



REUTERS/Neil Hall

PUBLIC SECTOR USAGE SCENARIO

Establishment of a separate company by a local authority

You have been asked to advise your client, a local authority, on supporting the establishment of a staff-run social enterprise organisation to deliver services back to the authority and the wider community.

The new organisation aims to deliver both statutory services, under contract to the local authority, and potentially other authorities, as well as additional services to the private sector and the public at large.

Staff have approached the authority under the Community Right to Challenge under the Localism Act 2011.



ADVISING THE AUTHORITY ON ITS OPTIONS

In the first instance, you will advise the authority on its obligations to consider such a request. Refer to our practice note on the *Localism Act 2011: community right to challenge* (uk.practicallaw.com/3-520-3487). The authority may decide to initiate a procurement exercise in accordance with the public procurement rules. For more information on this, see *Public procurement in the UK* (uk.practicallaw.com/5-383-9734).

However, the group of staff has not yet formed their company. They ask the authority for assistance with establishing the company and assurance that they will not be ineligible to bid for the contract on the basis that they would be bidding as a start-up.

The authority is keen to support the staff in their endeavour. To advise on the authority's powers to do so, and its decision-making, see our practice note on the *Localism Act 2011* (uk.practicallaw.com/9-518-3146) and other documents in our Local government topic (uk.practicallaw.com/topic4-384-2020) covering structures, powers and decision-making.

SCOPING THE PROJECT

The authority will form a project team of experts from Finance, HR and other support services, which will scope the requirements for the project. The authority expects the project team to consider both the establishment of the entity and any eventual procurement process. At this stage of the project, the new entity has yet to be created and is not considered as a separate client.

Legal input will be required in the following areas:

- The authority's statutory obligations. This is key to determining the nature of the services that will be outsourced.
- The authority's decision-making process, for example, input into reports to decision-makers. For guidance on this, refer to our toolkit on *public body decision-making* (uk.practicallaw.com/5-503-6713).
- Procurement strategy, timetable and documents.
- Drafting the contract for the services.
- Drafting any lease or licence to occupy if the new company will use the authority's premises.
- Company formation.
- Managing conflicts of interest, particularly in relation to drawing up the procurement documents. This is a challenge as the staff who know most about the service which is being outsourced may be transferring to the new entity and bidding for the contract.
- Employment issues, including around staff consultation, union engagement, TUPE and pensions.
- If the authority is to be involved in the ownership or management of the new company, it may need advice on its role and on making member or officer appointments (see our practice notes on Powers to participate in external organisations, and Appointment of members and officers to external organisations).

When scoping the project, our resources on *Mutualising public services* (uk.practicallaw.com/7-507-2663) and *Key legal considerations when establishing an employee-owned entity to deliver public services* (uk.practicallaw.com/9-513-9554) will be useful.

PROCUREMENT

When you are designing the procurement process, take a look at our *Public procurement law toolkit* (uk.practicallaw.com/6-525-2179) which guides you through our key resources on the law and related issues.

The authority is concerned about managing the procurement process alongside the establishment of the new organisation. It wants to know

whether a direct award can be made. The contract is an above threshold Part B services contract.

The following resources should help you advise the authority on whether a procurement process is required and, if so, what form it should take: *Part B, below threshold and other procurements outside the regulations* (uk.practicallaw.com/6-384-1798), *How do I decide if I have to competitively tender a Part B services contract?* (uk.practicallaw.com/4-519-8800) and *What are the risks of awarding a contract for Part B services without going through a procurement process?* (uk.practicallaw.com/9-519-8831).

If a procurement process is necessary, refer to the following documents: *Public procurement: Market consultation: Questions for the supplier market* (uk.practicallaw.com/5-519-8003), *OJEU notices* (uk.practicallaw.com/1-504-3112), *Pre-qualification questionnaire* (uk.practicallaw.com/6-383-4825), *Invitation to tender (public sector)* (uk.practicallaw.com/5-503-6789) and *Invitation to tender (Public sector): questions for tenderers* (uk.practicallaw.com/4-506-2694).

The practice note on *Evaluation of tenders* (uk.practicallaw.com/2-386-8761) will help determine how best to test bids against the authority's requirements.

Once the evaluation process is concluded, consider using our *Contract award letter* (uk.practicallaw.com/8-384-2136) and *Standstill letter to be sent to unsuccessful supplier* (uk.practicallaw.com/4-501-0389).

CONTRACT DOCUMENTS

The arrangement with the new entity is likely to involve a number of elements, including:

- A service agreement for the delivery of the outsourced services (uk.practicallaw.com/2-501-1525).
- A lease or licence for use of authority premises (uk.practicallaw.com/9-375-8981).
- A transfer agreement relating to other assets, which may form part of the contract.
- Terms for the transfer of staff including an admission agreement to the Local Government Pension Scheme (LGPS) if the new entity is to become an admitted body. See our toolkit on *Transfer of undertakings* (uk.practicallaw.com/7-506-5728) and *Local government pension scheme: admission agreement* (uk.practicallaw.com/4-505-610).

COMPANY FORMATION

The company may be a commercial trading company or a not for profit entity. Take a look at our company formation topic as well as practice notes on *Social enterprises: legal structures* (uk.practicallaw.com/2-502-5669) and *Mutualising public services* (uk.practicallaw.com/7-507-2663).

The authority will provide certain support to the organisation. To the extent that this is not included in a competitively tendered contract, the authority will need advice on the risk of breaching the rules on unlawful state aid – refer to our *state aid topic* (uk.practicallaw.com/topic1-103-1180?sv=3-382-2904) for more information on this.

It has been agreed that one of the authority's members will be a director of the new company. You will need to advise them on their duties and any conflicts of interest arising from their participation in the company. To make sure the guidance you provide is as up to date as possible, refer to our directors topic for resources on this or review notes on *Local government: appointment of members and officers to external organisations* (uk.practicallaw.com/3-503-6323) and *Local government: general principles of conduct for members and the consequences of a breach of conduct* (uk.practicallaw.com/8-384-2141).

CONCLUSION

Contracts with start-up organisations need to be flexible. However, the procurement rules limit the degree to which public contracts can be varied without going through another tender process. If change is required, consider our practice note on *Varying public contracts* (uk.practicallaw.com/1-516-8852).

When the draft Public Contracts Regulations 2015 come into force in the course of 2015, contracting authorities will be able to reserve participation in tender processes for certain types of contract to social enterprise organisations. For more information on the reforms see our practice note on *Reform of the EU public procurement regime* (uk.practicallaw.com/9-518-3151).

This will give contracting authorities more power to assist social enterprise start-ups by ring-fencing certain contracts for organisations from the voluntary and community sector.

