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Collaboration Support Resources

An introduction to contract law

Audience	Organisations at the stage of negotiating (or planning to negotiate) the terms of legal contracts to deliver services as part of a partnership.
Purpose	To introduce organisations to some of the key legal and practical issues relevant to service delivery contracts, and to offer advice and guidance on understanding and negotiating what goes into a potential contract.
Intended outcomes	Organisations: ☐ Have a basic understanding of legal contracts and how they differ from grant aid agreements. ☐ Are aware of some of the challenges they may face in negotiating contracts with commissioners and/or lead partners. ☐ Are introduced to common legal terms used in service contracts, so they can understand and assess draft contracts they may be asked to sign.

This document is part of a series of Collaboration Support Resources designed for voluntary and community organisations.

For more information about the whole series, and to use the other resources, go to http://www.voscur.org/collaborationresources

1. Background to contracts

How do contracts differ from grant aid agreements? Technically a 'grant' is a gift, but if a dispute about a grant aid agreement went to court, the judge would look at the terms line by line to see whether they constitute a contract given the five criteria (a) to (e) below. A grant can be subject to conditions, but, strictly speaking, it is not meant to create a binding legal relationship.

A contract on the other hand ***is*** meant to create a binding legal relationship. It has the following five characteristics:

a) Offer by one party
b) Acceptance of that offer by the other party
c) Agreed price, fee or other 'consideration' (such as mutual promises)
d) Clearly identified subject matter – what is being bought, sold, mutually agreed
e) Intention to create a legally binding relationship

To help you understand the terms in typical agreements and contracts, and so that you know what to look for if a partner offers you such a document, we have provided some examples:

- ☐ A typical *Grant Agreement* (with explanatory notes at the start).
- ☐ A typical *Contract for Public Services* (with explanatory notes at the start).
- ☐ The *Standard NHS Contract (2014)* *part 1* | *part 2* | *part 3*.

Section four of this document will help to explain legal terms used in these agreements. Don't worry if they appear impenetrable at first! They are complicated documents, but these resources and your colleagues and trustees can help ensure you understand their key terms. As a subcontractor, it's unlikely you'll ever be asked to sign the standard NHS contract, but the lead bidder of your collaboration may do, and as they will replicate some of its terms in your subcontract, it may help you to understand where the details and conditions come from.

An advantage of a contract is that if the organisation as provider does what the agreement requires, the purchaser must pay what is agreed. A disadvantage is that a purchaser can withhold payment or demand repayment if the provider has not delivered the service according to the contract. However, a grant aid service level agreement can also contain deduction and clawback clauses, as in the example grant agreement above. This shows that in practice the theoretical differences between a contract and a grant are often ambiguous, especially as most 'grants' these days come with some kind of specific targets or outputs, and are no longer 'gifts' towards an organisation's own strategic aims.

From an accountancy point of view, it is important to establish whether the income is a grant or payment for a service under a contract, as grants are normally not liable to corporation tax or VAT, whereas contract income is. Public bodies may stipulate whether VAT is applicable or, as in section 10 of the example grant aid agreement in the link above, leave the provider to decide for themselves. (Point 3.1.6 of the summary explains what section 10 of the agreement means.)

1.1. Other requirements of a contract

Under English law, many contracts do not have to be in writing, but they almost always are, because if they are purely verbal, and things go wrong later, you will have problems in proving the existence of the contract and identifying its terms.

For some types of contract, legislation requires them to be in writing and creates compulsory minimum terms or rights, even if they are not included in the written documents. This happens under, for example, employment, housing and consumer law. Contracts for the delivery of services to public bodies are usually not affected by such legislation, so all the terms and conditions should be explicitly included in the contractual documentation.

1.2. What is normally covered in a contract?

- ☐ **Names and addresses of the parties** and (if relevant) types of organisation and registration numbers
- ☐ **Length and type of contract** (e.g. fixed term or open ended; service agreement, development agreement)
- ☐ **Start** date (and **End** date if fixed term)
- ☐ **Aims and/or objectives:** context and description
- ☐ **Specifications which can include:**
  - inputs, timeframes/milestones, processes, outputs, standards required and quality outcomes to be achieved
  - methods of referral of users or access by users or beneficiaries
  - evaluation criteria, monitoring methods, evaluation methods and dealing with complaints
  - details paid and unpaid staff involved, recruitment, checks, employment terms and conditions
- ☐ **Finance:** payment (frequency and methods), capital or revenue, responsibility for insurance, liability for losses or breach
- ☐ **Managing change:** procedures for review, amendment, renewal, assignment and termination
- ☐ **Managing tension:** procedures for dealing with default, disputes, conciliation and arbitration

- ☐ **Managing risk and liability:** risk-sharing, warranties and indemnities, force majeure, enforcement by third parties

- ☐ **Applicable law:** which law governs the contract (e.g. English law, Scottish law) and which courts have jurisdiction

- ☐ **'Boilerplate' clauses:** such as definitions of terms, notice requirements, rights of third parties, 'entire agreement', enforcement and waiver

1.3. Can contracts ever be illegal or unenforceable?

Yes. The following types of contract would not be enforceable in the courts because they are automatically illegal and are therefore void (in other words, they have no effect in law).

- ☐ Agreements to do some unlawful civil or criminal act

- ☐ Contracts that are against public policy (e.g. they are in restraint of trade, promote sexual immorality, or interfere with the course of justice or the courts' jurisdiction)

- ☐ Contracts created through duress (unfair pressure on one party to agree) or undue influence

Some contracts may not be enforceable for other reasons:

- ☐ Contracts selling minors goods or services other than basic necessities

- ☐ Where there has been a misrepresentation (untrue or misleading statement) that has induced one of the parties to enter into the contract (the legal doctrine of '**misrepresentation**')

- ☐ If one or both parties were under a fundamental misunderstanding about what was being agreed (the legal doctrine of '**mistake**')

- ☐ Where the contract becomes frustrated: that is, impossible to perform for some reason beyond the control of either party (the legal doctrine of **'frustration'**)

2. Negotiating contracts with commissioners

There are many similar aims and challenges in negotiating contracts with commissioners and lead agencies (or prime contractors). Both typically have greater bargaining power than smaller VCS organisations, and it is in the interests of both to minimise what they pay out for the delivery of services, while maximising the share of risk and administrative responsibilities they pass on to the provider/subcontractor.

This section sets out some of these aims and challenges, and the next section (3) identifies additional key questions that potential subcontractors should consider.

2.1. Aims in negotiating a contract

- ☐ Achieving clarity as to exactly what is being provided, when, how, and for and by whom, and to each party's obligations and responsibilities.
- ☐ Agreeing the fee or price and methods and dates of payment.
- ☐ Agreement on troubleshooting clauses: what happens if things go wrong and each party's rights and duties when this happens, including risk and liability management and sharing. For example, the contract could limit the provider's liability to the value of the contract or any insurance cover the provider has, or the parties could agree to share liability if the contract becomes frustrated because of a force majeure event. (The legal term force majeure is explained in section 4 below.)
- ☐ Providing for dispute resolution, arbitration and mediation. Sometimes disagreements can arise about an issue that isn't explicitly covered in the terms of the contract, so a compromise needs to be negotiated that both parties agree to. It is usually more cost effective to set out the procedure for how such a compromise will be reached in advance, to avoid prolonged and expensive legal argument about whether or not the problem is covered by the existing contract, and then how to resolve the problem if not.
- ☐ Providing for early termination of the contract: why, when and how.
- ☐ Constructing monitoring and evaluation systems (if appropriate).
- ☐ Agreeing renewal or extension terms.
- ☐ Clarifying TUPE issues if the contract is awarded to someone else on expiry. These usually state that the provider cannot make major changes to the workforce or their employment terms and conditions during a stated period before the contract ends. The purchaser/commissioner may also require the outgoing provider to cooperate with the incoming provider in managing the TUPE process after the contract ends.

2.2. Overcoming common difficulties in negotiation

Unequal bargaining power

This can arise when one party is intrinsically in a position of power: for example when a statutory agency holds the purse strings, or when one party has the market on its side. A provider gains power if there is little competition in its area of work, for example, and so is

more able to dictate terms to a commissioner. Similarly, a prime contractor may know that there is a lot of competition in a certain area, and thus can drive down the terms of a subcontract. Also, large public bodies or main contractors often have their own standard-term contracts that are imposed on a take-it-or-leave-it basis. Lack of time for discussion between collaborating organisations or the stronger body's unwillingness to address a power imbalance between it and the providers/partners are common difficulties.

Legal advice and assistance in negotiating these can be helpful, but so also can a powerful presentation aimed at challenging misconceptions or stereotyping of the weaker partner. (*What can small organisations contribute to partnerships?* outlines some of these approaches.) Making sufficient time to negotiate, trying to ensure you deal with the same negotiator throughout and, as far as possible, giving logical and practical reasons for wanting certain clauses or amendments can also put you in a stronger position.

Agreeing the price or fees

This can be particularly difficult in innovative or developmental projects, when estimating future costs in terms of staff time and other resources feels like an exercise in how-long-is-a-piece-of-string. Providing a clear and easy mechanism for amending the contract or reviewing it regularly should help to address this.

These days public bodies want more and more outputs for smaller and smaller amounts of money and do not always appreciate that charity trustees are not legally allowed to use the charity's resources to subsidise public service delivery: see the Charity Commission's guidance on public service delivery by charities.

It is therefore important to have a firm grasp of your organisation's full costs. Many smaller organisations don't, especially those who work with a large proportion of volunteers, and understanding your real costs is often more difficult than it sounds. But if you can explain and justify your service costs to a commissioner or lead agency in a clear, robust way, you are in a much better position to negotiate with them over costs.
(New Philanthropy Capital and ACEVO published an old but still useful Introduction to Full Cost Recovery with an associated toolkit.)

Risk-sharing and risk management

Although public sector bodies are repeatedly advised by government that good practice is to try to share risk and liability, very often the public body expects the service deliverer to assume all risks attached to service delivery. If you must accept these risks, try to get as much insurance cover as you can or agree a limitation of liability clause (as outlined in section 2.1 above).

Dispute resolution

Agreeing a mutually trusted person or body to resolve disputes of fact can be difficult, as many professional mediators and arbitrators are very expensive: £500–£1,000 a day is not uncommon. It may be worth identifying an independent person or body that would be prepared to undertake this for free or at a lower charge.

TUPE

Where provider A loses a contract for delivering service C to provider B, under current employment law, provider A's staff who are primarily engaged in delivering service C transfer to provider B. This can be expensive if they are on public sector employment terms and conditions and/or in final salary pension schemes. Though it is sometimes hard to estimate TUPE liabilities at the start of a commissioning process, the cost of TUPE transfers and pensions has in the past meant that organisations choose not to submit a bid. It is therefore a crucial part of planning and due diligence.

2.3. Legal remedies (the last resort)

- ☐ If the contract is not performed by either party (or sometimes both!) or performed inadequately, then the ultimate sanction is to sue in the civil courts. The types of claims that can be brought are explained below.

- ☐ If the amount claimed or the total value of the contract is less than £10,000, the Small Claims Court (part of the County Court) can be used. If the amount claimed or total value is likely to be less than £25,000, it can be heard in the County Court. Claims over £50,000 must be taken to the High Court. Claims between £25,000 and £50,000 can be taken to either Court.

- ☐ **Damages:** this means compensation awarded to the party claiming the contract was breached. It is intended to put that party in the same position it would have been had the contract been properly performed. Damages can be **general** (that is, what the parties could reasonably have anticipated, had they thought about it) or **special** (items of direct loss that arose because of the breach of that particular contract): e.g. loss of business, inconvenience, damage to other property.

- ☐ **Return of a deposit:** or part payment to a buyer.

- ☐ **Restitution:** e.g. return of a full payment to a buyer.

- ☐ **Specific performance:** ordering one party to fulfil their part of the contract.

- ☐ **Injunction:** a restraining order to prevent a future breach of contract.

2.4. Further guidance for the voluntary sector on commissioning and public services

- ☐ ***Charities and Public Service Delivery: an introduction and overview*** **(The Charity Commission)**

- ☐ ***Before Signing on the Dotted Line: all you need to know about procuring public sector contracts*** **(NCVO)**

- ☐ ***Hearts and Minds: Commissioning from the Voluntary Sector*** **(Audit Commission)**

3. Negotiating contracts with lead agencies or main/prime contractors

Smaller organisations within consortia or that are wishing to work in partnership can be approached to be a subcontractor where a consortium or lead agency has secured the main contract. This can be as a result of a lead agency or consortium winning a formal tender or being awarded a contract as a preferred provider, as outlined in *Selecting a lead agency*.

Subcontracting bodies need to understand the main contract (between commissioner and lead agency or main contractor) and will face many of the same challenges they would have in negotiating directly with a commissioner. So you will need to be aware of the issues covered in the previous section. Sometimes the subcontract you will be asked to sign mirrors the main contract (called a 'back-to-back' subcontract), and sometimes it could be very different. You need to understand the relationship between the main contract and your subcontract, as outlined in the bullet points below.

Any organisation employing staff should have employers' liability insurance, which can also cover volunteers. Many contracts with public bodies require the provider to have public liability and, sometimes, professional indemnity insurance. Other useful insurance covers are business interruption or consequential loss insurance, trustee or directors' indemnity insurance, and legal expenses insurance.

The key questions that a subcontractor needs to ask are:

- ☐ What are the payment terms – in advance or in arrears? Does the contract provide for payment by results or is payment tied to milestones or outcomes?
- ☐ Are we protected if payment to our main contractor is made late by the commissioning body?
- ☐ Are there time limits for e.g. sending in invoices and monitoring information, or for completing activities?
- ☐ Are there any penalties for e.g. being late with sending in invoices or monitoring information, or for not fully complying with the performance terms?
- ☐ If something goes wrong, what is the extent of our liability and is there any way that we can limit it – for example to the value of our contract or the amount of any insurance cover we have?
- ☐ What insurance cover do we need?
- ☐ If we need to negotiate changes to our subcontract, how do we do this?
- ☐ Can the commissioning body or main contractor change any terms without our agreement?
- ☐ If we want to end the contract early, how do we do this?

- ☐ If we get into a dispute with the main contractor or the main contractor gets into a dispute with the commissioning body that affects us, what is the resolution procedure?

4. Understanding legal terminology

Legal jargon or plain bad drafting can prevent clarity and consensus. Legal advice can help, but you can ask a potential contracting party to clarify what it means by a clause or phrase. Contracts drawn up by lawyers can seem overly formal or one-sided and require further explanation of terms. However, the third-sector umbrella bodies, such as NCVO, are beginning to invest in producing plainer-English specimen documents. There is a more detailed dictionary of terminology at http://www.felp.ac.uk/taxonomy/term/365.

Some of the most common legal terms include:

Assignment: this means a transfer of a contract from one body to another where, for example, a new purchaser/supplier is replacing a previous one. The assignment agreement is signed by all three parties – the existing purchaser/supplier and the new purchaser/supplier.

Force Majeure: an event beyond anyone's reasonable control that '**frustrates**' a contract. It can include, for example, war, national emergency, strikes, civil unrest, weather conditions, floods, fires, or a change in the law making the contract illegal. The Bristol City Council example Contract for Services defines force majeure in section 20.

Indemnity/indemnify: a promise or making a promise to compensate someone financially for any loss or damage suffered.

Liability: an obligation to take financial and legal responsibility for an occurrence or a mistake or a failure to perform**. Limitation of liability** is where the parties agree that the amount payable is limited to a fixed amount: see Liquidated Damages.

Liquidated Damages: sometimes parties to commercial contracts agree that in the event of a breach a fixed agreed (or "liquidated") sum will be paid as Damages.

Negligence: the civil wrongdoing or "tort" of failing to take reasonable care or exercise reasonable skill incurring a liability for loss or damage suffered by a third party affected by the negligence act or failure to act.

Pro-forma: an agreed format for legal documents used during a contract – e.g. for purchaser orders, invoices and monitoring reports.

Representation/represents: a statement of fact made either to induce someone to enter into a contract or made in the contract itself. A false statement (misrepresentation) can result in the maker of the statement having to pay **damages** to the other party. You can find references to these in the Grant Agreement and Contract for Public Services examples in section 1.

Severance: it may sometimes happen that one of the clauses in a contract becomes illegal or unenforceable because of a change in the law. Severance provisions preserve the rest of the

contract as valid and treat it as if the illegal clause has simply been deleted, rather than the whole contract becoming invalid.

Undertaking/undertakes: this is a legally enforceable promise to do something – e.g. sign a contract or pay a sum of money to a third party.

Use of capital letters: where a term begins with capitals (for example "Service Quality Performance Indicator"), it has been defined specifically in the **Definitions** or **Interpretation** sections of the contract.

Warranty/warrants: a promise (enforceable by law) that, for example, goods or services provided are of a certain standard or quality or that the contracting organisation possesses certain qualities or characteristics. Damages for breach of warranty may often be greater than damages for misrepresentation.

Waiver: an agreement by one party not to enforce a claim or right against another party – e.g. A agrees to waive its right to make a claim against B. Conversely, a contract can provide that the extent of any waivers can be restricted – see clause 19 of the Consortium Members' Collaboration Agreement.

5. Frequently asked questions

5.1. Can a consortium arrangement create a contract?

"Consortium" is a Latin word meaning "partnership", "society" or "association". Whether or not it is a contractual or legally binding arrangement depends on the **intention of the parties/partners**, and how this intention is stated in the contract. An informal network that has no constitution but may have some terms of reference or a memorandum of understanding will not be governed by a contract. But where organisations e.g. enter into a lead body and partners' agreement, enter a joint working agreement or form a special purpose vehicle, then their relationship will be governed by contract.

5.2. What is the difference between a lead body and partners' consortium and a subcontracting arrangement?

It is very important to understand whether the activity or project is being funded by grant aid or under a main contract. Grant aiding bodies such as the Big Lottery and local authorities often encourage organisations to put in grant applications as a consortium – with a lead body and delivery partners. Often the lead body will be an equal delivery partner with the others. The grant is given to the lead body and that body is responsible for paying the other partners, ensuring that all monitoring information is collected from the partners and that they together have mechanisms for dealing with performance issues. Although the lead body may have other additional responsibilities over and above the other delivery partners, this arrangement is distinct from a 'pure' subcontracting arrangement in that the partners came together and decided in advance how they would work together, who would be lead and, usually, how all

partners contribute to decision-making. This is what makes the consortium more 'equal' than a pure subcontract.

Where an organisation has tendered for a contract individually, the subcontractors may or may not have been mentioned in the tender. The commissioning body will have an expectation that elements of the service will be subcontracted and may even specify the format of the subcontract. However, the main contract holder typically has much more, if not exclusive, right to decide with whom to subcontract delivery or not, and the terms of any subcontracts. It is usually therefore a less equal arrangement than a consortium, characterised by competitive negotiation rather than joint decision-making.

5.3. What is the difference between a hub and spoke model and a special purpose vehicle?

"Hub and spokes" describes the working relationship within a certain type of consortium where one body will act as the tendering organisation and will manage any contract that is obtained. The hub may also be a delivering body and may provide various support services to the spokes, such as assistance with attaining quality assurance standards and dispute resolution.

Where they wish this relationship to be fully formalised, the partners can form a special purpose vehicle to provide all these functions. Most voluntary sector consortia are

a) charitable limited companies;
b) charitable incorporated organisations; or
c) community interest companies (and therefore a sort of joint trading arm for the members).

5.4. Can a commissioner force an unincorporated consortium to incorporate?

It is increasingly common for statutory bodies to insist that any organisation providing contracted services *must* be an incorporated organisation, i.e. a limited company, a community benefit society or a charitable incorporated organisation (CIOs). This is particularly true if the service is something that the commissioning body has a statutory duty to provide. Thus, they may insist that the lead body or main contractor be incorporated or ask to deal with an incorporated consortium special purpose vehicle. So, faced with this, an unincorporated consortium must either choose to accept this condition, and therefore incorporate, or decide they don't accept the condition, and forfeit their opportunity to deliver the contract.

Occasionally they may also require that each subcontracting body be identified in the tender documents, so they are aware at the outset of who all the potential deliverers may be. It has occasionally happened that some tenders fail on the basis that the commissioner does not have confidence in all the members of the consortium or in all the proposed subcontracting bodies named in the tender. Conversely, you also need to be clear with your commissioning body that, where they have asked to deal with a special purpose vehicle, the fact that it is newly created will not jeopardise the tender – so the good track records of the members as providers will be taken into account, even if the consortium SPV itself has no previous track record as a service deliverer.

5.5. Is there a difference between a service level agreement and a contract?

The service level agreement was first introduced in the late 1980s and early 1990s and was an attempt by grant aiding statutory bodies to, in a sense, 'have their cake and eat it'. Grant agreements in many cases were merely letters confirming the amount of the grant, the dates it covered and the general expectations of the grant-giver concerning the grantee's use of the grant.

However, there are two inherent problems with this:

a) grants are technically gifts and so grant agreements are technically not legally enforceable if the grant had been misspent and was not recoverable; and

b) statutory authorities often did not want to replace grant arrangements with contracts because they would then have to comply with EU procurement rules.

So, they produced a much more detailed, specific and demanding form of grant agreement called a service level agreement which gave the grant-giver more control over outputs and performance but without creating a contract. However, the more this document contains contract-style terminology (e.g. warranties, indemnities, waivers, undertakings), the more likely it is to be found to be a contract, if it were legally challenged.