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Charity Law Unit

*Charities and the
Contract Culture:
Partners or
Contractors? Law and
Practice in Conflict*

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THE CHARITY LAW UNIT

The Charity Law Unit was established in October 1994 to provide a focus for the already well established reputation of the Faculty of Law, University of Liverpool for research and teaching in Charity Law. The Charity Law Unit has grown from strength to strength in the last five years and it is the only such unit in England and Wales.

The Charity Law Unit's mission is to be recognised as the centre of excellence for legal research of the charity sector. It aims to do this both by responding fully to the demands for legal research raised by the charity sector and by being pro-active in highlighting and pursuing legal research in areas where the law and its application requires clarification, guidance or possible reform.

The report, *Charities and the Contract Culture*, was written by Debra Morris, Director of the Charity Law Unit. She is author of *Schools: An Education in Charity Law*, published by Dartmouth Press in 1996, and she is assistant editor of the leading text on charity law, *Tudor on Charities*, published by Sweet & Maxwell. She is also case note editor of *Charity Law & Practice Review* and has written many articles in the area of charity law.

The empirical work for *Charities and the Contract Culture* was largely undertaken by Vicky Whitehouse who was employed as Research Assistant on the project.

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Charities and the Contract Culture would not have happened without the co-operation of the charities who agreed to take part in this project. Thanks are due to all who willingly shared their experiences of the ‘contract culture’ and gladly supplied us with all the documentation that was requested. The project also benefited from the experiences of the Purchasing Authorities who agreed to be interviewed and who allowed the Charity Law Unit access to their own policies and procedures related to the ‘contract culture’. Similarly, the lawyers who were contacted and who gave their own perspectives on the issues at hand are also thanked.

To respect their confidentiality, participants’ names and potentially identifying circumstances have been altered.

Thanks are due to Alan Chapman of Liverpool Council for Voluntary Service. In particular, his assistance in identifying the sample charities at the start of the project is much appreciated.

Within the Charity Law Unit, thanks are extended to Vicky Whitehouse, Research Assistant on *Charities and the Contract Culture*. Her ability and good nature meant that the empirical side of the project ran very smoothly. Her contribution to the project as a whole is gratefully acknowledged. Finally, my colleague, Jean Warburton is thanked for her constant support and advice before, during and, hopefully, after the duration of this project.

Debra Morris

July 1999

EXECUTIVE SUMMARY

This research seeks to identify problems of a legal nature which have arisen for charities as a result of the ‘contract culture’. This issue was dealt with at both a theoretical and a practical level.

As well as undertaking a close analysis of written documentation, the research involved representatives from both charities and Purchasing Authorities talking at length about their own experiences of the ‘contract culture’, raising a wide range of issues. Charities welcomed the opportunity both to voice their concerns, and also to identify what they perceive to be the positive outcomes, which have developed as a result of the ‘contract culture’.

Despite a huge growth in activity within the ‘contract culture’, much uncertainty still abounds. Many charities feel that they have been submerged within the ‘contract culture’ without much support. They have had to learn from experience. Purchasing Authorities often expressed similar views. Yet, because funding is so critical to the relationship between Purchasing Authorities and charities, it seems inevitable that Purchasing Authorities will always have the upper hand. Both parties accept that good working partnerships between Purchasing Authorities and charities are essential for effective provision of services to users. Yet, the report demonstrates that Purchasing Authorities often use their greater bargaining power in order to impose terms on charities in contracts for service provision without sufficient negotiation. The resulting contracts often lack mutuality, imposing the lion’s share of the obligations upon charities. The report shows that inability to access appropriate advice compounds the inequality of bargaining problem for smaller local charities that do not have the back-up of national support networks.

The report reveals that the **legal analysis** of the contract funding relationship appears to bear little resemblance to what happens **in practice**. Many conflicts were identified:

- In order to ascertain the extent and exact nature of the legal problems facing charities providing services through contracts, it is important for Purchasing Authorities and charities to clarify whether funding arrangements constitute legally enforceable agreements. Yet, both parties seem unclear. A legal analysis of the agreements tends to support the view that they **do** have legal effect. It would certainly be prudent for charities to proceed on the basis that their funding arrangements with Purchasing Authorities do have legal standing, potentially exposing charities (and possibly trustees themselves) to liability for breaches of contract.
- Contracts have not, in general, provided the security of funding for charities that might have been expected. This may mean that charities’ legal commitments, for

example, under contracts of employment or leases of property, entered into in order to carry out contracted service provision, might remain when their funding through contracts has ended.

- In law, charity trustees must run their charities independently. Yet, the report highlights the dangers faced by charities of unwanted or over-excessive intrusion by Purchasing Authorities - a common feature of the 'contract culture', caused by the lack of balance of power within contracts. First, charity trustees may find that they are acting in breach of charity law by agreeing to contract terms in which they have surrendered their right to exercise their own decision making powers. Secondly, because of the lack of balance of power, actual interference by Purchasing Authorities may go further than that allowed within the terms of the contract.
- Both parties recognise the benefits of charities working together so as to provide the best possible quality of service for users. However, one of the consequences of the 'contract culture' has been the growth in competition between charities themselves. Charity trustees may not now be making the most effective use of their resources, as required by law.
- The *raison d'être* of contracts for service provision is to provide services to users. Yet, reference to users within contracts is often hard to find. Contrary to expectations in a rights-based era, contracts have not been used as an opportunity to give rights to beneficiaries of charities.
- There are adverse legal implications for charities and their trustees delivering services which are not consistent with their charitable objects. Yet, the report illustrates the increasing propensity for charities to become involved in such activities.
- Another common feature of the 'contract culture' is the likelihood that charities are subsidising the costs of service provision through contract from their own charitable funds. The fact that, in law, this causes particular problems when the service provision is one that a public body is legally required to provide, seems to be largely ignored in practice.
- Despite the finding that funding agreements within the 'contract culture' constitute legally enforceable agreements, the report indicates that legal sanctions are rarely imposed upon parties delivering services through contractual relationships. Charities should not derive excessive comfort from this finding and become complacent. It only takes one Purchasing Authority to sue for breach of contract for a charity to find itself (and possibly its trustees) in grave financial difficulties.
- Charities' legal concerns arising out of the 'contract culture' tend not to be related to their charitable status. They are mainly related to Employment Law matters. The 'contract culture' has meant that charities are increasingly taking on the responsibilities and additional costs associated with employing staff.

- Similarly, property transactions necessitated due to service provision under contract, can also give rise to potentially complex legal implications.

In October 1998, the then Chief Charity Commissioner, Richard Fries said:

Strong partnerships between charities and public bodies are essential to the delivery of good quality, value for money public services in fields like social welfare, health and education. Charities cannot be mere agencies of public authorities and equally important is the ability of charities to retain and assert their independence from government and government bodies. (Charity Commission: 29 October 1998)

It cannot be denied that **both** parties appear to **want** to forge strong partnerships. Yet, this report makes clear that strong partnerships are a long way off. In order to bring this dream to reality, Purchasing Authorities need to put their words into actions. A good starting point would be in the negotiation of contract terms. Charity trustees, for their part, need to rely on the protection that Charity Law gives them in order to ensure that, in entering into contracts, they always have, as is their legal duty, the best interests of their beneficiaries at heart. If the 'deal' will not best serve their charities' beneficiaries, then charity trustees have a perfect excuse for not agreeing to it. If charity trustees were to adopt this approach, as well as going some way to equalise the balance of power between the parties, **law** and **practice** would also be brought more into line.

INTRODUCTION

The Contract Culture

In the past, certain charities have relied upon grants from public bodies to fund the services that they provide. Grants tended to represent a general contribution to a charity, which was not intended to support an identified output. More recently, however, as charities increasingly take over the role of public bodies in providing basic welfare support, there has been a move towards funding charities through contracts whereby payment is made by the public body to the charity for the provision of specific services. The increased amount of service provision by charities, together with the shift from grant-aid to contract payment, has prompted the emergence of the so-called 'contract culture'.

The National Council for Voluntary Organisations (NCVO) estimates that the overall size of the UK voluntary sector economy, in terms of gross income and as defined by general charities is £13.1 billion. Between 1991 and 1995, contract income from government increased by over 50% in real terms, and now, government contracts account for 14.9% of general charities' gross income (Hems and Passey: 1998).

The 'contract culture' has been received with mixed feelings by both charities and public bodies. On the one hand, contracts enable individual charities to clarify their own role, and some have provided a greater degree of certainty and financial security, allowing organisations to plan for the future. On the other hand, charities have had to cope with the complexities of contractual relationships as well as the increased service provision with which they are now involved. There is concern that charities are unprepared for the demands of contracting. There is also a risk that entering into contracts may result in charities losing their independence and autonomy as funding bodies have an increasing influence over policies and service provision.

The legal structure of many charities is based on a background of income generated from grants. Indeed, the law of charity itself was developed on the basis of trust and not contract. Consequently, many charities are now expected to carry out contracted activities within a legal climate designed for grant receipt. The theoretical interface between contract and trust law poses a number of practical legal problems for charities. For example, they may lack the necessary powers to enter into and carry out contracts. There are also further legal implications regarding the personal liability of charity trustees (Warburton and Morris: 1991).

This research aims to examine the legal implications for charities entering into the 'contract culture' by reference to their practical experience.

This research was not undertaken in isolation. Three additional initiatives which were ongoing during the course of the research, and which were informed by this research

and have, in turn, all informed it, are worth mentioning. First, the Charity Commission published its leaflet on *Charities and Contracts* (Charity Commission: 1998). The leaflet highlights issues that charities should consider, and those areas that it would be good practice for them to think about, before entering into contracts with public bodies to provide services. It covers both legal issues and also practical considerations (for example, the leaflet lists points to think about when costing a contract). Secondly, during the course of this research, the NCVO published its Guide to Contracts with Public Bodies, intended to provide practical help for charity staff and trustees when negotiating contracts with public bodies (Saunders: 1998). Thirdly, the Campaign for Fair Contracts was formed by an alliance of dissatisfied charities who complained, at the Campaign's inaugural meeting, in the Spring of 1999, that contracts lack appropriate mutuality and fairness, with charities being expected to carry all the financial risk (Pybus: 1999).

This research suggests that all these developments will be most welcomed, particularly by smaller charities who are finding themselves plunged into the 'contract culture' without much support.

In July 1998, the Better Regulation Task Force published its review of the regulations and administrative procedures surrounding government funding of the voluntary sector (Better Regulation Task Force: 1998). Whilst the report relates to central government funding, many of its recommendations are equally valid in relation to Local and Health Authorities in their roles as funders, and this research on charities and the 'contract culture' has also drawn upon its findings.

Finally, in November 1998, the Compact on relations between the government and the voluntary and community sector was launched (Home Office: 1998). It spells out in practical terms what needs to happen in order to forge a partnership between the government and the voluntary sector. As a framework for improved relations, it will be underpinned by codes of good practice covering funding, policy appraisal and consultation, volunteering, community groups and black and minority ethnic organisations. As with the Compact, the codes will be developed jointly with the voluntary sector's working group on government relations. The Compact only applies to central government, whilst this research concerns charities' relationships at the local level. However, local government is being encouraged to adopt and adapt the Compact's principles and undertakings.

It is hoped that the findings from this research will provide empirical evidence to support the arguments made in recent publications as well as presenting practical conclusions for best practice.

Outline of the Report

The next chapter explains how the research was carried out and gives some background to the charities that were involved. Whilst the research is primarily focused on the **legal issues** surrounding the 'contract culture' it is inevitable that many issues of a non-legal nature were raised whilst conducting the research. This report seeks to tease out the legal issues, which were not always at the forefront of the minds of those interviewed. Chapter 3 gives a broad overview of the main themes arising out

of the research. Chapters 4 and 5 look respectively at the potential legal problems that might concern charities as a result of the ‘contract culture’, and how these issues are dealt with (or largely ignored) in practice. By contrast, chapter 6 raises issues of a legal nature that **do** appear to be of concern to charities due to the ‘contract culture’. Ironically, these mainly do not concern issues related to charitable status. Chapter 7 returns to practical matters related to the contracts analysed that, it is suggested, add to difficulties surrounding the ‘contract culture’. The chapter includes some ‘bullet points’ suggesting best practice in contract construction. The final chapter contains conclusions.

The report is based on the original research described in chapter 2. However, the research builds upon earlier findings from other projects. These are referred to throughout the report. The bibliography contains full references to these earlier publications. Research in this area continues and therefore the bibliography also contains additional references which may provide supplementary background reading.

THE RESEARCH

The Charities

The research is based on a sample of 15 charities in the county of Merseyside, an area which, to some extent, undertook the transition to service delivery under contracts during the early stages of the 'contract culture' (Shore *et al*: 1994).

The sample consists of a range of charities which vary in size and organisational structure, have different sources of income and varying degrees of reliance upon the contribution of volunteers. There is a broad range of beneficiaries of the services provided by the sample, including the elderly, children, those with physical and mental disabilities and the homeless. In line with the 'language of the market' these people are referred to in this report as the 'service users'. The services provided under contract include both statutory and non-statutory services. Statutory services are those which Local Authorities are under a duty to provide. The sample charities all had experience of the 'contract culture' through funding arrangements with a range of public bodies, including Local and Health Authorities, central government departments and agencies, and other quasi-public bodies, such as National Lottery boards.

Charities became involved in the project through personal contact with the Charity Law Unit and with the aid of the local Council for Voluntary Service. All the charities co-operated with the research on the basis that their details would remain confidential. In order to protect their anonymity, each charity has been given a pseudonym and the following brief description:

Children First

Children First is a large national charity with a religious background, which cares for and supports disadvantaged children and young persons. Income is generated through a variety of sources including national campaigns, legacies, trading, as well as fees and grants from Local Authorities and central government. Seventy two per cent of Children First's child care costs are now met from voluntary income and, while Children First welcomes partnerships with public bodies, it is the voluntary income which gives it the potential to be innovative and creative in its work. At a local level, Children First's work includes a community development project providing a range of personal and social development opportunities to promote children's safety and enhance the quality of life of local residents.

People Care

People Care is a long established, but pioneering charity which aims to improve the quality of life for people of all ages in the United Kingdom and other countries in the European Union. At a local level, the vast pool of paid carers and volunteers provide a wide range of services, including residential care to individuals and communities in need throughout the region. People Care receives support through partnerships with the public, private and voluntary sectors. It has an increasing number of contracts with Local and Health Authorities. Fees for services now provide around one half of its income.

Healthy Minds

Healthy Minds is a local charity offering a range of day services to clients with mental health problems, including centre-based therapy groups, advice, self help, community based activities and home visits. Healthy Minds also provides appropriate supported accommodation in individual flats and group homes and works closely with local housing associations. Its main income derives from what is still described in its accounts as grant income.

Elderly Care

Elderly Care is an independent local charity, working as part of a national network of charities, to promote the needs of the elderly. It is an expanding charity and continues to develop various projects and schemes to assist the elderly across the region. With the assistance of volunteers, Elderly Care works in partnership with Local Authorities providing services to the elderly in their homes. Just less than one fifth of the Elderly Care's income derives from one Local Authority service level agreement. It has a non-charitable trading subsidiary from which it receives one third of its income.

Drink Safe

Drink Safe is a local charity providing services to individuals and families suffering as a result of alcohol misuse. Services provided by staff and volunteers include community and family counselling, advice and information, as well as training and education to workers from public and private bodies. The majority of Drink Safe's income is generated through contracts with Local and Health Authorities.

Families First

Families First is a national charity offering support and advice to families lacking adequate resources in order to maintain proper standards of home and child care. At a local level, Families First works with families predominantly drawn from the inner city area. Services provided include counselling, practical help in parenting, budgeting, diet, hygiene, and advice and representation in dealing with other bodies. A large proportion of the Families First's income comes from contracts with Local Authorities and grants.

Providing Help

Providing Help is a large North West charity, with a religious underpinning, providing resources and campaigning both locally and nationally to improve the quality of life of vulnerable children and adults. Many of the services are provided by volunteers and consist of residential care, welfare, community care and day support projects. Public bodies provide the main source of income for the provision of these services.

Unique Care

Unique Care is a local charity providing specialist services to those with a particular disability. It is the only service of its kind in the area. It offers confidential advice and counselling as well as practical help on a wide range of issues such as housing, welfare benefits, health and technology. Priorities of Unique Care include social work support, training and raising public awareness in the local community. Many of the services are provided through partnerships with both public and private sector organisations. Unique Care has service delivery agreements with three Local Authorities to provide social work and support services to people from all age groups and social backgrounds.

Home Care

Home Care is a rapidly growing independent local charity, working as part of a national network of charities, providing domiciliary care in the community. It is now one of the major providers of care within the region. One of the focuses of Home Care is to provide respite and support to carers of those suffering from mental, physical and terminal illnesses. Home Care works closely with public bodies and voluntary organisations providing joint care packages. Its funding derives from contracts with one Local Authority and one Health Authority.

Youth Leisure

Youth Leisure is a large local charity which provides welfare and recreational facilities for young people in the region. Facilities are generally aimed at those who are ordinarily unable to access such facilities due to restricted social and economic circumstances. The majority of the services provided by Youth Leisure are projects financed by Local and Health Authorities. Many of the services are offered in partnership with public bodies and voluntary organisations. Youth Leisure acts as a co-ordinating body and manages over 60 projects.

Women Survivors

Women Survivors is a small local charity that provides help and information to survivors of sexual abuse. It also aims to promote the education of the public into issues surrounding sexual abuse and its effects on survivors. Women Survivors has recently developed a telephone helpline allowing trained volunteers to offer counselling to women in need. The project is funded by a Local Authority service agreement.

Special Attention

Special Attention is a long established local charity, offering a wide range of support and specialist services to those with a particular disability. As well as offering practical assistance and advice, Special Attention provides social and leisure facilities, many of which are run by volunteers. Special Attention has contracts with two Local Authorities. These contracts continue to expand and constitute Special Attention's main source of income. Through these contracts, Special Attention provides assessments which result in individual rehabilitation, training and the provision of specialist equipment and services.

Help Here

Help Here is a small independent local charity, working as part of a national network of charities, providing free, confidential and impartial advice. Advice is offered predominantly on the telephone by volunteers. In recent years, Help Here has struggled financially and this has resulted in cuts in service delivery. The charity is dependent upon one Local Authority funding agreement.

City Living

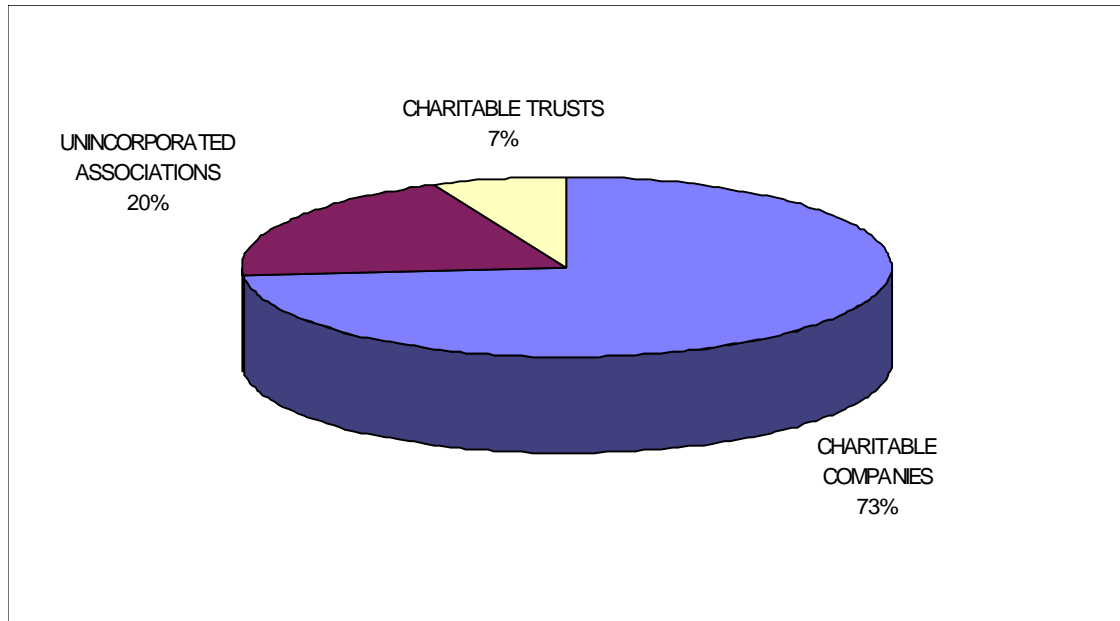
City Living is a local charity that works with homeless and inadequately housed people. The services offered are flexible and responsive to need and provide both short and long term support. The charity receives funding from a Local Authority, other public bodies and charitable organisations.

Green City

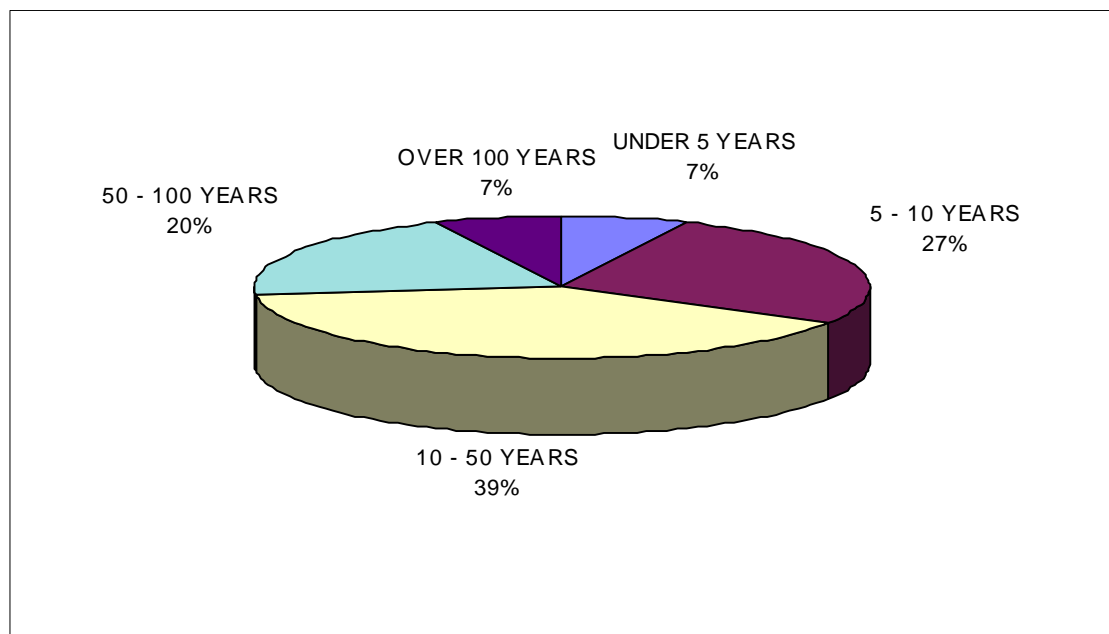
Green City is a small local charity working towards improving the environment in the area. Green City is involved in many campaigns and projects and has become part of the local and national decision-making processes which deal with environmental concerns. It has worked in partnership with a Local Authority and local companies. Being a small charity, Green City relies heavily on the input and contributions of its members. During the course of the research, its core funding package from a national public body came to an end.

The following analyses can be made of the charities within the project:

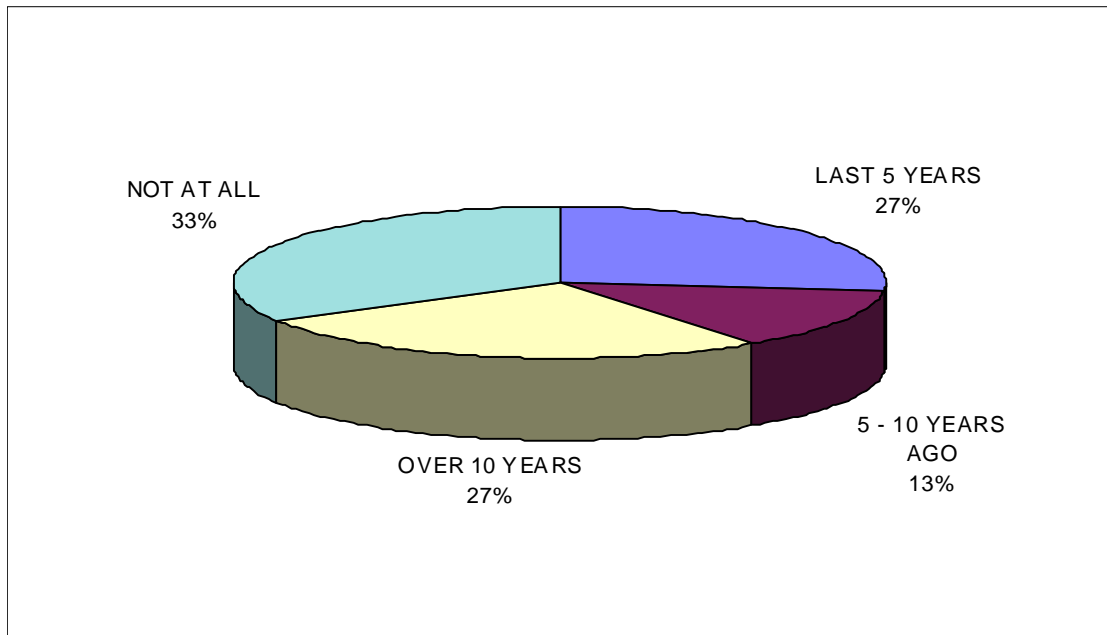
1. Legal Structure



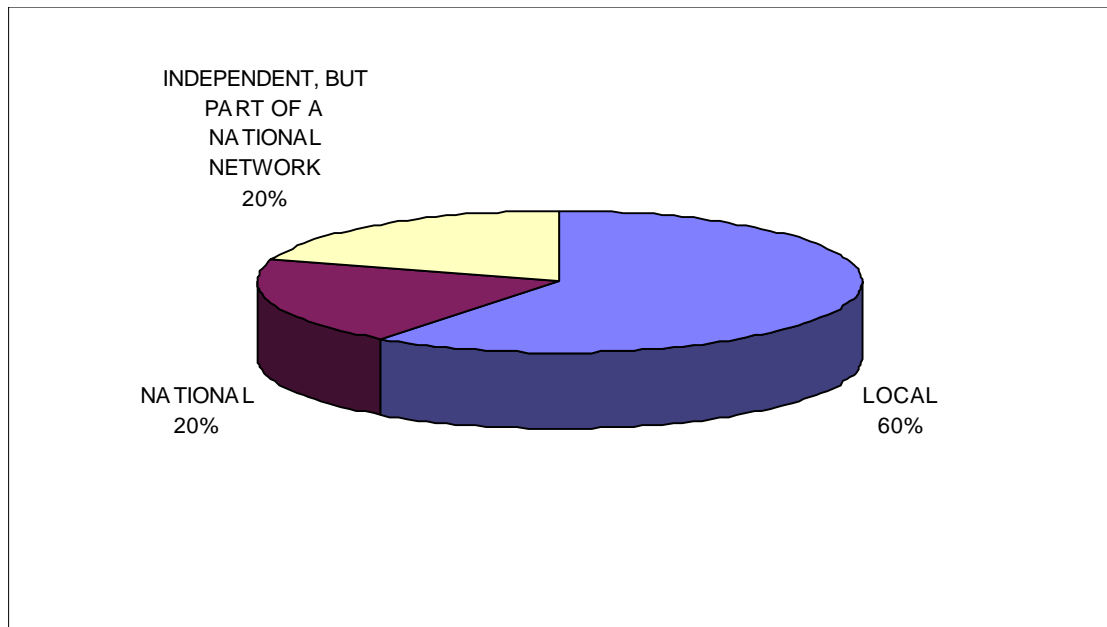
2. Age of Charity



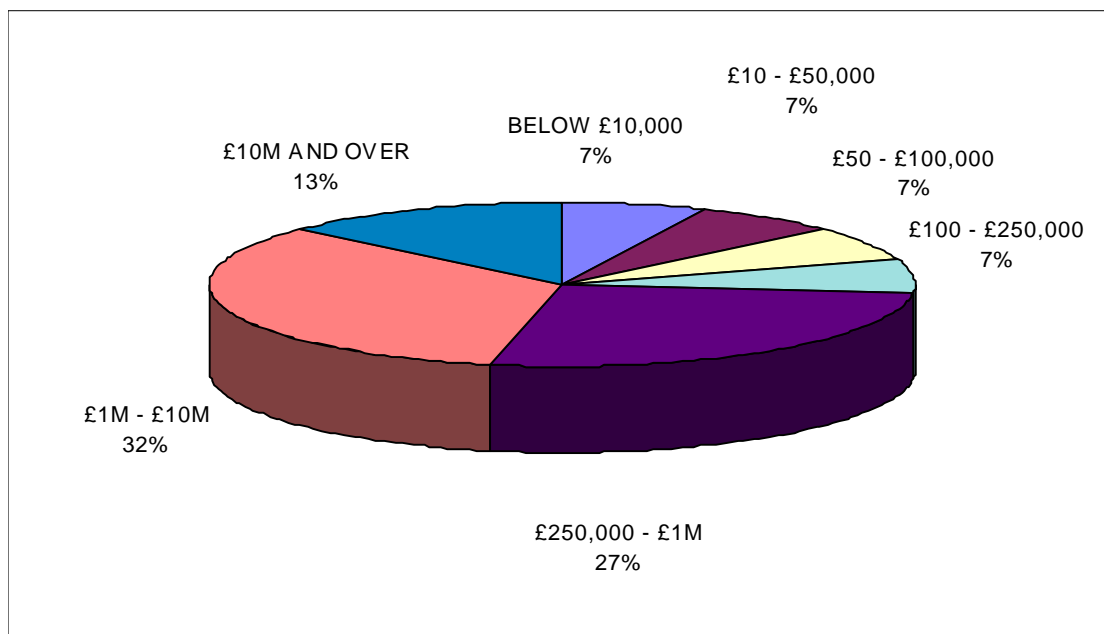
3. Last Amended Governing Documents



4. Local / National



5. Annual Income



The Research

Stage 1

Before any empirical work was carried out, a legal analysis of issues surrounding the ‘contract culture’ was undertaken. This involved looking at the contract process in the abstract and identifying potential legal problems that may arise for charities due to the shift in funding from grant to contract. This work applied general principles of law, whether they be Contract Law, Employment Law, Trust Law or (most specifically) Charity Law, to the current funding environment for charities and identified areas which may give rise to concern in law.

Stage 2

The second stage of the research consisted of a detailed analysis of the governing documents of the charities within the project, together with a sample of contracts entered into by those charities. In total, the contracts within the sample were with 12 different public bodies. A matrix was constructed for the contract analysis. This is published in the Appendix to this report. The analysis of governing documents and contracts was directed:

1. to ascertain whether, in law, each charity has the power to enter into a particular contract;

For example, a contract which a charity has entered into may require the charity to take a lease of a property. It is the governing documents which provide a charity with such powers.

2. to ascertain whether each charity's objects allow it to carry out the contract;
The services provided under a contract must be fully consistent with the objects of the charity outlined in its governing documents.

3. to identify the potential liabilities of both the charity and its trustees;
One of the main functions of contracts for service provision entered into by public bodies with charities is to allocate responsibility for service delivery clearly in the hands of the charity. This may ultimately lead to personal liability for charity trustees.

4. to ascertain what are the rights and remedies, if any, of the recipients of the services.

Public bodies have a duty of care to recipients of services provided under contract. Specific clauses and conditions within a contract should facilitate the involvement of recipients in various aspects of the services provided.

Despite the fact that confidentiality and anonymity was assured from the start, the acquisition of the documents required for the analysis proved to be a lengthy process. First, it was complicated by confusion within the charities caused by the use of a variety of terms for the same set of documents. For example, one charity appeared to possess two sets of governing documents. Close examination revealed that one set had been amended, and had thus become redundant, some 14 years ago. Other charities had difficulty locating their governing documents. Some local offices of national charities appeared not to possess copies of governing documents locally. Secondly, many charities were apprehensive about exposing the details of their services in the contractual documents. They were anxious that an analysis of the documents might incorporate an evaluation of their service provision and thus the quality and effectiveness of the organisation. Thirdly, the fact that the research originated from the Charity **Law** Unit caused some concern. Charities may have feared adverse legal repercussions following our analysis. Extensive personal contact with charity representatives helped the charities to develop confidence in the research and analysis, and this ultimately led to full co-operation and disclosure of all relevant documents.

Stage 3

Once all the documents had been examined, in depth semi-structured interviews were conducted with all 15 charities. Each interview, with charity representatives involved in the negotiation and implementation of the contracts, covered the same broad spectrum of themes, although the schedules were tailored to suit the circumstances of each individual charity.

The interviews were designed to discover:

- the extent to which outside legal advice was taken;
- the problems encountered in entering into the contract;
- the charity representatives' own understanding of the effects of the contract;
- the difficulties encountered in the implementation of the contract;
- any disputes and liabilities arising as a result of the contract.

Many different topics within the ‘contract culture’ were explored generating significant empirical data. For reasons of confidentiality, particularly sensitive issues raised from the case studies have not been individualised.

Stage 4

Once the documentary analysis and interviews had been completed, detailed case studies of each charity within the project were developed, incorporating all information collated.

Stage 5

The next stage of the research involved contacting a variety of public bodies who fund the delivery of service through contractual agreements with charities. These are referred to throughout this report as the Purchasing Authorities. Interviews were held with representatives from five Local and Health Authorities who play a significant role in the funding of services provided by charities on a contractual basis, in order to ascertain their experience of the ‘contract culture’. Each of these Purchasing Authorities had some funding agreements with one or more of the charities within the project. The aim was to get a view of the problems facing charities from a different perspective. Within the body of the report, the comments from the interviews with the Purchasing Authorities are not individualised.

Stage 6

To obtain a broader view of the specific legal problems connected with contracting by charities, interviews were also held with lawyers advising charities on contracting. The lawyers were selected for their experience in the field and were not exclusively from the North West region and had not necessarily advised the charities within the project.

The interviews were designed to discover:

- the legal problems commonly faced by lawyers when advising charities on contracts;
- the legal solutions adopted to address those problems;
- within the limits of professional confidentiality, particular examples of legal problems.

For reasons of confidentiality, information gained from these interviews has been subsumed within the text of the report.

In addition, a similar interview was conducted with a representative from the National Advisory Unit of a network of charities which featured within the project at a regional level.

THEMES

This chapter raises some of the main themes which emerged from the research.

Uncertainty Surrounding the Legal Status of the Funding Agreement

It might have been expected that one of the advantages of a shift from grant to contract funding would be that both parties would have a clearer understanding of their rights and responsibilities. However, one of the overriding themes emerging from the research was the uncertainty surrounding the ‘contract culture’. Many charities complained that the ‘contract culture’ had simply ‘crept up on them’ and that they had been forced to ‘learn as they went along’.

Most fundamentally, the main uncertainty seems to surround the status of the funding agreement itself, with the parties to the agreement often uncertain whether or not it amounts to a legally binding agreement.

The research found that the funding document can be given a variety of names such as: memorandum of agreement; service level agreement; service statement; contract. The document specifies the services which the charity agrees to deliver on behalf of the Purchasing Authority, in return for payment. It includes provisions, in varying degrees of details, setting out the legal obligations and requirements of both parties, namely the purchaser and the provider. The terms of the contract vary according to individual agreements, and are usually created by the purchaser or by the purchaser in conjunction with the provider.

According to a leading authority on Contract Law:

A contract is an agreement giving rise to obligations which are enforced or recognised by law. (Treitel: 1995, p.1)

In law, the name given to a document alone does not determine whether it is legally binding. Indeed, most contracts in law do not require a written document at all. The intention of the parties to create legally enforceable rights and responsibilities will make an agreement to provide services in exchange for payment into a legally binding contract. So, an agreement, though supported by consideration (payment in exchange for service delivery) is not a binding contract if it was made without any intentions of creating legal relations. With ordinary commercial agreements, there is a presumption that there is an intention to create a legally binding relationship. The onus of proving that there is no such intention in such a case is on the party who asserts that no legal effect was intended, and the onus is a heavy one. The law conventionally contrasts commercial agreements, with their presumption of an intention to create legal relations, with ‘domestic’ agreements, where the opposite presumption would apply. On the basis of that distinction, it would seem reasonable to conclude that the ‘contract culture’ agreements would fall within the commercial part of the divide.

In theory, this appears relatively straight forward. However, the evidence suggests that, in practice, the situation is somewhat unclear. It is interesting to note that researchers from other disciplines have also encountered difficulties when attempting to differentiate between old-style grants and new-style contracts within the 'contract culture' (e.g. Osborne and Waterston: 1994).

It would be wrong to describe the new funding environment as an entirely novel phenomenon for charities, but rather the product of a process of formalisation. Most commonly, services that charities were providing in return for part of their grant aid are now being subjected to contracts. This gradual change contributes to the uncertainties surrounding current practice. Only 10% of the agreements analysed had the word **contract** in the title. Moreover, 34% included the word **grant** in the title. This illustrates the blurring of boundaries between the older method of funding through grants, and the more recent, more prescriptive arrangements adopted under the 'contract culture'. Some charities felt more comfortable with the term 'service level agreement' as this was a 'less legal' term than 'contract' and did not represent, in their view, such a stark difference to grants. Many charities within the research are now providing the same services that they were previously providing when funded through grant aid, and it became apparent from the research that it often takes the Purchasing Authorities several years to develop a written document which fully reflects the current contracting environment.

This apparent failure to adapt to the present funding climate only causes confusion and uncertainty for charities. Mirroring the results of research undertaken a few years ago (Russell *et al*: 1995), and suggesting, moreover, that time has not, as might have been expected, clarified matters in the interim, this uncertainty was apparent throughout the interviews with both purchasers and providers of services delivered through contracts:

If you went to the Chamber of Commerce and told them how loose your contracts are, they'd laugh you out of the building because, in the business world, they just wouldn't take on a contract like that in the way that we do. (Special Attention)

Six charities stated that the legal status of their agreements was clear to them, and that some, but not all documents were legally binding. One charity was confident in professing that the documents clearly outlined the responsibilities of both parties and protected the charity from the funders withdrawing their income. On the other hand, four charities confessed that the legal grounding of their funding relationships was unclear to them. The confusion amongst the charities was neatly encapsulated in one particular case:

The hang up still for me is the definition of what is a contract. It is seen to be more a working document rather than a legalistic document. The legal complications and constraints are still there and yet people say that they aren't. (Drink Safe)

In contrast, the Purchasing Authorities were quite defiant about their understanding of the funding agreements that they entered into with charities:

We have deliberately not called the document a contract. The Department does not encourage you to go down the route of having legalised and complicated contracts.

There's a specification and there's a general agreement to work jointly on it, a partnership, but there isn't a kind of legally binding contract.

They are not actually contracts, the title they like to give them is Service Level Agreements because the word 'contract' takes on a legal definition.

However, despite this apparent confidence, there was still some evidence of uncertainty:

I suppose at the end of the day a Service Level Agreement is a form of contract.

The Service Level Agreements are tying to a point.

Our Legal Services Department keeps calling it a 'quasi contractual' basis.

Some Purchasing Authorities appear to make a distinction between statutory services provided by charities, which may be 'purchased' by way of 'contract' and non-statutory services which were felt to be 'funded' through 'funding arrangements'. This distinction does not work, however, when, as is usually the case, one 'funding document' might cover the provision of both statutory and non-statutory services.

One Purchasing Authority went so far as to suggest that it would take advantage of the confusion over the legal status of the 'contracts', particularly in relation to 'smaller local groups' who may perceive the funding arrangement as being legally binding:

That's the power that we've got.

Furthermore, all the Purchasing Authorities confirmed that the funding documents are drafted and approved by their Legal Departments, perhaps suggesting an underlying assumption that the agreements are considered to have some legal force.

A close examination of the funding documents within the research sample leads to the conclusion that, in the main, these would be regarded in law as binding contracts under the normal rule of Contract Law that expressly created commercial agreements are presumed to be legally binding.

The prevalence of confusion amongst parties involved in contracting is hardly surprising given the unhelpful nature of many of the contract clauses.

The presumption of an intention of the parties to a commercial agreement to be legally bound by the agreement **may** be negated by an express provision in the agreement. No such provisions were found in any of the contracts within the sample.

Of all the documents analysed in the research, one half had **no** specific clause in them as to their legal status. It is therefore suggested that these documents **do** have the force of law, with the presumption of contractual intention not having been rebutted in these cases.

Many of the documents had specific clauses in them which, far from rebutting a presumption of contractual intention, seemed to reinforce it. For example, 14% of the documents contained clauses clearly stating:

The Agreement is Governed, Construed and Interpreted by English Law.

This suggests that the agreements containing these clauses **are** legally enforceable, in that they presuppose the applicability of a legal regime, which, by definition, could only apply if an agreement were to have been intended to be legally binding in the first place.

One third of the documents stipulated whether or not the agreement in question gave rise to the legal relationship of partnership between the contracting parties. Of these, all bar one specified that the agreements did not constitute a partnership. It is suggested that by laying down specifically that a partnership relationship was **not** intended from what was **in other respects** a legally binding document, this re-inforces the view that the documents containing these clause **do** give rise to legally enforceable rights and obligations (i.e. they are contracts).

Clauses concerning the resolution of disputes are also revealing. Thirty two per cent of the contracts within the sample provided that any disputes between purchasers and providers should be referred to arbitration. Nearly one half of these made reference to the Arbitration Acts and most stated that the decision of the arbitrator is final and binding. The insertion of these clauses suggest that otherwise any disputes concerning the agreement would be dealt with through normal legal channels. Therefore it could be concluded that these agreements were intended to be legally binding also, in that they contained clauses that did nothing to rebut the presumption of contractual intention and that, instead, reinforced it.

It is concluded that, generally, it is wise for charity trustees to consider that their funding arrangements with Purchasing Authorities are legally binding. The implications of this finding are that, by embracing the ‘contract culture’ trustees are entering into legally binding agreements, which may ultimately lead to charities (or, with unincorporated bodies, trustees themselves) being sued for breach of contract. This will be considered further in chapter 4.

Uncertainty Surrounding Funding

Again, it might have been expected that the onset of the ‘contract culture’ would provide greater financial security for charities. The allocation of funds to charities by Purchasing Authorities has now become a strategic process:

Now, the organisations and their projects are not seen as something separate that are just contracted with. They are seen as part of a total package of services that link in with the things that the Department itself provides.

However, this has **not** led to increased financial security for charities. Decisions made by central and local government on an annual basis dictate the resources available to Purchasing Authorities, thereby affecting the duration of contractual arrangements entered into with charities. This creates uncertainty for both the providers **and** the purchasers of services delivered through contracts.

All the Purchasing Authorities interviewed recognised the benefits of longer term agreements which allow for forward planning. However, Purchasing Authorities expressed their reluctance to engage in longer term arrangements:

We've had budgetary difficulties over the year, so we need the ability to withdraw whenever we need to because of budgetary restraints.

As a result, Purchasing Authorities have adopted rolling agreements, whereby charities are funded on a yearly basis and must re-apply for funding annually, with a non-binding assumption by both parties that the funding will continue. Given the uncertainty of the Purchasing Authorities' own financial position, informing charities of the continuation of their funds can be delayed:

It depends on what is happening to us. We are ruled by the Department of Finance. We're a bit like a family household, if things have gone well then we can start making plans for the next financial year.

Procedures are inconsistent and can vary from year to year:

Last financial year we had our finances sorted for the following year in November. This year we have only gone to Committee in March because we're in a big over-spend situation and charities won't know exactly what they're going to get next year.

Again, this creates instability for the charities concerned:

They've been walking on eggshells for the last 2 or 3 months.

In order for a charity to sustain a level of service, or indeed, to improve it, some sort of long-term commitment is required. This causes particular problems in relation to the employment of staff by charities. The legal implications of redundancy will be considered in chapter 6. The practical consequences of employing staff on fixed-term one year contracts are obvious. As one Purchasing Authority acknowledged, in the first three months, staff are being inducted and in the last three months they are going to be working on their 'exit strategy' (i.e. looking for another job). In effect, a one year contract may only give the employer six months work.

Some certainty is provided by the fact that the Purchasing Authorities confirmed that renewal of contracts to the same charities that have provided the service in the past can usually be presumed. As one charity put it:

Unless a provider has made an absolute hash of delivering a service over the first contract period, they have got to be pretty awful not to be allowed to continue. (People Care)

This gives a certain degree of security for charities currently providing services. However, other charities seeking funding may be disadvantaged. Preferred provider lists are beneficial so long as you are on the list!

Given the uncertainty in relation to funding that is a feature of the 'contract culture', charity trustees may find that their legal commitments, for example, under contracts of employment or leases of property, entered into, in order to carry out contracted service provision (and discussed in chapter 6) might remain when their funding through contracts has ended. Uncertainty surrounding funding may increase the potential for

legal liabilities for trustees. Similarly, indemnities from charitable funds for trustees' personal liabilities, discussed in chapter 4, may not be available if funding is cut off.

Power Struggles I - Partnerships or Contracts with Purchasing Authorities?

It has been suggested by some that the emergence of the 'contract culture' should serve to promote a more equal relationship between charities and Purchasing Authorities, with charities enhancing their status as a result of successfully negotiating and running contracts (e.g. Kumar: 1997).

This was, at least in theory, borne out by the research. For example, it became apparent that some Purchasing Authorities are placing considerable emphasis on developing effective and strong working relationships with charities, focusing on the partnership approach. One Purchasing Authority had produced a written document outlining its own understanding of the concept of partnership with charities. The practical elements of such a relationship allow both parties to deal with any problems concerning service delivery as they arise, thus avoiding serious consequences, which may be of a legal nature, at a later date. Similarly, the purchaser and provider can work together to improve and develop the services provided. Purchasing Authorities said:

It's a partnership. It's not about us just policing what's happening.

We start from a position of trust.

We work together and think about the service. We're not trying to catch them out.

In practice, though, a different picture has emerged. For example, whilst stressing the need to maintain contact between the purchaser and the provider, in order to enable an effective relationship to develop, Purchasing Authorities acknowledged that the lack of sufficient resources meant that this rarely happened:

We do have a certain amount of face to face liaison with organisations but there is not really enough staff. We've got around 125 projects and only about two and a half people to actually do it.

Furthermore, some Purchasing Authorities clearly recognised their struggle to maintain 'equal' relations with charities:

During contract holders meetings it is very much like us and them, where we sit at the front and they're in the audience, which I hate. It's like being in the line of fire. I want to sit in the main body of the meeting because I would rather identify with them.

It's catch 22 for them. They don't exist if they don't have their funding and we know that.

The use of the word 'partnership' suggests an equal relationship. Charities displayed mixed feelings towards this concept. One charity was clear where it stood:

I suppose one of the aspects of having a partnership arrangement is trust and there is plainly no trust from [the Purchasing Authority] through this document. It's policing and monitoring and that can't be interpreted as being a partnership relationship at all. (Families First)

The majority of contractual documents are designed by the Purchasing Authorities, reflecting the balance of power in the relationship:

It may be called a draft contract but it is very much a package. Here you are, this is what we want, with no presumption of negotiation. (National Advisory Unit)

One charity told how it had, together with the Purchasing Authority, jointly composed the wording of a funding document which seemed to give both security and flexibility, with which both parties were happy. The Purchasing Authority then sent the agreement to its Legal Department where it remained for at least a year. It finally returned, twice as long as the draft and having abandoned the original notion of partnership:

We'd referred throughout to partnership, but of course to lawyers partnership means something completely different. They were inclined to interpret the contract, or want to have it interpreted, to our mind, in a very intrusive way. They wanted to access casework records and have direct contact with clients in order to ensure, presumably, that what we said that we were going to do was going to be done. We thought that was going just a bit too far really and we didn't want that. Their lawyers said that we've got to have it and that led to an impasse. (Families First)

Ultimately, the document was never signed by either party, but the money was provided and the service carried out. Many charities told similar stories of contracts taking literally years to agree.

In line with the findings from four earlier research studies (Taylor and Lewis: 1997) it was found that inequality of bargaining position between Purchasing Authorities and charities meant that the scope for negotiation around a contract, suggested by the 'partnership' concept, was often lacking. Whilst some charities were satisfied that they had the choice whether or not to accept clauses, others felt that there was pressure to take it or leave it:

If you leave it, someone else is always going to take it and if you are the one who nit-picks or is perceived as nit-picking, then you're going to be perceived as troublesome and unpopular. (People Care)

The problem of unequal bargains is not solely the domain of charities and is reflected in many contractual situations. English law is committed to the policy that contracts should be upheld. So, generally parties are free to bargain, and to bargain well or badly. In the words of Treitel:

[There is little support for] a general principle of relief against harsh bargains on the ground of inequality of bargaining power. (Treitel: 1995, p.383)

Some charities have found 'safety in numbers' and have been most successful in their contract negotiation with Purchasing Authorities when represented collectively through a consortium of charities. Others, that are part of national networks, have the back-up and 'name' of their national organisation to rely on. However, the evidence suggests that ultimately the Purchasing Authorities have the money and the power to make the final decisions which are sometimes at the expense of the charity:

Providers are often beaten down in a sense - you either drop your charges or you don't get the work, so it's difficult. (Home Care)

Upon examining the contracts in the sample, stark differences were found. Some contracts were very one-sided, placing no obligations whatsoever upon the Purchasing Authorities. The following clause from one of the contracts within the sample leaves no doubt as to where the balance of power lies:

The [Purchasing Authority] may issue to the Service Provider instructions in writing requiring him to vary the service or any part or part [sic] thereof and the Service Provider shall comply with such variation.

Others contracts were much more based around mutual responsibilities. To take the example of variation of contract terms once more:

The Authority and the Provider may at any time agree upon variations to this Agreement. Where appropriate, such variations will include provision for adjustment to the budget. Any variation shall be recorded in writing, signed by both parties and attached to this Agreement.

More than one half of the charities felt that they had a good relationship with their funders, which remained professional and flexible. However, there were feelings of frustration amongst some that the Purchasing Authorities were intrusive and dictatorial. These charities did not enjoy a partnership with the funders and found that they failed to respond to their needs:

They talk about partnership, they talk about joint responsibility, but I don't think that you ever see that in the contract. I'm sure that, if we got it badly wrong, we'd be hung out to dry. They wouldn't say, 'well they're only a charity, they're social workers not lawyers'. We could never ever pretend to be in that kind of world. (People Care)

A number of charities suggested that if their funding relationship could be described as a partnership, then the Purchasing Authorities were certainly the 'senior partners'.

Power struggles between charities and Purchasing Authorities, which the latter usually appear to win, may mean that charity trustees, in order to comply with contract provisions that may remove their own discretion to act, are committing breaches of trust. This will be explored further in chapters 4 and 5 (see 'Independence of Charity Trustees').

Power Struggle II - Partnerships or Competition amongst Charities?

In order to maximise resources within the charitable sector, earlier studies have shown that charities have been used to operating in a collaborative working environment in the past (e.g. Leat: 1995). However, healthy alliances may not fit within the 'contract culture'.

The emergence of the 'contract culture' has created a funding environment designed to stimulate competition, both within the charitable sector itself (sometimes between local and national organisations) and with the 'for profit' sector in fields like care for the elderly, or with the Purchasing Authorities' own remaining direct service organisations.

There are fears that competition and the market forces philosophy may undermine progress in local innovations.

Some Purchasing Authorities adopted the competitive tendering approach during the early days of contracting and identified some positive elements:

Charities have had to become more business-like, which, in some respects is a good thing because it stops people resting on their laurels and they have to look for alternative means of funding.

In the main, Purchasing Authorities were of the view that competitive tendering was not effective for the provision of social services:

You are talking about individual lives. I mean, you are not talking about somebody who can empty the bins. You want to be very sure that your provider really is up to doing the business for those people.

The problems that can be caused by competition between charities in the community were recognised. It is understandable that charities all seeking funds from the same pot of money will be fearful of each other. This is seen as self-defeating by some Purchasing Authorities. Rivalry between charities detracts from the service when people refrain from sharing information and working together:

This has led to distrust and a lack of communication between agencies and the services have become fragmented.

In an attempt to overcome some of these problems, and recognising the improved quality of service which can be achieved by charities working together, Purchasing Authorities have encouraged charities to work together in partnership. For example, one Purchasing Authority adopted a policy of looking at the extent to which charities have been involved with other groups and how far they have moved towards working as a partnership when determining renewal of contracts.

The research found that charities' attitudes towards the competitive funding environment, enhanced by the 'contract culture', has also been varied. Many charities felt no threat from their competitors and were motivated to strive to produce the best quality service for the best price. However, it was also recognised that the rivalry between charities that the 'contract culture' has injected is against the culture of the voluntary sector and can be damaging. One charity told how it had once shared information with another organisation which subsequently undercut it in a bid for a contract for service delivery. The charity had learnt its lesson and would not be so willing to share information with charities on such 'fishing expeditions' in the future. A Purchasing Authority told a similar story and commented:

That's the sort of thing you would expect to happen with ICI or whoever, not with charities, but that's the way things are going.

Several charities spoke of time and money wasted on unsuccessful tenders for contracts:

The difficulty was that the amount of work we put in actually cost a fair amount of money. Where were we going to take that money from? Maybe it can be absorbed in a larger organisation, but it can't in a small one. (Drink Safe)

Charities also talked of competing with in-house Purchasing Authority providers:

How on earth can those of us who operate outside of that magic circle get involved in that? We don't want to in one sense, but we would like there to be a transparent division of the purchasing and providing bits so that people purchasing are purchasing in the best interests of the user rather than with any other agenda. (Healthy Minds)

Charities also expressed concern that competition forces prices down, resulting in higher quality services being produced for less. This only places further financial pressures on charities. One charity was offered a contract from a Purchasing Authority and was told that the contract had previously been with another charity but that this was not working out. During the negotiating period, the charity invested much time and effort, only to be told subsequently that problems with the original charity were now resolved and that the contract was to stay with it. It was suspected that the Purchasing Authority was trying to drive the price down:

It takes a year's planning, a year's negotiation and then we all get played off against each other. (Special Attention)

There is a real fear amongst charities that service quality may eventually suffer. There is only so far that a charity can go in fee reduction without affecting the quality of service provided.

Like all trustees, charity trustees are under a legal duty to conserve the charity property (Duke: 1676). In a modern context, this means that charity trustees should manage and deploy charity resources to the best advantage of present and future service users. Power struggles amongst charities may sometimes mean that charities choose no longer to act in a collaborative manner. This may not be in the best interests of service users, and may in law, amount to a breach of trust by charity trustees.

The Human Element

One surprising finding from the contract analysis was that, despite the fact that the services to be provided were to human beings by human beings, there was little mention throughout the contracts of these people enjoying any rights or being subject to any responsibilities. There was often no reference in the contract to either the service users themselves or the people providing the services (paid staff or volunteers). For example, some of the contracts seemed to place all emphasis on the transfer and allocation of money. In these contracts, even the monitoring clauses were simply references to accountability for expenditure, with no mention of quality of service provided.

Only 50% of the contracts analysed contained clauses providing for evaluation of the service by reference to the service users themselves. Of those that did provide for service user evaluation, these were mainly by way of questionnaires, visits and meetings with service users and (where appropriate) their families. Less than one

quarter of the contracts within the sample contained provisions dealing with complaints procedures.

Recently, there has been a move by all the Purchasing Authorities, towards the introduction of developing outcome measurement, with performance targets set jointly by purchasers and providers. This approach moves away from statistics and attempts to monitor the **impact** on the service users. For example, whereas before a charity might have had to demonstrate that it was open 9 a.m. - 5 p.m. or that it had 50 people coming through the door every week, it will now have to demonstrate what is actually happening to those 50 people. This involves a heightened awareness of service users and their needs. Some Purchasing Authorities request feedback from service users who are given opportunities to play a part in the delivery of services and are represented on various strategic groups. One Purchasing Authority summarised the importance of this awareness:

All this input from users individualises and humanises the process. Data can be manipulated, so their involvement keeps the perspective accurate.

Unfortunately, the inclusion of service users in the development and improvement of policy and practice is not always productive. Purchasing Authorities feel users sometimes lack trust in them:

Time is wasted with organisations and people getting tied up in lacking confidence that their opinions will be heard. There is far too much ego, banter and politics.

Part I of the Local Government Bill (before Parliament in session 1998-99) subjects most bodies within the local government finance system in England and Wales to a new duty to make arrangements for the achievement of 'best value' in the performance of their functions. 'Best value' is described as securing continuous improvement in the exercise of all functions undertaken by the authority, whether statutory or not, having regard to a combination of economy, efficiency and effectiveness. The Government published a provisional list of twelve Key Principles of Best Value in June 1997. These were built upon in a Consultation Paper, published in March 1998 (DETR: March 1998) and the latest statement of the Government's policy on 'best value' was contained in chapter 7 of the White Paper published in July 1998, setting out the Government's wider plans for the future of local government (DETR: July 1998).

With the introduction of a duty on Purchasing Authorities to seek 'best value', outcome related funding is likely to be the rule rather than the exception in contracted funding in the future.

Echoing the findings of two earlier studies (Hedley and Davis Smith: 1994, Russell and Scott: 1997) another human element lacking from the contracts was reference to volunteers. Whilst some charities made it clear that they did not use volunteers in services provided under contract, others acknowledged that their service provision under contract relied heavily on the use of volunteers. This was despite the fact that many of their contracts made no reference whatsoever to volunteers. For example, one charity, whose contract did not recognise the existence of volunteers, when asked about volunteers said:

Yes, we stand or fall by that actually. If there were no voluntary groups or volunteers then there would be very little happening. (Children First)

One Purchasing Authority dismissed this anomaly by simply responding that references to ‘staff’ in contracts include unpaid staff. However, the use of volunteers brings specific responsibilities for charities, for example, to ensure that they are properly recruited, vetted, supervised, supported, trained, and, most importantly, available.

The avoidance of ‘rights language’ in contracts might seem particularly surprising in an era when civil rights are about to enjoy enhanced recognition and protection by virtue of the implementation of the Human Rights Act 1998. Historically, philanthropists have indicated the way in which their property is to be applied in terms of **purposes** only, without identifying specific **individuals** as beneficiaries. Charity law then has not been ‘rights based’ giving at most hope or expectancy (*‘spes’*) to individual beneficiaries. It might have been thought that the ‘contract culture’ could be used as an opportunity to modernise Charity Law, taking the emphasis away from ‘purposes’ and placing it upon ‘people’. This has not yet occurred.

Law Divorced from Reality

One of the most striking themes to arise out of the research is that the legal analysis of the contract funding relationship appears to bear little resemblance to what happens in practice.

For example, in many instances, charities told how written contracts had **never** been agreed and yet charities carry on providing services and Purchasing Authorities continue to pay them to do so. In this situation, the legal analysis suggests that the terms of the contract will be derived from the practice itself. This is despite the fact that the charities are often of the view that they do not have **any** agreement with the Purchasing Authority.

Similarly, when asked about items that were missing from written agreements (for example, complaints procedures for service users) charities often responded that they did have procedures relating to such matters, agreed with the Purchasing Authorities, but contained in separate policy documents which were not referred to in the funding agreements. When asked if they felt that they were bound to follow such procedures, charities usually answered positively. In this situation, therefore, the written agreement does not reflect the true legal relationship between the parties.

It is often the case that contract terms which have been agreed are rarely resorted to in practice. When questioned about specific clauses, some charities felt reasonably confident that they would not be enforced in practice:

There are traps in [the contract], but I am not too sure that, if push came to shove, there is anybody there [in the Purchasing Authority] to implement it, if we fell down a trap or even to alert us, so what’s the value of it? (Drink Safe)

Also, in chapter 5, it will be seen that, during the course of the research, charities told stories of Purchasing Authorities simply ignoring agreed contractual terms and acting

as they wished. This has particular consequences for the independence of charity trustees.

CHARITY LAW AND THE 'CONTRACT CULTURE' - THE THEORY

Before looking at some ways in which Charity Law may cause problems for charities in the 'contract culture', it should be noted that most charities take one of three legal structures: the trust; the unincorporated association; or the company. A charity in either of the first two forms does not have legal personality and its trustees must enter into contracts on its behalf. In all three structures, in order to retain charitable status, the funds must be applicable for charitable purposes only and there must be a sufficient element of public benefit in those purposes. Each structure has its own terminology to describe its trustees and its governing documents.

Under the Charities Act 1993, section 97, the charity trustees are the people responsible under the charity's governing documents for controlling the management and administration of the charity, regardless of whether they are actually called 'trustees'. For example, in the case of an unincorporated association, the executive or management committee are its charity trustees, and in the case of a charitable company, it is the directors who are the charity trustees.

The charity's governing documents will usually be either a trust deed (in the case of a charitable trust) a constitution (in the case of an unincorporated association) or memorandum and articles of association (in the case of a charitable company). Governing documents may unusually take the form of a Scheme of the Charity Commission, conveyance, will or other document describing the charity's purposes and, usually, how it is to be administered. Whatever form the governing documents take, the trustees should ensure that they have a good working knowledge of them.

Charitable Objects

The main duty of charity trustees is to act in accordance with the terms set out in their governing document (Duke: 1676). Services provided by charities on behalf of Purchasing Authorities must be consistent with the objects of the charity, laid out in its governing documents.

Charities should not agree by contract to provide services for a beneficial class that is wider than the charity's objects. For example, a charitable housing association for the elderly which has considerable expertise in housing management, cannot enter into a contract to manage a housing development for the general public. Similarly, a charity with objects for the relief of poverty in a specified town which has developed a very efficient and cost effective way of insulating houses cannot provide a similar service in an adjoining town either directly or by contract.

If a charity enters into a contract which is outside its objects, there may be serious implications for both the charity and its trustees. First, the charity trustees will be

acting in breach of trust and could ultimately face personal liability as a consequence. In the case of an unincorporated charity, the contract entered into in breach of trust will be enforceable by the other contracting party against the trustees in their personal capacity. The trustees will also be personally liable if any breach of the contract occurs. Any monies received by the trustees under the contract will be held by them on trust for the charity on the usual basis that a trustee cannot benefit from his or her trust (*Boardman v Phipps* [1967]).

If the charity is incorporated, the contract will be void and unenforceable except in favour of a third party who gave full consideration and who did not know that the contract was outside the objects of the charity or who did not know at the time of entering the contract that the company was a charity (Charities Act, 1993, section 65). Any monies received by the charity or its directors will be held for the charitable objects of the company. The directors may also be liable in damages to the other contracting party for breach of warranty of authority in respect of the void contract (*Firbank's Executors v Humphreys* (1886)).

Secondly, in relation to the charity itself, if the unauthorised contract becomes a major part of the charity's activities, the charity may face the prospect of losing its charitable status all together, as it is no longer established for exclusively charitable purposes. If the activity outside the charity's objects remains a limited part of its overall activities, charitable status will not be affected, but the court may restrain the unauthorised activities by injunction at the request of the Attorney General or, with the consent of the Charity Commission, at the request of any person interested in the charity (Charities Act 1993, section 33).

Finally, there are adverse tax consequences for a charity which enters into an unauthorised contract. The contracted activity will probably be regarded for tax purposes as a trade. Any profits on the contract will be liable to income tax under Schedule D Case I as the charity will not come within the exemption for profits deriving from a trade exercised in the carrying out of a primary purposes of the charity within the Income and Corporation Taxes Act 1988, section 505(1)(e). In addition, if any clearly identifiable income of the charity has been used to fund the contract, that income may be liable to tax as, depending upon the particular contract, it may not have been applied for charitable purposes only within section 505 of the 1988 Act. As such, the charity is in danger of losing part of its tax reliefs as sums expended in connection with the contract will probably be 'non-qualifying' expenditure within section 506(1) of the 1988 Act.

If the activities of a charity are not consistent with its objects, it may be possible to amend the governing documents to accommodate these changes in patterns of service provision. With unincorporated charities, the governing documents may contain an express power to vary the main objects clause. This will usually be conditional on the original objects no longer being effective and should be subject to the prior written approval of the Charity Commission. Without such a power, the variation will require the agreement of the Charity Commission in any event. If the Commission agrees to the change of objects, a Scheme will need to be made to amend the charity's governing documents under the Charities Act 1993, section 13. The changes must be justified and as near as practicable to the original purposes of the charity. A charitable

company may alter its objects by special resolution (under Companies Act 1985, section 4, as amended by Companies Act 1989, section 110(2)) but the prior written consent of the Charity Commission is required under the Charities Act 1993, section 64(2).

Powers

Even if a contract is within the objects of a charity, the charity will only be able to carry out the contract if it has the necessary powers to do the particular acts demanded by the contract. Charity trustees will need to check the governing documents of the charity to make sure that they have the power to deliver services under contract. They may, for example, need to have the power to employ staff, to hold property and to take out insurance.

If a charity proceeds to undertake a contract without having the necessary powers there are adverse legal consequences for the officers and the charity itself. In the case of an unincorporated charity, the particular transaction will bind the trustees personally. The charity property, however, will be protected because neither the trustees nor the third party will be entitled to an indemnity from property already held on trust in respect of an unauthorised contract (*Re Johnson* (1880); *Re Oxley* [1914]). The property of a charitable company does not enjoy similar protection in the event of unauthorised transactions by the directors. Under the Charities Act 1993, section 65, all commercial transactions beyond the powers of the directors will bind the charity unless the third party knew that the particular act was unauthorised. A director who enters into a contract on behalf of a charitable company which is beyond its powers will be acting in breach of fiduciary duty and may be liable under the remedy of account (Warburton: 1987).

If charities do not have the necessary powers they may need to amend the governing documents so as to broaden their powers. In the case of an unincorporated charity, unless there is a clause in the trust deed or constitution which allows the trustees to alter the administrative provisions of the deed, this will require an application to the Charity Commission. Under the Charities Act 1993, section 16, the Charity Commission has wide powers to make schemes for the administration of a charity. The procedure to be adopted by charitable companies requiring amendment to powers is the same as for alteration of objects.

Use of Charity Funds

All charity trustees are obliged to use charity funds for the specific purposes set out in the charity's governing documents and for no other purpose (*Att.-Gen. v Brandreth* (1842)). With unincorporated charities, trustees are also under an obligation to use any trust powers that they may have in accordance with the terms of the trust (*Re Hay's Settlement Trusts* [1981]). Any powers of a charitable company can generally only be exercised in furtherance of the objects of the company (*Rosemary Simmons Memorial Housing Association Ltd v United Dominions Trust Ltd* [1987]).

Within the 'contract culture' charities are often placed in the position of becoming substitute providers of core services for the state. Charitable funds ought not to be

used to support services which the state (whether it be through the Local or Health Authority) is legally required to provide through public funding, so charities should not underwrite services provided by contract from charitable resources.

The Charity Commission has customarily taken the view that charitable funds should not be used to meet the obligations of the state. This matter is discussed at some length in the Charity Commission's leaflet on contracts and is summarised thus:

Trustees cannot normally use a charity's funds to pay for services that a public body is legally required to provide at the public expense. (Charity Commission: 1998, para.20)

In the absence of specific objects allowing for the provision of public works and services which would otherwise be supplied at the expense of the taxpayer, charitable money should principally be used to supplement state provision, or to fill gaps in it. Trustees have an overriding obligation to put their charities' funds to the best possible use in furtherance of their objects, and they would not be making best use of charity funds if they used them to relieve the state of its legal obligations. Consequently, a charity, funded through charitable donations, should not use such funds to support statutory services which are provided under a contract. Both donors and volunteers may feel that they are being exploited in order to subsidise services that should be provided by the state and may not wish to continue to contribute to or offer their services.

It is quite often difficult to identify what core services the state must provide. For example, in many situations, Purchasing Authorities are given substantial discretion in determining the level of service required. Cost is a major consideration, whereas individual choice may not be. For example, under the National Health Service and Community Care Act 1990, Purchasing Authorities have certain statutory duties to discharge, but these may not necessarily take into account the individual service user's choice. The boundaries, both in terms of function and style, between public and charitable provision in the case of social welfare are rather blurred, and the line between partnership and substitution can be a fine one.

Responsibility of Charity Trustees

The implementation of the Charities Act 1992 (now Charities Act 1993) together with the publication of reports highlighting the responsibilities of charity trustees (e.g. Tumin: 1992) have had their effect. It is true that under the 'contract culture' the amount of money for which many trustees are now responsible has increased dramatically. There is a perception that the law imposes a considerable risk of **personal** liability in respect of contracts on trustees. The 'contract culture' has therefore contributed to the present difficulty in recruiting and retaining trustees, particularly those with the necessary professional skills (Russell and Scott: 1997).

If the charity is an incorporated charity, then the contract is between the charity, as a legal entity in its own right, and the Purchasing Authority. Since it is the charity, and not its trustees personally, who are party to the contract the trustees have **no** personal liability under the contract. (Directors of a charitable company may need to contribute

to the company's assets if the company continues to trade after it has become reasonably clear that the company is heading for insolvency.)

Personal liability is particularly relevant when contracts relate to services provided by unincorporated charities and trusts. These contractual agreements are actually entered into by the charity trustees on behalf of the charity. Consequently, the trustees themselves are personally responsible for the terms of any agreement entered into by themselves or any employee of the charity and for any damages payable if the terms of the contract are not fulfilled. However, provided that they acted properly in entering into the contract, trustees are entitled to an indemnity from the charity's resources to meet their contractual obligations. Problems will only arise if the charity does not have sufficient funds to meet these obligations, since the liability to do so remains with the trustees personally. The uncertainty surrounding funding in the 'contract culture', considered in chapter 3 may increase the chances of this happening.

With **both** charitable companies **and** unincorporated charities, if trustees commit a breach of trust which results in some financial loss to the charity, they become personally liable to make good that loss.

Contracts are legally enforceable agreements and it is important for trustees to understand the full extent of their commitments and responsibilities under a contract. The Charity Commission advise:

Trustees are legally responsible for a contract which an employee of the charity has committed them to. This can be true even when the trustees have not directly authorised the employee to enter into the contract. In those charities where contracts are negotiated by employees, rather than by the trustees themselves, the trustees need to make sure that internal controls are in place which prevent the charity being committed to significant contracts without the trustees' knowledge and approval. (Charity Commission: 1998, para.8)

Analysis of the contract provisions revealed that, ordinarily, the Purchasing Authority is absolved in the contract from any responsibility for the provision of the service. It is clear from the contract that the charity is providing the service in its own right and not on behalf of the Purchasing Authority.

Legal Sanctions for Breach of Contract

Close analysis of the contracts revealed a variety of options available to the Purchasing Authority in the event of breach of contract by the service providing charity. These varied according to the individual contracts and included:

- immediate termination of the agreement; (most draconian)
- termination of the agreement with reasonable notice;
- requiring breach to be remedied within a reasonable period;
- suspending payments until breach remedied.

One of the most comprehensive clauses that was identified outlined the time periods within which different 'scales' of default (according to how serious the breach of contract was) had to be rectified, once notification was given. The contract then specified the daily rate of 'damages' that would be sought, by way of deduction from future payments, if these time periods were not complied with.

Importantly, reflecting the balance of power within the contracts, less than one half of the contracts within the sample contained clauses which anticipated a possible breach of contract by the Purchasing Authority.

Twenty seven per cent of the contracts analysed had no provisions dealing specifically with the consequences of default.

Independence of Charity Trustees

The office of trustee is onerous. The law requires trustees to use a reasonable level of prudence, skill and care in administering their trust. A trustee has to perform a number of duties and exercise a number of discretions. In discharging duties, trustees must observe the utmost diligence in order to escape liability for any loss sustained. In exercising discretions, a trustee must act honestly and must use as much diligence as a prudent person of business would exercise in dealing with that person's own private affairs (*Speight v Gaunt* (1883)). A higher standard is imposed on paid trustees (*Bartlett v Barclays Bank Trust Co Ltd* [1980]).

If trustees are allowed a discretion about the use of charity funds, the general rule is that decisions concerning the charity must be taken by the trustees personally. The office of trustee is one of personal confidence, and so, in general, cannot be delegated. Trustees should not therefore delegate their discretions (*Speight v Gaunt* (1883)). They can always invite individuals to look into particular matters connected with the charity and to make recommendations, but the decision whether or not to act on the recommendations is for the trustees to take.

Even where power to delegate exists in their governing documents, the decision to exercise it must be prudent. The trustees must continue to be, and be seen to be, responsible for the charity's activities. This requires an efficient system of reporting and checks by which trustees are informed about all important aspects of the charity's affairs. It also requires that there should be no unquestioning acceptance of the views or proposals of the charity's employees. Their reports and recommendations should be scrutinised with appropriate rigour.

Charity trustees should identify and be explicit about the needs that their charity is intending to meet and then determine the best way to meet those needs. For example, determining the selection criteria for recipients of a charity service is the responsibility of those who run the charity, that is the charity trustees, in line with their governing documents. The governing documents will usually specify that it is the trustees who must exercise powers of appointment, by choosing who the beneficiaries of the charity will be.

CHARITY LAW AND THE ‘CONTRACT CULTURE’ - THE PRACTICE

In this chapter, the theory, as explained in chapter 4, is tested against the empirical research undertaken.

Charitable Objects

An analysis of the governing documents of the charities within the project, together with a sample of their contracts revealed that all the service provision contracted for in the contracts examined was within the charities’ objects as identified in the governing documents of the respective charities.

However, one of the most alarming findings from the interviews with Purchasing Authorities was their perception of the frequency with which charities provide services which are beyond their objects:

In our experience charities do move outside their objects to get funds according to our objectives. People do adapt their services when there are opportunities for new money.

Purchasing Authorities usually receive charities’ governing documents when entering into contracts with them, but at least one Purchasing Authority acknowledged that limited resources meant that these were rarely read carefully:

I wouldn’t be surprised to find that 10% of organisations are exceeding what they are actually set up to do.

One Purchasing Authority had previously been in contact with the Charity Commission concerning a charity with which it had a contract and over which it had doubts, and was told that the services being sold were not within the charity’s objects. The Purchasing Authority immediately withdrew the funding, presumably leaving the charity with even more problems!

Most charities stated that they were currently providing services in accordance with their objects, and some were defiant that this would not change:

We’re not in the dangerous business of chasing the money because we’ve seen it happen before. Charities see a pot of money, they want it and they’ll promise the earth, the moon and the stars. (Youth Leisure)

However, it was clear that some charities **had** diversified and were engaged in contracts for service delivery which were not central to their charities’ goals, reflecting the trend identified by the Purchasing Authorities. For example, one charity struggled to explain how training and finding employment for adults who would ultimately work with children fitted within the charity’s overall aim which was to care for and support

children, describing it as ‘co-incidental’ that there was a convergence between its current activities and its objects.

Other charities also felt that it was only by chance that their priorities matched those of the Purchasing Authority at that particular time. The risk of charities being directed into activities which are perceived as those areas in which Purchasing Authorities want to buy services was recognised. This is consistent with other findings on the impact of contracts (e.g. Russell *et al*: 1995). It was apparent that although charities may be confident that what they currently provide is within their objects, they held fears for the future and there was some doubt as to whether they could maintain this position given the funding climate:

Ultimately, our priorities will be decided on funding. (Unique Care)

Only one charity said that it had taken legal advice on a contract specifically in order to ascertain whether it would be consistent with its charitable status to provide the contracted service.

The research found that local charities may be led astray more easily than national charities, where the potential risks of the charity losing sight of its own priorities is minimised as national funding and association would be in jeopardy.

One of the reasons for the initial finding within the research sample that activities and charities’ objects were consistent may be due to prior amendment of charities’ governing documents. Several charities had recently changed their governing documents and others said that they were in the process of doing so. There is evidence that, since the onset of delivery of services through contracts, this procedure has become a strategy adopted by charities. The advantages for charities of broadening their objects was clear:

We made [our governing documents] more vague. So instead of being specific about what we can and can’t do, it allows us to do virtually anything in the interests of providing services for [the class of beneficiaries]. (Special Attention)

This mirrors recent developments in Company Law, where companies also seek to broaden their objects clauses. A Consultation Paper published in March 1998 (at the time of the announcement of the Company Law Review) noted that those setting up companies are often anxious to make sure that no constraints are placed on the future direction that their company might take, and hence describe its objects or purpose in the memorandum of association at great length in order to allow for every conceivable circumstance (DTI: 1998). In order to avoid the need for such ‘boilerplate’ statements, section 3A was inserted in the Companies Act 1985 (in 1989) allowing companies to describe themselves as a ‘general commercial company’. The Consultation Paper noted, however, that section 3A had been little used because it was still not regarded as covering every eventuality.

Whilst amending objects clauses, so as to make them as wide as possible, may eradicate potential legal problems for charities outlined in chapter 4, it has moral implications and more importantly, may enhance some of the problems charities now

face as a result of the 'contract culture'. Primarily, charities face the threat of losing their independence and autonomy:

It was a case of saying, this potential funding is there, how can we look at the whole thing and re-focus towards that. (Children First)

Powers

The research has found that the lack of specific powers to carry out a contract is a problem which arises more frequently in relation to older charities; the constitutions of newer charities are usually drafted with a more comprehensive range of powers.

Importantly, the research identified one charity within the project whose powers came nowhere near what were required in order for it to carry out the contracted work with which it was in fact involved. It was reassuring to learn that this charity's governing documents, which had not been updated since the charity's establishment, were about to be revised.

Another charity described how it had entered into contractual arrangements with Purchasing Authorities on behalf of smaller organisations that did not have the constitutional set up that would facilitate the employment of staff and the taking out of liability insurance etc.

Use of Charity Funds

In line with findings from earlier and broader studies (e.g. Thompson: 1997), it is clear from the research that contracts do not always cover the full costs of service delivery and charities are 'topping up' their services with charitable income:

There is a real kind of dilemma because the Charity Commission are now saying to us, it's no longer appropriate or indeed permissible to underwrite contracted services and yet there is an assumption on the part of the statutory purchasers that we will underwrite shortfalls, that effectively we pay for the privilege of providing their service for them. I think that the law needs to be clarified on that. (People Care)

Eleven charities clearly acknowledged that they had subsidised services. Others were vague in their response but no charity clearly denied that this was the case. One charity did, however, point out that the advent of the 'contract culture' meant that it could make it clear in writing that its work **was** being under-funded. In the past, it had provided specialised welfare services to children on a 'goodwill basis' despite the fact that it was only funded to provide such services for adults. The charity then used the opportunity of the 'contract culture' to identify clearly in the contract the fact that it was only funded to work with adults. Ultimately this led to the re-negotiation of the contract with an enhanced fee and a clearly defined inclusion of the provision of services to children in high priority situations. So the funding gap was clearly identified and plugged. This particular charity defined the 'contract culture' thus:

It cuts both ways. [The Purchasing Authorities] say, better for less, and we say, nothing for nothing, because traditionally a lot of things were done under goodwill. Now once you start getting into the contract it's very clear and specific. I think that it takes a lot of the goodwill out. (Unique Care)

One of the main concerns of several charities was that the management fee in their contracts did not fully reflect their actual costs. Charities referred to the infrastructure that supports contract provision, including: the payroll; legal advice; pensions; accommodation; staff training; and, insurance. However:

All [the Purchasing Authorities] want to pay for is the direct costs. (People Care)

Some charities take a philosophical view - what you lose on the roundabouts you gain on the swings. For example, one charity felt that its management fees in one contract were under-costed, but it was making reasonable surpluses on some others. It spoke of 'loss leaders', hoping eventually to make the 'whole thing balance'. However, other charities were now keen to ensure that every individual contracted service is fully funded. One charity warned that charities with one central contract and other smaller ones built around it must ensure that the smaller ones are paying for themselves, since there is always a chance that the central contract may be cut.

Other charities felt happy that the Purchasing Authorities now accepted that a correctly negotiated management fee should be an important part of the contract, although this had not been the position at first:

They had a very poor understanding of how you cost things, and particularly how you allocate core costs and overheads. Because up until recently they've never done that. They've never costed their own services properly, so when they hive-off a service, all they look at is the very direct costs of the services. They don't realise what a very high proportion of costs in a cost centre are down to things other than the direct cost of delivering that particular service in a particular place. And it's been an up-hill struggle to get a lot of them to understand that you have to cover all your costs, not just some of them. (National Advisory Unit)

When asked about the estimated costs (in terms of time and money) of constructing a contract, several charities spoke of hidden costs and said that they preferred not to think about it too closely. One charity summed it up:

I think that we'd all get a fright and that for me is not reflected in the contract. (Drink Safe)

Purchasing Authorities have their own dilemmas:

Because of our own budgetary constraints, we sometimes say that organisations can manage on a little bit less because they have been raising lots of funds. That is always the source of anxiety because people don't like us to touch their funds that they have raised from other sources. They say that they are being penalised for being successful.

This point is exemplified in the following claw-back clause, found within a contract from the sample:

<p>[The charity] shall notify [The Purchasing Authority] of any income (including rental income) or profit or any unexpected receipt in excess of the estimated level taken into account in determining requirements, which accrues from [the service provision]. [The Purchasing Authority] may require a share of any income, profit or receipt, unless it is satisfied it will be used for the benefit of the [the service provision].</p>

These sort of clauses are clearly a throw-back to grant funding days and are inappropriate for contract funded service provision. There was no reciprocal clause binding the Purchasing Authority to cover any over-spend by the charity!

One charity summed up the views of many on subsidising services:

As a charity, we're there to provide services and we're there to care and we wouldn't be very caring if we turned round and said, tough. So we don't do it often because we can't afford to do it often, but when there is a need there, yes, we do subsidise services. (Home Care)

Responsibility of Charity Trustees

The *On Trust* report in 1992 highlighted the difficulties in determining where the role of charity trustees stops and that of paid staff begins. It was found that trustees were often unwilling to offer firm direction to their organisation (Tumin: 1992). In the context of the 'contract culture' the report predicted that professional staff will be taking the principal role in contract negotiation and management, leading to a danger that trustees are simply left to rubber-stamp their decisions. More recently, research has shown that in larger charities the chief executive/ trustee chair relationship is changing (Blackmore *et al*: 1998). That research revealed that emerging practice is that trustees tend to refrain from interfering in operational management, but should ensure that there are clear lines of accountability and a framework within which the chief executive can manage.

Within the 'contract culture' it has been seen that there are occasions, particularly with unincorporated charities, where personal liability for trustees may arise. Despite this, trustees from only **one** of the charities in the sample played an active role in contracting. Moreover, trustees from ten of the charities played no role at all in the negotiation and implementation of contracts. When asked what was the role of trustees concerning contracts, one charity said:

None, other than it's their contract, isn't it? (Healthy Minds)

A couple of the charities required trustees to oversee and approve any contractual arrangements before they are accepted. However, the majority simply reported a contract back to the trustees as a *fait accompli*. One charity told how it was not only the trustees that did not see the written document:

We didn't actually get sight of the finished documentation until about six months into the year. We were already way into the contract before we actually saw sight of it, but we were led to believe that there would be no surprises, no changes. (Unique Care)

Assigning responsibility for contracting arrangements with paid workers is acceptable for trustees, provided that clear boundaries for contract negotiation have been set by trustees. For example, trustees should make it clear that contracts should only be entered into in order to provide services which are within the charities' objects. Similarly, paid workers involved in contract negotiation should be aware that the 'price' agreed for a contract should cover the costs of providing the service (in order to avoid subsidising services).

Despite the large proportion of non-active trustees, six charities felt that their trustees were aware of their own potential liabilities resulting from contracting. Other charities were not sure and could only assume that their trustees were knowledgeable in this area. There was some concern within the charities regarding recruitment of trustees which is becoming increasingly difficult:

What worries me a bit is that it's hard enough to get good trustees and I think that it would put some more people off when they start to realise that. (Elderly Care)

One charity felt that its own trustees, largely drawn from the business community, had an awareness of contractual obligations and that this was not off-putting for them. There was more concern for trustees of smaller charities with which it was associated. These trustees started off as 'honest volunteers who liked mucking in' and for them, now 'the warm fluffy stuff' has been replaced with the bottom line of potential legal liability, which could be quite daunting.

Legal Sanctions for Breach of Contract

Despite various mechanisms being available within the contracts to Purchasing Authorities if problems in service delivery arise, the research findings suggest that legal sanctions are rarely imposed upon parties delivering services through contractual relationships. Many felt that the charities' performance and service delivery was monitored closely throughout the duration of the contract, so that any problems or contentious issues which may potentially result in legal action were identified and solved during their early stages:

If there are troubles coming over the hill you'll see them, so you can head problems off at the pass early on. We would hope that it would never get to those sorts of stages. (Youth Leisure)

The most common measure adopted in practice appears to be the withdrawal of the contract money for a period until the unsatisfactory situation is rectified. Charities often expected to be given notice of breaches and a chance to put matters right. If the breach was not remedied, charities simply expected that they would receive notice that their contracts would not be renewed. One Purchasing Authority told how it had withheld one quarter's funding from a charity when the charity had failed to implement a confidentiality policy in line with its commitment in the relevant contract.

Many charities, fortunately, had not been in a position of potential conflict. When asked about the legal status of its funding document and the potential for liability if there were breaches, it was pointed out to one charity that the Purchasing Authority appeared from the contract to have wide powers to be exercised in its absolute (as opposed to reasonable) discretion. The charity's response was:

In the day to day practice it doesn't seem that way. However, if there was a problem then I think that you're in a different situation there. (Children First)

One charity fully understood the legal implications of indemnity clauses, commonly included in contracts:

The legally binding part is that you indemnify the funder and that's one of the principles on which they operate. They are actually protected themselves. It's unlikely that they will take you to court unless they've got a major claim against them and then they'll involve you in the process. If [the Purchasing Authority] is funding a piece of work and something goes wrong, it would then say that you, as our partner in this, are involved. So that's the legal process, it's indemnifying the funder. (Youth Leisure)

As proof of the lack of balance of power within these contracts, it is interesting to note that there was only **one** contract within the sample examined that also contained a 'reverse' indemnity clause, providing that:

[The Purchasing Authority] will indemnify [the charity] against any liability, loss or claim or proceedings whatsoever arising:
 (a) out of breach by the Authority of its obligations under this Agreement; or
 (b) caused by any act or neglect of the Authority or any person for whom the Authority is responsible.

Another charity also recognised that the legal issues that are difficult to resolve often revolve around the allocation of areas of responsibility. It acknowledged that charities can easily slip up and take on further responsibility than was anticipated. For example, a clause allocating responsibility to the charity for advice given to service users had to be amended, once its lawyers had seen it, so as to make it clear that the charity was only accepting liability for advice given after the commencement of the contract. The charity warned:

It's so easy to sign a contract that might have a lot of open-ended liabilities in it. (Special Attention)

Some charities felt confident that Purchasing Authorities had much to lose by taking charities to court on the basis of contractual agreements:

They are getting such a good service from 95% of charities that deliver services at a more economic rate for them, that they've got to take some risks. I think that if they put charities in court they would actually lose out. It would certainly bump the price up. (Youth Leisure)

Charities were clearly more concerned about the political and funding implications of potential breach of contract, rather than the legal consequences:

Our name would be mud out there and that has a knock-on effect elsewhere. But in terms of taking us to court, it's not there yet. They would just dry up the money. (Youth Leisure)

Clearly, it is not only the performance of the charity which may cause conflict. Although, in most contracts examined within the sample, the obligations are nearly all upon the charity, Purchasing Authorities may fail to uphold their side of the agreement, which will usually relate to payment. For example, one charity entered into a contract, agreed by the relevant Director of Service within the Purchasing Authority, which stipulated that the charity would receive one single payment at the beginning of the term. In practice, the Purchasing Authority representative responsible for the day to day management of finances refused to honour the arrangement. After numerous unsuccessful attempts to negotiate, the charity representative took the written contract to the Director of Service at the Purchasing Authority who replied immediately with a cheque for the full amount and a written apology. The charity was fully aware of the

implications of its action, potentially jeopardising its long-term position. The charity explained:

One gets the impression that their record keeping is either on purpose or accidentally very appallingly bad and, therefore, they don't know and all of a sudden you turn round and say 'well, I'm sorry, that's not what we agreed, and I can produce the bits of paper' and they get upset. I felt better for having the contract as there was at least something written down, but I realised that enforcing it through legal channels was nearly impossible if I wanted to continue doing work. (Healthy Minds)

Although the charity was unclear of the legal status of its contractual agreement, it was used to ensure that the charity got what was promised. This was, no doubt, a pyrrhic victory though, as the charity was also aware that such a clause, allowing for payment up front, would probably not be accepted by the Purchasing Authority for inclusion in future contracts!

A number of charities suggested that political lobbying to local councillors would provide a more realistic remedy for charities than legal sanctions:

I don't ever see legal action based on these documents. They are contracts, but I don't view them as contracts in the hard-nosed commercial way. I see this as a genuine honourable agreement. (Elderly Care)

Independence of Charity Trustees

Purchasing Authorities highlighted the importance of allowing charities to develop and maintained that encouraging and enabling service development for charities remains one of their priorities:

We do try to give agencies space to develop and innovate. It is difficult to get the balance right. We don't want charities to be at a standstill with provision as they become stagnant.

It's just trying to get them to provide the service that we need while still being able to develop themselves and to feel autonomous because we don't want them to become part of the big [Authority] machine. They need to retain their independence. We do try to encourage them to be independent.

These comments indicate that there is some recognition by Purchasing Authorities of the dangers of charities losing their autonomy and independence in their attempt to conform with Purchasing Authority priorities. Purchasing Authorities seemed to suggest that this trend would only increase in the future:

It could well be that, rather than charities coming to us and saying, we want to develop this, it will be the people here who are developing the strategy that will identify provisions or schemes that they want to get funded and will then ask the relevant charities to submit a bid.

Charities also engaged in this debate. Many remained defiant that they would not compromise their autonomy, whilst other charities felt that they were restricted in terms of innovation and development because of funding restraints:

The difficulty always is creating the monies to give any extended service delivery so you tend to stand still. It's not possible to write that into a contract as much as I would like us to be

able to do. The word 'development' you will see is almost conspicuous by its absence.
(Drink Safe)

If we wanted to create a new service the funding is not there for us to do it any more.
(Unique Care)

Many of the charities confessed that they would be willing to alter their own terms of service provision to suit a bid or the conditions of funding:

I couldn't say that we have maintained full autonomy because there are influences from them which we have to take on board and that's obvious, I think, because they've got the bank book. (Home Care)

Again, it was stressed that charities would not be willing to abandon their principles, but they would take risks in re-focusing the direction of their work or re-directing resources in order to win contracts. By allowing financial decisions to take over core service decisions in this way, charities risk being manipulated by the funders. They may ultimately abandon their own direction and the flexibility which enables them to meet the needs of the community, in order to conform with the policies of the funders, which vary according to political influences.

A more concrete aspect of this loss of independence is evident by the fact that Purchasing Authorities are able to incorporate terms into contracts dictating certain conditions of service delivery that compromise the independence of charities. Perhaps most common was the inclusion of a contractual clause concerning the eligibility criteria for service users, in some cases giving the Purchasing Authorities total control over their selection. A typical clause from amongst the contract sample:

The Purchaser will make timely, accurate and reliable referrals. In determining eligibility for service, only [the Purchasing Authority's] eligibility criteria for the relevant user group will be used.

Only **two** contracts examined within the sample contained clauses specifically saying:

The Provider shall have the right of final veto in respect of any such people referred to it.

Even with funding arrangements that did not give ultimate control over selection of service users to the Purchasing Authority, the issue of self-referral of service users was raised as a problem by several charities:

We're taking substantial numbers of self-referrals, but the Purchasing Authority is not happy with this and want us to take a lot more work from them. It has got to the extent where I wouldn't be surprised if they turned round and said that if we're not doing work for them which alleviates the demand on their own officers, then there will be a cut in the funding.
(Families First)

In effect, there would be a financial penalty for not towing the line, even though, in this particular case, the contract only required the charity to accept a minimum number of service users referred by the Purchasing Authority. Clearly the charity's autonomy and its ability to provide services to whom it wanted were very much under threat. Taylor and Lewis also highlight 'client selection' as a concern in their studies on contracting and its effects on voluntary organisations (Taylor and Lewis: 1997).

Another concrete element to the general problems related to charities' autonomy concerns personnel issues arising from contract provision. Purchasing Authorities certainly appear to exercise their muscles in this area, making it clear that they consider that holding the purse strings gives them the right to interfere in what is clearly a managerial role which should lie firmly with charity trustees. Other studies have also noted that personnel is an area in which Purchasing Authorities might adopt an overtly instrumental approach to voluntary organisations (e.g. Harris: 1997).

It has been seen that the 'contract culture' has facilitated incursions on the independence of trustees in two ways. First, the terms of the contract itself may take away trustees' decision-making powers. Secondly, and perhaps more invidious, interference by Purchasing Authorities may go **beyond** that allowed within the terms of the contract. In this case, law and practice are in conflict, and it is the lack of balance of power, discussed in chapter 3 (see 'Power Struggles I'), which prevents charities from restraining such action on the part of the Purchasing Authority.

Charities were very keen to tell their stories:

- a Purchasing Authority insisted on having a representative on the interview panel selecting employees to provide the service under contract. In this case, the charity welcomed external input as it felt that this prevented it from becoming insular. However, the importance of retaining final decision making powers was stressed by the charity;
- a charity's representatives were forced to attend an approved training schemes run by the Purchasing Authority before the charity could interview candidates to be employed to provide services under the contract;
- a Purchasing Authority came in and simply dismissed a charity employee employed to provide services under contract, who was on long-term sick leave;
- a Purchasing Authority threatened to withhold money committed under a contract when a charity employee was appointed to 'act up' as Chief Executive, after a suitable external candidate for the post failed to materialise following advertising.

An examination of the sample of contracts within the research found no clauses which would justify such interference as told in these stories, except in one extreme example where the Purchasing Authority was not only to be 'directly involved in the recruitment of staff' but was also entitled to:

Instruct [the Charity] to take disciplinary action against or to remove from the whole or any part of the service any person employed by [the Charity] and [the Charity] shall immediately comply with such instruction.

A further clause provided that:

[The Purchasing Authority] shall in no circumstances be liable to either [the Charity] or the employee in respect of any liability loss or damage occasioned by any such removal or disciplinary action.
--

In effect, this would allow the Purchasing Authority to dismiss staff and then leave the charity to pay any compensation awarded for unfair dismissal!

Interference due to the ‘contract culture’ has also led to many charities completing internal restructuring in order to accommodate the demands of ‘contract culture’. Much of this is considered by the charities to be beneficial. One charity within the research was completely re-structured as a result of the ‘contract culture’:

We started again from scratch with a brand new charity. You can't get more fundamental than that. We decided that we could not cope with the contract culture with an old institutional structure. (Healthy Minds)

One Purchasing Authority stated that **all** its contracts were with charities with limited company status, suggesting that unincorporated bodies would not be in with a chance of funding. Another said that it would be wary of contracting with ‘one-man bands’, suggesting a preference for organisations having a national capability. No account is taken here of the expertise of the individuals making up new local bodies who may clearly be discriminated against.

Changes due to the ‘contract culture’ have also been administrative which have involved designing stronger systems, becoming more organised, publishing policies and re-managing budgets. Managerial changes have incorporated new management roles and alterations to job descriptions. In some cases, this has demanded the creation of an entirely new post dedicated to recording, evaluating and monitoring outputs according to contract requirements. Other charities have brought somebody in from the business world specifically in order to negotiate contracts on their behalf. Whilst these alterations may have been unsettling initially, and caused some personnel difficulties, most charities accepted that they are advantageous to the long-term position of the charity. The difficulties of smaller charities, particularly local bodies without the back-up of a national organisation, making these kinds of changes was also acknowledged.

The current trend for charities to merge was also raised as a reaction to the ‘contract culture’ by both charities and Purchasing Authorities. It may become the case of ‘survival of the largest’.

PRACTICAL LEGAL CONCERNS

The nature of legal problems actually faced by charities providing services through contracts vary according to the type of service provided, the size and the legal structure of the organisation and the measures required in order for the charity to be able to deliver the specified output, for example, employment of staff, lease of a building.

The research findings suggest that, in practice, legal problems concerned with charitable status rarely arise in the context of the 'contract culture'. This chapter examines charities' practical encounters with 'the law' due to the 'contract culture'.

Legal Advice

Despite the uncertainty surrounding the legal status of funding documents, twelve of the charities within the sample had sought legal advice when negotiating and ultimately agreeing to provide services through contracts with Purchasing Authorities. One quarter of these were able to take advice from trustees who happened to be lawyers, although only one charity relied solely on this source for advice. Those charities which are a local branch of a larger national organisation had the benefit of accessing their own Legal Departments. Similarly, the larger charities were already in regular contact with lawyers on a number of other issues and thus advice on contracts was readily available. Those charities who did not seek legal advice directly related to the contracts did refer to lawyers in relation to contracts of employment necessitated due to contracts.

Whilst relying on legally qualified trustees for advice can be convenient, the dangers must also be recognised. Although lawyers may have a good working knowledge of contracts and the legal technicalities involved, their experience may not be directly applicable to contracts held by charities for social or health care provision which demand specialist knowledge of service specifications and judgments in terms of appropriate service provision, monitoring, costing, quality assurance and so on. The dangers were highlighted during one interview:

Having a solicitor on your Board can lull you into a false sense of security that you know what you're doing when you don't. (National Advisory Unit)

Employment Law Issues

The 'contract culture' has meant that charities are increasingly taking on the responsibilities and additional costs associated with employing staff. When discussing the 'contract culture' issues surrounding Employment Law seemed to be a common concern held by charities:

As soon as you start employing staff, you are responsible for Equal Opportunities, Health & Safety, length of employment, recruitment and selection. It's all part of a business and you need skill to do it. (Special Attention)

Employment Law just seems to change month by month with regulation coming from Europe, doesn't it? (Elderly Care)

The National Advisory Unit of a network of charities involved in the research has recently appointed a Personnel Officer whose sole task is to advise charities on personnel issues:

One of the reasons is because of the growth in the 'contract culture' and the knock-on effects of that, for the way employment contracts are handled. (National Advisory Unit)

Employment Status

Given the uncertainty of the funding environment, many contracts held with charities are limited to one years duration. This short-term nature of many contracts has encouraged the casualisation of labour even amongst charities who may be very wary of it or opposed to it in principle. It is therefore common for charities to use 'casual' labour. In practice, these workers' contracts keep getting renewed from year to year. In legal terms, such supposedly 'casual' staff who are working regular hours with regular clients over long periods of time, must still be regarded as employees. One charity told how, following legal advice, it realised that certain 'casual workers' who worked around 5 hours per week, were actually part-time employees with entitlement to appropriate employment rights (including holiday pay, sick pay, maternity pay etc.). It was acknowledged that this would lead to an unexpected adjustment to the cost of contracted service provision.

Redundancy

As discussed in chapter 3, there is usually an assumption by both parties that short-term funding agreement will continue for the next term, but political influences determining Purchasing Authority objectives and the constant threat of budgetary restraints restrict the possibilities of long-term funding arrangements. More importantly in this context, the uncertain financial position of Purchasing Authorities dictates that the process of informing charities of future funding is inconsistent and can vary from year to year.

Against this background, the legal implications of redundancy were raised as an issue by many charities:

There are some charities [in this area] that I'm aware of that serve redundancy notices to their staff every March. (Unique Care)

Although larger charities are sometimes able to re-deploy staff elsewhere when contracts for service provision are not renewed, other charities may be forced to terminate employment contracts and, because of late notification of non-renewal, may be unable to meet their obligations under Employment Law, for example, to give adequate notice to staff. This results in an increase in Employment Tribunal hearings and can have serious financial consequences for the charities concerned. Charities are

also aware of the need to maintain adequate reserves in order to discharge any liabilities that may arise from a redundancy situation.

The extra work and potential costs of dealing with redundancy, enhanced by the uncertainty surrounding funding within the 'contract culture' (see chapter 3) mean that there is less time and money for charities to spend upon their charitable objects. Simply sending out annual redundancy notices, even if these are later revoked, is a timely and costly exercise for charities to be undertaking.

Working Time Regulations

In addition, one of the larger charities explained the financial impact upon it of the recent changes in Employment Law concerning the implementation of the Working Time Directive. The Working Time Regulations 1998 came into effect in October 1998 and give rise to wholly new rights and obligations relating to work and rest. The principal provisions, which apply to both full and part-time workers, are:

- a limit on average weekly working time to 48 hours (though individuals can choose to work longer);
- a limit on night workers' average normal daily working time to 8 hours;
- a requirement to offer health assessments to night workers;
- minimum daily and weekly rest periods;
- rest breaks at work;
- paid annual leave.

The increase in the legal entitlements for all workers covered by the Regulations, such as paid holiday leave will mean that the cost of service delivery will increase accordingly. So far, there has been inadequate recognition of this by Purchasing Authorities.

In the light of the Regulations, charities need to review their working hours, rest and holiday arrangements to ensure that they comply. Part-time workers are entitled, pro rata, to the same rights. Adequate records should be kept to be able to show that workers are taking their daily, weekly and annual time off and are not working more than the maximum allowed hours.

Minimum Wage

Similarly, at the time of the interviews, some charities were beginning to think about the implications of the National Minimum Wage Act 1999 and were concerned that salary increases were not being taken into account by Purchasing Authorities.

From 1 April 1999, the national minimum wage for workers over 21 is £3.60 per hour. For workers from 18 to 21 it is £3 per hour. The minimum wage applies to virtually all workers including sessionals, part-timers, casuals etc. The minimum wage does not apply to genuine volunteers who receive no pay or receive only reimbursement for genuine out-of-pocket expenses, nor does it apply to volunteers who receive room, board and pocket money because they must live away from home in order to volunteer. The minimum wage is, however, likely to apply to other 'volunteers' who receive

payment above genuine reimbursement. This could include, for example, lump sum expenses, sessional fees, one-off payments etc.

It is a criminal offence for an employer not to keep the required records, or to keep false records. Where workers earn less than £12,000 gross per year in payments of less than £1,000 per month, the employer must keep detailed records of hours worked and hourly pay. For workers earning more than this, the employer must keep records which are adequate to show that the minimum wage is being paid.

The NCVO estimates that with the introduction of the national minimum wage, staff costs for general charities will increase by £51 million, assuming that current staffing levels are maintained. The greatest impact will be felt by smaller charities and those employing part-time workers (Hems and van Doorn: 1998).

Property Law Matters

A number of charities raised issues relating to properties which they owned or leased and which were used for the purpose of service provision under contract. It was acknowledged that even the most simple property transactions can have potentially complex legal implications:

There are an awful lot of minefields when you're leasing a building and that needs specific care and attention. (Special Attention)

The most fundamental issue for charities is that they must have power to enter into any relevant property transactions. The authors of *Charity Land and Premises* consider this sufficiently important to suggest that charities should carry out a constitutional 'health check' before embarking on **any** property transactions. Under this 'health check' trustees should:

- *know who holds the original of the charity's governing documents and each trustee should have a copy;*
- *ascertain what legal structure their charity takes;*
- *ask what powers they have;*
- *ensure that they have a full, up-to-date list of the charity trustees;*
- *check whether all of the present trustees are validly appointed and within their terms of office and whether there are any vacancies which need to be filled;*
- *consider whether they need to pass a resolution authorising some of their number to execute documents. (Richens and Fletcher: 1996, ch.1)*

With contract funded work, because contracts have a limited life, the research found that most property-related service provision tends to be run from property which is leased rather than purchased.

Unless a charity is incorporated, it is the trustees who will be personally liable if the charity does not pay the rent or comply with any obligations under a lease. Trustees will be entitled to be indemnified out of the charity's assets against this liability, but once those assets are gone, their own personal assets are at stake. Even with a charitable company, landlords often insist that sureties are provided for the charity's obligations and charity trustees are sometimes asked to act as sureties. This means that they effectively guarantee that the tenant will pay the rent and comply with the

obligations under the lease. If the tenant defaults, the landlord can sue the sureties personally. Trustee sureties should at least ensure that they are replaced by other sureties if they cease to be trustees. Without such replacement, their personal liability will continue.

Some charities who had sought legal advice in relation to leases were disappointed later to discover that the advice had been incorrect. For example, one charity spoke of a lease being negotiated on its behalf, whose terms were later discovered to be inappropriate for the sort of service that it would be running from the leased property. The details are somewhat vague, but it appears that ultimately the charity did not enter the premises, could not afford to take on the lease, and was, during the course of the research period, trying to negotiate its way out of the lease. On the other hand, it was only after taking legal advice that another charity realised that the terms of a lease from the Purchasing Authority, to which it was about to sign up, included an obligation on the charity to be responsible for the sewerage underneath the building, which needed some work:

When we pointed it out to [the Purchasing Authority] they said, 'oh we wouldn't have expected you to do that' and we said 'well it's in the contract'. I hadn't noticed it, until the lawyers gave their advice. (Special Attention)

Some of the charities held leases from Purchasing Authorities, but others made it clear that they would prefer to run their contracted services from external premises, in an attempt to maintain a degree of independence from the Purchasing Authority:

We didn't want to be seen as a little satellite agency within [the Purchasing Authority]. Being here in a community setting is completely free of any association with [the Purchasing Authority] which is overwhelmingly what [the service users] want. (Women Survivors)

One Purchasing Authority also recognised the problem of being both a Landlord of a charity and a Purchaser from it. The advent of the 'contract culture' has raised particular problems for charities that only pay a nominal rent and this has to be reflected in the contract in some way.

Another charity came into difficulty when, having purchased new premises, its old property leased from the Purchasing Authority was vandalised just as the charity was about to end its lease. The Purchasing Authority refused to end the lease with the property in this condition. Ever since, the charity has continued to pay rent and has attempted to secure the property - an impossible task. To make matters worse, the charity discovered that it did not have appropriate insurance cover - clearly an oversight when the lease was originally taken some twenty years ago. This oversight was going to leave the charity with a potential liability of nearly £30,000. At a local level, the charity seemed confident that a compromise could be sought with the Purchasing Authority. However, the charity's national finance officer, having seen the figures, has forced the charity to initiate precautionary measures, including inviting some of its employees to resign. This could give rise to additional costs to the charity as a result of Employment Law rights, in particular, in the context of redundancy (see 'Employment Law Issues, Redundancy', earlier in this chapter).

One charity told how it had overlooked the renewal of a lease, which then had to be remedied with some expensive legal advice.

Other charities were aware of limitations within their leases. So, for example, some charities were conscious that sub-contracting their service provision may be incompatible with the terms of their leases.

Conflict of Interest

A number of charities raised the issue of having representatives of Purchasing Authorities as members of their trustee boards. The general view seemed to be that this was becoming more uncommon as charities' funding moved from grants to contracts. Clearly the potential arises for conflict of interest if a charity trustee is also a member or officer of the Purchasing Authority with which the charity is about to negotiate a contract. In line with the findings in earlier studies (e.g. Todd and Ware: 1997) in a number of charities, Purchasing Authority representatives, recognising a possible contradiction between purchaser and provider roles, withdrew from formal involvement on management committees when funding became contractual. This was often perceived as a loss to the charity who had previously welcomed the involvement of Local or Health Authority staff on its management board. In such situations, there is no reason why Purchasing Authority representatives cannot retain their involvement with charities in an advisory capacity.

Other research has however found that when such representatives **do** maintain their position on trustee boards, their presence at board meetings can sometimes be detrimental as it inhibits open discussion concerning funding strategies (Harris: 1997).

MAKING THE CONTRACTS WORK

In this chapter, practical issues that have arisen from the research, and in particular, issues surrounding the construction of the contracts will be discussed. The chapter concludes with a number of ‘bullet points’ that suggest best practice relating to contract drafting between charities and Purchasing Authorities.

Personnel

An issue that was raised by many charities concerned the nominated officers within the Purchasing Authorities with whom contracts were negotiated. Many complained that the individuals changed posts frequently. It is very common for the person with key responsibility for the negotiation and running of a contract to change several times both during negotiation and currency of the contract. A typical comment:

We must have gone through half a dozen of them, which does not make for very consistent dealings. (Healthy Minds)

This is not helped by the fact that parties to contracts often appear to take several years to reach agreement.

Some charities spoke of the appropriateness (or not) of the person with whom they had contact within the Purchasing Authority. Sometimes charities felt that they were dealing with individuals who were too senior to have time to deal with their contract negotiation. Other times, junior people were involved and it later became apparent that they did not have the authority to enter into any agreements. Others were concerned that individuals within the Purchasing Authority with dominant personalities and views could have a real affect upon the way in which a service was ultimately delivered. To balance this, however, one charity remembered how a contract had prevented what it perceived as the unreasonableness of one individual from having a greater impact. Under a contract, the Purchasing Authority had the right to have a nominated officer examine the service delivery. The officer, who had taken a strong line against the charity, inspected the service, identified several areas of concern, and was prepared to end the contract there and then:

I was relieved to see in the contract that I had a certain period of time to ensure that we complied with the terms as stated. In that case, the contract modified that individual's input. (People Care)

From these comments it seems that charities would prefer a consistent approach from Purchasing Authorities, preferably delivered throughout by the same personnel.

Problems are clearly compounded when charities have contracts with several Purchasing Authorities adopting different approaches.

Of the contracts analysed within the sample, 36% did not contain a clause clearly giving the name and details of a person within the Purchasing Authority with whom the charity could make contact. Of those contracts that did give some detail, less than one half provided the name of a person, with most only giving an address.

A number of charities also recognised the advantage of employing somebody whose sole responsibility was to negotiate and manage contract delivery. Unfortunately, for many smaller charities, the inequality of bargaining positions between Purchasing Authorities and charities is further magnified, as this option will not be available to them.

Model Documents

The Purchasing Authorities that were interviewed use their own model funding documents which outline provisions such as outcomes of the service, financial terms and the responsibilities of the parties. Each Purchasing Authority carries a range of documents which vary according to the level and length of funding, the nature of the service, the needs of users and the relationship between the parties. The use of model documents was considered convenient and beneficial to both parties. According to one Purchasing Authority:

The feedback I've had from charities is that they basically welcome it, they find it an easy document to work with.

One Purchasing Authority is introducing a process whereby every Department will adopt a uniform contractual document which may include additional pages for specific departmental requirements:

At present we are looking to work uniformly in contracting with the voluntary sector. It won't be long before we come up with an overall policy for [the Purchasing Authority].

This concept was brought about following confusion between different Departments within the same Purchasing Authority, where 'joined-up' local government was obviously not yet fully developed:

One of the things that we find is that perhaps we are funding an organisation which operates out of a Leisure Services Department building, so we are giving them money to provide a service. As part of that service, they are having to pay rent, so in effect our Department is paying money to another Department. There are all sorts of anomalies that we're trying to iron out.

Charities often seemed to be concerned about the 'appropriateness' of the model contracts used:

Particularly in the early days [Purchasing Authorities] simply adapted standard contracts that they already had. I mean, they would literally delete 'bin emptying' and insert 'domiciliary care'. It was awful. (National Advisory Unit)

In the contracts examined within the sample, it was often found that a 'rogue clause' seemed to appear out of nowhere, clearly having originated in another document where it may have been more appropriately placed. Every now and again 'legal language' would creep in. For example, one contract for service delivery referred to the payment

from the Purchasing Authority to the charity as the 'dowry'. The suitability of contracts is often dependent upon where the contracts originated - legal services departments, purchasing departments or service orientated departments. Charities seemed most happy when the task of contract drafting was with those who would then be responsible for contract management. These are the people with 'hands-on' knowledge of how the contract would work on the ground.

A number of charities suggested that the starting point for negotiation of a contract should be the service provision itself. This meant that the service provision would come first and the contract later. That was what had in fact happened in several cases. Unfortunately, this sort of arrangement does not bear up to close legal analysis!

Some charities were keen to ensure that the contracts acknowledged that the service provider was in fact a charity:

Model contracts are fine provided that they're open to interpretation. The context and spirit of the voluntary sector delivering the service must be recognised. (Youth Leisure).

Only **two** of the contracts examined had specific clauses in them recognising the charitable status of the service provider.

Time Well Spent?

Despite the fact that charities are often presented with model contracts to start with, the research revealed that contract negotiation invariably takes several months. Other research has also found that long periods for contract negotiation are the norm (e.g. Taylor and Lewis: 1997). Some charities commented that it is not unusual for the negotiation to continue for years. This was particularly so in the early days of the 'contract culture', when Purchasing Authorities were trying to get agreement on contracts for the first time:

That took years, six, seven maybe. There were numerous drafts given to us and we submitted numerous of our own and didn't get anywhere. I think that they just hadn't ever faced up to the implications of it all. (Healthy Minds)

Others found that time paid spent on negotiation did pay off in the end:

We were able to point out how and why it wasn't appropriate and what it costs to employ a certain person in the job. It took a year, but we actually got what we wanted out of it. (Special Attention)

Many charities also pointed out that if contracts lasted for longer periods of time, then the negotiation time would be more cost effective. Purchasing Authorities also recognised the efficiency value of reduced administration that longer term agreements would bring:

You would not have to do a Service Level Agreement every year.

Currently, the most that charities can hope for is three year contracts. Less than one half of the contracts analysed within the research sample were to last for more than two years.

Some charities complained about the work involved in preparing data required by Purchasing Authorities for the purposes of monitoring. As well as being time consuming to prepare, some complained that the statistical data requested would not provide meaningful information for the Purchasing Authorities anyway. This may change with the introduction of the 'best value' regime described in chapter 3. The data content and presentation requirements vary with the contracts, and this can make for some time-consuming paper-work for charities. Problems are multiplied when different contracts with different Purchasing Authorities relate to the same service delivery:

You can actually have a contract with two funders for the same project. We often have different reporting systems for both so, in terms of administration, it becomes very complex.
(City Living)

When asked whether consistent monitoring and reporting procedures across the board would help matters, one charity acknowledged that different funders may require different aspects of the contracted work to be accounted for and that this may make it difficult to use the same data presented in one single format. For example, if the service concerns the provision of accommodation for the elderly, one Purchasing Authority (say Social Services Department) may need very detailed information about the needs of the residents, whereas the joint funding Purchasing Authority (say Housing Department) may need information about the level of accommodation support offered. Similarly, monitoring requirements need to vary in intensity according to the type of service provided. For example, a monthly visiting scheme for the elderly does not require the same level of monitoring as the provision of accommodation for the elderly.

One development, to be followed with great interest, is charities' current attempts to negotiate a set of model or standard contracts with national umbrella bodies of Purchasing Authorities. Both the NCVO and the Campaign for Fair Contracts have put this item on the agenda for further action during 1999. Meetings have already taken place between a representative of the Local Government Association and the NCVO Charities and Contracts Working Group. Attendance at such a meeting in the Spring of 1999 suggests that there is a long way to go before national model contracts will be put on the negotiating table.

Quality Control

Many charities complained about the way in which their service delivery had hitherto been measured, and the newly developing 'outcomes approach' to funding was welcomed by many:

I wish we could get to outcomes rather than inputs. Outcome funding would be around us agreeing what we would do with x number of people in a certain time and the cost. You would actually be measuring outcomes, rather than how have we organised our charity.
(People Care)

No-one's saying to me, identify the individual needs of the people and produce a plan, which is what we do internally. That's where we drive the quality, not with the contract. (Healthy Minds)

There was, however, concern all round, as to how to measure outcomes. Whilst it is possible to use statistical information in order to measure performance in some areas (for example, the number of visits may give some indication of a charity's ability to 'engage and communicate') many activities result in qualitative rather than quantitative outcomes. Charities acknowledged that they need to put in place effective systems for monitoring outcomes and most saw this as a positive development, rather than an intrusion forced upon them by the Purchasing Authorities. Charities were keen to promote means of identifying and evaluating the impact on the service users of being provided with the service. All agreed that measuring enhanced 'quality of life' for service users is extremely difficult, but potentially less intrusive than Purchasing Authorities insisting on specified inputs. Describing a current contract, one charity said:

It's very much saying, this is how [the Purchasing Authority] want you to behave, and there's nothing in all that about, how we measure what quality is. Is what we're doing good or bad? None of that's there. (Healthy Minds)

Some charities appeared to be somewhat cynical of the new 'best value' regime to be adopted by many Purchasing Authorities. Outcome funding was described as a 'fad' or 'flavour of the month'. Its political origins were clearly recognised and some felt that Purchasing Authorities were merely paying lip service to the idea:

[The Purchasing Authority's] ideas of outcomes are not what we would regard as outcomes at all. What we regard as an outcome is did the service user receive what they came in for. (Unique Care)

Other Purchasing Authorities were clearly further down the road of developing policies to deal with outcome funding:

[The Purchasing Authority] has realised the complexity of it and is taking a good long think about it. It is setting up working groups to look at it. (Unique Care)

One Purchasing Authority, clearly giving this matter some serious thought, provided the research with some key words that might be helpful when framing outcome objectives:

<u>Desired Effect</u>	<u>On Whom or What</u>	<u>Specific Outcome</u>
increase	service user	skills for
decrease	patient	knowledge in
maintain	individual's	confidence in
reduce	child's	likelihood of
improve	agency's	incidence of
enable	family's	ability to

Bullet Points on Contract Construction

From examining a wide range of contractual documents concerned with diverse service provision and deriving from various Purchasing Authorities, the following issues, relating specifically to contract construction, emerged and would seem useful to publicise. Many of these points were reinforced during interviews, with both charities and Purchasing Authorities. Some of these have been identified as providing examples of good practice within the 'contract culture'. Others were recognised as issues of concern, where lessons can hopefully be learnt from current bad practice.

Presentation

- Use clear headings
- Keep sections clear and concise
- Use as little jargon or legal language as possible
- Most attention should be given to the service specification which should be clearly defined
- If using a model contract, try to individualise for specific service and users
- Avoid repetition

Clarifying Provisions

- Legal status should be clear
- Include a definition section, if necessary
- If notices have to be given, specify to whom and how
- See Appendix to this report for matrix with suggested headings to be included
- Clauses should only be inserted if both parties intend them to be enforced
- Insert name and contact details for representatives of both purchaser and provider
- Do not merge issues
- Make clear distinctions between breach of agreement and termination (for other reasons) sections

Human Element

- Recognise service users (including their evaluation)
- Include provisions dealing with complaints procedures
- Refer to use of volunteers and provisions for them e.g. supervision
- Ensure all the parties involved in service provision are clearly defined (e.g. does staff include volunteers, does carers mean employees or family carers)

- Ensure that confidentiality is respected for service users

Balance of Power

- Balanced recognition of mutual obligations of providers and purchasers
- Purchasing Authorities should only have limited and necessary rights of interference with trustees' obligations to manage their charities' own affairs (for example, charities should be free to employ and dismiss at their own discretion)
- Charity's records and premises should only be inspected by Purchasing Authorities on reasonable grounds and with notice
- Specify that selection of service users is ultimately by providers
- Where discretions are to be exercised or opinions sought, it should be clear that these should be based upon reasonable grounds
- Equally, if consents are required, these should only be withheld upon reasonable grounds
- There should be no unilateral right to amend contract terms
- Termination should only be effected for reasonable cause
- Termination clauses should be reciprocal

Funding

- Try to agree on contracts of at least three years duration
- If there is a rolling contract, indicate when the charity will be informed of renewal
- Make conditions for late payment
- Allow for reasonable review of prices
- Build in inflation costs
- Insert a clause specifically ruling out the use of charitable funds to subsidise the contracted service provision
- Avoid monthly payments or payments in arrears
- Avoid claw-back provisions

Dispute Resolution

- Termination clauses should be precisely drafted
- Include a clause concerning mediation, preferably with a named mediator. Avoid the Arbitration Acts route - it may turn out to be too expensive for the charity to pursue
- Do not exclude certain issues from the mediation option

CONCLUSIONS

The evidence presented in this report represents the contradictory practices which manifest within the realms of the 'contract culture'. While contracts are now fundamental for the funding of charities, the current legal environment does not support the 'contract culture' but emits opposing signals.

Legal Status of Funding Agreements

It is important that the legal status of funding agreements is clarified. The current lack of clarity in the determination of whether or not a particular funding agreement gives rise to a binding contract in law, is of some concern to charities. It may be crucial to ascertain the legal status of a relationship, since, under the 'contract culture', taken to its logical conclusion, accountability for charities may mean being sued by Purchasing Authorities for breach of contract. Many charities were prepared to acknowledge that this was a possibility but preferred not to think about it or its consequences, hoping that their relationships with Purchasing Authorities would always be such that legal action against them would not result. Conversely, most charities were resigned to the fact that, due to the lack of balance of power in the 'contract culture', they would usually not be in a position to pursue legal action against a Purchasing Authority, as they were too fearful of the repercussions of such action.

Relationships

It is clear from the research that in order to create and maintain a constructive and successful working relationship between charities and Purchasing Authorities, both parties must have an understanding of each other's role and objectives and what each can contribute to new joint working arrangements. In short, their relationship needs to be re-defined and strengthened.

Overall, the Purchasing Authorities indicate that there is growing appreciation for the concerns and expectations of charities entering into the 'contract culture'. It was recognised that charities are not always given the credit that they deserve for the services that they provide and are sometimes considered to be amateurs. There is also a feeling amongst Purchasing Authorities that charities do not always acknowledge that some matters are completely out of their control and are affected by external political factors. One Purchasing Authority made a plea:

Don't shoot the messenger - it wasn't my decision!

Although there still remains some degree of lack of understanding, it appears that mutual awareness by Purchasing Authorities and charities of each others working practices is improving:

The base levels of professionalism didn't seem to be recognised before and in part that's our fault, we didn't shout about it enough. I think that with the advent of contracting, there is a greater recognition of that now. It's going to take a lot more time, but it's beginning to happen. (Drink Safe)

If Purchasing Authorities want real partnerships with charities, they must also learn to share their risks. This means that contract terms must be created by both parties together, on a more even basis. Power struggles between Purchasing Authorities and charities are counter productive and may not allow charity trustees to carry out their functions effectively. It has been seen that entering into unfair contracts may amount to breach of trust on the part of charity trustees.

Mission Drift and Dependency

There appear to be a number of external influences which may result in charities providing services which are not consistent with their objects set out in the governing documents, or services which allow them to carry out general charitable activities which are within their broadly defined objects but, which dilute the charity's own specific mission. Charities may have little choice other than to follow the money by responding to the priorities set not by themselves but by the Purchasing Authorities. It seems that ultimately, decisions regarding the direction of services provided by charities are made by Government dictating the funding priorities. Many charities seem to be resigned to this:

If you'd asked me the same question five years ago I would probably have said, no, I don't agree with contracts, I think that they're restrictive on what organisations can and can't do. Having said that, I think that argument was lost a long time ago and we just have to get on with making it work. (Children First)

Some charities do not blame the 'contract culture' for this 'dependency culture' and some were keen to point out its advantages:

I don't think that we're any more compromised than we were. I think that you are always compromised once you talk money whether you have a contract or a grant. I don't think that it's any worse than it was and, in my view I think potentially it's a lot better. (Healthy Minds)

The research highlighted the fact that the 'contract culture' appears to affect the distribution of power in different types of charities in different ways. Clearly, much depends upon the leverage that a charity is able to exert. This can be seen from the following four examples, all of which have emerged from the research. First, those in the strongest position include charities that possess monopoly power within their service area. Where charities are in a niche market, meeting needs that would otherwise not be met, Purchasing Authorities are less likely to be in a position to influence the way in which a service is provided, or to whom it is provided. The relationship in this scenario will be one of interdependence because the Purchasing Authorities need the services of the charity as much as the latter requires income. Secondly, charities with multiple sources of funds will, for a different reason, be in a similarly comfortable position, as they are not dependent on a single government source and this may assist their negotiating position. Thirdly, with charities that provide services that are readily available elsewhere, the impact of contract funding

will be more pronounced. Finally, a charity that becomes highly dependent on contract funding will be extremely vulnerable, especially if it is relying on one single contract, that may or not be renewed, at the whim of the purchaser. The staff of such a charity may have been increased to cope with the demands of the contract, but income and staffing levels cannot be maintained unless the contract continues. These four examples are not mutually exclusive, so a funding scenario could exist which involves several of these elements, again highlighting the divergent levels of dependency for different charities.

Overriding all these examples, it must be stated that the size of a charity and the consequent impact upon it of the 'contract culture' was a recurrent theme of the research. Some smaller charities may simply not have the resources or the infrastructure to make the adaptations necessary in order to survive within the 'contract culture'. Consequently they may be at an immediate disadvantage and ultimately unable to cope with the demands of the 'contract culture'.

The legal implications of 'mission drift' have been considered in chapter 4. Charity trustees should be aware of these consequences and, armed with the knowledge that entering into contracts may ultimately give rise to breach of trust, they should use this as a defence so as to stand their ground when negotiating contracts. In this way, charities should then use the opportunity that contracts bring, in order to negotiate to provide services that **are** within their objects and that they want to provide.

Same or Different?

The initial philosophy of charitable organisations was to provide where the state did not. This aim gradually became to supplement core services provided by the state. If charities are now contracted to provide what have hitherto been mainstream public sector services, it must be asked how far they will come to resemble the public sector that they are replacing? This becomes all the more important when it is appreciated that charities appear to be regularly subsidising this work with their own charitable funds. Only **one** contract examined within the sample specifically stated that the purpose/ objective of the service to be provided under contract was:

To supplement and compliment, not to replace statutory services, and to work closely with them.

One of the major qualities of the sector has been its ability to be flexible and responsive to the needs of the community. However, charities are finding it very difficult to continue their traditional development role alongside direct provision of service under contract. Their flexibility is curbed, as they are forced to respond to the money which is available, irrespective of the potential risk of shifting from their original direction. Charities are very conscious of this concern and some have tried to find ways of overcoming the problem. For example, some are increasing their charitable fund-raising activities in order to pay for this sort of development work:

It guarantees us our independence, and the money would be used, for example, for developing new types of services over a short period, a sort of proving period. (People Care)

Others are attempting to take a more strategic approach:

We've tried to influence [the Purchasing Authority's] policies so that when they are dishing out money against their criteria - against their published policy strategy documents - what we want to do is already in there. It doesn't always work though. (Healthy Minds)

It has been seen that charity trustees are under a legal duty to use their resources in a way that is most beneficial for their charity's service users. In a modern context, this duty should include developing strategies to ensure that Purchasing Authorities meet the full costs of providing a service which they are legally required to provide. Similarly, trustees of a charity must decide whether or not contract funded service provision *per se* is the best method for their charity to achieve its objective of providing for its beneficiaries.

Conflicting Law and Practice

Some of the onerous obligations of charity trustees have been discussed in this report. It has to be concluded that there exists a gulf between the law in theory, on the one hand, and conflicting practice on the other. Other recent research on charity governance and management has also revealed a perception that there is an inconsistency between charity law and what is now in fact happening on the ground (Blackmore *et al*: 1998). The law appears to impose the most exacting responsibilities upon trustees, and yet, in practice, limitations on trustees' ability to manage their charities on a day to day basis mean that these high legal standards cannot always be met. It is comforting to note that trustees will not usually be punished or held personally liable for the consequences of errors. A trustee who has acted honestly, reasonably and ought fairly to be excused for a breach of trust may be relieved of liability by the court at its discretion (Trustee Act 1925, section 61). What is considered reasonable will depend upon the particular circumstances of each case. The words of Lord Eldon in 1826 are helpful here:

With respect to the general principle on which the court deals with the trustees of a charity, though it holds a strict hand on them, when there is wilful misapplication, it will not press severely upon them, where it sees nothing but mistake. It often happens, from the nature of the instrument creating the trust, that there is great difficulty in determining how the funds of a charity ought to be administered. If the administration of the funds, though mistaken, has been honest, and unconnected with any corrupt purpose, the Court, while it directs for the future, refuses to visit with punishment what has been done in time past. To act on any other principle will be to deter all prudent persons from becoming trustees of charities. (Att.-Gen. v Exeter Corp.n (1826)).

There is therefore some comfort for trustees. Power struggles within the 'contract culture' considered in chapter 3 may mean trustees surrendering discretion or agreeing to provide services which are outside their objects. It is possible that relief from liability for these sorts of breaches of trust would be granted under section 61.

Unfortunately, in the harsh realities of the commercial world, there is no such relief for potential liabilities under contracts of employment or leases of property, as discussed in chapter 5, which may arise as a result of the 'contract culture' and its inherent dangers due to uncertainty surrounding funding, highlighted in chapter 3. Nor will section 61

help in cases of breaches of contracts for service provision, if a litigation environment ever develops in this field.

The other major area of conflicting legal theory and practice concerns the legal interpretation of the contracts examined within the sample and their implementation in practice. On many occasions it has been seen that the contract seems to say one thing and yet practice dictates another. The point was made during the research that once contracts are agreed, they are often filed away and never looked at again. This is all very well, until something goes wrong. Many charities acknowledged that, ultimately, they could envisage legal action whereby the Purchasing Authority relied upon a contractual term which was not being complied with by the charity.

Charities are encouraged to ensure that their contractual arrangements reflect their practice in service provision. It is to be hoped that if contracts are appropriately drafted then this will provide some legal protection for charities if problems do arise in relation to service provision. It is also suggested that it is in the drafting of the contracts that charities and Purchasing Authorities can begin to develop their partnership approach, which can then be reflected throughout the duration of the service provision. In this respect, perhaps it is the actual process of the creation of the contracts which is more important than their observance.

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APPENDIX

The following matrix was designed against which the contractual documents examined within the sample were analysed. As a checklist, both charities and Purchasing Authorities may find it useful to consider whether terms under the following headings are appropriate for insertion in their own contracts:

Administrative Details

Name, address and contact number of provider
 Name, address and contact number of purchaser
 Document title
 Legal status of document
 Definitions

Terms Of Agreement

Duration
 Variation
 Termination

Payment

- a) Terms of payment
- b) Review of prices (e.g. inflation)
- c) Tax

Renewal
 Notices

Personnel Issues

Staff

- a) Training
- b) Standards
- c) Supervision

Volunteers

Transfer of Undertakings Regulations

Equal Opportunities

Provision for staff
Provision for service users

Service Provision

Service specification
Selection of users
Quality assurance
Outcomes (including how they are to be measured)
Performance monitoring and evaluation (i.e. reporting and accounting)
Subcontracting/ assignment

Complaints Procedure

Staff
Volunteers
Service users

Role Of Service Users

Service user evaluation
Influence over service provided
Input into relocation

Confidentiality

Re service users
Operational/ commercial confidentiality
Publicity

Property

Ownership of land
Leases

Liability

Indemnity (include who is liable for what)
Insurance (how to pay for liabilities)

Disagreement

Breach of agreement

Resolution of Disputes

- a) Mediation
- b) Arbitration

Legal Technicalities/ Regulation

Recognition of charitable status
Requirement of compliance with specific legal regulations
Conflicts of interest
Health and safety requirements

Unnecessary Clauses**Other**