



Public Service Delivery – The Legal Implications

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Public Service Delivery – the Legal Implications

1. The Differing Perspectives

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Introduction

1. In this session we are going to address some of the legal issues arising from the involvement of charities in the delivery of services to the public. It is fair to say that this is a topic that merits and, indeed, has been the subject of conferences devoted entirely to the issues raised by public service delivery by charities and not for profit bodies. Inevitably, therefore, this paper and its companion by my colleague Sara Nicholls are intended as introductions to the legal aspects of the large and dynamic subject.
2. In the time available to us we are going to firstly address the issues from a number of viewpoints, as follows:
 - The service commissioner.
 - The charity.
 - The policy makers.
3. In the second part of this presentation we will look at specific issues of contract terms and how charities should approach the drafting and negotiation of funding and services contracts.
4. I should also add that we will mainly be focussing on the position as it relates to public services delivered or funded by the Assembly Government. However, it should be remembered there will be certain public services particularly in the law and order and the prison and probation ("offender management") spheres where policy remains the responsibility of an England and Wales department of state and which will be guided by the policy developments in England co-ordinated by the Office of the Third Sector.

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The service commissioner

5. We are currently in a period of reform in the way that public services are delivered. Historically, of course, many of the services that we now regard as “public, were in fact undertaken almost exclusively by charities and these have only relatively recently been seen as proper activities for the state to engage in. Education, health care and what we would now term social care are the obvious examples.
6. With what one might term the “nationalisation” of services such as health and education the model for service delivery for many decades was one of direct provision of capital assets and staffing by the public sector. Goods and services were contracted from the private sector, but they were restricted, broadly speaking, to the procurement of supplies, works and specialised professional services (e.g. architecture and engineering consultancy). However, a trend dating from as long ago as the Local Government, Planning and Land Act 1980 and its controls of local authority direct labour organisations, envisaged local authorities as “enablers”, commissioning services that were subject to the “discipline” of the market. Similar initiatives were pursued within central government and the NHS.
7. At the same time, the procurement of works, goods and services by public bodies came under the influence of European competition law and policies designed to create a single market in their supply to public sector bodies. These rules now find their expression in the Public Service Contracts Regulations 2006.
8. The range of public services that are provided or commissioned by public bodies now cover fields as diverse as:
 - Advice and advocacy.
 - Care of the elderly and provision of sheltered accommodation.
 - Education.
 - Medical care and treatment.
 - Museums, art galleries and libraries.
 - Recreational and leisure services.
 - Recycling, refuse collection and disposal.
 - Social housing, and
 - Urban or rural regeneration.

9. The commissioners of these services can broadly be categorised as either departments or agencies of central government or local authorities, although the nature and scale of its operations probably places the NHS in a category of its own.
10. Looked at from the perspective of a commissioner considering contracting for services, there are going to be three primary questions:
 - Does the commissioning body have the power to contract for these services?
 - What obligations are there in respect of value for money, and
 - What procedural rules must be observed?

Let us look at each in turn.

11. The bodies who commission public services nowadays derive virtually all their powers from Acts of Parliament and, in the case of the NHS and local government, exclusively so. Powers conferred by Act of Parliament must be ascertained by reference to the terms of the Act and “the powers which the corporation may lawfully use in furtherance of these objects must either be expressly conferred or derived by reasonable implication from its provisions”². This is still commonly known as the doctrine of “*ultra vires*”.
12. The effects of the doctrine on the validity of contracts are potentially fatal. Contracts entered into by public bodies outside their statutory powers risk being challenged and declared unlawful through judicial review proceedings and thus unenforceable, with the unpalatable consequences that contractors were unable to sue for payment or otherwise enforce the contract. This situation was highlighted in two high profile cases where the courts found contracts to have been entered into “*ultra vires*” as void and unenforceable. One of these cases related to the enforcement of a guarantee by a local authority for a company set up to undertake a leisure development that the local authority could not because of central government capital controls³ and the other related to the use of interest rate “swap” transactions in the management of local government finances⁴.
13. I mention these cases because they severely restricted the interpretation of Acts of Parliament relating to the powers of public bodies. In particular they upheld a narrow interpretation of what could be reasonably implied into powers granted by an Act. Specifically, in both of these

² See *Baroness Wenlock v. River Dee Co (1885)*

³ See *Credit Suisse v Allerdale BC*. Court of Appeal 1997.

cases it was the power of a local authority under section 111 of the Local Government Act 1972 to do things "... calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions."

14. Consequently, when the present government embarked on its "modernisation" of the public services it was necessary to take legislative action to prevent the restrictive application of the rule to inhibit the "enabling" role of the public sector and following in the wake of the passage by its predecessors of the Deregulation and Contracting Out Act 1994, which generally permitted the use of private contractors by ministers, office-holders and local authorities. Then the present government passed the Local Government (Contracts) Act 1997, which permitted local authorities make assets or services available to contractors under contracts for the discharge of local authority functions. Finally, in the Local Government Act 2000 local authorities were given broad powers of competence to undertake a community leadership role by virtue of the powers conferred by section 2 which provides that a local authority is to have power to do anything which it considers would achieve the economic, social or environmental well-being of its area or part of it. The broad interpretation of these powers was subsequently upheld by the court⁵.
15. While considering the issue of public bodies' powers it is also relevant to note that statutory powers are characterised as either mandatory or permissive. For example, the provision primary and secondary education is a mandatory obligation; in other words a local authority that is a local education authority must exercise the powers and make the provision. On the other hand the provision of most leisure facilities is permissive, so a local authority can decide if it wishes to operate a leisure centre.
16. Having established that it has the power to contract the public body will then consider what its obligations to procure value for money are. As far as central government and the NHS is concerned the oversight of the economy and efficiency of the public sector will rest with the National Audit Office and the Wales Audit Office and Public Accounts Committee at Westminster and the Assembly Audit Committee in Cardiff Bay. Local Government is subject to different and more prescriptive arrangements, derived from the Local Government Act 1999 to:

⁴ See *Hazell v. Hammersmith and Fulham LBC*, House of Lords 1992.

⁵ See *R.(on the application of J) v. Enfield LBC (2002)*.

- Secure continuous improvement in the way in which they exercise their functions, having regard to a combination of economy, efficiency and effectiveness;
 - Consult widely on how to do so, and report publicly on the outcome;
 - Conduct reviews of their functions;
 - Prepare a performance plan for each financial year.
17. In England, the 1999 Act arrangements are known as “Best Value”. In Wales since 2002 it has been termed the “Wales Improvement Programme”. This has generally resulted in more of a “light touch” style of regulation in Wales, as seen in the Guidance issued to local authorities by the Assembly Government in 2005⁶. The difference in emphasis should also be considered in the context of the broader Assembly agenda for improvement – *Making Connections* and the Assembly’s statutory duty to maintain a local government scheme to sustain and promote local government in the exercise of its functions and to maintain the joint Partnership Council with local government⁷.
18. Finally in the context of obtaining value, reference should be made to the general obligation on local authorities in disposing of land to obtain the best consideration reasonably obtainable, unless the Assembly Government consents to a disposal for less (see section 123 Local Government Act 1972). Provision has been made for certain categories of disposal to be generally exempt and not to require specific consent from the Assembly. The present General Disposal Consent (Wales) was issued in 2003 and allows local authorities to dispose of land generally to charities on lease for nominal consideration.
19. Finally, there is the question of the procedure to be followed in procuring contractors to deliver public services. Public sector procurement is wedded to the process of tendering and as already noted the larger procurements of works, goods and services are regulated by the Public Contracts Regulations 2006. The tendering procedures permitted by the regulations are a topic that requires consideration in its own right and is outside the compass of this paper, but there is one point that I do want to highlight in this section.
20. The regulations not only specify how procurements are to be conducted by contracting authorities (essentially any public body or a body more than 50% funded by a contracting

⁶ Circular 28/2005.

⁷ Section 111 and Schedule 9, Government of Wales Act 1998.

authority). Where the regulations apply to services they apply with greater intensity to some services than others. The so called "Category A" services, such as building works and many professional services, especially those of a technical nature are regulated in respect of the whole of the tender process. However, the so called "Category B" services are subject only to certain requirements about notification of the results of procurement exercises and certain provisions prohibiting the use of technical specifications to discriminate against potential tenderers. A contracting authority may also stipulate contract conditions provided that these are compatible with Community law and these may include conditions of a social or environmental nature.

21. The imposition of social clauses may be particularly relevant where public services are being undertaken by a charity with particular social objectives, such as bringing long term unemployed persons in a particular area into employment. Both the nature of social provisions that can be included in a contract and the ability to include a tenderer's willingness to comply with such requirements in determining whether a tender is the most economically advantageous are fraught with difficulty. This is because of the fundamental tension between the principle of non-discrimination in Community law and the social objectives that the contracting authority is seeking to further. The Office of the Third Sector action plan⁸ recognised the difficulty of including social clauses and the risks they posed for legal challenge as a result of the best value regime and EU rules. As a result the Office of the Third sector proposes later this year to publish a set of template social clauses in an attempt to address this issue. These clauses will be of equal relevance in Wales.
22. Continuing the EU law theme, service commissioners must also be alert to the potential for the EU rules on State Aid becoming engaged when charities are commissioned to deliver public services. This is a particular risk where charities become engaged in economic regeneration activities, particularly those involving making of grants to social enterprises using public sector funds. The general principle of the state aid rules is that it is prohibited if aid is:
 - Provided through state resources.
 - Favours certain undertakings or the production of certain goods.

⁸ Partnership in Public Services An action plan for third sector involvement (December 2006), paragraph 57.
http://www.cabinetoffice.gov.uk/third_sector/documents/public_service_delivery/psd_action_plan.pdf

- It distorts or threatens to distort competition, and
 - Affects trade between member states.
23. Most importantly, aid that is not permitted by the EU Treaty or has not been ruled compatible with the Common Market by the Commission is recoverable in full from the recipient. In addition, the Commission applies a very low threshold to determining if there is a distortion of competition and intra EU trade.
24. Of particular relevance therefore to charities acting as agents for distributing funds is the “*de minimis*” rule which allows state aid to any recipient up to a maximum of € 100,000 overall over any three year period.

The Charity

25. I now turn to the legal implications for charities. This conference takes place against the background of two major interventions in the debate on public service delivery by the sector’s regulator. These are the publication of updated guidance in the form of “Charities and Public Service Delivery – An introduction and overview (CC37)”⁹. At the same time the Commission published the results of a survey of 4,000 charities on the delivery of public services: “Stand and deliver: The future for charities delivering public services”¹⁰. It is fair to say that these documents strike a note of caution that is in contrast to the enthusiasm of policy makers for the “Third Sector” and to which I shall refer in a moment.
26. The Commission’s approach is summed up in their latest newsletter¹¹:
- “The Commission has always been neutral about whether charities should deliver public services or not, and it really is a decision for trustees. However, the evidence in our report underlines the need for trustees to carefully agree their charity’s approach to public service delivery, including its approach to charging.”
27. Charity law does not prohibit charities from delivering public services under funding agreements or using their own funds to do so. However, the responsibilities of charity trustees remain exactly the same and the following must always be considered:

⁹ See: <http://www.charity-commission.gov.uk/Library/publications/pdfs/cc37text.pdf>

¹⁰ See: <http://www.charity-commission.gov.uk/Library/publications/pdfs/RS15text.pdf>

¹¹ Charity Commission News Issue 26 <http://www.charity-commission.gov.uk/Library/tcc/pdfs/ccnews26.pdf>

- Charities can only deliver public services that are within their objects and powers;
- Charities must be independent of government and other funders;
- Trustees must act only in the interests of the charity and its beneficiaries; and
- Trustees must make decisions in line with their duty of care and duty to act prudently.

28. CC37 is a comprehensive document with the legal requirements of charity law as it affects public service delivery, clearly indicated. It is, frankly, required reading for every charity that engages with the public sector and trying to summarise it in a short talk like this does not do its content or the breadth of its coverage justice.

29. However, the Chair of the Charity Commission, in a speech launching the survey results last February summed up the Commission's message as:

- Guard your independence
- Know your worth
- Stick to your mission

In particular, there was a note of caution against the emergence of a fourth sector in the form of charities delivering public services that were charities in name only¹².

30. In this section of the session I therefore want to focus on the question of independence. The Charity Commission's views on this are published in "The Independence of Charities from the State" (RR7)¹³ and the key messages of this are worth emphasising.

31. However, it is first important to note that there is nothing wrong with the state establishing charities to fulfil public purposes and deliver services to the public – many of our greatest cultural institutions, for example, were established in this way. However, once created by the state, a charity is set free and acquires the legal obligation to determine how best to pursue its charitable mission in the interests of its beneficiaries. The most enduring and probably best known examples of this are the Arts Councils; founded by Royal Charter and clothed with charitable status precisely in order to ensure that decisions on who should receive state funding of the arts is carried out at "arm's length" from the state provider of the funds.

32. In many cases, where central or local government set up charities themselves, they will retain the right to appoint some or all of the trustees. As a matter of law, this is not objectionable as

¹² For full text see: http://www.charity-commission.gov.uk/recent_changes/speech.asp

¹³ See: <http://www.charity-commission.gov.uk/Library/publications/pdfs/rr7text.pdf>

such. However, the appointing body is itself bound when appointing trustees to exercise this power solely in the interests of the charity. In theory, the appointment of a wholly unsuitable trustee by the state would therefore be amendable to challenge in the courts to secure their removal as being an improper exercise of the power of appointment. Proving such a claim in practice, of course, is another matter. Nevertheless the legal rule in this instance emphasises the importance of open and transparent appointment procedures on the part of third parties.

33. This leads on naturally to the principle that trustees, once appointed, must act solely in the interests of the charity. In the context of trustees appointed by a third party public body it means that a trustee is not a delegate of the appointing body, nor can a funding body insist on appointing a trustee as a condition of funding.
34. Independence is not a totally clear cut concept. This makes it all too easy for a charity undertaking public service to drift from "arm's length" independence to being a client of the state. The Charity Commission have identified a number of characteristics of an independent "arm's length" relationship and the fewer of these that apply the less independent the charity is of the state. These characteristics represent an important check list that the prudent charity will consider from time to time in the context of its level of state funding. I would venture to suggest that charities delivering extensive public services or receiving a high level of grant or funding will probably not be able to display every characteristic of independence – it is the overall picture that emerges from considering the characteristics that counts.
35. It is therefore worth considering what these characteristics of an independent charity are:
 - The trustees have choice about whether or not to accept funding on the terms proposed. In some cases, for example national museums and libraries, they are substantially reliant on their annual grant in aid from the state to continue in existence. This being the case, it means that other characteristics become proportionately more significant and should be more zealously protected.
 - The taking of their own legal and financial advice.
 - The drawing up of their own policies and business plan.
 - They would negotiate at arm's length with the governmental authority. Once again, the ability to do this in contractual terms depends on whether the charity is negotiating a

reciprocal contract for services, as opposed to receiving a grant for core funding without which the charity's objects could not be pursued at all.

- Trustees with conflicts of interest would not participate in discussions and provisions in governing instruments allowing trustees to participate in decision making notwithstanding a conflict of interest must be regarded with suspicion in the context of the independence of the charity.
- The contract for the delivery of the services must preserve the fundamental discretion as to the selection of beneficiaries and the provision of services. This is one of the most difficult lines to tread, because it is unrealistic to expect a charity to be given an entirely free hand given the obligations of public bodies to protect public funds.
- Equally, terms that simply require the carrying out of the policies of governmental authorities are plainly not the same as charitable purposes. The proliferation of policy statements by government, especially in the fields of access and equality and which find their way into funding and contract situations can sometimes make trustees uncomfortable that they are being co-opted into the overall public sector policy framework in return for funding.
- The trustees would not agree to conditions that undermined the confidentiality of their discussions, for example by the presence of observers from the funding body. This is another difficult issue. The presence of an observer can be a useful channel of communication, especially as some charities hold at least part of their meetings in public either as a matter of course or from time to time. The important thing is for the funding body to respect the rights of the trustees to meet, deliberate and reach decisions in confidence if it is in the charity's interests.
- Trustees are free to make their own decisions on matters outside the scope of the funding arrangement; for example on the expenditure of privately donated funds or the level of information required on the charity's other operations.

The policy makers

36. I have identified the policy makers as a specific category, because it is policy that has driven the present vogue to adopt the "Third Sector" as an important component of public service delivery

in future. That said the most recent policy pronouncements have recognised that there are still many procedural impediments to be overcome if charities and the state are to achieve a mutually beneficial outcome.

37. The Office of the Third Sector action plan is instructive from the legal perspective in recognising a number of important issues:
 - If public service delivery by charities is to be delivered through competitive processes rather than traditional grant arrangements, then tendering needs to be tailored to encourage charities to incur the time and effort in tendering. The need to streamline pre qualification has been identified as an issue as has the length of contracts to make the cost of tendering worthwhile. However, this only reiterates a point made in the Gershon report on public sector efficiency published in 2004.
 - The ability of the public sector to at least minimise the burden on charities of having to take their own legal advice by seeking to develop with “national and local partners” a range of model contract provisions for particular services. By tendering to a well understood “standard form” the need to have to take legal advice every time a contract is entered into can be avoided.
38. However, the enthusiasm to try and reduce barriers to charities competing for public service contracts needs to be tempered by consideration of the need for there to be a “level playing field”. There are some types of public service – the education sector springs to mind – where the services are available from both private sector and Third Sector actors in the market. There are thus limitations on the extent to which the perceived burdens of tendering can be relaxed in favour of the Third Sector, without running the risk of the private sector complaining that the Third Sector is being unduly favoured.
39. On the positive side, however, is the recognition that the Third Sector has been exploited to a degree by the use of short term contracts whose duration would make them unattractive to a public sector operator.
40. The final area of policy making that I would like to mention is the future of the National Assembly’s Voluntary Sector Scheme¹⁴. As we meet today, the scheme is made under section 114

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See: <http://www.cymru.gov.uk/documents/cms/2/ChamberBusiness/37DE69040002933B000007CF000000/34d4609831dc68752cfe6386ad6f52fa.pdf>

of the Government of Wales Act 1998. It is the counterpart of similar schemes for local government and the business sector, which make them formal partners in the “inclusive” style of Assembly Government. With the election of the Third National Assembly in a few days time, the Voluntary Sector Scheme will be regulated under section 74 of the Government of Wales Act 2006. There will be some changes in the procedural arrangements.

41. Under the 1998 Act there was a duty on the Assembly, after each election, to formally consider if the scheme should be remade or revised. The original scheme was subject to an Independent Commission Review commissioned after the election of the Second Assembly.
42. The 2006 Act will formally split the executive from the elected assembly. There will be an Assembly Government comprising a First Minister appointed by the Queen on the recommendation of the National Assembly. The First Minister will, in turn recommend to the Queen the appointment of Welsh Ministers and a Counsel General. The National Assembly will be a separate legislative and deliberative body, regulating their own internal affairs through an Assembly Commission.
43. Consequently, section 74 of the 2006 Act will now place the main duties in respect of the making of the Voluntary Sector Scheme on the Welsh Ministers. In particular, the decision on whether or when to revise or remake the scheme will be in the discretion of the Welsh Ministers. The scheme and any revision, as well as an annual report of the implementation of the scheme must be published and laid before the National Assembly.
44. It will be interesting to see what the approach of the new Welsh Ministers will be to the revision of the existing scheme, especially in the light of the most recent pronouncements of the Charity Commission.

This briefing note is intended solely as an overview of the law. It was last updated on 23 April 2007. No responsibility can be accepted for the completeness or accuracy of this briefing note and professional advice should be taken in relation to any specific problems.

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