

Guidance on template contract for social impact bonds and payment by results

To accompany template contract for payment by results, including social impact bonds

Introduction

These guidance notes have been prepared to assist users of the DCMS template contract. The guidance notes and the template contract have been prepared following consultation with commissioners, investors, intermediaries and service providers.

Background

The government is committed to enabling new forms of commissioning and contracting that improve both the outcomes derived from delivery of public services and the value for money achieved by public expenditure.

There has also been increasing use of mechanisms such as payments by results contracts, seeking to change the emphasis and risk profile of services contracts let by public bodies. There have been encouraging examples of innovation taking place in this area, such as the use of social impact bonds to create the space in which new approaches can be explored.

To encourage and support the increased use of these new approaches, the DCMS has developed a template contract for use by public sector commissioners. It is designed as a starting point for a range of different approaches and this guidance, which accompanies the template contract, offers advice on how to adapt the contract to suit the detail of the approach adopted by any particular commissioner and its partners.

How to use this guidance

This first part of the guidance (Part A) highlights the critical issues to be borne in mind by parties contemplating this form of commissioning and contracting. These include:

- what a social impact bond is, its relationship to payment by results contracts and the performance and payment risk spectrum that these contracts fall within the drafting principles that have been applied in developing the template contract
- the way in which it is suggested the template contract is used
- some of the structures that may be adopted by service providers and their investors to deliver these contracts
- the commissioning process to be adopted.

Two of the critical messages to take from this section include:

- The importance of commissioners making a conscious decision of where they wish to position themselves on the performance and payment risk spectrum and being confident in their reasons for doing so
- The importance of the relationship between the template contract, the specification for the outcomes and services to be commissioned and the payment mechanism via which the service provider shall be reimbursed.

This guidance uses ordinary language to describe the contract and related arrangements. The term ‘authority’ or ‘commissioner’ is used to describe the commissioning body, ‘contractor’ is used to describe the party which is signing up to the template contract, ‘service provider’ is used to describe a party delivering a service as part of the arrangements (whether as contractor or as a subcontractor), ‘investor’ is used to describe a party financing a contractor and ‘intermediary’ is used to describe a party providing advice and other related services to one or more parties.

The second part of this guidance (Part B) provides a clause by clause commentary on the contract and any issues that should be taken into account in choosing whether or not to adapt each clause.

Part A: Commissioning and contracting social impact bonds

Social impact bonds

A social impact bond (“SIB”) is a funding mechanism which enables:

- A public authority to commission innovative services that attempt new approaches to delivering desirable social outcomes and to share the risk of exploring those new approaches.
- Service providers to benefit from increased flexibility in delivering agreed outcomes. It will not bear the cash-flow impact of payment being deferred until the outcomes are known, but may (potentially) take a share of the risk and/or reward in respect of whether the services it provides deliver the desired outcomes. It is anticipated that the service provider will be a voluntary, community or social enterprise organisation with the technical skills, but not the capital reserves, to deliver a contract on a wholly, or largely, payments for outcomes basis.
- Investors to finance activity designed to achieve significant social outcomes by providing working capital to voluntary, community and social enterprise providers to deliver services. Investors assume a large part of the risk that the interventions they fund will be successful. If interventions succeed, the investors will, in addition to enabling these outcomes, receive a financial return on their investment.

It follows that social impact bonds are likely to be most relevant where a public authority is seeking to commission fundamentally new approaches to deliver particular social outcomes.

The template contract is the contract between the public authority and the contractor with primary responsibility for delivery of those social outcomes, providing the framework for what that authority is commissioning and how it will pay for it. The social impact bond is the means by which the contractor funds the activities it undertakes to achieve those outcomes. The contract will establish the minimum expected outcomes the contractor is required to deliver - i.e. how many outcomes are expected to be achieved, as a minimum, in a given week / month / year during the life of the social impact bond.

There are various ways in which such projects may be funded. It is not felt appropriate to be prescriptive, certainly at this stage of the markets development, about the detail of how such funding may be put together, so no templates have been developed in relation to financing agreements. The template contract should assist, however, by offering funders a large degree of consistency in the terms upon which their potential investees will be measured and paid.

It should also be helpful for public authorities, investors, intermediaries and service providers to use a template contract knowing that the majority of its terms are standardised, leaving only genuinely project specific elements in need of development. Savings of time and money should be possible as a result.

This template contract is drafted on the basis that by the time the contract signature takes place, the commissioning authority will have satisfied itself (through a combination of the procurement process and due diligence

undertaken on the contractor's documentation) that the contractor has everything in place – both in terms of finance to pay, initially, for the service provision, and a supply chain – to meet all the contractual obligations to the authority that it is assuming under the contract.

This being the case, the template contract does not anticipate that authorities will need to obtain commitments directly from investors in relation to the financing of the contractor, though there may be limited circumstances in specific situations where an authority feels this is appropriate.

Similarly, rather than be prescriptive about the precise terms upon which a contractor is funded, or engages with its supply chain, service providers and investors are free to come up with the structures they regard as the most favourable, with the benefit of knowing, in broad terms, the basis upon which they will be expected to contract with an authority.

We recognise that whilst there will be circumstances where a public authority is looking to procure something very innovative and wishes to pay purely on an outcomes basis, there are also increasingly frequent situations where public authorities are interested in paying for services with an element of the fee dependent on delivery of outcomes.

There is, of course, substantial overlap (though also some significant points of departure) between those contracts where the full payment is deferred and dependent on achievement of outcomes and those where the majority of the payment is made as the service is provided (e.g. as a service fee), but a proportion of the payment is deferred, and dependent on outcomes.

The template contract is suitable for use in both circumstances, subject to

noting where in this guidance we distinguish particular provisions as more appropriate to one or the other approach.

It is important that parties to these contracts are clear about the extent to which the risk relating to performance and payment is being allocated (and the reasons for this) and that the relevant contract provisions are consistent with and reflect this.

Drafting Principles

The underlying aims in producing this template include:

- Providing a balanced document that should be broadly acceptable to commissioners, service providers and investors.
- Striking a balance between simplicity, materiality and proportionality.
- Providing a clear position on substantive issues (to limit time spent negotiating those) but leaving it open for genuine project specifics or issues of particular concern to commissioners, service providers and investors (if any) to be added in.

The issues addressed in this template are those regarded as relevant to all or the great majority of payment by results service contracts, whether funded via a SIB or not. Parties may feel in relation to specific projects that some provisions are not required, or alternative approaches are more suitable. Generally, these options are anticipated in this guidance.

The template contract has been subject to consultation and is informed by the responses to that consultation. As such, it is believed to be largely acceptable to commissioners, intermediaries and investors. It is acknowledged that some adaptation will be necessary to the template, particularly to reflect:

- The particular extent to which the commissioner is seeking to transfer performance and payment risk
- The means by which service provision is being financed
- Integration of the proposed payment mechanism and specification into the contract
- Other issues specific to the project.

The first two of these have, to a large extent been anticipated in the template contract and identified in this guidance. Beyond this, however, commissioners are advised to consider carefully whether further departures from the template will achieve sufficient benefit to justify the potential cost of increased negotiation.

The performance and payment risk spectrum

It is helpful to think of these contracts as sitting on a spectrum. At one end, there are contracts where payments are wholly dependent on outcomes. The contractor will, it is anticipated, fund the work it carries out to deliver those outcomes through a social impact bond (although these could also be delivered by organisations bearing the risk on their own balance sheets, if they are sufficiently capitalised to do so). In these circumstances, it is appropriate that the specification does little more than identify the target outcomes and any statutory and regulatory requirements that must be met in engaging with the target user groups. The contract should contain limited rights only for the authority to intervene in how it is being performed, given that the contractor will be taking on the risk that outcomes may not be achieved and that, as a result, payments may not be made.

Where an authority commissions on a combined fee for service and payment by results basis (so makes a partial payment as services are

being delivered, with the remainder deferred and subject to achievement of certain outcomes), it may feel it requires more say in how those services are performed, leading to more detail in the specification and more rights in the contract. Even then, however, it should be remembered that the more prescriptive an authority is, the less appropriate it is to expect the contractor to accept the performance risk. Proportionality should be a guiding principle in relation to any adaptation of the template contract.

The legal terms sit alongside and have to be integrated with two other aspects of the contract that cannot be standardised to the same extent as the legal terms: the specification and the payment mechanism (i.e. the process by which the parties shall measure whether and when payments fall due and accompanying evidential requirements). Reference has already been made to the importance of the commissioner understanding where it wishes to be on the spectrum of risk transfer around performance and payment and the specification and the payment mechanism need to be developed with that in mind, so a consistent position is presented throughout the contract. Some further principles on the approach to take to payments are contained in Part B.

Parties

This contract focuses on the services being commissioned and the outcomes being sought. As such, it is between the contracting authority and the lead contractor. To the extent a SIB may be required and there may be an intermediary involved in the project, bringing service provider(s) and investor(s) together, we anticipate any contractual arrangements directly with the intermediary and/or investors that are felt desirable may be dealt with separately.

In the context of a SIB, in many cases we anticipate that the lead contractor may be a special purpose vehicle (“SPV”) set up to manage this contract specifically. This will have the advantage, for the investors and the service provider(s), of reducing the prospect of the other activities of the service provider(s) impacting adversely upon what is being done in relation to this project and on the creditworthiness of the entity receiving the funding. It also creates the possibility of various stakeholders sharing the risks and rewards of the project through participating in the ownership and control of the SPV (including the service provider(s) and, possibly, the authority if it so wished).

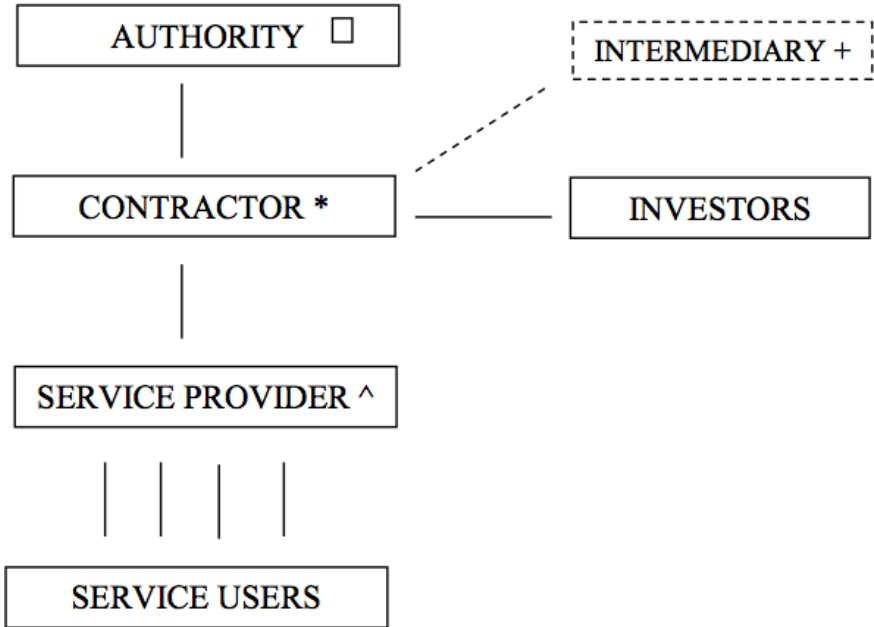
Where there is an SPV, it will subcontract all the substantive obligations to one or a number of specialist service providers. Where this happens, the SPV shall remain primarily responsible to the authority for the performance of the contractual obligations, but will only, itself, have to observe them to the extent they relate to the SPV’s own (very limited) administrative and contract management activities.

Where an SPV is not used, some of the provisions in the template agreement (for example the Deed of Assurance) may not be required. These provisions are identified in this guidance.

Similarly, the nature of the contractor (whether an SPV or not) and the supply chain it uses will inform the position adopted in relation to matters such as subcontracting and changes in ownership. These issues are also addressed in this guidance.

Some examples of possible contract structures

Possible structures where a SIB is used:



□ It is possible that more than one authority may commission a service and outcomes, or that the authority will be the lead commissioner, but receive payments from other public sector bodies interested in seeing the services delivered and the outcomes achieved.

* The contractor may be:

- An intermediary – i.e. an entity funded by the investors to procure and manage a supply chain to deliver the outcomes.
- An SPV – i.e. a new company set up specifically for the project in question. This may be owned by the investors, but the main service provider(s) may also invest in the SPV to bear some of the performance risk associated with the project - and share in the potential rewards of success (as, in theory, might the commissioning

authority).

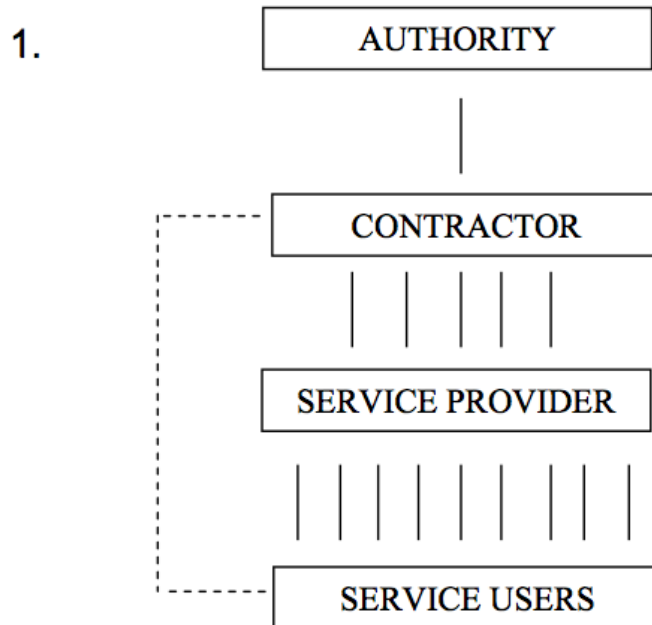
- The main service provider – i.e. the investors provide the funding directly to the party primarily responsible for delivering the outcomes.

^ There are a number of approaches the contractor may adopt to perform the Services and deliver the Outcomes:

- The contractor may subcontract all (or substantially all) of the obligations under the contract it has with the authority to one service provider. This service provider may perform the contract in its entirety itself.
- The contractor may subcontract all the obligations under the Services Agreement to one service provider. It may perform most or some of the obligations itself, but subcontract parts to third parties.
- The contractor may subcontract all the obligations under the Services Agreement to one service provider. It may perform none of the substantive services itself, but subcontract all such obligations to third parties and co-ordinate their activities. (This may be less likely in practice as there may be duplication of roles between the contractor and service provider).
- The contractor may subcontract the obligations under the Services Agreement to a variety of service providers, coordinating their input to deliver the Services and Outcomes as a whole.

+ An intermediary may be involved, particularly where a contract is being created in a new sector, or there is a need for specialist support to raise investment capital for the project. It may provide advisory services to the contractor. Potentially, an intermediary may also provide advice to an authority, or investors, though not on the same project (unless all parties were satisfied any conflicts of interest could be appropriately managed). There have been cases previously of the intermediary essentially fulfilling the role of contractor, though this may be less likely to happen as the market matures.

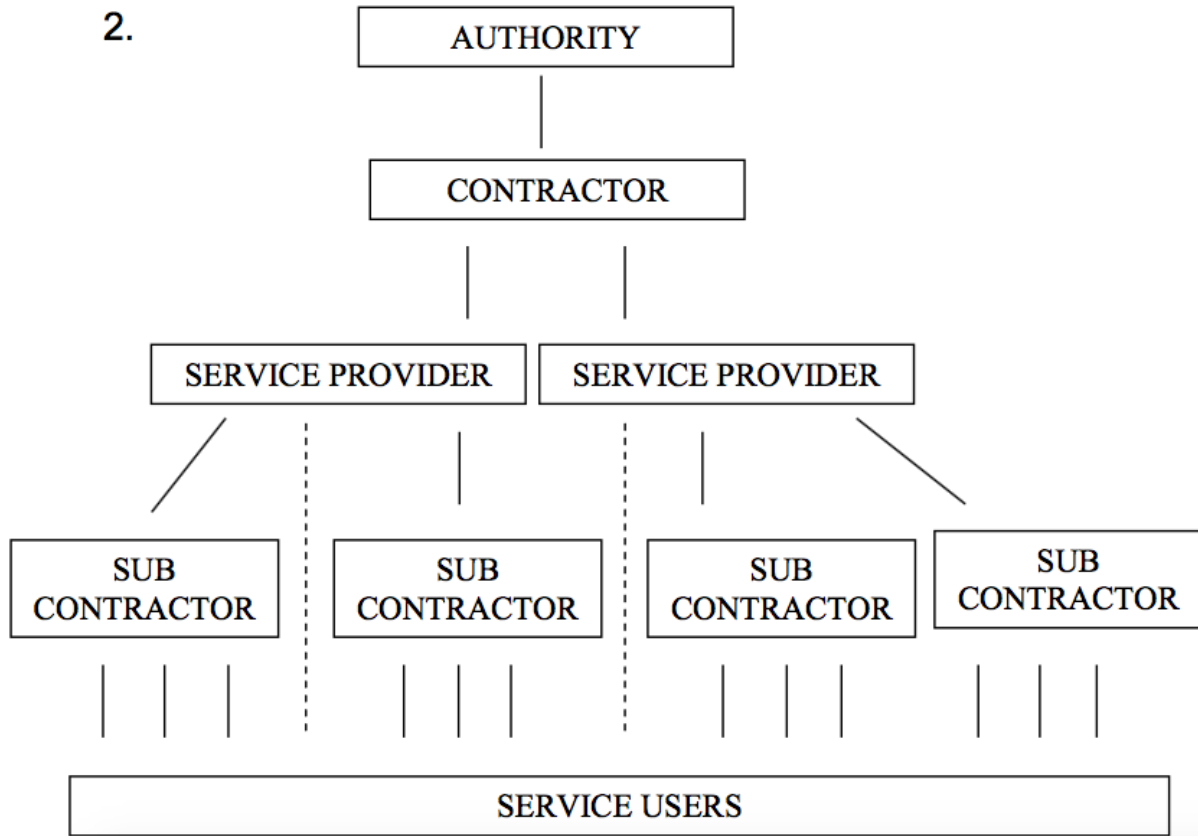
Possible structures where a SIB is not required:



These structures are more likely to arise where there are service fees payable and the financing requirements are therefore less significant.

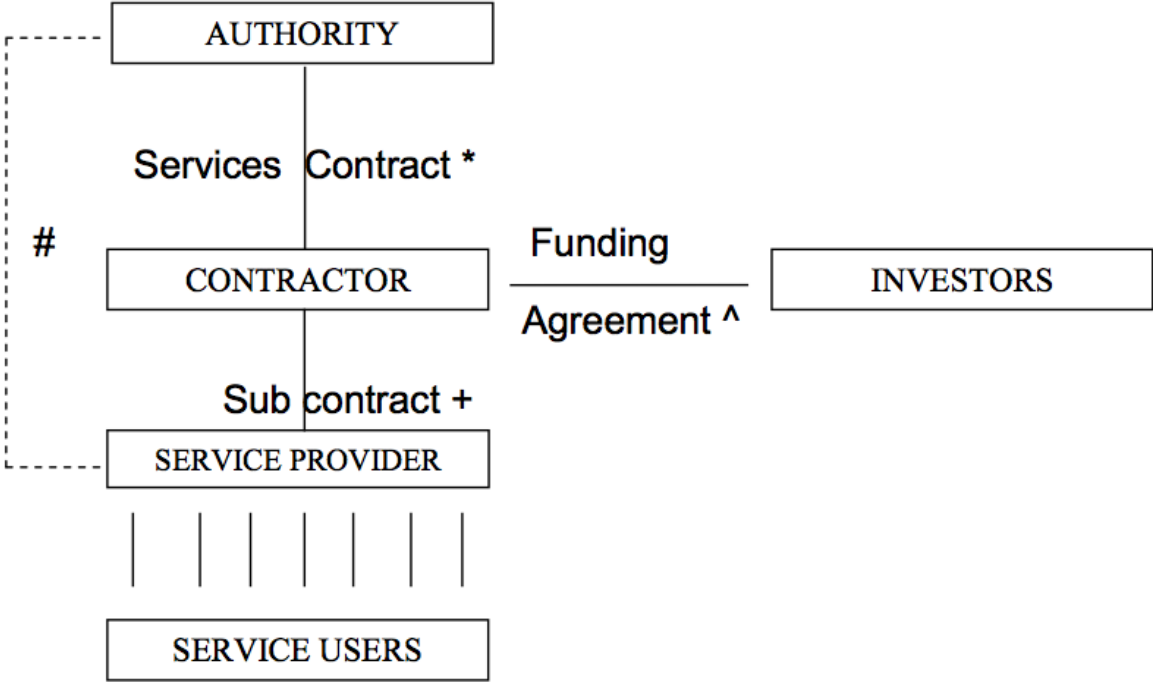
- The authority contracts with a main (“prime”) contractor.
- The contractor subcontracts the obligations to a number of service providers who deliver services to service users.
- The dotted line acknowledges that the contractor may also deliver some services direct to service users itself.
- The contractor does not seek external funding through the social impact bond, because payment for outcomes is only part of the payment structure, and/or because it relies on its own reserves or loans outside of the social impact bond structure to address the delay in payments.

2.



The difference between this structure and the previous one is that the prime contractor contracts with a limited number of service providers (which may be only one) who, in turn, subcontract to third parties to engage with the service users. The service provider(s) may also provide an element of the services themselves.

Typical main contractual documents required where a SIB is utilised:



*The Services Contract would be based upon the template, with specification and payment mechanism relating to the project attached as schedules.

^ Where the investors provide debt funding, there will be a loan agreement and there may be security documents. There may also be a subscription agreement between the investors and the contractor if the contractor is an SPV that the investors invest by way of equity.

A Deed of Assurance may be appropriate from a main subcontractor to the authority where there is an SPV in the structure and one or more material subcontractors. See Part B, paragraph 4 for more details on this.

+ There will be one subcontract entered into with each service provider.

The Approach to Commissioning

This approach to commissioning offers great potential to improve the outcomes delivered through public expenditure. The template contract is an attempt to simplify part of that process. However, by their nature, these projects are challenging. They are often attempting to address some of the most complex social issues in innovative ways and with a relatively new commissioning approach.

This requires innovation in how the public authority approaches the whole process (not just how the bidders respond to it). A lot of thought and research may well be required in advance of embarking upon a project to establish important matters, such as:

- what the most desirable outcomes may be (and how much the authority is prepared to pay for such outcomes)
- what the best means of measuring whether they have been achieved are (and when this measurement should take place)
- whether there may be additional benefits (or undesirable consequences) resulting from this approach

There may be significant value in the commissioner engaging with current or past users of the service and/or service providers, to understand better what is likely to be effective, before designing its project. Alternatively, an authority may elect to build that sort of input into the procurement process itself, engaging in a form of competitive dialogue with its bidders.

The procurement process

The commissioner needs to have clarity around how it will run the procurement process before it embarks upon it. Is it confident it knows exactly what it wants and so can run a restricted procedure where it is essentially asking bidders to accept the terms offered and to price them? This will mean having great confidence that the specification, the payment

mechanism and the contract (the template, adapted to reflect the particular project and the authority's requirements) will work, individually and collectively, to encourage the optimal response from the successful bidder. It may also limit the ability of all the parties in the contract to depart from the proposed approach once the process begins.

Or is the commissioner intending to use the procurement process to engage in dialogue with bidders to give it confidence that when it contracts it is doing so informed by the outcome of a competitive process and will have a robust basis upon which to proceed? This may involve a more protracted and intensive procurement process, but allows greater flexibility.

It is critical that the authority considers these issues and takes a deliberate decision over the most appropriate approach to adopt at the very outset of the project and does not find itself already committed to a particular path before engaging seriously with these fundamental questions.

Some considerations for commissioners

Payment by results is not appropriate in many circumstances. Adopting it without care may lead to:

- paying too much for something that could be achieved by other, cheaper means
- paying too little to incentivise the desired level of performance
- paying for outcomes that would have happened anyway
- paying for the wrong outcomes through mis-specification
- paying significant set-up costs that are not merited by the outcomes achieved
- creating perverse incentives in service delivery, (if what is most remunerative for the service provider and what delivers the best outcomes as a whole are different)
- procuring a service whose outcomes cannot be measured objectively
- exposure to undue reputational risk

Commissioners need to understand which form of commissioning is appropriate for which outcomes. For example:

If parties know what works and are already achieving wholly positive outcomes in a cost effective way, then commissioners should probably be using 'fee for services' contracts to pay for and get what works best without paying for risk transfer and investor cost of capital.

If parties do not know what may work, payment for outcomes may be more appropriate – though it needs to be understood that this involves risk (and the prospect of failure) which needs to be allocated appropriately.

Commissioners need to be clear where they are expecting innovation to take place and attach the risk payments to that. For example, if the view is that the services currently being delivered locally are the right services but what needs to be different is the co-ordination of those services by a lead contractor who has case management and supply chain management skills, then it may make sense to use a structure where the service deliverers are paid a fee for those services and the lead contractor a risk adjusted price to reflect its success in coordinating the services to achieve the desired outcome.

A significant amount of innovation needs to be done at commissioning level in terms of pooling budgets and working collaboratively across departments to focus on optimising outcomes. This is consistent with the desire to personalise services where individuals may have needs spanning a wide range of services.

To assess whether a payment for outcomes approach is appropriate, a commissioner should know the following:

- The counterfactual (i.e. the dataset against which performance will be assessed)
- That the outcomes are measurable and attributable
- That the complexity of the approach is not disproportionate to the anticipated benefit from adopting it
- That the payments work appropriately to reward the service providers at all levels of outcome delivery (i.e. there are no points where it ceases to make economic sense for a party).

Part B: Template contract clause commentary

Capitalised terms used in Part B of this guidance are as defined in the Template Contract.

Statement of shared aims

As stated, these contracts, particularly where involving SIBs and the services that are funded by them represent a new approach to delivering each of social outcomes, public services and financial investment. The best outcomes will be achieved where the parties' relationship is collaborative in working towards achieving the common outcomes they aspire to commission, deliver, and fund, rather than purely transactional. Clause 2 offers a framework for understanding, interpreting and applying the obligations of the parties in the template contract.

Term

There is provision in Clause 3 for conditions precedent, though in practice these should rarely be relevant and may often be deleted (i.e. 3.2 and 3.3).

There is also drafting for an option to extend / renew the agreement (cf 3.4-3.6). Authorities will need to make specific reference to this in their procurement documentation in order to take advantage of this approach. Their contract should then reflect that decision by including, amending, or deleting those clauses.

The template contract contains an indicative term of 5 years – see definition of Operational Period. Each Authority will need to consider the length of an appropriate contract period to achieve the desired outcomes

and adapt the contract appropriately. It should also be noted that the term is in respect of the active provision of services by the Contractor. There is likely to be a subsequent period during which outcomes shall be monitored (and payments may be due) that also needs to be taken into account.

Mobilisation

It may often be the case that preparatory work needs to be undertaken to achieve a point at which the new Services can begin to be delivered effectively. This is addressed by Clause 4. This assumes that both parties (the Authority and the Contractor) will have obligations to perform during this period and that these will be set out in a Mobilisation Plan. This plan will be project specific and will work on the basis that everything that needs to be done will be in place to enable an anticipated start to the full Services on a defined Services Commencement Date. If it becomes apparent this will not be achieved, the parties will meet to agree an appropriate response. The template anticipates this may include resetting the Service Commencement Date and thus preserving the full length of the Operational Period during which the Services are to be provided.

Thought should also be given to the optimal time to commence service delivery, taking into account the impact of seasonality on proposed interventions; for example, beginning a contract in October to place clients in work, in a location highly dependent on summer tourism, may be less than ideal.

Deed of assurance

As indicated, where SIBs are used, the general assumption is that an SPV may be utilised and performance of the Services subcontracted by the SPV to a specialist service provider (possibly, itself, a co-investor in the SPV), though this may not always be the case. As the SPV will have limited resources, the Authority may want to have confidence that material

subcontractors will deliver. This serves a dual purpose for the Authority. If the SPV defaults, leading to termination, but has insufficient assets itself, the Authority may then (but only then) look to the service provider to ensure that there is no discontinuity of service provision.

It should be noted that the Deed of Assurance does not give the Authority any additional rights to performance manage the service provider or to exercise any rights against the service provider during the subsistence of the main contract with the SPV.

Where an SPV is not used, it is not anticipated a Deed of Assurance will be necessary, as the Authority should be able to rely on its direct contractual relationship with the Contractor. However, even where an SPV is not used, a Deed of Assurance may be relevant where a Contractor is not, itself, providing any or many of the services but relying upon one or more subcontractors to do so to a material degree.

Warranties and representations

Clause 6 contains some standard warranties and representations that an Authority would seek when entering into a contract with a third party to provide reassurance that the position at contract signature is as it has been led to believe.

Conflicts of interest

Clause 7 acknowledges the possibility of conflicts of interest arising and provides a very high level means of addressing these. An Authority should consider carefully the circumstances relating to the project in question and related matters which may make such a provision more or less appropriate. Depending on the project, an Authority may feel it can dispense with this provision (or may want to make it more specific).

Co-operation

Clause 8 sets out mutual obligations to act in good faith and to co-operate, but also puts some parameters around those obligations to provide clarity in terms of what the parties may expect from one another during the Agreement Term.

The services

Clause 9 contains the primary obligations upon the Contractor around performance of the Services. This provides that the Services will be carried out in accordance with:

The Services Specification – it is anticipated this will be focused heavily on the outcomes sought and not how these are to be achieved.

All applicable legislation – rather than include detailed provisions in the contract in relation to some of the relevant pieces of legislation, this agreement simply places the obligation upon the Contractor to ensure all relevant law is complied with. An SPV will step this down in its entirety to the specialist service provider, who should know what this means for them (and it will only remain relevant to the SPV in the context of its contract management and administrative function).

The Authority Policies – the Agreement anticipates that the Authority will identify in the procurement process which of their policies they specifically wish to see adhered to in the performance of the Services and for these to be referenced in Schedule 1 part 2. Where there are specific provisions in the contract dealing with an issue, it is not intended that Authority Policies are used to supplement the contract drafting, imposing additional obligations on the Contractor. The Contractor will have the opportunity as part of the procurement process and contract finalisation to identify any it

feels are not appropriate. Where an SPV is used, the expectation is it will step this down in its entirety to the specialist service provider, who should know what this means for them (and it will only remain relevant to the SPV in the context of its contract management and administrative function).

Good Industry Practice – as defined in the contract.

The effect of the above, together with the focus on payment for the outcomes achieved, encourages the view that the Authority should not expect to specify how the Services are performed. In this agreement, there are some high level requirements included in relation to engaging sufficient numbers of personnel and that they are suitably qualified. There is also an obligation to have an appropriate quality assurance system in place. These are intended to give the Authority something to reference if they have specific concerns about how the Service is being delivered, whilst avoiding being prescriptive where possible.

The contract terms addressing the Contractor's obligations in relation to the Services and the Authority's rights to specify how these are performed are an area where the spectrum referred to in paragraph 2.3 above is relevant in assessing the level of prescription appropriate.

Authority obligations

It is assumed that there may be specific acts on the part of the Authority (for example making referrals and provision of data and information) that are necessary to enable the Contractor to deliver the Services effectively. These will be described in Schedule 1 part 3 and will be project specific.

Clause 10.2 also contains a commitment from the Authority not to do anything that may jeopardise the ability of the Contractor to perform the service or achieve the Outcomes.

Representatives

Clause 11 provides a mechanism for the parties to identify individuals who shall be authorised to act in the name of the parties in the performance of the contract.

Review, monitoring and obligations

Clause 12.1.2 is an attempt to recognise that if contracts are designed with the genuine aim to encourage innovation and attempt to find new solutions to social problems, it is inevitable that not all contracts will be perfectly structured from the outset. This clause attempts to give the parties the comfort that there is a mechanism through which they can work to calibrate the contract further, if necessary, with a view to ensuring the project achieves its overall objective, defined as ‘the Objective’ in the template agreement. This is intended to be the ultimate aim of the parties, which the outcomes metrics provide the means of measuring. By way of example, the Objective the parties are seeking to achieve with a project may be to return individuals to the workforce and the contract may identify outcomes triggering payments for things like service users attending sessions on preparing CVs, references and for interviews. The purpose of the review mechanism is to establish whether the chosen outcomes are proving effective in achieving the Objective; whether different outcomes might be more effective; or the same outcomes with different calibrations (e.g. because the calibrations are driving behaviours that achieve the contractual goals / payments, but do not have the expected effect on the service users’ prospects of employment in the relevant location and with the relevant demographic).

The obligation in clause 12.1.2 is only an obligation to consider the position. This is because it is recognised that the parties (and the investors) have taken significant decisions on the basis of the signed agreement. This provision requires the parties to explore if there are ways to improve the

effectiveness of the contract without detriment to the parties and Service Users, but requires unanimity for action to flow from it. (It is assumed that the Contractor shall not agree to any change without the approval of its investors).

The Contract Review Date provides identifiable moments during the Agreement Term when the parties shall come together in a review meeting to consider these issues and how to respond to them. It is suggested the review dates occur six months into the contract to identify and address any teething troubles and then on an annual basis.

There is clearly a balance to be struck between restricting the bureaucratic burden on the Contractor and obliging it to keep and make available information relating to the performance of the Services in sufficient detail to enable the Authority to understand whether the Outcomes are likely to be achieved; whether payments should be made; and whether this is an effective way of seeking to deliver such outcomes in the future. The Authority will also have responsibilities in terms of audit that it needs to comply with. Clause 12.2 – 12.4 and Schedule 8 attempt to reflect this balance, leaving scope for an Authority to identify in Schedule 8 the level of information it feels appropriate to require in relation to the particular project in question.

Again, where the contract sits on the spectrum of performance and payment risk being passed to the Contractor is relevant, to a degree, to the level of information it may be appropriate for the Authority to require.

Payments

This template contract operates on the assumption that there will be two payments made: one a Services Fee for the ongoing provision of services by the Contractor and the other an Outcomes Payment, which will be

dependent on achieving the proposed results. Where a contract has payments wholly dependent on achievement of outcomes, the drafting may be modified accordingly.

Clause 13 in the agreement deals with the mechanics of making payments. The details of what will be paid when and the triggers for those payments are assumed to be contained in a payment mechanism included in Schedule 2 to the agreement.

A payment mechanism has not been proposed, as this will to a large extent be particular to each project and will depend on the outcomes, evidential requirements and underlying nature of the intervention. However, a starting point might be:

- the Services Fee comprises a regular monthly payment in arrears in respect of the basic service
- the balance is payable on the Authority being satisfied
- the agreed Outcomes have been delivered it may be more nuanced than this. A project may be structured so that the risk allocation is tiered and different parties are accepting different risks, consistent with what the risks each is considered best placed to manage.

Evidence from projects already operating on payments by results lines suggests the (easy to say, but difficult to achieve) objective is a mechanism that manages to align the interests of the commissioning authority, the service provider, the investors and the service users – hence the references in the contract to shared aims and opportunities to review whether improvements can be introduced. Appropriate risk allocation, so that each risk rests with the party best able to manage it, is critical.

There are technical challenges to be faced in terms of addressing issues such as attribution (i.e. is the Contractor responsible for the Outcomes achieved, or is the Authority paying for something that would have

happened anyway) and how the design of the payment structure translates back into the contract. This involves addressing questions such as:

- How will the parties know when the Outcomes have been achieved?
- Can this be evidenced and how robust is the quality of the data, and the data collection and management systems?
- Can it be evidenced without burdening service users?
- To what extent might Outcomes be time critical?
- What rights are appropriate so the Authority may satisfy itself with the evidence, to challenge it if necessary and to address recurring issues?

In establishing the Outcomes and the payment mechanism, a balance needs to be struck between:

- simplicity (e.g. not having too many different targets and being able to establish easily whether they have been met)
- commerciality (e.g. recognising the costs attached to delaying payments)
- certainty (e.g. clarity of definition and objectivity of assessment)
- relevance (e.g. measuring what will make a difference to the service users and achieve the Objective)
- avoidance of perverse incentives (e.g. not creating a mechanism that drives behaviours towards working with only some service users, or only working with service users in certain ways).

However, a message coming from the consultation was the importance of ensuring that compliance with the contract does not have a negative effect on the ability to deliver the Outcomes. The evidence and documentation required should be relevant and inform analysis of the contract's effectiveness without creating an unnecessary bureaucratic burden or leading to disengagement with the service by its users. Once again, this indicates the benefit of a collaborative approach in the design of the contract overall, involving those with the relevant experience and specialities.

There is no provision in the template contract for payments to be indexed. This means that either service providers (and, potentially, Investors) will have to build into their pricing the effect of inflation over the term of the agreement, or the payment mechanism might have the anticipated effect of inflation taken into account in any proposed uplifts in fees over that time. Alternatively, indexation could be applied to the payments under the contract on an annual basis and drafting included to this effect. The Authority should be clear which approach it wishes to adopt as part of its procurement exercise.

Clause 13.12 anticipates the possibility of payments falling due after the agreement has terminated. This may well happen where measurement of the Outcomes can only take place at some future date. Clause 25 (Continuation) means that this obligation on the Authority to make any such payments survives the expiry of the agreement.

Change procedure

The contract contains a simple procedure by which the parties may propose and seek to agree changes to the contract. This is contained in Clause 14 and Schedule 6. It anticipates changes around the scale of the service to be delivered or who it is targeting (whereas the review at clause 12.1 is more about whether the contract structure (for example the metrics chosen, the means and frequency of assessing them or the payment profile) are, in practice, proving the most effective way to encourage delivery of the outcomes and achieve value for money). Delivering the best outcomes and achieving value for money are not necessarily mutually exclusive. Both are dependent upon the cooperation and good faith (and are ultimately at the discretion) of the parties. Where there are external Investors, it is assumed the Contractor will not agree any change to the contract without investor approval.

Data protection

Protection of data is likely to be relevant to many contracts of this nature, although to differing degrees depending upon the nature of the Service. The drafting proposed in Clause 15 is basic rather than exhaustive.

The Authority can include its specific requirements around data sharing in Schedule 4.

Authorities may wish to consider whether and to what extent the Parties should commit to making publicly available information (that is not commercially sensitive) around the Services and the Outcomes, so that others can learn from the work undertaken. – compare clause 17.9. The presumption is towards publishing outcomes achieved and other information not established to be commercially sensitive.

There is an expectation on the part of the Cabinet Office that parties that use this template contract as a starting point or for key aspects of their agreement will share a redacted version of their executed agreement with the Cabinet Office to inform and improve future commissioning of public services.

Freedom of information, confidential information and publicity

These matters are addressed in Clauses 16 to 18 using standard approaches for local authorities. Depending on the nature of the project and local sensitivities, authorities may wish to adapt these provisions, but in doing so should be mindful of the impact of moving away from the template and potentially increasing the administrative burden associated with the project.

The clause on publicity attempts to retain a simple approach and anticipates there will be guidelines developed between the parties, along standard lines used by them in their business generally, to address the details of how this should be dealt with. (This allows for flexibility between more and less sensitive types of project). The clause is drafted to address proactive attempts on the part of the parties to promote their involvement in the project (eg press releases and conferences). It is not intended to constrain, for example, the ability to respond to any questions about the project or requests for information coming from the press.

Intellectual property

The intent of the drafting in Clause 19 is to strike a balance between the Contractor's commercial interests and those of the Authority around being able to procure the service (or an equivalent) following expiry or termination of this agreement. Assuming the contract is a success, the aim is that it can be repeated and this should not be inhibited, unreasonably, by a party's claims to intellectual property rights ("IPR").

The obligation is on the Contractor to ensure it has all necessary IPR to perform the Services and to grant sufficient rights for the Authority to use the intellectual property in accordance with the agreement.

The obligation is on the Authority not to use the intellectual property in a way that infringes third party rights that it has been made aware of.

Indemnities

The Contractor indemnifies the Authority, in Clause 20, against:

- direct losses relating to death or personal injury; property damage; and third party claims arising from the performance of the Contractor's obligations
- losses relating to third party claims for breach of statutory duty arising from breaches by the Contractor (where there are no other remedies under the agreement)

The indemnities do not apply where the Contractor is acting on the written instruction of the Authority or where caused by negligence, wilful misconduct or breach by the Authority.

A limit on liability is proposed equivalent to the levels of insurance cover required to be maintained under the agreement. In respect of uninsured losses, a figure that is proportionate both to the value of the contract and the likely losses arising under this head, should be inserted on a project specific basis.

Insurance

The requirement for the Contractor to take out insurance (and to procure its subcontractor does) is to give the Authority comfort that if it has a claim against those parties there is likely to be funds available to meet them.

The required insurance schedule and the insurance clause may be reviewed by insurance brokers to ensure they reflect what is available in the market and current practice (in terms, e.g. of noting on policies etc) for the nature of the services to be provided.

Force majeure

This clause provides a means for the parties to suspend the terms of the agreement where events outside their control prevent them from fulfilling their contractual obligations. If these events persist for three months and the parties cannot agree a way of dealing with such circumstances, either may terminate the agreement.

Bribery, corrupt gifts and fraud

This clause contains standard provisions enabling the Authority to guard against any acts of bribery, corruption or fraud occurring within the Contractor or its supply chain and permitting the Authority to terminate the agreement in the event of breach.

Default and termination

This clause sets out the different levels of response to breaches of contract by the parties. It is another part of the agreement where different approaches may be appropriate, depending upon the amount of risk that has been transferred to the Contractor for performance delivery.

Where the Contractor is in default, this may take a number of forms. It is a Service Failure where there is a material failure to deliver the Services. This triggers a requirement on the Contractor to propose a Performance Improvement Plan to remedy the default (or avoid its repetition).

If, during the periodic contract review undertaken in accordance with Clause 12.1.2, the Parties establish that improvements are required if the Satisfactory Level of Outcomes is to be achieved, a Negative Outcomes Assessment is triggered. The Satisfactory Level of Outcomes is the level which all parties, (the Authority, the Contractor, Investors and Service

Users) would be expected to regard as acceptable, but which is by no means the best that could be achieved. It is to be defined on a project specific basis, (possibly by reference to a proportion – to be agreed – of the maximum outcomes achievable / funded under the contract).

(As with a Service Failure) where there is a Negative Outcome Assessment, the Contractor must propose a Performance Improvement Plan to remedy the failure in question. Clause 24.1 contains a process for agreeing the detail of this plan with the Authority. The Contractor must then implement the plan.

Where there is a failure to implement a Performance Improvement Plan within the agreed timescale, or a Service Failure or Negative Outcome Assessment that is not capable of being addressed through a Performance Improvement Plan, there is a Contractor Default. This also arises in certain other cases, for example, the insolvency of the Contractor or for specific contractual breaches such as of the subcontracting, change in ownership or insurance provisions. The default trigger for contracts with high levels of Service Fee may focus more on immediate service delivery, rather than prospective achievement of outcomes.

The Authority serves notice on the Contractor where there is a Contractor Default and, depending upon the default, this will either trigger termination of the agreement, or give the Contractor a period in which to remedy the breach.

Clause 24 also addresses default on the part of the Authority. The Authority has the ability to undermine the Contractor's efforts to meet its obligations – either by failing to pay the Contractor or by not fulfilling its own contractual obligations.

The proposal, in such circumstances, is (if the Authority does not remedy

such defaults when notified of them) that the Contractor can terminate the contract. Where it has taken on significant risk in relation to achieving Outcomes, particularly where it has had to take on external funding, it should receive appropriate compensation, as having assumed that risk it is now being denied the opportunity to gain the reward associated with doing so.

This should provide significant reassurance to Investors that the risk of contracting with the Authority is reduced. And though it is potentially costly for an Authority, it is something it is within its control to manage, so it should not materialise.

The compensation referred to above is defined as the Authority Default Termination Sum. The definition of this at present simply sets out the principle that in such circumstances the Contractor should be left in the position it would have been in if the contract had continued to the Expiry Date and it had achieved all of the Outcomes (as the actions of the Authority are denying it this opportunity). It may be an alternative basis upon which compensation should be calculated is preferred, such as paying, say, an amount reflecting the Contractor's achievement of the Outcomes to date for the remainder of the contract period, possibly with some uplift to reflect the lost opportunity for improvement. Either way, it will be necessary to add more detail around how this would be calculated. The detail of this is likely to depend upon the means by which the Contractor is funded and the financial model used by the Contractor and Investors to estimate returns over the life of the contract.

Either Party has the right to terminate the agreement at any time, once 18 months have elapsed since the Service Commencement Date, on six months' notice. This means that if the Contractor (or its Investors) is clear it will be unable to deliver the outcomes so will never be paid fully for the Services, it can cut its losses, being paid for any Outcomes achieved by the Services delivered, but nothing further. It also means that if the Authority

decides (possibly for political reasons) that it no longer wishes to pay for the Services or have the contractual commitment in respect of the Outcomes, it can bring the arrangement to an end. Again, because this is within its control, the Authority will be liable for the Authority Default Termination Sum in such circumstances.

Continuation

This clause identifies those provisions that shall survive termination or expiry of the agreement. It is particularly relevant in the context of outcomes being assessed and payments made, potentially, for some time after expiry or termination of the agreement.

Transition

This clause requires the Contractor to co-operate with the Authority to ensure the smooth transition of the Service at the end of the contract to a new service provider.

This includes transferring all information that is required in order to deliver the services and achieve the outcomes effectively, though the Contractor is not required to transfer commercially sensitive information.

Employment and pensions

The template assumes that, as this is likely to be a new service, there will not be existing employees transferring to the Contractor under TUPE when it commences delivering the Services. The contract will be priced on that basis and the contract acknowledges this position in Clause 27.1 providing clarity to all parties on this point.

The remainder of Clause 27 and Clause 28 deal with the situation when the contract comes to an end, placing obligations upon the Contractor to facilitate a smooth transition of the Services to a third party if appropriate.

It will be important for the parties on each transaction to establish whether TUPE will be applicable on service commencement and to address this, if necessary, in the drafting.

Dispute resolution procedure

Clause 29 contains a relatively straightforward process for resolving disputes. Matters that cannot be resolved by the staff of the parties shall first be escalated to the chief executives. If they remain unresolved, they may be referred either to mediation or the courts.

Assignment and subcontracting

The Authority may assign the agreement to another contracting authority or a body succeeding to its statutory functions. The Contractor is prohibited from assigning the agreement.

The Contractor requires the prior written consent of the Authority in order to subcontract. This is provided in the agreement itself in relation to initial subcontractors (on the basis the Authority will have satisfied itself with those arrangements before signing the agreement). Such consent must not be unreasonably withheld or delayed where the rest of Clause 30 is complied with.

In terms of future subcontracting, the assumption is that a service financed through a SIB is likely to be delivered through an SPV and one main subcontractor.

The agreement, however, also anticipates arrangements that may be more typical in a payment by results scenario where a 'prime' contractor may be using an extended supply chain to provide services and deliver results. These include requiring the Contractor to conform to its Tender Submission in terms of use of the proposed supply chain; it includes specifying the manner in which future subcontractors may be procured; and it specifies some of the terms on which the Contractor is expected to subcontract with third parties.

It may be appropriate to adapt clause 30 depending upon the extent of the risk allocation proposed and the actual composition of both the Contractor and its supply chain.

Change in ownership

This clause places restrictions on the ability of the Contractor to undergo changes in its ownership or control.

Certain parties are always proscribed as unsuitable.

The consent of the Authority is always required. Subject to 27.2 above, the Authority may withhold its consent only where the effect is to change the overall control of the Contractor compared to the position at the date of the agreement.

Boilerplate provisions

Clauses 32 to 38 are regarded as standard terms.