy consultation may be triggered. The trigger is where 20 or more redundancies are proposed within a 90 day period. This is distinct from and must be carried out in addition to the obligation to consult and inform with regard to TUPE. It may be convenient to commence the redundancy consultation and TUPE consultations simultaneously.

5.12.2 If less than 20 posts are proposed for redundancy, individual consultation can start on the date of transfer but consultation prior to transfer will not discharge the incoming contractor’s obligation to consult individually. Even where there is collective consultation, consultation with individual employees proposed as redundant should be carried out to avoid unfair dismissal claims.

5.13 Clause 3 – Equality and Human Rights requirements

5.13.1 The Equality Act 2010 (EqA 2010) operates to protect individuals possessing a protected characteristic from discrimination in relation to both employment and the provision of goods and services. Protected characteristics under the EqA 2010 are age, sex, sexual orientation, religion or belief, race, disability, gender reassignment, marital status, pregnancy and maternity. Individuals may be protected by association with another person who possesses a protected characteristic or if there is a perception, which may be false, that they possess a protected characteristic. Discrimination may take on a number of forms including harassment and victimisation.

5.13.2 This section obliges you to comply with the EqA 2010 and other employment legislation which is required of you by statute. However, a breach of such obligations under the contract may result in both a breach of contract and breach of legislation. You should therefore familiarise yourself with the relevant requirements and you should have in place policies setting out how you expect your organisation to comply with your obligations in this regard.

5.13.3 You are required under clause 3(b) to have in place an equal opportunities policy. However, in order to ensure that you were able to robustly counter any claim of discrimination you would need to provide evidence that the policy was effectively communicated to staff and that training was provided both to all staff and to managers involved in recruitment, promotion, redundancy etc decisions.

5.13.4 Under clause 3(d) you are required to notify the Contractor’s Relationship Manager if you become aware of any investigation or proceedings brought against you. You may wish to bring this obligation to the knowledge of the person in charge of HR issues as it may take some time within the organisation for any grievances or disciplinary

issues relating to discrimination to be brought to your attention. You may consider agreeing to notify the Contractor only when disciplinary action is taken above a certain level e.g. a final written warning or a grievance has been upheld. Depending on the size of the organisation, the obligation to notify for every incident may be onerous and of little relevance to the Contractor if the complaint is not upheld.

5.13.5 Clause 3(e) obliges you to comply with external investigations and you may have a procedure in place where a third party is involved in investigations. You should consider whether this reflects your current practice.

5.14 Clause 9 Subcontractor Personnel

5.14.1 Clause 9 requires the subcontractor to employ enough staff, who have the right to work in the UK and are appropriately qualified and competent. This requires you to train your staff appropriately, including attending training required by the Contractor.

5.14.2 Under Clause 9.1(b) you should clarify that "sufficient number of Subcontractor Personnel" is by reference to your judgment as the contractor undertaking the services to enable you to retain control over how you choose to manage your workforce. In a similar vain, you should consider whether you are able to meet the requirements set out in relation to managing staff. For example, you may wish to limit the obligations to "make reasonable endeavours". This is so that, for example under clause (b)(v) you do not breach the contract if employees consistently fail to turn up to training.

5.14.3 There is a risk of conflict between the requirement to retain sufficient, competent and well trained staff versus the requirement to retain a flexible workforce in order to deliver the services and it may be appropriate to structure staff contracts accordingly. There is some suggestion that successful reductions in reoffending are related to ongoing and long-term relationships with staff and therefore flexible contractual arrangements may need to be balanced against your ability to retain a high calibre of staff.

5.14.4 Under clause 9.2, you are required to ensure that staff meet the relevant vetting requirements issued by the Ministry of Justice. If staff or volunteers are working in "regulated activities", which includes work with young people under 18 years old, or work with vulnerable adults then a criminal records check will be required. Information about whether employees have undertaken such checks should be requested as part of the due diligence exercise. The Disclosure and Barring Service replaced the Criminal Records Bureau in September 2012. For more information see www.gov.uk/government/organisations/disclosure-and-barring-service/about.

5.15 Schedule 14 Employee transfers

5.15.1 The suggested draft wording in the Explanatory Guide at 17.3 should form the basis of wording to be used where the parties are agreed that TUPE will apply. Broadly, this requires the outgoing contractor and new contractor to comply with their obligations under TUPE as explained above. Failures to inform and consult are joint and several by both the outgoing contractor and new contractor unless it concerns a failure by the new contractor to tell the outgoing contractor of any measure it is proposing, in which case the liability rests with the new contractor. On transfer, the liabilities of employees transfer. For example, if the outgoing contractor operates discriminatory practices, the new contractor will be liable for the failures of the outgoing contractor if a claim is upheld. Advice should be sought as this is a complicated area of law. However, in general, both parties will want to agree that the

outgoing contractor should be liable for breaches pre-transfer and the new contractor to be liable for breaches post-transfer. Parties may agree to indemnify each other in respect of those loses in the ISPA.

5.15.2 An indemnity will provide that if the outgoing contractor fails to comply with its obligations under TUPE and as a result the employee brings a claim against the new contractor, the outgoing contractor will be liable for the losses of the new contractor and vice versa. An indemnity is the strongest form of protection you can have contractually because the payment which the party is required to make equals the actual loss incurred by the other party. However, an obligation to make payment is only effective to the extent that the other party is able to make that payment and you should be aware of this when negotiating indemnities, for example if the outgoing contractor will wind down or become insolvent following transfer.

5.15.3 The suggested draft wording does not include a cap on the indemnity. However, you should check whether wording in the rest of the agreement impacts on this clause for example in the general warranty provisions at clause 6.1.

5.15.4 The wording in this provision is very broad and you should consider the following:

- The parties may wish to agree co-operation over and above the statutory requirements particularly where redundancies or restructure is envisaged and set out their obligations in this respect contractually.

- Are there any members of staff whom the outgoing contractor wishes to retain? This can be agreed between the outgoing contractor, incoming contractor and the employee by way of a Settlement Agreement and legal advice should be sought in this case.

- Ideally, the definition of "liability" should be defined between the parties. It is important to consider what type of losses may result in the event that one of the parties fails to meet their obligations. You should consider that even if you are not the employer following transfer and therefore not responsible for any liabilities, an employee may bring a speculative claim and there will be costs involved in defending that claim. Some examples of the types of categories which you may wish to include are: demands, actions, and any award, compensation, damages, tribunal awards, fines, losses including mention of legal costs and expenses. Parties may also consider including a mechanism for agreeing to allocate the costs of making a payment in settlement where it is in the interests of both parties.

5.16 Clause 16(h) exit and exit plan

5.16.1 The exit provisions relate to the termination of the provision of the services by the supplier and the transfer of the services to a subsequent supplier or back in-house. The exit provisions should generally reflect the outline of the entry provisions (i.e. those relating to the initial transfer of the services) and further detail can be found in Module 7.

5.16.2 From an employment perspective this clause essentially implements a freeze on changes to staff once notice has been given on the contract. You may wish to define "material" in the context of material adverse impact for certainty. As the definition of Subcontractor Personnel includes all staff with whom you have contracted to provide the services, this clause should be mirrored in any sub-contracts you have with other contractors to provide the services under the ISPA.

5.16.3 There is a risk that staff leave the organisation to work for a competitor as a result of the transfer and there is also a risk that the competitor may solicit staff. You should therefore consider whether you want to include a restriction in the ISPA on preventing the poaching of key staff upon transfer. The aim of this clause would be to ensure that the outgoing contractor and new contractor do not solicit each other's staff during the agreement or for a specified period after termination. A prohibition on solicitation is likely to be enforceable during the period of the contract but the restriction after termination may be challenged as a restraint of trade. Therefore, any period of restriction following termination should be carefully considered to be reasonably required to protect the interests of the party seeking to enforce it. Any breach of this provision should be linked to the defaulting party to make a demand to claim a sum linked to the employee's pay plus the recruitment costs in replacing such an individual.

6.1 Pensions

6.1.1 The transfer of employees under TUPE can involve complex pension issues for an incoming contractor. It is therefore vital to ensure that you undertake due diligence so you understand the minimum level of pension benefits you must provide following a TUPE transfer.

6.1.2 The starting point is that an employee transfers their employment from the outgoing contractor to the new contractor on the same terms and conditions which would include pension provisions. So, for example, if the employee is contractually entitled to employer contributions to a personal pension scheme, group personal pension scheme or a stakeholder scheme the new contractor would be required to honour this term. There are, however, a number of exceptions to this rule.

6.2 Pension exception

6.2.1 Occupational pension schemes do not transfer under TUPE. An occupational scheme is defined in law and you should seek guidance from your pension provider. Broadly, these schemes can either be:

- Salary related (also called Defined Benefit or Final Salary schemes) giving a pension based on the employee's salary at or near retirement and how long he or she was a member of the scheme;

- Money purchase (Defined Contribution) where contributions paid into the scheme are invested and on retirement are used to buy a pension, so that the amount depends on the value of the investment and the cost of purchasing an annuity (to provide a regular pension) at the time of retirement; or

- Mixed benefit schemes which combine elements of both Defined Benefit and Defined Contribution schemes.

6.2.2 However, even where there is an occupational scheme case law makes clear that certain pension benefits may transfer, for example, the right to an early retirement pension on redundancy. This is a very technical area of law and advice should be sought.

6.2.3 Where there is an occupational pension scheme, the new employer is required to offer the transferring employees access to a money purchase pension or stakeholder scheme, with an employer contribution rate that at least matches the employee's own contribution rate up to a ceiling of 6% of pay. It should be noted that the Department of Work and Pensions are in consultation to amend these regulations but at the time of writing, new legislation has not yet come into force. You should also consider that changes to pension arrangements are likely to constitute “measures” for the purposes of information and consultation under TUPE.

6.3 Public-sector pension schemes

6.3.1 The New Fair Deal policy published by HM Treasury in October 2013 provides that public sector staff who transfer from the public to the private sector must be offered continued access to the relevant public sector pension scheme of which they were a member or eligible to join prior to the transfer. This will be of relevance where Probation Trust staff transfer.

6.4 Auto-enrolment

6.4.1 Under new legislation introduced from 1 October 2012, all UK employers will eventually be required to automatically enrol certain eligible workers, known as jobholders, into a pension scheme and to pay a minimum level of contributions to the scheme.

6.4.2 Although the auto-enrolment regime came into effect on 1 October 2012, each employer will be informed in advance of its own "staging date" from when it must comply. An employer's staging date will depend on the size of its PAYE scheme, with the largest schemes being required to comply first.

6.4.3 The practical effect is that a receiving employer under a TUPE transfer may have to comply with two regimes meaning a transferring employee may have to be assessed by the receiving employer to establish his auto-enrolment status. This is because the Pensions Regulator has confirmed that if an employer transfers some or all of its employees to a new employer under TUPE, the transferring employees will be treated as working under a new contract for the purposes of auto-enrolment and the new contractor employer will need to make an assessment of their auto-enrolment status at the point of transfer.

6.4.4 The interaction between the TUPE legislation and the auto-enrolment requirements may be complex and advice should be sought if receiving employees from an employer who has already reached its staging date.

6.5 Pension scheme exit debt

6.5.1 If your organisation is a member of a multi-employer occupational pension scheme, then you should ensure that that your organisation doesn’t inadvertently withdraw from the scheme as this could crystallise substantial debts. If you are unsure if this applies to your organisation, you should check with your company pension provider.

6.6 Key action points

6.6.1 As an incoming supplier:

- Decide whether you believe TUPE applies and seek to agree this with all other relevant parties

- Carry out an appropriate due diligence exercise
- Ensure that the employee information is accurate
- Consider whether the right employees are transferring
- Inform outgoing contractor of any measures you propose to take
- Provide information and consult with staff representatives as appropriate

As an outgoing supplier:

- Consider whether TUPE applies
- Ensure that the information and consultation process is adequate
- Deal with requests for employee information and provide Employee Liability Information as a minimum.
- Provide information and consult with staff representatives as appropriate.

6.7 Resources

- Chapters 26 to 39, Employees, Workers, Volunteers and Other Staff, Russell-Cooke Voluntary Sector Legal Handbook
- Russell-Cooke Website Briefings- http://www.russell-cooke.co.uk/articles.cfm?id=4&sub
- DBS Service information - www.gov.uk/government/organisations/disclosure-and-barring-service/about

Module 7

Dispute resolution, implications of contract loss and termination

Index

7.1 Introduction

7.1.1 Clauses relating to contract term and termination are always some of the first provisions that should be considered when entering into a contract. It is essential to understand the ways in which a contract can be terminated and what the potential implications and costs might be for your organisation. This will form the basis of any contract planning and budgeting, including ensuring that there are sufficient resources and funding in place to discharge the contractual obligations and provide the services effectively throughout the term.

7.1.2 There are a number of ways in which the ISPA can be terminated by the Ministry of Justice (MoJ), the Contractor and Subcontractor, which are discussed further in paragraphs 7.2-7.4 below. The potential effects and costs of termination should be planned for as far as possible to ensure that your organisation is not left with obligations that cannot be met or funded once the ISPA (and the payments under it) has come to an end.

7.1.3 Any disputes or conflicts that arise under a contract can be time consuming, disruptive and potentially very expensive. As a result, contracts will often include dispute resolution provisions that must be followed should a dispute arise. It is preferable in most cases to try and resolve a conflict informally between the parties, or via some form of alternative dispute resolution, rather than pursuing a claim through the courts. The ISPA provides for mediation, which is only effective if the parties reach an agreement.

7.1.4 In this module we will explain and comment upon the termination provisions contained in the ISPA and highlight the key issues to consider in connection with contract loss and dispute resolution procedures.

7.2 Contractual term

7.2.1 It is important to have a clear understanding of both the planned length of the contractual term of the ISPA and the degree to which it can be shortened as a result of earlier termination.

7.2.2 The ISPA begins on the date that the agreement is signed and dated by the parties and will continue in force until terminated in accordance with the termination provisions under the contract.

7.2.3 The ISPA has a fixed initial term of three years ("Initial Term") (Clause 15.2 (b).) However, there are instances where the ISPA can be terminated during the Initial Term, which are explained in paragraph 7.4 below. It is important for a Subcontractor to understand that it has no right to terminate the ISPA before the Initial Term ends. Therefore, you will need to plan and allocate resources accordingly.

7.2.4 This planning and allocation may be difficult as there is some contractual uncertainty. This is because the Contractor has the right to change the Service Levels and Service Credits by giving just 3 months notice (Clause 1.4(a)). Whilst the Subcontractor can make a claim to the Contractor for any losses as a result of the changes, the Contractor must be reasonably satisfied that the changes were a direct cause of the cost incurred by the Subcontractor. The Contractor will only pay additional costs over an agreed Excess. This Excess needs to be negotiated. If, for example, the Contractor changes the Service Credits and Service Levels to a point where the ISPA becomes financially unviable, the Subcontractor cannot simply give notice to terminate the ISPA and walk away during the Initial Period.

7.3 Voluntary termination

7.3.1 The ISPA cannot be terminated by either party during the Initial Term, unless there is a Termination Event – see paragraph 7.4 below.

7.3.2 After the Initial Term, the ISPA can be terminated by either party having given not less than 6 months' written notice to the other party. Effectively, after two and half years, notice can be given that the ISPA will expire at the end of the Initial Term. However, a party wishing use this termination right must first obtain the consent of the "Authority" (defined as the Secretary of State for Justice (clause 15.2 (a)). The risk here is that you may find that you are prevented from exiting from the ISPA if the MoJ refuses to give its consent. The Explanatory Guidance notes at paragraph 19.3 state that clause 15.2(a) is only relevant for "Material Sub-Contracts". A Material Sub-Contract is one where subcontracted services form a "material" part of the services in the Service Agreement. Essentially it will be a substantial or important element of the Services Agreement. If this is the case additional conditions may be imposed in clause 1.1(g) of the ISPA. You should establish whether your ISPA is Material Sub-Contract from the outset.

7.4 Termination events

7.4.1 The ISPA will terminate on the occurrence of a number of events, including:

7.4.2 **Termination of Service Agreement**

7.4.2.1 The Contractor may terminate the agreement if the Services Agreement is terminated for any reason. This is a key risk under the ISPA, as the Subcontractor is at the behest of what happens at the MoJ/Contractor level under the Services Agreement. No minimum required notice period is specified and there is no obligation for the Contractor to pay the Subcontractor any compensation for losses incurred as a result of the ISPA being terminated this way. Ideally the Contractor should compensate the Subcontractor if the Services Agreement is terminated as a result of a fault by the Contractor. Schedule 6 of the ISPA could contain termination compensation provisions.

7.4.3 **Insolvency**

7.4.3.1 Either party may terminate the ISPA with immediate effect if the other party makes any arrangement with its creditors or becomes insolvent and goes into administration. These are usual termination provisions that are found in most service contracts. Insolvency is a complicated area of law and further advice should be sought if necessary.

7.4.4 **Material breach**

7.4.4.1 Either party may terminate the ISPA if the other party is in “material breach” of the contract and either;

- the breach is not capable of remedy;
- the breach is capable of remedy, but has not been remedied within 30 days of receiving notice to do so; or
- a similar breach has occurred in the proceeding 90 days.

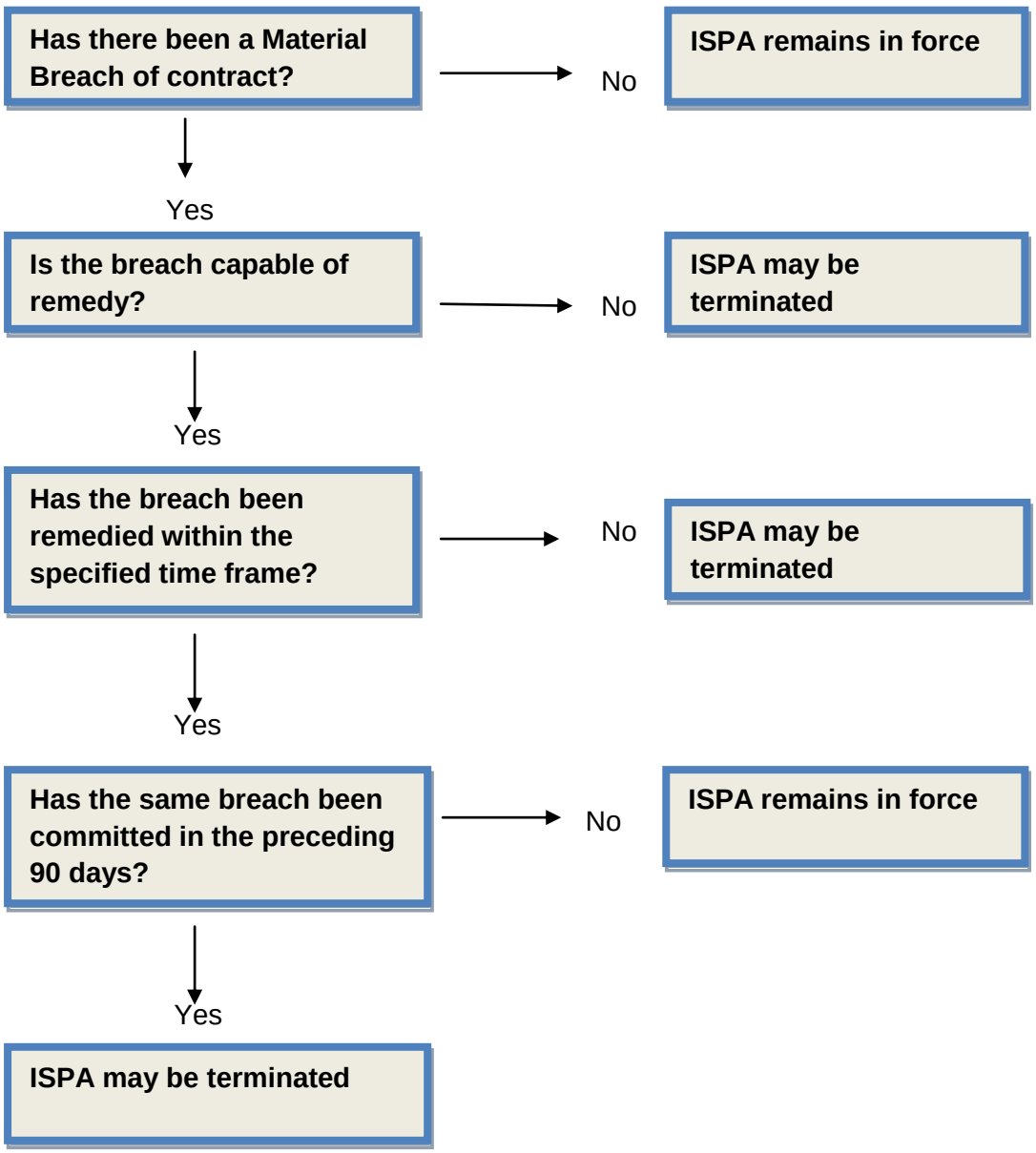
7.4.5 What constitutes a material breach of the contract is not defined, and can be much argued about. This will usually be a “serious” or “significant” breach. It would be preferable if the Contractor has to show a higher degree of fault on your part i.e. a fundamental breach that goes to the root of the contract.

7.4.6 The Courts will take the commercial circumstances of a particular case into account when deciding whether a breach is “material”. This can include the nature of the contract and obligations involved, the impact of the breach on the innocent party and the circumstances in which the breach arises. In order to avoid disputes over what constitutes a material breach, the best approach is to include a definition in the contract. This may be something you wish to raise with the Contractor when negotiating the contract.

7.4.7 If a material breach does occur, the innocent party must issue a notice of termination specifying the nature and details of the breach and when the “Exit Period” will commence. The ISPA recommends this to be 5 working days after the date of the notice, but an alternative time period can be inserted. The ISPA will terminate on the

expiry of the Exit Period (unless the breach is rectified within 20 working days). If the defaulting party fails to rectify the breach within this time frame, the Exit Period will commence five working days after the expiry of the 20 day rectification period.

7.4.8 The following diagram sets out each stage of the termination procedure for material breach:



7.5 Force Majeure and other Relief Events

7.5.1 There may be instances where you cannot perform the ISPA through no fault of your own. If this is the case, you should not be considered to be in breach of the ISPA.. Although, as with most contracts, the clauses that have been included in the ISPA do not make this as simple as it sounds. The events specified as Relief Events and Force Majeure are narrow and you may want to negotiate this point to include a wider scope of events.

7.5.2 A Force Majeure Event is defined as events such as flooding and earthquakes. Essentially Force Majeure Events are external circumstances beyond the control of a party. Again, a party must act quickly if it thinks a Force Majeure Event has occurred. It must give notice as quickly as possible and take all steps as set out in the Good Industry Practice to overcome/minimise the effect on the Services (clause 8.2 (a).) Where a Force Majeure Event occurs for more than 24 hours the Subcontractor will not be paid for the Services (because it won't be providing them) and the Contractor can use another provider. Once the Force Majeure Event is over the Subcontractor can resume performance of the Services.

7.5.3 Clause 8.1 covers what happens during a "Relief Event". A Relief Event is a failure of the Contractor to carry out a "Dependency". A Dependency is defined as an action that the Contractor is required to take, as set out in Schedule 4. This schedule is currently blank and therefore we cannot provide examples at present. Effectively, it will be something that the Contractor is obliged to do. Simply, if a Subcontractor breaches the ISPA due to the Contractor not performing an obligation (i.e. itself committing a breach), it will not be deemed as a breach by the Subcontractor.

7.5.4 However, there are various procedures that need to be followed in order for a Subcontractor to claim that a Relief Event has occurred and the Contractor has the opportunity to remedy their breach (clause 8.1.(c)). Crucially, when the Subcontractor realises a Relief Event will affect its ability to perform the ISPA it must notify the Contractor as soon as possible and within 15 working days. E.g. if the Contractor does not provide you with certain information you may not be able to provide the service. You must notify the Contractor that they have not supplied the information as soon as possible and keep pressing for it. Within 10 working days after the notice has been given to the Contractor the Sub-Contractor must explain what loss it has suffered due to the Contractor's breach. The Contractor will still not be obliged to compensate the Subcontractor for those losses if it doesn't think those losses were caused by its breach or if the loss could be mitigated or recovered.

7.5.5 Additionally, where losses/costs will be paid, the Contractor does not have to pay the full amount. Similar to insurance, clause 8.1 (e)(i) places a figure (currently unspecified) as an excess. Therefore the Sub-contractor can only recover the amount that is more than the excess. E.g. if the excess amount was £60 and the loss was £120, the Subcontractor could only recover £60. The figure inserted as the excess should be carefully negotiated.

7.5.6 A tool that the Subcontractor could use to its advantage where difficulties arise with the Contractor is the Cabinet Office's Mystery Shopper, in order to raise concerns about the Contractor's practices. More details on the Mystery Shopper can be found at paragraph 3 of the Explanatory Guidance.

7.5.7 When a Relief Event or Force Majeure Event occurs it is absolutely essential to instigate and maintain excellent lines of communication with your Contractor and carefully document events and communications with the Contractor.

7.6 Exit Plan

7.6.1 The ISPA requires the Subcontractor to produce an "Exit Plan" to ensure the orderly transition of the contract to a new Subcontractor upon termination. Clause 16(a) specifies that this should be produced within 120 business days from the start of the contract. This time period can be amended if necessary. The parties must meet to discuss and agree the contents of the Plan, based upon the principles set out in Schedule 13. This schedule has not yet been produced. You must update the Exit

Plan annually and submit it to the Contractor for review. If the ISPA is terminated, a final Exit Plan must be agreed and implemented. If the parties cannot agree a Plan, the dispute resolution procedure will be enacted (see paragraph 7.9 below).

7.6.2 During the Exit Period you must continue to perform the Services (and ensure that any subcontractor continues to perform any subcontracted services) in accordance with the terms of the ISPA. You must also provide the Contractor with assistance to allow the services to continue without interruption and to facilitate the orderly transfer of the services to a new provider. During the Exit Period, you must not make any material changes to personnel that could have an adverse impact on the Contractor's business or the services, without the prior consent of the Contractor. This is potentially quite an onerous term, as you will not be able to freely deal with your staff during this time. This type of requirement is usual and is due to TUPE legislation and the potential for employment claims to be made if changes occur due to termination. Please refer to paragraph 6.9 in Module 5 for more information on this.

7.6.3 During the Exit Period, the Contractor must notify you of any plans to retender the services. You may re-submit a bid, which must be considered by the Contractor.

7.6.4 Note that corresponding termination rights should be included in any subcontract that is entered into so that you have the ability to terminate a subcontract if the ISPA is terminated for any reason. Otherwise your organisation could be in the unwanted position of having to make payments to the subcontractor without corresponding payments continuing under the ISPA.

7.7 Implications of contract loss

7.7.1 There are a number of factors and potential consequences to consider when a contract is terminated.

7.7.2 A Subcontractor is likely to have a range of resources and arrangements in place in connection with delivery of the services, including staff, premises and service contracts that cannot be funded if the ISPA is terminated.

7.7.3 **Staff**

7.7.3.1 It is likely that you will have a number of staff allocated to providing the services under the ISPA, whose funding will cease if the contract is terminated.

7.7.3.2 It is possible that these staff will transfer to the new provider taking over the services, under the TUPE regulations. You will not know whether this will happen when you start work under ISPA and you may want to add a provision that allows for you to receive a termination payment to cover any costs if staff do not TUPE transfer, as you may need to budget for redundancy or redeployment costs. You may have increased liabilities in respect of any employment rights, such as redundancy, arising before the date of the transfer. The ISPA contains no assurances that staff will TUPE over to a new provider. More information on potential TUPE liabilities can be found in Module 5.

7.7.4 **Premises**

7.7.4.1 In addition, you may also have premises that are used in connection with providing the services under the ISPA. The premises might be held under a lease with obligations to pay rent and other outgoings for the whole of the lease term. You do not want to be in the situation where you are paying rent on premises that are no

longer needed or cannot be funded. It is therefore very important that any lease term coincides with the break points under the ISPA i.e. no longer than 3 years during the "Initial Period" and a 6 month corresponding break right thereafter. However, as the ISPA could be terminated at any time if the Service Agreement is terminated, you will want to have the flexibility to terminate a lease at any time. This is often not possible, and there is a risk that you will be liable to pay for a lease you no longer need. This type of issue should be raised with the Contractor and if possible gain assurances that those costs will be recoverable.

7.7.5 **Service Contracts**

7.7.5.1 You may have entered into other contracts in support of the ISPA for any number of services, such as photocopier leases or cleaning contracts etc. You should check the terms of these contracts to ensure that they can be brought to an end in the event that the ISPA is terminated. As with any leases, contracts should have flexible termination provisions that mirror those of the ISPA. If not, the cost of termination needs to be budgeted for.

7.7.6 **Volunteers**

7.7.6.1 Volunteer agreements should always make it clear that no employment relationship exists. If no employment relationship exists, TUPE would not apply. However, you may need to think about the needs and wishes of your volunteers as a matter of good practice. You will need to consider whether you could offer volunteers alternative work within your organisation, or whether they may want to volunteer with a new provider of the service.

7.7.7 **Destruction of Material**

7.7.7.1 The ISPA also contains provisions governing the handling of any data or materials relating to or used in connection with the services upon termination. During the Exit Period the Subcontractor may be required to either destroy or return such materials upon the request of the Contractor. Any confidential information belonging to either party must also be either destroyed or returned to the owner.

7.7.8 If the ISPA has been terminated as a result of a breach on the part of your organisation, financial liabilities may also be incurred and damages payable to the Contractor in respect of any loss incurred as a consequence of the breach. This liability will be subject to the cap on liability contained in clause 7 of the ISPA. The exposure to financial liabilities and damages is explained in Module 2. Also, as well as financial risk, it is important to remember that the Contractor may be entitled to take other further action, including commencing court proceedings. Disputes of this nature should be referred to the dispute resolution procedure under Clause 23, which is discussed in greater detail a paragraph 7.8 below.

7.7.9 The key point to consider in terms of contract loss is that it can potentially be a very expensive exercise if it is not planned for or mitigated fully. This will be easier to achieve if the ISPA is terminated upon 6 months notice in accordance with clause 15.2(b), but will be more difficult if it is terminated on shorter notice under clause 15.5 (termination for material breach).

7.8 Contract changes

7.8.1 A key risk in any contract is what happens when things change. (See Module 2 for more information).

7.8.2 **Changes to service levels**

7.8.2.1 This is dealt with in Clause 1.4 of the ISPA. A number of issues can arise:

- There is no limit to the amount of changes that may take place. For example, the Contractor could quadruple the amount of services to be provided, or reduce it by 95%.

- Changes are subject to Schedule 7 (Change Control), which is currently blank. This will need to be agreed with the Contractor.

- The Contract has the discretion to make changes to Service Levels under the ISPA to reflect changes made to the Services Agreement. Try to seek full information and prior consultation before the imposition of a change or variation to the ISPA.

7.8.3 **Changes due to external factors**

7.8.3.1 There is no provision for changes in payment in the ISPA. It would therefore be sensible to include provisions to protect yourself against cost changes in Schedule 6 (Charges).

7.8.3.2 Other factors outside of your control include:

- High inflation

- New legislation and good practice requirements

- Large national funding cuts.

7.9 Dispute resolution

7.9.1 A contract of this nature will commonly include a dispute resolution clause, which sets out the procedure that the parties must follow should a dispute arise under the contract. Conflicts or disputes can arise in relation to any number of issues, including payments, the provision of services or the conduct of staff etc. The main aim of such a clause is to resolve disputes amicably and informally without commencing court proceedings, which can be costly and time consuming.

7.9.2 Alternative dispute resolution (ADR) can involve a range of techniques to try to resolve disputes without having to take legal action through the courts. These techniques can include mediation, arbitration or expert determination.

7.9.3 Clause 23 of the ISPA governs the ADR process that must be followed by both parties should a dispute arise under the contract. The provisions call for a tiered approach, or an “escalation of measures”, that should be employed at each stage of a conflict.

7.9.4 The key premise is that both parties must consult in good faith to try and resolve a dispute. The first stage is for the dispute to be referred to each party's named Relationship Manager. If the dispute cannot be resolved by the Relationship Managers within 10 working days from the date of the dispute arising, either party may give written notice to the other that a dispute has occurred. The dispute must then be referred to the Chief Executives of each party within 5 working days.

7.9.5 If the dispute cannot be resolved by the Chief Executives within 10 working days, the ISPA provides that the dispute "may" be referred to mediation at either party's request. This wording means that mediation is an optional measure, and that court proceedings could be pursued instead. You may wish to make mediation a compulsory step of the dispute resolution process.

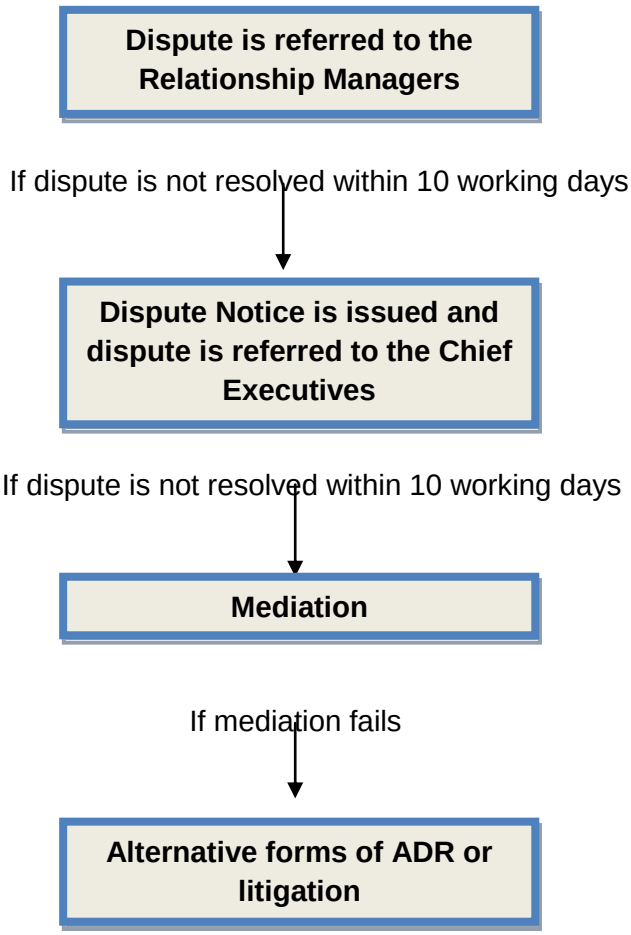
7.9.6 Mediation is a structured, but informal facilitated negotiation between the parties where an independent mediator helps the parties to reach a resolution. If mediation fails, the parties retain the right to use litigation if necessary.

7.9.7 The ISPA states that any mediation shall be conducted by a mediator that is appointed by the parties, or an external body (the Centre for Effective Dispute Resolution), if a mutually acceptable mediator is not appointed within 15 working days. The mediation shall take place at a mutually convenient location and will follow the procedure established by the mediator. Importantly, the cost of any mediation should be borne equally between the parties.

7.9.8 If mediation fails to resolve the dispute then other forms of ADR could be used, or court proceedings issued. It would be helpful if key disputes could be referred to an independent expert such as an accountant. Such "expert determination" is binding and could be used to decide whether a Relief Event has occurred and whose fault it was (clause 8.1), or whether the Subcontractor has failed to provide the services (clause 1.2).

7.9.9 The dispute resolution procedure does not prevent a party from seeking interim relief from the courts (i.e. an injunction to prevent a party from carrying out a particular action), at any stage of the ADR process.

7.9.10 The following diagram sets out each stage of the ADR process under the ISPA:



7.9.11 Your staff should be aware of this escalation process and the time frames involved in the ADR procedure.

7.9.12 Effective use of ADR is often preferable to court proceedings, which as mentioned, can be expensive and time consuming for all involved.

7.10 Key action points

7.10.1 In summary, it is essential to be aware of all the potential ways in which the ISPA can be terminated and to plan accordingly. Potential financial loss can be limited if steps are taken to mitigate the effects of termination as far as possible. This will include (but will not be limited to):

- establishing and understanding the terms of the Services Agreement;
- seeking clarification as to whether the Subcontract is "materially significant" and therefore whether termination requires the agreement of the Authority.
- mitigating the risk of breaching the ISPA by ensuring that all obligations are understood and discharged effectively;
- defining as far as possible what constitutes a material breach;

- effective use of the dispute resolution procedure to resolve any conflicts that could lead to termination;

- including corresponding rights of termination in any subcontracts;

- adequate contract planning, including the effective management of resources and other connected contractual arrangements;

- considering the implications of TUPE on termination and taking further employment law advice where necessary; and

- seeking contract changes that protect you i.e.

    - limit the scope for change in the services description;

    - agree a low excess in Clause 1.4(c) with regard to the cost of a change; and

    - agree provisions in Schedule 7 (Change Protocol) that protect you, which include the use of expert determination if there is a dispute.

7.10.2 There are circumstances, such as termination of the Services Agreement by the Authority, that you can do very little to prevent or plan for. This is one of the key risks of sub-contracting under the ISPA and is something that has to be weighed up and considered as part of the wider commercial implications of taking on services under the contract.

7.11 Resources

7.11.1 Chapter 21, *Contracts and Contract Law*, Russell-Cooke Voluntary Sector Legal Handbook.

Module 8

Data protection, confidentiality and intellectual property

Index

8.1 Introduction

8.1.1 In this Module we will be providing an overview of the information, data protection, confidentiality and intellectual property provisions of the ISPA, particularly as outlined in Clauses 18 to 20 of the ISPA. We will highlight the key issues that your organisation needs to consider in relation to data management and the protection of your intellectual property.

8.1.2 Providing services under a contract inevitably generates the creation and use of a great deal of data, information and material. If information and data used in connection with a contract is mismanaged, misused or treated carelessly there is a significant risk that your organisation will be in breach of both contractual and statutory obligations.

8.1.3 Contractual arrangements often call for the intellectual property rights of one party to be used by the other when providing or promoting the services under the contract. Your organisation's name, brand and reputation are essential assets, which should be protected as far as possible. Paragraph 8.6 below provides more information on how intellectual property rights are dealt with under the ISPA.

8.1.4 A point to note is that the terms of clauses 18 to 20 are usual terms to be found in this type of contract and are unlikely to be negotiable. Organisations should not underestimate the costs- both financially and in terms of time and management it takes to ensure the necessary records are maintained.

8.2 Data protection

8.2.1 Overview – the law

8.2.1.1 The handling of personal data requires an organisation to comply with a number of obligations to protect that data under the Data Protection Act 1998 (DPA).

8.2.1.2 The main underlying purposes of the Data Protection Act are to prevent the misuse of an individual's personal information and to allay concerns that many people have about privacy and the extent to which information can be used and passed on without their knowledge or consent.

8.2.1.3 The DPA applies to personal data about identifiable living individuals (data subjects). Personal data does not have to be written. It can include video, CCTV, photographic, audio and other non-text data etc.

8.2.1.4 A data controller is an organisation or individual who decides, either on its own or with others, how data is to be processed and the purposes for which it is used. An organisation or individual who handles information on behalf of a data controller, but has no say in how the information is collected or used, is a data processor.

8.2.1.5 Where organisations undertake joint activities, share data or enter into partnerships with other bodies, it is essential to establish who is or are the data controller(s) and who, if anyone, is a data processor, and how their relationship is regulated. Further information about these arrangements under ISPA can be found at paragraph 8.2.2.2 below.

8.2.1.6 Additional requirements apply to the processing of sensitive personal data, such as information relating to the data subject's racial or ethnic origin, political opinions, religious or similar beliefs, physical or mental health; the commission or alleged commission by the data subject of any offence or any proceedings for any offence committed or allegedly committed by the data subject.

8.2.1.7 The detailed requirements of the DPA are beyond the scope of this guidance note, but further information can be found on the Information Commissioner's Office (ICO) website (see the list of resources at the end of this Module). Data Protection is a very complex area of law and specialist legal advice should always be sought where necessary.

8.2.2 ISPA- contractual terms

8.2.2.1 The data protection provisions of the ISPA are contained at clause 18.2.

8.2.2.2 The ISPA provides that the Contractor is the data controller and the Subcontractor the data processor. The Subcontractor must only process personal data in accordance with the instructions of the Contractor (clause 18.2(b)). However, note that your organisation may also be a data controller in respect of any personal data it collects that is not connected to the services provided under the ISPA.

8.2.2.3 You must only process personal data that is reasonably required to be processed, and for no other purpose other than in connection with the services. You must not disclose any personal data to third parties other than to employees and subcontractors that reasonably need to receive the data in order to carry out the services, or unless it is required under a court order (clause 18.2.(c)).

8.2.2.4 The ISPA does however require a Subcontractor to provide details of personal data that it processes under the contract to the Contractor if requested to do so. You must make your clients/ service users aware of your duties and obtain the necessary consents to share data with the Contractor, MoJ and possibly other public bodies. Equally, you must notify the Contractor of any requests you receive from data subjects about the processing or copying of data and act upon the Contractor's instructions when responding to such a request.

8.2.2.5 You are required to adopt adequate technical and organisational measures to safeguard personal data and to prevent unlawful use or accidental loss or destruction of that personal data. This includes; only allowing properly trained and authorised staff to handle the data, implementing effective record and data management systems and carrying out regular reviews of those systems. Note that the Contractor has the right to request written evidence of the data management methods used by the Subcontractor, to ensure that they are compliant with the DPA. This information must be supplied within 20 days of request.

8.2.2.6 Under the DPA, it is the Data Controller (i.e. the Contractor), rather than the Data Processor that must adhere to the terms of the DPA, and who will be the subject of any enforcement action by the ICO. A Data Controller will always therefore pass on these obligations under contract, which is what is happening in Clause 18.2. Note that a breach of the data protection provisions by a Subcontractor could be considered a "material breach" of the contract and lead to termination of the contract under clause 15.5. Please see Module 7 for more information on breach and termination.

8.3 Subcontractors records and provision of information

8.3.1 Under clause 18.1 the Subcontractor is obliged to maintain a range of different records. Unsurprisingly, detailed records need to be kept on overheads, expenditure, performance against Service Levels and the payment of Service Credits. The Subcontractor must also maintain a record of all staff matters including turnover, pay and disciplinary matters. They will be important in order for you assess the costs associated with the Services and can be used as evidence to justify why the Contractor should cover any losses if they change the Service Levels required and/or the price associated with those changes.

8.3.2 The Guidance Note to the ISPA also provides that if you are working with offenders, you must keep up to date records for each person on the MoJ's chosen reporting system. Any damage or loss of the data must be rectified at your own cost. It is a usual term for a Subcontractor to be responsible for storing data and indemnifying the Contractor for any losses or damage it creates.

8.3.3 Note that clause 18.2(c)ii provides that the Subcontractor must not transfer any personal data outside the UK without the prior consent of the MoJ. This clause aims to protect personal data, but is more restrictive than most contracts, which often state that personal data cannot be transferred outside of the EEA. This clause could potentially impact on backed up data that is stored with external non-UK based companies in a "cloud". Current EU data protection law is that the transfer of personal data out of the EEA is prohibited unless a country provides adequate protections and is on its "white list". The US also has a "Safe Harbor" list to which organisations sign up. It would seem onerous for the MoJ to prevent the transfer of data to external data storage companies if they were based in a country on the EU's "white list" or on the US Safe Harbor list. This is something that could be negotiated with the Tier 1 and flagged with the MoJ if you think that the restriction will impact on your organisation.

8.3.4 The fact that the Subcontractor must maintain those records does not give the Contractor complete freedom to have sight of all of those records. They, the MoJ, and other specifically mentioned parties can request and be provided with information that it reasonably requires to manage the Service Agreement and deliver the services. However, this is an area where disagreements could arise between the

Subcontractor and Contractor about what needs to be disclosed. Unfortunately, there is no simple step that can be taken to remove the risk of this occurring.

8.4 Confidentiality

8.4.1 In addition to protecting personal data, the ISPA also contains provisions on the management and disclosure of "confidential information". When contracting with another party there is inevitably going to be an exchange of information and data about each entity, some of which may be confidential. Contracts such as this will usually contain clauses governing how such confidential information will be handled and protected.

8.4.2 The ISPA defines confidential information as being:

"*information that ought to be considered as confidential (however it is conveyed or on whatever media it is stored) and may include information whose disclosure would, or would be likely to, prejudice the commercial interests of any person, trade secrets, Intellectual Property Rights and know-how of either party and all personal and sensitive personal data within the meaning of the Data Protection Act 1998" ("Confidential Information*").

Confidential information also includes any "Commercially Sensitive Information", which is to be included in Schedule 15.

8.4.3 Both parties are under a duty to keep the Confidential Information of the other party confidential (whether it is marked "confidential" or not). It would however aid the parties if all confidential information is marked as such.

8.4.4 Confidential Information may only be used for the purposes of the ISPA and delivery of the services. It may be passed on to employees, directors, subcontractors and professional advisors on a "need-to-know" basis only. The party in receipt of this Confidential Information must ensure that these groups keep the information confidential in accordance with the terms of the ISPA. Where a recipient does not fall into one of these categories, it may be necessary to get that person to enter into a written confidentiality agreement (clause 18.4(g)).

8.4.5 These obligations do not apply in all circumstances. The instances when Confidential Information may be disclosed are detailed at clauses 18.4(g) and (g) of the ISPA, and include when the information is already in the public domain, if the Contractor is required to disclose information under the terms of the Services Agreement, or if either party is required to so by law.

8.4.6 Under clause 18.4(a) of the ISPA, both parties are permitted to disclose the terms of the ISPA, other than any Commercially Sensitive Information, (which must be kept confidential). Note that the MoJ is entitled to receive a copy of the ISPA, any amendments to it, along any subcontracts that you enter into.

8.4.7 In terms of publicising the ISPA, you are permitted to communicate with the press and other communications media to promote and publicise the services (clause 18.3(a)). Although in doing so you must be mindful of your obligation to not disclose Confidential Information and must consult with the Contractor before engaging in any publicity. Additionally any publicity that involves filming or photography at premises where the Services take place, needs prior consent from the MoJ (clauses 18.3(b) and (c)). These clauses do clash with the apparent freedom to disclose non-Confidential Information "without restriction" at clause 18.4 (a). We would suggest

that Subcontractors act cautiously and at the least inform the Contractor of any publicity.

8.5 Freedom of Information

8.5.1 The Freedom of Information Act 2000 (FOIA) provides a general right of access, although with significant exceptions, to information held by public authorities. A body may also be designated as a public authority for the purposes of the FOIA if it appears to exercise functions of a public nature. Voluntary sector organisations are not currently designated as public authorities for the purposes of the FOIA, but public authorities will often pass these obligations down to subcontracting parties in the subcontract.

8.5.2 Under cause 18.5 ISPA, you and the Contractor are required to assist the MoJ in fulfilling its disclosure requirements under the FOIA. If the Contractor receives a request for information that is held by you, you must provide that information within 5 working days and assist the Contractor in meeting the time frames set out in the FOIA.

8.5.3 Under no circumstances are you, or your subcontractors allowed to respond to a request directly. Any request received by you must be passed on to the Contractor within 2 working days. This is a very short time frame, and staff should be prepared and briefed on the procedure for passing on requests, and the time frames involved, so that you are not in breach of the terms of the ISPA.

8.5.4 There can be significant costs and administration time involved in processing and dealing with freedom of information requests in the specified time periods. It is difficult to assess and plan for how many requests will be made in connection with the services. However, given the political nature of the Transforming Rehabilitation Programme, it is possible that there will be a higher level of FOIA requests than would be usual for these types of contact.

8.5.5 Note that you must retain records and information held in connection with the ISPA for a specified amount of time (to be agreed with the Contractor). This links to your wider record keeping obligations under the ISPA discussed at paragraph 8.3 above.

8.6 Intellectual Property & Project Data

8.6.1 The protection of your organisation's intellectual property (IP) should always be considered when entering into a contract such as the ISPA. This is a very important asset in terms of your organisation's brand and reputation, and should not be overlooked in contracting situations.

8.6.2 IP refers to non-tangible assets such as names, logos, goodwill and rights arising from the creation and invention of new products and creative works. The ISPA defines Intellectual Property Rights (IPRs) under the contract as all patents, trademarks, copyright, database rights, moral rights, rights in a design, know-how, confidential information and all other intellectual property rights whether registered or not, together with any goodwill that is to be used by the Contractor for the purposes of providing the services.

8.6.3 The ISPA provides that any IPRs that are in existence before the date of the contract will remain the property of the original owner. Therefore any "background" IP is unaffected. Neither party may use the other's brand or trade marks without prior

consent. If consent is given, then any use must be in accordance with that party's brand guidelines and within the terms of any licence that is granted.

8.6.4 The Contractor grants the Subcontractor a licence to use the MoJ's IPRs in connection with delivery of the services only (clause 19.2). In turn, you must grant the Contractor, the MoJ and any related party a licence to use your IPRs to the extent necessary to "receive and use the services" (clause 19.5). "Subcontractor IPRs" are not defined under the ISPA and so could potentially refer to all IP owned by you and third parties if you are using the IP of another organisation under licence etc. This is quite an onerous term that essentially allows the Contractor and MoJ to use any of your IP. The parameters of this use should be clarified with the Contractor. You should also note that this licence includes a right to sub-license to third parties, which makes it very difficult to control who will be using your IP.

8.6.5 As mentioned in paragraph 18.6.4 above, it is possible that you will be using IP that is owned by a third party. You must take care that you are not infringing these third party rights by granting licences to use this IP when you may not have permission to do so. This is quite a complicated area of law and further advice should be sought where necessary.

8.6.6 Upon termination of the ISPA all rights under these licences will end and you must stop using any of the MoJ's IP.

8.6.7 You must notify the Contractor if you become aware of any potential infringement of the MoJ's IPRs, or any claims that they are infringing the rights of a third party. You are also required to indemnify the Contractor against any financial loss it suffers as a result of a claim made against the Contractor that its receipt of the services infringes the IPRs of a third party. This essentially means that you are protecting the Contractor against any IP infringement where you are at fault. The Contractor does however give you a corresponding indemnity against any loss incurred by you as a result of the Contractor supplying materials to you that infringe the IPRs of another person or organisation. This does give you a degree of protection.

8.6.8 However, the documents, materials and data ("Project Data") that are created, acquired or used in relation to the services are owned by the MoJ (clause 20.1). This will include materials and documents that you create and use during the delivery of the services. This means that you will not retain any right to use those materials for future projects, whilst the MoJ will be at liberty to use them for other purposes.. The ISPA includes a licence back to you to use the Project Data solely for the extent necessary to provide the Services under the IPSA. Therefore, you cannot use them for other projects or services you may have with other parties, nor can you use them for general marketing purposes. This may seem unfair, particularly, if you developed them. However, these terms are not unusual and we imagine there would be limited scope to amend these terms.

8.6.9 You must also store and use Project Data in the ways specified under the ISPA (clause 20.1(c)). This includes; keeping it segregated from other data, preventing loss or corruption of the data and ensuring backup and storage in accordance with good industry practice. Any damage or loss of the data must be rectified at your own cost.

In summary, the IP provisions under the ISPA are heavily weighted in the Contractor's and Authority's favour. You should clarify the parameters of Contractor's and Authority's use of your organisation's IPRs to ensure that your brand and reputation is not diluted or damaged

in any way. There is potential for you to negotiate a slight expansion in your use of Project Data but it is very unlikely that the Contractor will move significantly on these clauses.

Key action points:

- Ensure that your organisation has adequate systems in place for the management and protection of personal data, Project Data and Confidential Information.
- Ensure that your organisation and staff are fully aware of the data protection implications under the ISPA and DPA when handling and processing personal data and sensitive personal data.
- Inform service users of your obligation to share personal data with the Contractor, MoJ and possibly other related parties.
- Make sure that staff and subcontractors are fully aware of the obligation not to disclose Confidential Information.
- Label and record confidential information as "confidential" wherever possible.
- Be aware of the tight time frames for notifying the Contractor of any freedom of information requests and have the necessary systems in place to deal with such requests within the prescribed time frames.
- Carefully document any existing IP that you want to ensure you keep control of after the end of the contract.
- Take care to use other people's IP in accordance with the terms of the ISPA, but also take steps to ensure that your own IP is being used in the correct way and is adequately protected.

8.7 Resources

8.7.1 Chapter 43, *Data Protection and use of Information*, Russell-Cooke Voluntary Sector Legal Handbook.

8.7.2 Chapter 44, *Intellectual Property*, Russell-Cooke Voluntary Sector Legal Handbook

8.7.3 Information Commissioner's Office: www.ico.gov.uk

8.7.4 UK Intellectual Property Office: www.ipo.gov.uk

Module 9

Other implications including working practices, volunteers, policies and data management

Index

9.1 Introduction

9.1.1 Winning a contract under the ISPA regime may be simply one of many contracts that you have tendered for and you may well be very familiar with the particular requirements that a contract brings. However, for those of you for whom it's a new or less common phenomenon, you need to think through the whole of your operation to see if the requirements of the Services Agreement (the main contract between the MoJ and the Tier 1 Contractor), the ISPA (the contract between you and the Tier 1 Contractor), and the nature of the Services provided can be adequately met and managed. Below is just a sample of some of the things that you are going to need to consider.

9.2 The Services

9.2.1 The ISPA simply requires you to deliver the Services in accordance with Service Levels defined in Schedule 5. One problem that we encounter when advising charities and VCSE's is that they aspire to achieve the very best practice. In specifying the Service, such organisations have to remember that while they may aspire to do the very best, they ought to get the Service Levels specified as modestly as they can, so that they can absolutely guarantee that they won't be in breach of the ISPA by failing to deliver any of them.

9.2.2 A particular issue that an organisation needs to bear in mind is that delivering a service requires the co-operation, referral or support of other bodies, be it NOMs or a Tier 1 Contractor or anyone else. It ought to be spelled out in detail that your performance is dependent upon a third party's support or information. Whatever

assurances you receive from the Contractor, you should ensure that the support you are expecting is very fully specified in the ISPA.

9.3 Good Industry Practice

9.3.1 This is defined in Schedule 2 (Definitions) of the IPSA, but includes the skill, care, prudence and foresight to be expected from a skilled and experienced operator under similar circumstances. Note the reference to foresight. What could change or go wrong? Have you made provision for it?

9.3.2 If you are going to be asked to demonstrate that what you are doing is Good Industry Practice, what are the guidelines or bench marks that you are going to refer to demonstrate that you have reached an appropriate standard? Will reaching those standards increase your cost or require new practices? You need to have thought this through before there is an argument about it.

9.3 Policies

9.3.1 The ISPA may well require you to demonstrate that you have appropriate policies and procedures in place. Existing policies may need amending or checking.

9.4 Business continuity

9.4.1 You may already have good business continuity plans. These may need to be updated and improved and there may be additional costs incurred in order to meet the level of business continuity protection required by Schedule 8 of the ISPA.

9.5 Audit

9.5.1 Clause 14 of the ISPA requires you to have an audit which complies with the as yet unspecified provisions of Schedule 10. In negotiating the ISPA, you need to be sure that these audit requirements are ones you and your auditors can meet, and that you have costed any additional costs generated by that requirement. Clause 14(b) of the ISPA specifies that the MoJ shall have the same rights as the Contractor in respect of audit. This implies that in addition to specifying that there will be an audit, the auditors of the Contractor and the MoJ can also have access to your documentation. You will want to agree firewalls between documents relating to the ISPA Services and those relating to other parts of your work.

9.6 Documentation and records

9.6.1 Operating in a contractual environment means that you have to be able to prove and quantify record keeping. Record preservation has got to take on a new importance which may mean training and support to staff to comply with this.

9.6.2 Not only must records be maintained but they must be in a form that you can access. The final form of the ISPA is likely to specify the forms in which you must report to the Contractor. Do remember that once the ISPA is finished, this is not the end of the matter. The Contractor or the MoJ may well come back and audit you to see that you can prove that you delivered the outputs for which you were paid, years after the event. At a minimum, you should carefully preserve and know where you can locate all the documents relating to the delivery of the Services for a period of seven years.

9.6.3 The requirement to deal with freedom of information or data subject access enquiries may require you to deal with information more quickly than you previously had to (see Module 8 for more information).

9.6.4 Clauses 20.1(f) and 20.1(g) require that if you fail to comply with the Contractors ICT policies or as a result of any other breaches of the ISPA, data is lost or corrupted, you will carry out any action to replace or repair the data at your own cost. At the point of bidding you should get hold of the MoJ's ICT policies since these policies can involve a significant investment in data storage and therefore cost.

9.7 **Health and safety**

9.7.1 Clearly complying with good industry practice will require up to date and effective health and safety practices. If you are not confident that you have these in place, now is the time to look at them.

9.8 **Volunteers**

9.8.1 You need to think about the implications for your volunteers and the culture of the organisation if the ISPA is going to take you into new areas or acquire new demands. For example, the record keeping requirements of the ISPA may come as an unpleasant surprise to volunteers used to working with you in a much more informal atmosphere.

9.8.2 You need to look at the way you train and support volunteers and your volunteering agreement to ensure that it is compliant with the requirements of the ISPA. To give an example, if a volunteer creates material related to the Services, they will technically own the copyright in it unless you have arranged in the volunteering agreement for the copyright to belong to yourselves. You need to do this because under the ISPA you are passing ownership of that copyright up the contracting chain to the MoJ and will not be retaining ownership you. You also provide an indemnity to the MoJ for any claims made to the MoJ from a person who states their intellectual property rights have been infringed by the MoJ.

9.8.3 Contracts like ISPA may also lead to you trying to find ways of making your volunteers more committed, more timely or otherwise compliant. Be very careful not to offer rewards that will convert their volunteering status into workers' or employees' rights. Again, your volunteering agreement is a key document and should be reviewed and updated.

9.8.4 In that review, issues like confidentiality will also need attention.

9.9 Information assurances

9.9.1 This section and the associated schedule has not been completed either in the ISPA or in the Tier 1 contract but it is likely to contain a covenant or promise that certain key information on which the Services depend is correct. It is absolutely vital that in negotiating the ISPA you ensure that an appropriate promise is included stating that the key information on which you have relied in providing the promise to provide the Service and calculating the costs is correct. Such a promise should provide you with the right to claim compensation if you find the information supplied was misleading.

9.9.2 However, you should not let this reduce your vigilance when doing due diligence on the key requirements of the ISPA. It is very important in any negotiation not to accept assurances which are not built into the ISPA. If you cannot get them built into the ISPA, you should carefully document them in correspondence or emails between you and the Contractor and ensure that the records of those assurances are retained. This won't give absolute contractual protection but may provide the basis for renegotiation if things do not turn out as promised.

9.10 ISPA Questionnaire

9.10.1 Section 6.3 and Schedule 2 of the ISPA deal with a questionnaire to be completed before the ISPA is entered into. In the main it seems designed to assist the MoJ and show that the subcontracting is being undertaken fairly, however a Subcontractor such as yourself cannot rely on the intervention of the MoJ.

9.10.2 It does give some possible basis on which to undertake negotiations. The provisions of clause 11 of the ISPA will also assist here.

9.10.3 As to the rest of the questionnaire, it just explores your understanding of the process and has little protective value.

9.11 Key action points

- Conduct a realistic assessment of any problems that might arise in trying to deliver the service at the level required.
- Have you established what you believe good industry practice to be?
- Review the business continuity plan.
- Review document retention and record keeping procedures to ensure that they comply with the ISPA.
- Review volunteering agreements.
- Document the basis of the agreement and any assurances given. Where possible ensure that these are included in the contract itself.

9.12 Resources

- Chapter 39, *Volunteers*, Russell-Cooke Voluntary Sector Legal Handbook.
- Chapter 40, *Health & Safety*, Russell-Cooke Voluntary Sector Legal Handbook.

Module 10

Entering negotiations: Issues to consider

Index

10.1 Introduction

10.1.1 It can be daunting to enter into negotiations with a large organisation, but they will expect you to negotiate and to fight your corner, so do not be worried about asking for the changes in the ISPA that you want.

10.1.2 However, be realistic as to what changes might be offered. As with any negotiation process, it is good to be clear in your own mind about areas that are open for negotiation and what issues are deal-breakers for your organisation.

10.1.3 Before starting any discussions, you need to arm yourselves with a real understanding of the process and the position of the parties. At the very least, you need to look at the standard Tier 1 Contract and it would be much, much better if you had actually got a copy of the Contract won by the Tier 1 Contractor if they have already won it. If they are negotiating, then I think asking for a copy of their bid is important. You have also got to look at all the background documentation.

10.1.4 Two documents that emanate from the government you need to know well. The first is the Compact which sets out the broad principles that the government expects its departments to use when contracting. Your argument will be that these broad principles should be reflected in the ISPA that you have with the Tier 1 Contractor. You can only do that if you understand and know the Compact principles.

10.1.5 The second is the document specifically referred to in the ISPA, the Market Stewardship Principles. This represents an attempt by the government to ensure that subcontracting processes are conducted in a reasonable and fair way. Unfortunately, the key provisions such as risk allocation do not give you an actual concrete tool by which you can require that risks are not passed down to you by the Tier 1 Contractor. The document emphasises that there needs to be discussion and consideration about all the issues. Unless you are prepared to escalate the process by complaining to the MoJ with possible adverse commercial consequences, these Market Stewardship Principles do not give you a lever by which you can actually require the Tier 1 Contractor not to pass risk to you when in your view it is deeply inappropriate.

Clearly it provides a very good basis for a robust argument on the issues, but you will need to recognise the commercial realities at work here.

10.1.6 Recognising the commercial realities is absolutely key to any negotiations. Have you made an assessment of how critical your input is to the Tier 1 Contractor? If you are someone they cannot dispense with, you may well be able to achieve considerable improvements in the ISPA. If there are a range of alternative providers lining up behind you ready to sign what is put in front of them, you are likely to find that achieving much in the way of change is down to your persuasive skills and not based on a strong negotiating position.

10.1.7 Clearly if you have done the work suggested below at the bid stage to ensure that there is a concrete commitment to your input into the project, then you are much harder to dispense with than if you are simply referred to as possible additional services in an inconclusive or unquantified way.

10.2 What is open for negotiation?

10.2.1 The ISPA is currently in draft form. The consultation period for this discussion draft closed on February 20th. A final standard ISPA will be produced, but the MoJ have been unable to give a date for this.

10.2.2 As outlined in the Explanatory Guide it is intended that the ISPA is the starting point for subcontracts with Tier 2s and most Tier 3s. It must be used for Tier 2 organisations that are registered with the MoJ and it is deemed to be good practice for Tier 3s. It is expected that it will be negotiated and clauses will be removed or changed. There may be some clauses which are deemed mandatory and these will be identified by the MoJ, presumably in the final version.

10.2.3 It is a framework document, and there will be a good deal to be added in the case of individual ISPAs. These will include details of Services and payments etc, but there is also, currently, room to negotiate the “standard conditions”, such as around intellectual property, Service Levels and volume guarantees.

10.2.4 The MoJ expects that for Tier 1 organisations subcontracting with Tier 2 organisations the ISPA will be their starting point. For Tier 3 organisations (smaller organisations that are more likely to be providing specialist services), it is less clear. The ISPA is held up as good practice and the principles of transparency and passing down appropriate levels of risk apply. This may meant that a shortened version of the ISPA is used for smaller contracts. It is possible that grants may be on offer, though this is likely to be exceptional.

10.2.5 In short, there is room for negotiation. How much can be negotiated is likely to depend on the level of service your organisation will be providing.

10.2.6 What can you negotiate? In theory, you can negotiate change in any provision in the ISPA suggested to you other than ones which are legally binding on the Tier 1 Contractor because of the terms of its contract with NOMS. Even where the Tier 1 Contractor is required by that contract to do something, it doesn’t mean that you need necessarily to accept that. It may well be that the obligation can stay with the Tier 1 Contractor and you can contract without agreeing to provide it. However, there will be provisions, for example, to co-operate in the Freedom of Information process or to deal with the intellectual property issues which are clearly spelled out in the Tier 1 Contract in which the main Contractor will not be able to vary.

10.2.7 The areas where you are most likely to be able to make progress are around the definition of the Services that you are being asked to provide and the price that you are being asked to provide it at and the timing or other trigger points for payments. Contracts like the ISPA may work on a Fee for Service or a Payment by Results mechanism. If you are going to be paid on a Payment by Results mechanism, you need to reserve your negotiating position to ensure that you only sign up for results that you are able to deliver.

In considering whether you are able to deliver them or not, it is important to remember that even if you believe you have the skills and expertise to deliver them, you must consider whether that delivery will not be dependent on the co-operation, referral, provision of service or other input by a third party. If it is, you need to put in provisions that guarantee that the co-operation or input is available.

10.3 Market Stewardship Principles

10.3.1 The Market Stewardship Principles are set out in Schedule 3 of the ISPA. These set out the intention of the MoJ and its desire to ensure that the Supply Chain is effective, transparent and risk is passed down in a reasonable way.

10.3.2 The problem is that they are largely principles that apply between the Contractor and the MoJ and therefore will only be enforceable by them, not by you. However, they do form a valuable tool for negotiating. If you feel they are being breached and these issues cannot be dealt with through negotiation, it is also possible to use the Cabinet Office Mystery Shopper Service to raise these issues with government (see below). But this is likely to take several months.

10.3.3 The principles are:

10.3.3.1 **Adherence to Appropriate Management of Risk in the Supply Chain.**

This includes:

- not passing risk down to Subcontractors inappropriately;
- allocating work appropriately and giving you a balanced case load;
- provisions for managing fluctuations in case load and the impact on income;
- providing transparent payment terms;
- minimum contract terms – which are identified as likely to be three years for most contracts, However note that within the ISPA there is potentially a significant risk of early termination (See Module 7);
- intellectual property rights – this is simply a demand for them to be transparent. In itself it offers no protection.

10.3.3.2 **Alignment of Ethos in the Supply Chain**

- This outlines the expectation that both parties will be clear about what is important to them and build trust. The Contractors should set out a statement outline support on offer, meet appropriately to ensure good relationship management and record meetings.

10.3.3.3 **Visibility Across the Supply Chain**

- This outlines expectations with regard to fair payment terms, volumes, apportionment of referrals (particularly so that not all risky cases are passed on). It also sets out the expectation that retendering of contracts will be done visibly – usually meaning that they are openly tendered and advertised.

10.3.3.4 **Reward and Recognition for Good Performance**

- This outlines the expectation that rewards will be fairly shared across the Supply Chain.

10.3.3.5 **Application of the Principles of the Compact when working with Civil Society Organisations**

- The Compact sets out various principles with regard to working with government. There is an expectation that these principles will be followed.

10.4 The Cabinet Office Mystery Shopper Service

10.4.1 If you feel that there has been poor practice in the subcontracting process or if there are Supply Chain issues, then you can use the Cabinet Office Mystery Shopper scheme, which allows you to report your concerns to the Cabinet Office who will investigate them. Last year over 100 reports of poor practice across all government departments were investigated, and a report is available on these. The Mystery Shopper service applies to government departments and Primes (Tier 1) Contractors.

10.4.2 The remit of the Mystery Shopper Scheme is to:

- Provide a clear, structured and direct route for suppliers to raise concerns about public procurement practice when attempts at resolving issues with a contracting authority or a first tier supplier have failed.

- Provide reasoned feedback to enquirers on their concerns.

- Help the Cabinet Office identify areas of poor procurement practice so it can work with the contracting authority to put them right, and help ensure similar cases do not arise in future.

- Take action to reduce the likelihood of similar issues arising in other authorities

10.4.3 You need to consider both the time delays and the impact of such a report on your relationship with your Contractor.

10.4.4 If you feel something is seriously wrong, it may also be possible to use the courts through the process of Judicial Review. There are very tight timetables. In most cases you will have had to apply to the court within one month of the decision you object to. Take immediate legal advice from a firm with knowledge of these special areas of the Public Law Project (0808 165 0170).

10.5 Entering negotiations while Tier 1 Contractors are still bidding for CPA areas

10.5.1 Tier 1 Contractors are currently in an Invitation to Negotiate phase. They are expected to present to NOMS at the MoJ a plan for how they will deliver the Services in a local area by June 16th 2014. NOMS will expect them to have a very good understanding of the CPA area, and the Services that are currently provided within it, and to present them with a "credible" Supply Chain.

10.5.2 This means that this is a good time to be opening discussions with Tier 1 Contractors and you may have attended networking meetings or been involved in discussions already.

10.5.3 A number of Tier 1 Contractors are bidding in each CPA area. See the map referred to in Part 1 of this document. As the negotiation process continues, this map is likely to change. The MoJ will not release information in changes as to who is bidding in which area until specific "refresh" dates every few months, so you may find that some bidders in your area have changed.

10.5.4 Unless you are very confident about who will win the Tier 1 Contractor, you should not commit to exclusivity. You should not be asked to commit to exclusivity by a Tier 1 bidder.

10.5.5 Clearly Tier 1 Contractors are not yet in a position to offer contracts. It is not clear which Tier 1 Contractors will be running which CPAs, the ISPA is still in draft form and the contract between NOMS and the Tier 1 Contractor will not have been agreed. It is also unlikely that Tier 1 Contractors would want to enter protracted and costly legal negotiations when it is unclear that they have won the contract.

10.5.6 However, you can ask for written assurances from potential Tier 1 Contractors, before you agree to be named as a partner in the bid. You could seek to agree broad heads of terms with regard to service, volumes, and other areas such as those listed below.

10.6 Assurances which may be sought during the Tier 1 bidding stage

10.6.1 It would be useful for you to consider what in the way of concrete assurances you may want or need from the Contractor: This may depend on the level of your contract. These might include:

10.6.1.1 Limitations on the percentage the Tier 1 Contractor can take off for "admin/profit".

10.6.1.2 Guarantees of a minimum volume or that a particular project or work stream will be included in your ISPA.

10.6.1.3 Assurance of the "quality" or suitability of client referrals or allocations.

10.6.1.4 Clear payment terms that adequately reward you and are based on a cash flow that you can manage, and that realistically reflect the uncertainties in the contract.

10.6.1.5 Sight of their bid, their confirmation that their budgeting for their bid is based on costing/spot rates that are acceptable to you.

10.6.1.6 Agreement to not use your logo or intellectual property without your consent on each occasion.

10.6.1.7 A clear indication of the type of work you will be given, size/volume of your role in the bid and their confirmation that they won't renege on that.

10.6.1.8 Binding mutual confidentiality obligations.

10.6.1.9 Binding mutual obligations on them not to recruit or offer employment to your staff. There have been a number of occasions when Tier 1 Contractors have cherry picked key staff from partners.

10.6.1.10 Not to publish any announcements referring to your involvement in the bid or contract or forming part of their Supply Chain without your consent.

10.6.1.11 That they will not commence or continue discussions with any organisation offering services competitive to yours and to provide you with information about all partners with whom they will be operating. You may then wish to consider whether any reputational or other issues arise because of the nature of the other partners in the bidding group or supply chain.

10.6.1.12 That they should not for the duration of the ISPA offer services that compete with the service that you offer or take in-house services which you're proposing to provide.

10.6.1.13 To set up mechanisms to keep you informed of developments in the bid.

10.6.1.14 To inform you if there are changes in the ownership or control of the Tier 1 Contractor.

10.6.1.15 To nominate liaison people with appropriate contact arrangements.

10.7 Key action points

10.7.1 There are many issues which you will want to seek to negotiate should you get to the stage where you are negotiating a firm contract. These are set out in the modules and you are advised to get legal advice prior to signing such a contract.

10.8 Resources

- The Compact **www.compactvoice.org.uk/sites/default/files/the_compact.pdf.**
- The Mystery Shopper Scheme **www.gov.uk/doing-business-with-government-a-guide-for-smes#mystery-shopper-scheme**

Glossary of Key Terms

Schedule 1 of the ISPA includes a definition of the key terms of the ISPA.

We also felt it would be helpful to outline some of the most relevant terms here, to help you as you read the subcontracting document.

Authority means the Secretary of State for Justice, who holds the head agreement (Services Agreement) with the Community Rehabilitation Companies. Changes to this agreement may be passed down to your subcontract. Also the Authority may be required to agree to, for example, the termination of your contract.

Change means each addition to or amendment of the ISPA other than certain clauses. This is important because some changes (defined as Changes, with a capital C) will be handled through a Change Protocol – which is a procedure for how to agree and implement the change. Other types of changes (such as changes in liabilities) are excluded from the Change Protocol, but can be varied in other ways, through a variation clause.

Charges are the payments from the Contractor to you as a subcontractor. These are calculated as will be described in Schedule 5;

Contractor is the organisation that will contract with you. It is NOT the Tier 1 bidder (eg A4E) but rather the Community Rehabilitation Company (the CRC) that has been bought by the bidder. The CRC will be owned by the preferred bidder, but the government will retain some shares to retain some control over the CRC. Your contract will be with the CRC, albeit majority owned by the Tier 1 bidder.

Contract Period in the terms of the contract is the date of the agreement to the Termination date. Currently it is recommended that **the Initial Term** is a minimum of three years, but the contract may continue beyond this period.

Dependency means the actions of the Contractor set out in Schedule 4 of the ISPA. This usually refers to actions that you as a subcontractor are dependent upon in order to satisfactorily complete your work, so for example, giving you the information you require to engage with a client.

Employment Regulations means the Transfer of Undertakings (Protection of Employment) Regulations 2006 – otherwise known as TUPE.

Force Majeure refers to chance events that are beyond the reasonable control of either party – flooding and riots for example.

Good Industry Practice means that degree of skill, care, prudence and foresight and operating practice which would reasonably and ordinarily be expected of a skilled and experienced operator under similar circumstances;

Materially significant. Not yet defined. The Contractor can only terminate a subcontract that is “materially significant” with agreement with the MoJ. There is not as yet a definition of “materially significant”, but it presumably relates to delivery of core elements of the Services Agreement. It would be worth ensuring that you understand if your subcontract is “materially significant” from the outset and including this in the contract documentation.

Project Data means any data, documents, materials etc, used under the ISPA

Relief Event is a failure of the Contractor to carry out a Dependency – an action which the Contractor is required to take, on which your service depends.

Service Credits: Service Credits usually refer to a reduction in the payment that you, as the subcontractor will get as a result of not meeting the Service Levels. The Service Credits will be set out in Schedule 5;

Service Levels means the level of service that you agree to provide to trigger the payment. There currently aren't examples of this, and you will need to negotiate these levels carefully. They might be set out like Key Performance Indicators – i.e.achieving a certain percentage of a result, or as a specification of the service you will provide – e.g. seeing a client for one hour every month. They should be a description of the *minimum* service you would be required to do, not a full description of the service that you hope to do. The Service Levels will be set out in Schedule 5;

Services Agreement is the head agreement between the Secretary of State for Justice and the Contractor under which this subcontract falls

Tiers 2 and 3: Although not used specifically in the ISPA, the ISPA will be required for Tier 2 organisations, and recommended only, for Tier 3 organisations. There is no definition of Tier 2 and Tier 3 at the moment. The general understanding is that Tier 2s will probably be larger organisations undertaking "materially significant" elements of the contract, and Tier 3s will be subcontractors taking on smaller elements of the contract. This has not been defined by the MoJ. You should ask for a clear understanding of whether you are deemed to be providing a "materially significant" service as it may affect the termination rights under your contract.

Disclaimer

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