

# Third way

Whichever party wins the general election, there is cross-party support for entrusting the delivery of more public services to charities, not-for-profits and emerging social enterprises (collectively the 'Third Sector'). The government has invested large sums in training public sector commissioners on how to do this and has created a range of investment funds to kickstart market capacity, like Futurebuilders and Communitybuilders.

Third sector organisations are perceived as having certain advantages. Allowing community-based groups to deliver more services embodies a new spirit of localism and builds civic engagement. It is also said that third sector organisations are better at working with difficult-to-reach user groups, such as refugee communities or offenders, who may be suspicious of and less inclined to use services provided by state agencies. Operating outside the constraints of state bureaucracy, they should also be able to innovate and implement change quickly.

The volume of services contracted out to third sector organisations has been steadily growing. The market for outsourced public services in the UK was estimated to be worth £79bn in total in 2008. Of this, some £7.8bn was provided by charities and not-for-profit organisations in 2008/9.

For local authorities, commissioning services from the third sector presents some interesting challenges. These can be grouped under three main headings: market capacity, procurement issues and contract risks.

## Stimulating market capacity

Local authorities are expected to actively build third sector capacity in their area. The Local Government

Performance Framework includes National Indicator 7, which measures the contribution local government makes to improve the environment for independent third sector organisations to operate successfully.

Guidance states that encouraging a vibrant, diverse and independent third sector is 'a vital part of a fair and enterprising society. It can help communities to be more cohesive and inclusive, and help individuals to have more say over issues that affect them'. One way to achieve this is for authorities to award more contracts for service delivery to third sector organisations.

However, third sector organisations face some very practical challenges in winning these contracts. Our own research highlighted some of the issues that providers face when dealing with local authorities (see further: [tinyurl.com/yg4azgy](http://tinyurl.com/yg4azgy)). These include:

- Lack of early and effective consultation in the development of authority policy, programmes and strategies, leading to poorly packaged or unattractive procurements;
- Failure to properly assess third sector organisations' capabilities and to consider them as serious contenders. Insufficient recognition has been given by authorities to their strengths and skills. Procurement teams can be too risk averse and have a perception that the third sector lack the resources, organisation, and business skills to deliver;
- Difficulty in finding out about contract opportunities and who to approach about becoming a supplier. The third sector may often lack knowledge and experience of local government procedures and have difficulty in breaking into the market;
- A trend towards use of large-scale contracts, and rationalisation of the supplier base through large frameworks, may rule out many third sector organisations. Difficulty in forging alliances with prime contractors may prevent them from playing a support role in the supply chain;

- Complex and costly prequalification and tendering procedures with unrealistic timescales, prescriptive specifications and excessively

burdensome contract terms. These can mean invitations to tender are consigned to the 'too difficult' pile; and

- Lack of a level playing field in procurement, particularly relating to the unwillingness of some procurers to allow full cost recovery in tender prices, including a proportion of the organisation's overheads and management charges.

## Procurement issues

In our recent survey of third sector organisations, 71% of respondents felt that the bidding process for service contracts is not getting any easier. Back in 2004, the government published guidance for local authorities entitled *Think Smart, Think Voluntary Sector*, which offered some very practical tips for authorities on how to stimulate the market for third sector service delivery. These remain just as relevant now.

The critical success factors highlighted were:

- Understand the market through ongoing dialogue. Get to know the third sector organisations locally, their capabilities, and their problems in dealing with you;
- Consult early on viability of policies, programmes and procurement strategies;
- Open contract opportunities to the third sector by providing information about how to become a supplier, wide publication of contracts in accessible media, training and support;
- Focus procurement on outputs/outcomes rather than

processes, to incentivise third sector players and capture their expertise and innovation; and

- Keep contract drafting simple and proportionate – reducing complexity and bureaucracy helps to reduce the costs of procurement.

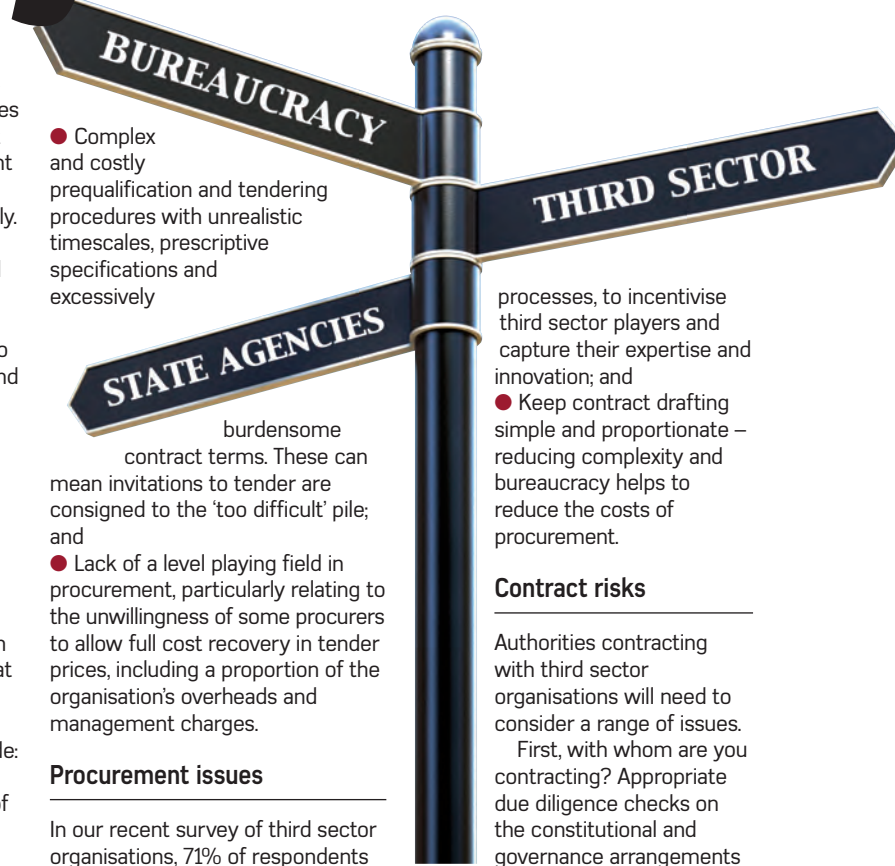
## Contract risks

Authorities contracting with third sector organisations will need to consider a range of issues.

First, with whom are you contracting? Appropriate due diligence checks on the constitutional and governance arrangements of the provider will be

essential, as well as the usual financial and background checks. Procurers will need to be familiar with the new legal formats for third sector organisations, such as the community interest company, and the charitable incorporated organisation (likely to come into force later this year). There is also a renaissance of more traditional forms like the industrial and provident society.

Practical issues can arise – for example, it was widely thought that because the community interest company enjoyed a statutory 'asset lock', this prevented the sale of key assets. Not so, as the recent disposal by Ealing Community Transport CIC of its kerbside recycling business to May Gurney plc demonstrates. Does the organisation have the necessary powers to undertake the activity? We were recently asked to advise a housing association on its power to operate a local authority day centre, only to find that it did not have the



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powers to do so, requiring an emergency general meeting to amend the constitution.

Other key commercial issues include the following:

● **Performance and payment regime:** local authorities are increasingly looking to tie payments to delivering successful outcomes. Third sector organisations will want to satisfy themselves that the performance measures are reasonable and attainable. A contract where income may not even cover costs is a recipe for insolvency. The timings of payment will also be crucial to the provider's cashflow;

● **Employment and pensions issues:** where a service is being outsourced for the first time or being reproced, it is very likely that the Transfer of Undertakings (TUPE) regulations will apply. This is often the sleeping giant of contract risks. The practical effect of TUPE will be to transfer the existing workforce to the successful bidder (and the resulting cost base), together with any existing claims from employees that may be

pending. Often local authorities may struggle to provide bidders with quality information about employees in advance of the transfer date. This can be a source of uncertainty which causes providers to price in additional risk. Transferring employee pensions requires particular care, especially where public sector benefits have to be replicated;

● **Risk, indemnities and insurance:** the parties need to be clear about the allocation of contract risks. Authorities will wish to satisfy themselves that providers have in place the necessary public liability, employers' liability, malpractice and property/ business interruption insurances;

● **Confidentiality and data protection:** providing services in some sensitive sectors may involve passing on confidential data about service users. Appropriate clauses and procedures will be required;

● **Termination and exit from the contract:** in certain circumstances, both parties will be looking for an exit route. It is in both parties' interests that this is a last resort. It

may be necessary to include some intermediate steps to allow disputes to be resolved informally or formally, perhaps using ADR techniques, before proceeding to a termination. The parties will need to consider what would happen in this 'armageddon' scenario though – particularly where vulnerable service users are involved. In practice, the authority may have a statutory duty to step in and provide the service. It will need the cooperation of the outgoing service provider, access to key documents and personnel, intellectual property rights and employee lists.

To address the issue of fairness of dealings between third sector and public agencies, representatives of key stakeholders developed The Compact. First published in 1998 and recently updated, this document is a charter of fundamental principles that should apply to contracts in this sector. For example, under paragraph 4.8 of the Compact Code for Procurement and Funding, the government undertakes 'to discuss risks upfront and place responsibility with the

public sector body or voluntary and community organisation best able to manage them'. We have found that awareness of this charter among procurement officers is limited (see more at [www.tinyurl.com/lmacah](http://www.tinyurl.com/lmacah)). We are likely to hear more of this charter in coming months.

Initiatives like Total Place and community asset transfers are likely to encourage third sector providers to seek out more contract opportunities, as authorities move from being providers to enablers and facilitators, in a much more diverse market of service providers. In an era of fiscal austerity, grant funding and charitable giving is likely to decline; contracted income will therefore become an attractive proposition for these organisations. Local authorities and their legal teams will need to ensure they have the processes, skills and techniques for responding to and managing this expanding market.

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