

STAFF MUTUALS AND THE RIGHT OF STAFF TO RUN SERVICES

key - all numbered sources are listed at the end

What they are

- 01** Staff buy-outs have been familiar for many years. They were at times hindered by the policy of the day but are now being actively encouraged, notably in England by the government's plan for the Big Society (**1599**).
- 02** They are sometimes distinguished from management buy-outs. The process is however the same whoever does the buying out. In practice buy-out is by whichever managers or staff (or both) comprise the body formed to make the purchase.
- 03** English ministers now refer to these bodies as **staff mutuals**. This term has for years been widely used for mutual building societies, cooperative retail societies, and other bodies controlled by their users; but not until now for bodies controlled by their staff. It does not therefore define any particular type of delivery vehicle but it does symbolise the continuing involvement of staff in management, and their interest in the continuing viability of the new body which they helped to set up. It also makes a convenient collective term, and this Note uses it for that purpose.

Legislation for them

- 04** Many staff mutuals are expected as a result of the Localism Bill. This would place a duty on principal authorities in England (**102**; 66) to consider 'expressions of interest' by relevant bodies in providing relevant services. Relevant bodies include **any two or more employees** (**102**; 66.5) and relevant services include all services except any which ministers specify in regulations (**102**; 66.4).
- 05** Authorities will be able to reject expressions of interest only on grounds specified by ministers (**102**; 68). The CLG consultation paper on the Community Right to Challenge proposes that an expression may be rejected (**1605**; 7.3) if
- ◆ the body submitting it is incapable of providing the service, or is not a suitable body to do so
 - ◆ a procurement exercise for it has already started
 - ◆ another body has already expressed an interest in it
- 06** If authorities accept them, they will be required to conduct a procurement exercise 'appropriate to the value and nature of the contract which would be awarded' (**102**; 68.2). Not all appropriate procurement exercises involve competition, but many do, including the biggest. Staff mutuals will **not therefore necessarily win** contracts for the work in which they express an interest.
- 07** CLG believes that 1 April 2014 is the earliest date on which these provisions may come into effect (**1605**; 9.2).
- 08** Extracts from the CLG consultation paper are attached as Annex A.
- 09** This Note addresses
- ◆ which comes first - the buy-out, the funding, incorporation, or winning a contract
 - ◆ what sort of body to set up
 - ◆ when contracts have to be advertised
 - ◆ how to conduct the competition
 - ◆ how to involve staff in management

WHICH COMES FIRST ?

- 10** Anybody wanting to engage in any sort of business normally has to meet the cost of setting up to do so, including
- ◆ tendering
 - ◆ the buy-out, and
 - ◆ forming a corporate body capable of performing a contract

What needs buying ?

- 11 There is at first often little for anybody to buy - just the assets of the in-house organisation. The assets include the goodwill but this is negligible until there is some **guarantee of future business**. There can be no such guarantee until contracts are awarded, and this cannot be done until there are corporate bodies to award them to. This adds to the difficulty, addressed later, of raising capital for any purpose **before contracts have been won**.
- 12 The difficulty is greatest for work and services which require the use of high value assets, like depots and specialised vehicles. It is hard for staff to raise the capital necessary for buying them, whatever the juncture at which they have to do it. Authorities whose main objective is to help staff buy-outs, rather than to raise money by selling assets, are free to retain the assets and **require the contractor to use them**.

Who pays ?

- 13 Until now this has had to be done at the expense of the staff and managers who will comprise or set up the new service-providing body, and in their own time. It therefore gave staff two problems
- ◆ how to **incorporate themselves** and complete the buy-out, to enable them to submit firm tenders
 - ◆ how to **obtain the necessary financial backing** for all that, before winning any contract, and therefore before becoming a credit-worthy going concern. Staff have sometimes had to provide the security themselves, by mortgaging their own houses
- 14 CLG suggests that bodies expressing interests can overcome the funding problem by forming joint ventures (1605; 5.6).
- 15 Several other ways of avoiding it may be available. They are for a new body
- ◆ to **incorporate itself** after becoming the preferred tenderer. This can be done only if the authority accepts tenders from non-corporate bodies who are willing, if successful, to incorporate themselves within whatever timescale the contract lays down. This is now increasingly common practice, because it enables non-corporate consortia to submit tenders
 - ◆ to obtain **conditional commitment** from a funder (not the funding itself) if and when the body is declared to be the preferred tenderer. Most authorities do however choose to declare preferred tenderers only when arranging more complex contracts
 - ◆ to make a shareholders' agreement with selected investors to form an (inexpensive) **shell company** to submit a tender, and for these investors to take up their shares if and when their tender is successful
- 16 The Cabinet Office has in addition said (1599) that over £10m would be **available from the exchequer** 'to help the best fledgling mutuals reach investment readiness'. Authorities are also free to **meet some or all the costs themselves**, using their wellbeing powers (46; 2) (55; 21).
- 17 Any such financial help to a body **to compete for contracts** would however be hard to justify to their competitors. It would also count as **state aid**, which constitutes an infringement of the Treaty on the Functioning of the European Union 2008 (which replaced the Treaty of Rome) though subject to many exemptions. These exemptions include a de minimis exemption of €0.2m for aid to any one undertaking in any period of 3 years (1580; 1).
- 18 CLG proposes that, whatever the methods which bodies intend to use to raise the necessary capital, they should state it in their expressions of interest (1605; 7.3).
- 19 There is no requirement for staff to make all, or any, of their side of the preparations **before** expressing an interest in the work.

THE TYPES OF BODIES AVAILABLE

- 20 The Bill provides for no new types of bodies. Staff mutuals will therefore have to take the form of
- ◆ companies limited by shares

- ◆ companies limited by guarantee
 - ◆ community interest companies
 - ◆ community benefit societies
 - ◆ cooperative societies
 - ◆ commercial partnerships
 - ◆ limited liability partnerships
- or
- ◆ trusts

- 21 They may in addition shortly be able to take the form of charitable incorporated organisations.
- 22 Some of these bodies may **also** be
- ◆ joint venture bodies
 - ◆ social enterprises
 - ◆ charitable bodies
- 23 Commentators often refer to these three as if they are distinct types of bodies, additional to the previous eight, but **this is misleading**. Each covers instead whichever bodies of the nine main types have the necessary special features.
- 24 Small groups of workers sometimes propose to carry out contracts as **unincorporated associations**. This is however usually inconvenient for both parties, and sometimes hazardous. It is unnecessary, given the ease with which some of the other bodies mentioned can be set up. Commercial partnerships are usually the quickest and easiest to set up, and can be converted into limited liability partnerships in due course. Companies can also be set up comparatively quickly and inexpensively.
- 25 Many books have been written about each of these different types of bodies. The main practical, legal and regulatory features of these bodies are summarised in the CJC Guide to Choosing Partnership Vehicles 2008
<http://secure.cipfa.org.uk/cgi-bin/CIPFA.storefront/EN/Product/BV025>
- 26 The main features of these bodies are described in Annex B to this Note. All have their own pros and cons. But **no type of body has all the pros and none of the cons**, or is ever likely to. Enthusiasts nevertheless sometimes talk as if they are commending the use of such imaginary bodies, usually when they fail to specify what sort of body they are talking about; or when they refer to them simply as 'partnerships'.

ADVERTISING CONTRACTS

Contract notices in the Official Journal of the European Union

- 27 If the EU directives would require contract notices in OJEU, the contract also has to be competed for in accordance with the directives. Notices in OJEU are **not** however required if the contract
- ◆ is for a 'Part B' service, **or**
 - ◆ is below specified financial thresholds, **or**
 - ◆ is awarded to a company wholly owned by the contracting authority

Contracts for Part B services

- 28 Part B services are legal, education, health, social, catering, investigation, recreational, cultural and sporting services; and personnel placement and supply services.
- 29 The directives apply to them, but only as to
- ◆ specifications and award notices (168; 2.2 & Sch 3) (202a; 6.11)
 - ◆ requirements (described later) for advertising

Contracts below the thresholds

- 30 The thresholds are (168; 8) €0.193m for services and €4.845m for works. The Regulations closely prescribe how contracts are valued for the purpose of deciding whether they reach the thresholds.

Companies wholly owned by the contracting authority

- 31 A contract let by a contracting authority is not subject to the directives (1092) if it is awarded to another body over which the contracting authority **exercises similar control to that which it exercises over its own departments**, for example a wholly owned company (1294) for which the authority appoints all the directors (1295); or for which a group of such authorities does so (1502). In other words, the Directive treats all contracts awarded by any such bodies as being internal transactions.
- 32 Wholly-owned companies are however still subject to the directives
- ◆ if shares in them are sold, even if **after the award of contracts** to them (1501) (1520) or
 - ◆ if they trade commercially (1518)
- 33 Staff would not therefore be able to hold shares in wholly owned companies, the decisions of their directors would be subject to veto, and companies would be unable to tender for the work of other bodies. The founders of few if any staff mutuals are likely to want to form companies with such limited scope.

The requirements of the exemptions

- 34 The Treaty prohibits authorities discriminating against service providers **on the grounds of nationality** (95; 18). Discrimination means giving service providers from other member states less chance of winning contracts than those from the authority's home state.
- 35 The EC interprets the Treaty and recent ECJ judgements as **requiring contracts to be advertised** if authorities consider that they would (not 'if they would') interest service providers in other member states (1299; 1.3).
- 36 The greater that authorities think the interest of overseas service providers is likely to be, the wider the coverage of their advertisements needs to be (1299; 2.1.3).
- 37 Actions against authorities under the Treaty for failure to advertise contracts do however require the production of evidence of cross-border interest (1517).

Additional advertising requirements in the Consolidating Directive 2004

- 38 In 2004 the Directive introduced a parallel requirement for advertisement, **not relying on the terms of the Treaty**. It may therefore be enforceable even **if only domestic service providers might be interested** (61; 2) (168; 4.3), and even for Part B services.
- 39 Obviously it cannot mean that **all** contracts have to be advertised, but there is no guidance or case law as to *which* contracts have to be advertised.

When neither the Directive nor the Treaty apply

- 40 If neither the Directive nor the Treaty require competition, authorities are **free to decide what type of competition, if any**, to arrange; subject to their own standing orders and financial regulations. These can of course be suspended, subject as always to the duty of best value. The Cabinet Office has suggested (1599) that competition can be dispensed with if savings from the proposed buy-out can be forecast.

CONDUCTING THE COMPETITION

- 41 The Bill requires procurement to be 'appropriate to the value and nature of the contract'. This is plain enough but does leave open some special questions which will arise only for contracts awarded following expressions of interest. These special questions will need to be answered by the Regulations. CLG has not addressed them in the consultation paper.

The special questions

- 42 Questions of special importance to staff seeking to become mutuals include
- ◆ will expressions of interest in work have to be accepted where it forms part of larger packages of work for which economies of scale have been secured by sharing or delegating them ? CLG proposes that services will still be open to expressions of interest even if already delegated to NHS bodies (1605; 2.3)
 - ◆ will authorities be free to add to the packages of work in which interest has been expressed, in order to secure economies of scale ? will it be possible to make up bigger packages provided lotting is allowed for the work in which interest was expressed ?
 - ◆ what will happen if staff who express an interest fail to tender ? will the work then be contracted out in the ordinary way ? or can it be withdrawn from the competition if this can be done early enough to avoid any risk of claims for damages ?

Whether staff transfer

- 43 Principal local authorities may second staff to any other employers, including their own contractors, if they consider this would be likely to promote or improve the economic, social or environmental wellbeing of the whole or any part of their areas (46; 2) (55; 21). This does however need agreement by the transferor employer, the transferee employer, and the staff transferred.
- 45 In-house staff who did not originally opt to form or join a staff mutual may therefore be seconded to it, provided all the parties agree.
- 46 TUPE rights are however normally inalienable (170; 18) even if all employees accept secondment (1256). Seconded employees therefore retain their right to TUPE transfers indefinitely. Contractors cannot therefore be given any **guarantee** that staff will not at some stage seek transfer.

Support services for new bodies

- 47 Local authorities may by agreement continue to provide staff mutuals with support services, in accordance with the terms of their trading powers (59; 95) (55; 8).

Staff participation and share ownership

- 47 These can be arranged for staff whose work is contracted out. For contracts which do not have to be advertised in OJEU, and which are not therefore subject to the full requirements of the directive, tenders may be sought only from bodies *which already have* such arrangements in place. This cannot however be done for contracts which do have to be advertised in OJEU, because having such arrangements in place is not one of the specified factors in tenderer selection.
- 48 Making such arrangements *before staff are transferred* may however be made a contract condition even for a contract which does have to be advertised in OJEU.
- 49 In both cases all other role in management, and shares, would be left in the hands of parties unknown to staff at the time when they express interest, and thereby trigger the competition. Authorities can nevertheless help to secure greater certainty about the future management structure by requiring the winner to form a joint venture body, with the client authority as the other partner.

INVOLVING STAFF IN MANAGEMENT

- 50 The purpose of encouraging the formation of staff mutuals is to make the best use of their service knowledge and commitment. How to make such use does however depend on whether the staff referred to are
- ◆ **founder staff** (those who expressed an interest, tendered, or helped to found the new body) **or**
 - ◆ **current staff** (those from time employed by the mutual)

Involving founder staff

- 51 Management involvement can be preserved for the **founders** of new bodies. They can be
- ◆ partners in commercial or limited liability partnerships
 - ◆ ordinary shareholders of CLS or CICs
 - ◆ members of CLGs or workers' cooperatives
 - ◆ trustees
- 52 The extent of their involvement, and arrangements for continuing or terminating it, depend entirely on the terms of the articles, rules or constitutions of the new bodies in question.
- 53 UK commercial law is in most respects flexible about such terms. The main constraint is practical, and is that all such terms have to be acceptable to any other founders.

Involving current employees

- 54 The extent of the involvement of current employees likewise depends on the terms of the articles, rules or constitutions of the new bodies in question.
- 55 It is common for these to provide for **specified officers** to be directors or members of boards or management committees. They may also provide for the periodic **election of workers' representatives** on boards or management committees, by all specified types of employees.
- 56 **Coops UK** has published a guide to setting up a democratically controlled business
<http://www.uk.coop/sites/default/files/Starting-a-Co-operative.pdf>

ANNEX A - EXTRACTS FROM CLG CONSULTATION PAPER ON COMMUNITY RIGHT TO CHALLENGE

- 2.3 Where services are jointly commissioned whether that service is subject to the Community Right to Challenge would depend on whether the body responsible for the function that the service relates to is a relevant authority or not. For example, if a service relates to the function of a County Council (a relevant authority) but is jointly commissioned by the authority and the NHS, it would be subject to the Community Right to Challenge, but if the responsible body for the function was the NHS it would not.
- 3 Relevant authorities may specify periods of time during which Expressions of Interest may be submitted to deliver particular services or parts of services. This is to enable authorities to align this with their commissioning cycles
- 4.1 The Community Right to Challenge provisions in the Localism Bill enable relevant authorities to specify periods during which Expressions of Interest may be submitted either for all services or for particular services. This is designed to limit the burden on relevant authorities by enabling the process of submitting Expressions of Interest to form part of commissioning cycles for services. Where a service is already delivered by a provider other than the authority this will enable the authority to consider Expressions of Interest alongside the future of the service, prior to the expiry of the contract.
- 5.3 We propose that the following information should be included in any Expression of Interest . . .
- ◆ how the relevant body is proposing to deliver the service differently:
 - ◆ the outcome to be achieved by the relevant body's provision or involvement in provision of the relevant service(s). In particular this would include the 'social value' of a proposal – whether it promoted or improved the social, economic or environmental well-being of the relevant authority's area including that of individual service users. It could also include the relevant body's case that it would be able to deliver good value for money.
 - ◆ the relevant body's financial situation.
 - ◆ The . . . case that they are capable of providing or being involved in providing the relevant service(s), or are taking steps to ensure they will be in such a position ahead of the procurement exercise.
- 5.4 Whilst in many cases the relevant body will be in a position to compete in a procurement exercise at the time they submit an Expression of Interest, others will need to take steps to be in such a position. We expect this to apply in particular to small or newly formed voluntary and community organisations and local authority employees. This may, for example, include accessing support, raising finance, or gaining

appropriate accreditation. We would expect authorities considering such Expressions of Interest to allow for such relevant bodies to set out the action they will take in advance of a procurement exercise to ensure they are in a position to compete.

- 5.6** Relevant bodies submitting an Expression of Interest may propose to deliver the service in partnership with one or more other delivery bodies. These may be either other relevant bodies or non-relevant bodies, including private sector partners. So, for example, staff of the relevant authority may propose to deliver a service as a joint venture with another organisation.
- 7.3** We propose that the following should be grounds for rejecting an Expression of Interest:
- ◆ The relevant body is not capable of providing or being involved in providing the relevant service.
 - ◆ The relevant body is not otherwise a suitable person or body to provide or be involved in providing the relevant service.
 - ◆ The relevant service is already the subject of a procurement exercise relating to the provision of the relevant service (or of negotiations for a grant agreement).
 - ◆ Acceptance of the Expression of Interest could mean the authority would not comply with the duty in section 3(1) of the Local Government Act 1999 (best value authorities: general duty) or accepting the Expression of Interest would mean that the service would deliver poorer value for money.
 - ◆ Another Expression of Interest has been accepted. For example, if three Expressions of Interest are submitted for the same service then the authority would be able to accept the one that offered the best service and reject the other two.
- 9.2** Subject to Parliamentary approval we anticipate that the Localism Bill will obtain Royal Assent in Autumn 2011, and that the Community Right to Challenge will be commenced from April 2012 at the earliest.

ANNEX B - THE MAIN TYPES OF BODIES AVAILABLE

Companies limited by shares

- B.01** CLSs are owned by their shareholders. These draw up their
- ◆ **memorandums of association**, which define their company objects and
 - ◆ **articles of association**, which define their constitutions, and the roles and responsibilities of their directors
- B.02** CLSs can have **any management structure** provided for by their articles, and the directors are either appointed collectively by ordinary shareholders, or nominated by specified shareholders if their articles provide for this.
- B.03** They have to be **registered** in the Companies Register. Registration is quick and inexpensive. Dormant ready-registered companies can be bought even more cheaply on the open market but it is rare for their company names and articles not to need amending. This can be done but takes longer than registering a new company.
- B.04** The intending founder shareholders normally make an (enforceable) shareholders' agreement before setting up their companies.

Companies limited by guarantee

- B.05** CLGs have members, not shareholders. Members **guarantee to pay a fixed sum, usually £1**, to cover any debts of the CLG. This is the limit of their liability.
- B.06** They provide a satisfactory basis for most non-profit making activities. Their articles can provide for the involvement of any desired partners in decision making, **with any desired committee structure**. Different classes of members may be agreed.
- B.07** If CLGs do make profits these are **ploughed back** into company activities, not distributed.

B.08 An increasing number of workers' cooperatives are now CLGs.

B.09 Unlike CLSs, CLGs are often registered as **charities**.

B.10 CLGs work in most other respects in the **same way as CLSs**.

Community interest companies

B.11 CICs are companies limited by shares or guarantee which have applied for registration and have satisfied the CREG (the Regulator of CICs) that they are **in the public or community interest**. No other types of vehicles are eligible for registration.

B.12 CICs are subject to

- ◆ the **special statutory requirements** in the Companies (Audit, Investigation & Community Enterprise) Act 2004. These are intended to make CICs more attractive to benevolent investors who look for a modest return and security for their investments
- ◆ **regulation by the CREG**, who has wide powers of supervision and intervention. These are required to be exercised in such a way as to maintain confidence in CICs
- ◆ most of the normal requirements of the **Companies Acts**

B.13 The main requirements of the 2004 Act are for every CIC to have **an asset lock** and **interest and dividend caps**.

B.14 **Asset locks** require

- ◆ articles or memoranda to prescribe the conditions under which assets may be transferred
- ◆ any distribution to members of residual assets on winding up to be restricted to the value of paid-up shares
- ◆ any excess residual assets then have to be distributed to such other asset-locked bodies as the CREG directs

B.15 **Interest caps** limit **performance-related interest on debentures** to the Bank of England base lending rate + 4%.

B.16 **Dividend caps** limit **dividends** to the lesser of

- ◆ the Bank of England base lending rate + 4%, on the value of paid up shares
- or
- ◆ 35% of distributable profits

Community benefit societies

B.17 CBSs are societies **registered by the FSA** as being for the benefit of the community. Together with cooperative societies and credit unions they are referred to collectively as industrial & provident societies.

B.18 They are corporate bodies and their members have shares, and their liability for society debts is **limited to their shareholdings**.

B.19 They are organised strictly on a **one-member one-vote** basis. Members are sovereign but equal, and elect management committees to run the business in accordance with their instructions.

B.20 Shares are often nominal, and may not normally exceed £20,000 each except those held by other CBSs, and those held by local authorities if assisting a society which is also a housing association. No member can hold a majority shareholding.

B.21 Surpluses have to be dealt with in accordance with their rules. They are normally either **ploughed back** into society activities, or **held in reserves**.

B.22 CBSs may be converted into CLSs or CLGs by a special resolution of members, and vice-versa. And if the registered objects of CBSs are exclusively charitable, they may apply to HMR&C for recognition as charities for tax purposes.

B.23 CICs thus have advantages over CLSs and CLGs, but are harder to set up.

B.24 Many CBSs have recently become CICs.

Workers cooperatives

B.25 These are societies for the mutual benefit of their members. They include workers', retail, wholesale and agricultural cooperatives.

B.26 They are registered by the FSB.

B.27 Every cooperative has its own **registered objects**, which state its permitted activities and rules. These must cover

- ◆ qualifications for membership;
- ◆ voting rights
- ◆ arrangements for transferring shares
- ◆ how profits are to be applied

B.28 Cooperatives are organised on a **one-member one-vote** basis. Members are sovereign but equal, and elect management committees to run the business in accordance with members' instructions.

B.29 No member can hold a **majority shareholding**. Shares may not exceed £20,000 each except those held by other cooperatives, or those held by local authorities if assisting a cooperative which is also a housing society.

B.30 Surpluses have to be dealt with in accordance with their rules. If they are distributed, this is done in the form of dividends, in accordance with their rules.

Commercial partnerships

B.31 Partnership is the relationship between two or more people 'carrying out a business in common with a view to profit'. All such businesses are widely referred to as 'partnerships'.

B.32 They are **not corporate bodies**. Legal proceedings are taken by and against the partners jointly and severally, and the actions of any one partner may bind all the others.

B.33 Partnerships do not have memoranda or articles of association. Instead, members draw up **partnership agreements** containing whatever provisions they may choose. These define the relationship between the partners, including their rights and responsibilities to one another. They are private documents, and do not have to be registered.

B.34 Agreements usually specify

- ◆ the **capital to be subscribed** by each partner
- ◆ how **profits will be distributed**. This may be in proportion to capital contributions but does not have to be. Often the special skills and other inputs contributed by the different partners is taken into account
- ◆ how far **any partner may bind the others**

B.35 Partners may, by agreement, amend partnership agreements whenever they choose, for example to **admit new partners** or provide for **existing partners to withdraw**.

B.36 Partnerships can therefore be **set up quickly** as effective decision-making bodies, however small the numbers of employees who express an interest.

Limited liability partnerships

B.37 LLPs are **corporate bodies**. Legal proceedings are taken by and against them in their own right. All their members enjoy limited liability for partnership debts.

- B.38** The price of this concession is that LLPs are subject both to the **Partnerships Acts** and to many of the requirements of the **Companies Acts**.
- B.39** To obtain LLP status, partnerships have to register prescribed information about themselves with the Companies Registrar, and sign an incorporation document. LLPs are therefore more time-consuming to set up than traditional commercial partnerships but less so than companies.
- B.40** LLPs can be formed only from commercial partnerships. There is no provision for any other bodies to be converted into LLPs, but all can become partners in them.

Trusts

- B.41** Trusts can be created by **any written document**, including correspondence, or **implied** by the conduct of the parties.
- B.42** They can be used to protect and manage assets on behalf of their beneficiaries in the public, private and voluntary sectors, and also in private life.
- B.43** Any corporate body or person in any sector may, by agreement, entrust care, custody or management to any other such body or person. Trustees are bound by the document which created the trust (if there is one) and also by the extensive statute and case law on trusts.
- B.44** Most trusts are **non-corporate bodies**, so that all legal proceedings for or against them trusts had to be taken by or against the trustees personally.
- B.45** English & Welsh trusts may however apply to the Charity Commission for **certificates of incorporation**. They then become corporate bodies, and their assets are held, and proceedings brought collectively, in the name of the trustees. This greatly simplifies the holding of assets. Records demonstrating proof of ownership do not then have to be amended for each change in the trustees. But incorporation in this way does not diminish the joint and several personal liability of the trustees.
- B.46** Unless the governing document states otherwise any act or decision of the trustees must be **unanimous**.
- B.47** There is little scope for formal **delegation of any trust function** to committees. Trustees can delegate their duties only by granting power of attorney.
- B.48** Trust status can thus put all the parties in a straightjacket. **Leasing assets to them for fixed terms** does however build in an opportunity for review and renegotiation. This may be the most effective way in which founders can influence usage.
- B.49** So far as is known, local authorities have **awarded no contracts** to non-charitable trusts.
- B.50** Scottish trusts are either public or private. **Public trusts** are founded for the benefit of the public at large, or of a section of the public, not for beneficiaries specified by the founder. Their terms can be enforced by member of the public.

Joint ventures

- B.51** A joint venture is not a **vehicle**, but an **enterprise** in which two or more partners join, and in which they share the risks and rewards.
- B.52** A common reason for local authorities to set them up is to make the best use of **the skills of former in house teams**, while private sector partners provide special subject knowledge, management skill or marketing.
- B.53** The vehicles used are almost always CLSs or LLPs. These have markedly different pros and cons when used as JV vehicles.

- B.54** Authorities normally have to settle for being **minority shareholders** of joint venture CLSs, which gives other partners control of boards. Authorities which see dangers in being outvoted can avoid it by
- ◆ requiring the inclusion in articles of association of veto rights over key decisions, such as the winding up the company; or
 - ◆ taking special shares whose possession will give similar rights
- but only by agreement with the other partners, who may expect to be paid a high price for it.
- B.55** Joint venture LLPs have the following two major advantages over JVCos
- ◆ no shares have to be subscribed. Profits are distributed in **whatever proportions are agreed** in JV agreements. Proportions may therefore reflect the special skills and other inputs contributed by the different partners. Authorities are then under no pressure to relinquish key assets just to obtain shares
 - ◆ the partners are taxed separately on their profit shares. Local authorities partners therefore **pay no corporation tax**, whereas CLSs' profits are subject to corporation tax before dividends are distributed

Social enterprises

- B.56** Social enterprises are bodies which trade for specified economic, social and environmental purposes; and which are committed by their governing documents to **devote their surpluses to achieving these purposes**.
- B.57** Many were until recently CLSs, CLGs, CBSs, or cooperative societies. An increasing number are now CICs.
- B.58** Social enterprises, because of their objectives and the constraints on the disposal of their profits, belong to the third sector, however that is defined. They are accepted as such for the purposes of most if not all funding and grant aid.
- B.59** Social enterprises have formed consortia
- ◆ with other social enterprises, to provide the **necessary range of specialisms** required for public sector contracts
 - ◆ and with **active community organisations and campaign groups**, which provide advice and local support
- B.60** Consortium members normally retain their own identities, and have their own demarcation and service level agreements within their consortia.

Charities

- B.61** To be charitable, a body must
- ◆ have purposes **all of which** are recognised as exclusively charitable. This precludes the taking on of additional non-charitable activities, however constructive
 - ◆ be established for **public benefit** (a different test, distinct from charitable purposes, and subject to its own statutory guidance)
 - ◆ have no purposes which include any **advantage for their own members**
- B.62** If CLGs and trustees qualify, and obtain registration as charities, charity law applies to them as well as the law of their own sectors.
- B.63** The funds and other assets of charitable bodies have to be used for charitable purposes. This severely restricts the payment of salaries or dividends, or the award of business contracts, by charitable bodies **to their trustees**.
- B.64** Charitable bodies are exempt from **income and corporation taxes** on all their income (including rents, profits and interest) provided these are used for charitable purposes but not VAT. To qualify for exemption, any trade does however have to be conducted in the course of carrying out the **primary purpose** of the charity; or in the course of **work done by the beneficiaries** of the charity. Charitable bodies with their own revenue-producing activities may nevertheless preserve their charitable status by

hiving off these activities to wholly owned (non-charitable) subsidiary companies. The profits of such subsidiaries may then be passed back to their parent bodies, under covenant.

B.65 Where charitable purposes can no longer be fulfilled, trustees are required to re-apply charitable property (which includes funds) **cy près** (meaning to the nearest thing). New cy près purposes also have to be charitable purposes. Constraints on the use of charitable funds and assets thus make their earlier transfer, donation or grant to a charity virtually irreversible. Bodies which do anything which results in the loss of their charitable status do not just carry on as non-charitable bodies; their charitable property can instead be used **only for some new charitable purpose**.

B.66 It therefore seems unlikely that many staff mutuals will seek registration as charities.

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