STONE KING

Bath and North East Somerset Council – Shared Services with Schools

LEGAL AND PRACTICAL CONSIDERATIONS INVOLVED IN SETTING UP A SHARED SERVICE SCHOOL IMPROVEMENT VEHICLE

(1) BACKGROUND

With funding pressures, and increasing demands on schools to demonstrate real value for money and to ensure school improvement, we are seeing more and more, schools coming together to explore collaborative options. Shared service vehicles are common in the further and higher education sectors, but less common in the school sector (although there is an increasing appetite for them, and probably more in the future, due to funding cuts and, perhaps due to an increase in innovation in the sector).

We have been instructed by Bath & North East Somerset Council (BANES) to prepare a report on the benefits and issues involved in setting up a shared service vehicle for schools within BANES. We understand that the key driver for the vehicle is to secure school improvement for schools within BANES, although the legal vehicle could also be used to provide further efficiencies, such as coordinated procurement, and in time, could evolve to provide back office support services to the member schools. The vehicle could evolve even further, to offer traded services to schools outside the local authority area, bringing in an additional income stream. This report touches upon all these considerations.

In an environment of increasingly challenging funding cuts, the vehicle could help schools in reducing costs, and cutting time and administration, leading to greater economic efficiency. This could, and should, serve to free up more time for the schools to concentrate on teaching and learning.

This paper focuses on how a shared service vehicle could be set up with a dual function of:

(1) securing school improvement;
(2) bringing financial savings to the schools within BANES.

We understand that the proposal is for BANES to be a stakeholder (and facilitator) in the legal vehicle, but that it would be collectively owned and operated by the schools which wish to join it. It would be a truly collaborative vehicle, a vehicle ‘designed by schools, for schools’.

(2) AUTHORITY TO PARTICPATE IN SHARED SERVICE VEHICLE

Local authorities are increasingly collaborating with external organisations in the public, private and third sectors to secure the co-ordination of the various organisations' activities, to discharge their functions more efficiently, and to benefit their communities. Local authorities have the following powers to participate in external bodies:

(a) Section 111 of the Local Government Act 1972.
(b) Section 2 of the Local Government Act 2000 (the well-being power) (applies to authorities in Wales).

(c) Section 1 of the Localism Act 2011 (the general power of competence) (applies to authorities in England).
(d) Section 95 of the Local Government Act 2003 (power to trade).
(e) Other powers to participate in companies for specific purposes.

- It is therefore within BANE'S powers to become a stakeholder in the shared service vehicle (although please note our comments below at paragraph (3) below as to the level of BANE's involvement).
- Academy Trusts have the power in their Articles of Association to establish subsidiary companies.
- Maintained schools have the power to do so, subject to compliance with the School Company Regulations 2002 (as amended). Any shared service would need to be compliant with these regulations.

(3) LEVEL OF LOCAL AUTHORITY PARTICPATION IN THE SHARED SERVICE VEHICLE

We anticipate that the schools may wish BANES's involvement within the shared service vehicle to be limited to less than 20% (both at board and at member/shareholder level). This is line with the way in which academy trusts are set up. Otherwise, the shared service vehicle would be 'LA influenced' which means that it would:

- be required to identify itself as being local authority influenced on all business letters, notices and other documents of the company;
- be required to remove any director who became disqualified from holding membership of a local authority;
- be barred from publishing any material which might affect public support for a political party;
- be required to provide to the local authority's auditors with information about the shared service vehicle which they might need to audit of the local authority's accounts;
- be required to provide the Audit Commission with such information as it required;
- be required to provide councillors with any information they needed to discharge their duties;
- be required to obtain the Audit Commission's consent to the appointment of any auditor.

(4) DELIVERING EFFECTIVE SHARED SERVICES

Collaboration is often done on a project by project basis, and the legal arrangements (setting up a legal vehicle or conducting arrangements through purely contractual arrangements) depend largely on the type of services the parties wish to share, and following an assessment of the risks involved.

It is entirely possible for BANES and the schools to collaborate by setting up a joint committee, regulated through a 'collaboration agreement', however, following initial discussions, and an assessment of the likely activities (both now and in the future), we would advise that a company is established at the outset by the schools/BANES. A purely collaborative vehicle can often lack structure, and there would be no legal entity to ring-fence risk to BANES, and to the schools. A formal company structure also has the added benefit in offering greater stability (it will establish a level of commitment and certainty which would be missing from informal collaboration). A formal company structure (akin to the umbrella trust) also provides clear accountability. It is important to note that under this model that each of the academy trusts/maintained schools would retain its own legal status and identity.

We advise that the shared service vehicle is set up to be 'Teckal compliant'. The word 'Teckal' is derived from procurement case law. By setting the company up in this way, it means that services could be provided to the schools without them having to conduct a formal procurement exercise for those services (akin to purchasing from an in-house department).

It is worth noting that 80% of the activities of the 'Teckal entity' must be carried out for the 'owners/members' of the legal vehicle. This will need to be carefully considered if the vehicle is also going to be used to provide services to 'non-owner' schools (although there is always the possibility of setting up a trading company to provide external services to non-members).

Please refer to **Schedule 1** for an analysis of the 'Teckal Test', which is codified in the Public Contract Regulations 2015.

(5) TYPE OF LEGAL VEHICLE

If BANES wish to seek financial investment from the shared service vehicle, then we would advise that the vehicle is set up as a company limited by shares, or as a Community Interest Company (CIC) (although it is important to note that the amount of financial investment within a CIC is restricted by its asset lock).

An alternative option is for the shared service vehicle to be set up as a charity under the charitable head of "promoting the effectiveness and efficiency of charities' and 'advancement of education', although this model would preclude BANES receiving any share of the profits generated , and charities are limited in the type of trade they can get involved with. Profits could be gifted to charity members (to the schools which are charities) or simply reinvested in the shared service vehicle.

The key characteristics of each vehicle are set out at **Schedule 2**. Each vehicle is cheap and easy to set up. Our recommendation would be that a CIC would be a suitable legal vehicle based on the activities and purpose of the group.

We recommend that that the partners consider operating a 'virtual business model' initially (see **page 7** for more information).

(6) WHICH SERVICES TO SHARE?

A wide range of services could potentially be shared.

We are aware that the key function of the vehicle will be to secure school improvement, and we anticipate that the following school improvement services (amongst others) could be provided by the shared services vehicle:

- Learning hubs and networks- which could be cluster geographically (or via some other mechanism).

- Development and research.
- CPD.
- Leadership, professional growth and capacity building.
- Peer review.
- Teaching training, retention and development- such as Teaching School/SCITT.

The fact that schools have common systems and processes should also contribute to achieving efficiency gains. The services most often moved into shared service vehicles are finance, payroll, HR and IT, but there are many other areas that could be considered.

Schools often carry out individual procurement, which can be time-consuming, risky and cumbersome. Joint procurement through the shared services vehicle (via the shared service vehicle setting up framework agreements for schools) is likely to lead to reductions in costs, and potentially better rates for schools, as well as free up personnel time, to spend on securing school improvement. It is interesting to note that the Crescent Purchasing Consortium, commonly known as CPC (which is owned by the Further Education sector) is able to secure commission payments depending on the overall school expenditure, allowing for an additional income stream.

A model showing how the vehicle could look can be found at **Schedule 3.**

(7) BENEFITS OF THE SHARED SERVICE VEHICLE

Depending on the service, savings may result from:

- Lower capital costs.
- Lower development costs.
- Reduced software maintenance costs and system support costs.
- Improved commercial bargaining power for procurement.
- The avoidance of duplication.
- Increased efficiency from standardised processes and technologies (including common ICT and shared platforms).
- Lower personnel costs.
- Improved service, leading to improved customer experience, as a result of greater focus and skills in the shared service centre, and the opportunity to reorganise services around the customer.
- Improved morale amongst staff providing the shared services.
- Senior management focusing their attention on adding value, rather than transaction processing activities.
- Greater resilience from a wider base and more staff with key skills for the specific services.
- Shared training and development opportunities for staff.
- A foundation for trading or expansion to other bodies.

(8) CHALLENGES TO DELIVERING SHARED SERVICES

The two most important challenges in the schools sector are:

(i) the need for schools to maintain their independence (persuading schools/MATs/single academy trusts (SATs) that they can share support functions without threatening academic or operational independence is a key issue, however, this is not an insurmountable barrier (models of success in the sector);

(ii) Union/staff opposition (due to potential loss of jobs if the shared service vehicle were to provide back office support functions). Again, this is not an insurmountable barrier.

Other significant challenges for shared services include:

- **Commitment**- there is a need to ensure *real* commitment to a shared service arrangement by its participants. If a partner were able to leave such an arrangement or cut back their contribution at short notice this could have an adverse effect on the other partners. It is therefore important to ensure agreements clearly cover the withdrawal a partner.

- **People** – consideration as to whether staff be seconded or transferred under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) into any new entity established? What about new support staff? Should they be employed directly by the shared service vehicle? What are the LGPS pensions implications?

    - How should organisations deal with laws, regulations and cultural issues?
    - Careful planning for these issues, engage staff at an early stage, good communication, but they be effectively managed. It may be that LGPS savings can also be made if the shared service vehicle is to employ staff.

- **Technology** – different systems with different operating practices and skill sets. Consideration should be given to:

    - Maintaining information integrity, whilst integrating systems is important. The use of common systems is not a prerequisite for shared services, although it will most likely have a significant impact on long-term efficiencies.
    - Institutions also need to bear in mind data protection, FOIA and confidentiality obligations. We would recommend that these issues are dealt with in a Members Agreement (and via agreed legally compliant protocols).

- **Processes** –consideration should be given as to how can commonality be provided for a group of potentially diverse organisations whilst providing the necessary flexibility for genuine differences? We believe that the shared service vehicle can be set up in such a way so as to complement the existing organisations. The member schools will each maintain their legal status.

- **Governance/accountability** –accountability mechanisms need to be appropriate.

- **Affordability** – availability of seed funding, redundancy costs, capital investments (premises, new systems) –savings/payback.
- **Stakeholders** – potential impact on pupils, staff, local businesses to be factored in. Early engagement with stakeholders and a voice is generally considered best practice and leads to greater success.

(9) STEP PLAN – THE COMPANY'S EVOLUTION

There are a variety of planning models available for achieving effective shared services. All of them have a number of stages which any organisation wishing to implement a shared service programme will have to go through. We have set out some initial thoughts and considerations below:

YEAR 1

STEP 1	**EXPORE VIABILTY WITH EXISTING MATS AND ORGANIC GROWTH** It may be easier to discuss the proposal with an existing MAT (or MAT**s**) to gauge their views on the proposal and viability before seeking buy in from other schools/trusts. The company could initially be set up with a small number of schools/trusts, and grow organically. This is the most likely scenario, and our advice would be to consider developing it in this manner. Often start-ups are set up as virtual business models to facilitate increased flexibility and utilisation of both financial and human resources. Thanks to the advances of digital technology it is becoming easier to run a successful, financially viable, growing business, without any staff and outsourcing functions where they need external specialist support, and moving to look at premises and staffing as and when the organisation grows and the commitment from stakeholders and finance is there. It's possible, with careful management, to build up an entire company with freelance, contract and 'virtual employees'; manning an office with staff who aren't really there. The benefit a virtual business model is that it allows an organisation to start off small, grow organically to see if it works.
STEP 2	**ETHOS AND VISION** The ethos and vision, the role of existing functions which remain 'local' to the schools, the balance between cost reduction and service/school improvements and the level and form of commitment required by the schools to make the company a viable option should be determined at any early stage. For example:

	To provide high quality, value for money services to schools and educational settings • Respond to needs identified by Head teachers and governors • Publicise the high quality expertise in of BANES schools and share that good practice • To further foster school-to-school support
STEP 3	**BUSINESS CASE (FINANCIAL ANALYSIS)** This should detail school/BANES requirements, identify the governance arrangements, identify likely efficiencies (not just financial), taking into account short-term increases in costs, set a realistic timeframe, and agree how benefits are to be allocated between customer/provider.
STEP 4	**SEED FUNDING** An approach should be made to the RSC with a Business Plan to secure seed funding for development, and central support.
STEP 5	**COMMUNICATE** It is important that schools and stakeholders are consulted to gain buy-in before proceeding. If the model proposed by BANES is to be a true partnership with its schools, then we would advise that they are heavily involved in its creation and development.
STEP 6	**AGREE GOVERNANCE STRUCTURE AND ESTABLISH COMPANY** It is will be important to determine who the Board will comprise and the commitments the schools will be required to make. The company can then be registered and 'go live'. The nature of shared services is that they develop organically over time. It will therefore be important for BANES and the schools to work out what the company will do in the first 3 years of operation.
STEP 7	**APPOINT OPERATING OFFICER TO IMPLEMENT BUSINESS PLAN**

YEARS 2/3 - CONSIDERATIONS

Years 2/3	Reflect on lessons learnt
	Commission services from member schools/BANES/third parties
	Consider external business function (traded services
	Teaching School/SCITT
	Company becomes MAT sponsor
	MAT leadership

SCHEDULE 1

Teckal

The broad objectives of Public Contract Regulations 2015 (PCR15) (which BANES and its schools, as 'contracting authorities' must comply with) are to ensure that public bodies award contracts that are above the specified value thresholds only after fair competition, and only on the basis of the most economically advantageous offer.

The *Teckal* case established that, under certain circumstances, a contract let to a third party will not count as a public service contract if "*the local authority exercises over the person [ie the company] concerned a control which is similar to that which it exercises over its own departments and, at the same time, that person carries out the essential part of its activities with the controlling local authority or authorities"*. These principles are now codified in the PCR15.

Teckal allows for back office support and other services could be outsourced to a Teckal entity enabling member schools to buy those services from the Teckal entity without having to formally procure those services, provided that the Teckal test laid down in the PCR15 relating to control and activity is satisfied, as detailed below:

- **Control:** the members of the Teckal entity must exercise sufficient control over the Teckal entity; and
- **Activity:** the Teckal entity must carry out the essential part of its activities its members.

the "Teckal Test".

<u>Control</u>

The control exercised by the members must be similar to that which the members themselves exercise over their own departments. Sufficient control is deemed to exist where a 'contracting authority' exercises "decisive influence over both strategic objectives and significant decisions" of the Teckal entity.

There can be more than one contracting authority owner (as there would be in this instance), so joint control by the members is permitted.

<u>Activity</u>

There has been considerable uncertainty around what level of activity is required to satisfy the second part of the 'Teckal Test'. This has now been clarified by the PCR15. The concept of "essential activity" is replaced with a requirement that the level of activity carried out by the controlled body for the owner schools is "more than 80%".

The provisions on joint control mean that where there is more than one 'owner' the levels of activity can vary for each for different owners. The requirement for more than 80% activity is satisfied by calculating the activity carried out for all of the 'owners'.

Private sector participation

No “direct private capital participation” in the Teckal entity is allowed. There is an exception to this general rule which permits “non-controlling and non-blocking forms of private capital participation” where (1) it is required by national legislation; and (2) where those participants do not exert a decisive influence on the Teckal entity.

Calculation of Activity levels

Regulation 12 of the PCR15 contains provisions concerning the calculation of the required +80%/-20% activity levels. The calculations are to be based on average total turnover or “an appropriate alternative activity-based measure” for three years preceding the contract award.

There are also provisions covering the situation where data for the preceding three years is not available or is no longer relevant because the relevant organisation had not been created, was not active or has been reorganised. In these cases “it shall be sufficient to show that the measurement of activity is credible, particularly by means of business projections”. These rather vague provisions leave quite a lot of room for interpretation of precisely what evidence is needed to establish the required levels of activity.

SCHEDULE 2

DECIDING THE LEGAL FORM

(1) Advantages of a corporate joint venture arrangement over purely contractual arrangements

The key advantage of setting up a legal vehicle is that it operates on an arm's-length basis from both the customer and supplier organisations. Operational risk is ring-fenced in the legal vehicle. A legal vehicle makes it easier for a team to be established that can be dedicated to focusing on delivering the services away from the day-to-day pressures of the respective partner businesses.

A legal structure enables the assets of the venture to be owned by the vehicle, and enables parties to access a wider range of options than may be available through more traditional arrangements.

(2) Legal Vehicles – options, pros and cons

Depending of the activities of the shared service vehicle, it may be possible to set the shared service vehicle up as a charity, company limited by shares or as a community interest company. Due to the restrictions on return from any investment, it is unlikely that a charitable option would be appealing to BANES, but for the sake of completeness, we have included it below.

2.1 Charity

A charitable company is a company registered under the Companies Act 2006 that is established for wholly charitable purposes for the public benefit. Charities can only engage in activities which are legally recognised to be charitable. It may be possible to set the shared service vehicle up as a charity under the charitable head of promoting the effectiveness and efficiency of a charity, although it would preclude BANES from receiving any profit from the shared serviced vehicle.

Other characteristics of charities

Regulation

Charities are regulated by the Charity Commission and are considered to be heavily regulated.

Tax

Charities benefit from Corporation Tax relief, Capital Gains Tax relief and Stamp Duty Land Tax relief. CICs do not benefit from these tax exemptions.

Trading

Charities are limited in the type of trade they can get involved with. While charities may trade more or less freely in pursuit of their charitable objectives, there are restrictions on trade with the objective of generating funds for the charity. Charities may not engage in commercially-oriented trades where a significant risk to their assets would be involved. To sidestep this restriction charities often set up subsidiary trading companies.

2.2 Community Interest Company (CIC)

What is a Community Interest Company?

A community interest company ("CIC") is a type of company, designed primarily for social enterprises that want to use their profits and assets for the public good. CICs are particularly attractive to those wishing to enjoy the benefits of limited company status and want to make it clear that they are established for the benefit of the community, but are not able, or do not wish to become charities. They vary in size from small community-based organisations to multimillion pound enterprises. CICs are relatively easy to set up, with all the flexibility and certainty of the company form, but with some special features which ensure that they work for the benefit of the community.

Fundamentally a CIC is a normal company. They can be established as companies limited by guarantee (which the majority are) or companies limited by shares. However, there are some unique and important additional features to safeguard the CIC's social mission, for example to protect the CIC's assets, dividends and other payments to shareholders are subject to a statutory cap as part of an asset lock (see below). There are model constitutions available from the CIC Regulator, with the exception of CICs structured as public limited companies.

What does a CIC do?

Providing a CIC benefits the community and does not exist for political aims, there are few restrictions on its activities. For example, a CIC may:

- Run a business (e.g. a retail or manufacturing operation) as a trading arm to generate profits to support activities which directly benefit the community;
- Benefit the community more directly, such as by running day centres, or providing transport or other services in the community.

The Community Interest Test

To become a CIC, an enterprise or business must pass the "Community Interest Test", which requires an enterprise or business to conduct its affairs in such a way that a reasonable person might consider that its activities are being carried on for the benefit of the community.

The Asset Lock

The asset lock is a fundamental feature of a CIC. It is important to understand the concept before setting up a CIC, as it has permanent and long-term consequences. "Asset Lock" is a general term used to cover all the provisions designed to ensure that the assets of a CIC (including any profits and other surpluses generated by its activities) are used for the benefit of the community.

A transfer of assets must satisfy certain requirements. This means that subject to the CIC meeting its obligations, its assets must either be retained within the CIC to be used for the community purposes for which it was formed, or, if they are transferred out of the CIC, the transfer must satisfy certain criteria.

The Dividend Cap

A CIC which is a company limited by guarantee without share capital has no shareholders and so cannot pay dividends. CICs with Schedule 2 Articles may only pay dividends to specified asset-locked bodies, or other asset-locked bodies with the consent of the CIC Regulator. Subject to same rules that apply to ordinary companies (distributable profits), the amount of dividend is not subject to the dividend cap. CICs with Schedule 3 Articles may pay dividends to non-asset locked bodies i.e. investors, subject to the dividend cap.

If an asset-locked body holds shares, then there is no additional constraint on the payment of dividends, provided that:

- the CIC Regulator has consented to the payment; or
- the asset-locked body concerned is named as a possible recipient of the company's assets in its Articles.

The dividend will be subject to the dividend cap if shares:

- are not held by an asset-locked body, or
- are held by an asset-locked body not specified in the Articles of Association and the CIC Regulator has not consented to the payment of the dividend.

Unlike most companies CICs may only declare a dividend by ordinary, or special resolution, of the members. This means that the directors cannot declare a dividend without consulting the members and gaining their support.

The dividend cap used to have three elements to it, but this was recently simplified so that the only restriction is now a maximum aggregate dividend, which limits the total dividend declared in terms ofthe profits available for distribution. Currently, the limit is 35% of the distributable profits.

Interest on loans

Subject to any restrictions in their articles, CICs can borrow money in the same way as other companies can and can pay normal commercial rates of interest to lenders. However there is a cap on the amount of performance related interest that a CIC can pay on a loan; like the dividend cap, the intention is to limit the amount of assets that can be transferred out of the CIC.

Paying directors

CICs have the option to pay directors, however, the community interest test and the asset lock (see below) apply as much to the remuneration of directors as to any other area of a CICs business. Therefore directors' remuneration should never be more than is reasonable and remuneration arrangements should always be transparent. If the CIC is paying its directors more than they are really worth (to itself or the community that it serves) then it may well be breaching its asset lock. Such a breach may give rise to legal action.

Who regulates CICs and are the reporting requirements the same for normal companies?
CICs are regulated by the CIC Regulator. The Government expects the CIC Regulator to be a “light touch regulator” who will encourage the development of the CIC brand and provide guidance and assistance on matters relating to CICs. However, the CIC Regulator will respond to complaints from stakeholders and has considerable powers to act to protect the community interest.

As with all companies, CICs must file annual accounts and an annual return with Companies House. In addition, a CIC has to file a community interest report annually, which explains how the CIC has pursued the community interest and involved its stakeholders and will, if applicable, give details of payments to directors and any dividends paid.

Summary

Advantages:

- The CIC brand provides reassurance to stakeholders, as the asset lock and community purpose are regulated;
- higher profile for social enterprises and a growing network and voice within the social enterprise and third sector;
- Transparency of operation through the annual CIC report;
- Permanent statutory clauses, which cannot be removed, such as the asset lock which ensures that assets are used for the benefit of the community and other clauses which ensure members retain control;
- Continuity of purpose – once a CIC is incorporated it will continue providing benefit to the community until it is dissolved or converted into a charity. If it is wound up, any residual assets (after satisfying any creditors), will be transferred to another asset-locked body, such as a charity or another CIC;
- Quick, easy and cheap to set up;
- Limited liability for members;
- Flexible company form – the structure, governance and membership can be tailored to the needs of a particular CIC;
- Access to debt markets (loans and bonds);
- A CIC limited by shares can expand by selling its shares;
- The company form is familiar to the business community; and
- Access to community development finance
- Some CICs have been able to successfully get rates relief (see disadvantages as rates relief is by no means guaranteed)
- Some funders will only give to (i) charities and (ii) CICs, and so it is possibly a better vehicle than being a normal company.

Disadvantages:

- No tax incentives apply, so a CIC is subject to business rates, corporation tax etc (although some local authorities grant discretionary rate relief to CICs);

- Public awareness – donors and volunteers etc. may not be familiar with CICs;
- Public trust and confidence, which is high in relation to the charitable sector, may not be as high where public awareness is low; and
- Corporate Social Responsibility policies may favour charities.

2.3 Company limited by shares

Another option would be to set the shared service vehicle up as a company limited by shares. "Limited by shares" means that the liability of the shareholders to creditors of the company is limited to the capital originally invested, i.e. the nominal value of the shares and any premium paid in return for the issue of the shares by the company. A shareholder's personal assets are thus protected in the event of the company's insolvency, but any money invested in the company may be lost. Whilst, a company limited by shares does not have the restrictions of a charitable company or CIC, it does not receive the tax incentives of a charitable company, nor some of the advantages of a CIC.

(4)How to set up the legal vehicle

Once the legal structure has been decided, the partners (BANES and the schools) who are to become the founding members of the shared service vehicle will need to agree the objectives and governance structures applicable to the joint venture, including:

- Relative shareholdings/membership rights.
- Services and activities to be provided.
- Corporate governance /board appointments.
- Voting rights and powers of veto.
- Funding and exit arrangements.
- Details of any people or assets committed by the parties into the venture.

These will be documented in formal constitutional documents comprising a members' agreement and the shared services constitution (the form dependent on the preferred legal vehicle).

Stone King LLP
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Schedule 3

SAMPLE MODEL

SHARED SERVICES AND OUTSOURCING AS A MEANS OF COLLABORATION