



Guidance

Schools, Chief Education Officers,
Governing Bodies
and other interested parties

Date of Issue: 20/01/03

Related documents:
Annex A & Annex B

Guidance on School Companies

Overview

This guidance provides assistance with the establishment and operation of companies under sections 11 and 12 of the Education Act 2002 and subsequent regulations under those sections The School Companies Regulations 2002 and The School Companies (Private Finance Initiative Companies) Regulations 2002.

Further Information

LEA Policy Team
Local Standards Policy
School Workforce Unit
Sanctuary Buildings

department for

education and skills

creating opportunity, releasing potential, achieving excellence

Introduction

1. This guidance provides assistance with the establishment and operation of companies under sections 11 and 12 of the Education Act 2002 and subsequent regulations under those sections (The School Companies Regulations 2002 and The School Companies (Private Finance Initiative Companies) Regulations 2002. Sections 11 and 12 of the Act come into effect from 20 January 2003 and are purely enabling – formation of a company by a school governing body is voluntary. The guidance is intended for schools, local education authorities and others interested in how school companies will work. It explains the policy intentions behind the legislative provisions and offers some guidance on how to set up and operate a school company. It is not intended to be a definitive statement of the law; this is provided by sections 11 and 12 of the Education Act 2002 and the Regulations. These documents can be obtained from Her Majesty's Stationery Office (HMSO) or from the HMSO website at <http://www.hmso.gov.uk>. This guidance does not cover the provisions of section 13 of the Education Act 2002 concerning the Secretary of State's power to form and participate in companies.

2. Section 11 of the Education Act 2002 enables governing bodies of maintained schools to form companies on their own, or with other schools or with certain other education bodies for prescribed purposes. Before this, the extent to which schools could act as a group was limited. While a school governing body already has the power (under Schedule 10 of the School Standards and Framework Act 1998) to form a company to assist in the running of the school, groups of schools have not been able to form a company with each other or with other bodies. Schools were not able to contract jointly with a service provider to make savings through economies of scale. School governing bodies were also unable to provide services or facilities to other schools or carry out LEA functions nor could they easily pool resources. The provisions of the Education Act 2002 now allow groups of schools to acquire a legal identity that will make them attractive and credible purchasers and suppliers of services. The policy is designed to give companies the greatest degree of flexibility while providing a secure framework in which to operate.

3. Schools will be able to set up companies to undertake three types of activity:

- **purchasing goods and services** for schools in the company
- **providing services or facilities** to other schools either directly or facilitating that provision by a third party
- **exercising functions** which an LEA is able to contract out

GUIDANCE ON SCHOOL COMPANIES

4. Companies will be able to undertake one or all of these types of activity. The formation of a company is entirely **optional**. The Government is not seeking to burden schools and governing bodies with a requirement. However, significant benefits could make worthwhile the initial investment in time and resources of setting up a company.

5. The company is a vehicle to provide groups of schools with a legal identity to procure and provide services and facilities collectively. Forming a company is a well-established and relatively straightforward procedure. The mechanism of a company also allows schools a certain degree of flexibility to develop the constitution and membership to reflect their individual circumstances within the parameters outlined below. It also provides financial protection for schools in that the companies which they are able to set up under these provisions must be limited liability companies.

Benefits

6. Some schools will be able to take advantage of the real benefits of being involved in school companies. Schools should be able to make more innovative arrangements for purchasing goods and services in co-operation with other schools, resulting in significant savings. Those savings will arise from having a company structure that can contract with the suppliers directly and avoid the need for several individual contracts between supplier and schools. This is only possible because a company has its own legal personality. A group of schools working together will be able to wield greater purchasing power with suppliers. They will be able to devote a more focused resource to the function, and buy in greater bulk.

7. The company structure will enable schools to save money and free up staff time by sharing the cost of employing a person to deal with purchasing and supply issues. A school company can employ that person, whereas a less formal arrangement cannot create a separate entity able to employ staff.

8. Forming a school company to deliver services will enable the best schools to use the expertise they have developed to help other schools in new ways. It could, if all parties agree, deliver part of an LEA's school improvement or curriculum development programme. The company would receive income for delivering that service and members of the company would be able to benefit from any profits that the company may generate.

9. Allowing teachers in schools with the capacity to do so to share their expertise with other schools can benefit both providing and receiving schools. Providing services to other schools can offer good teachers a fresh challenge and encourage professional development, as well as creating alternative career opportunities for teachers. Schools receiving services in this way will be able to benefit from the advice and support our best teachers are able to offer.

GUIDANCE ON SCHOOL COMPANIES

Types of company

10. School companies will be private companies limited either by shares or by guarantee. It is not appropriate for these companies to be publicly listed and answerable to a large number of shareholders, nor will the company be of sufficient value for their shares to be traded publicly.

11. A company limited by shares will issue shares to members that will reflect their investment in the company. A company limited by guarantee is a company where each member guarantees the debts of the company up to a set limit which is normally a nominal figure of £10, instead of subscribing for shares. A company limited by shares is a more appropriate structure where the company is seeking to make a profit and to divide that profit between the members. A company limited by guarantee is more appropriate when the company is not seeking to make a profit e.g. when the company is merely purchasing goods and services on behalf of the member schools.

Forming a company

12. School companies are required to register under the Companies Act 1985. Companies House, the government agency responsible for company registration in Great Britain, has produced guidance on forming a company called **Company Formation** available at www.companieshouse.gov.uk. While the staff of Companies House can offer some guidance, it is best to take the advice of a solicitor on forming a company, particularly to draft the company's constitution so that it properly reflects the aims of the members of the company and the purposes they wish it to fulfil. The procedures are relatively straightforward and should allow members of the company to reflect, within the legal requirements, the way they would like their school company to operate. **Annex A** of this guidance summarises the procedures for forming a company.

13. Setting up might well be the most labour intensive period in a company's life because the members will need to make important decisions regarding the structure of the company, its aims, how it is to be funded, how any profits are to be divided and, if it is to employ staff, its employment terms and staffing. The members will need to think carefully and establish a shared understanding of what they are willing to put into the company and what they want to get out of it. The legal process can be simplified and costs can be kept down by purchasing an 'off the shelf' company and then adapting the memorandum and articles to fit the purposes of the school company. An example memorandum of association and articles of association is attached as part of **Annex A**. Schools and others might find this example helpful; it is not meant as a template and is not definitive. Form 10 and Form 12 are standard forms issued by Companies House which need to be completed when forming a company. These forms are accessible through their website or obtainable from the address at the end of this guidance.

GUIDANCE ON SCHOOL COMPANIES

Membership

14. Any governing body of a maintained school with a delegated budget can form a company. Schools wanting to form a company together need not be within the same LEA boundaries nor need they be engaged in teaching the same age range.

15. However, schools will need permission from their LEA to join a company. This is in order to ensure that schools have the managerial and financial capability required to take part in a school company. Only those with managerial or financial problems will be prevented from joining (see paragraph 19 below).

16. Other organisations such as Higher and Further Education institutions, local authorities in England, independent schools (including City Technology Colleges and Academies) are able to join school companies (the full list is set out in regulation 5 of The School Companies Regulations 2002). Companies providing education services can also become members of school companies, as long as education or the provision of goods or services ancillary to education is '**a significant proportion of their business**'.

17. Individuals are permitted to be members of school companies. Certain categories of people are not allowed to be members of a school governing body - for example, – bankrupts, those with criminal convictions, disqualified directors, those prohibited or restricted from teaching or working with children. These restrictions are extended to prevent those individuals from becoming members of a school company.

18. Employees of maintained schools' governing bodies and of LEAs are excluded from being members of the company as private individuals. Schedule 1 of the Regulations sets out the groups of individuals who are excluded from membership of school companies.

LEA consent to membership

19. A maintained school's governing body needs permission from its local education authority before it can become a member of a school company (section 12(1) Education Act 2002). In considering applications from governing bodies to join or form a company, an LEA will take account of the financial and managerial capability of the schools concerned. The circumstances in which an LEA can refuse to give permission are limited and prescribed in Part II of the Regulations. They are where a school

- is subject to special measures or has serious weaknesses;
- has weak management or finances and joining a company may prevent the school from addressing these weaknesses;

GUIDANCE ON SCHOOL COMPANIES

- has been at fault for a previous insolvency of a school company;
- has belonged to a school company which failed to act in accordance with the regulations within the last 3 years

Section 12 of the act also prevents a school governing body from joining a school company if its school's delegated budget has been suspended.

20. A school that has been refused permission to join a company and thinks this decision is unfair can complain to the Secretary of State by using the right of complaint schools have already against LEAs acting unreasonably.

21. Since they are formed as independent schools, Academies and CTCs will not need an LEA's permission to join school companies.

Supervision of school companies

22. All school companies will have supervising authorities. The supervising authority has the following functions:

- (a) Monitoring the management and finances of the school company, including scrutiny of audited annual company accounts;
- (b) Considering requests from school companies to borrow;
- (c) Notifying the Secretary of State of company membership, name or registered number and any changes to these details within 28 days; and
- (d) Directing governing bodies to withdraw from a school company in certain circumstances.

23. The supervising authority will normally be the LEA within which the member schools are based. Where member schools are from more than one LEA area, LEAs will be expected to agree amongst themselves which will become the supervising authority. Where local agreement cannot be reached, the Secretary of State will decide which LEA should be the supervising authority. Where an LEA is a member of the school company, and is the only LEA which maintains schools whose governing bodies are members of the company, it will become the supervising authority. If there is another LEA whose schools are involved and which is not a member then that LEA will be the supervising authority. Where a school company considers that the LEA which is to be the company's supervising authority, would be in commercial competition with the company, the company may request that the Secretary of State designate another LEA as the supervising authority.

GUIDANCE ON SCHOOL COMPANIES

24. The supervising authority has defined powers over companies, some of which can only be exercised in certain circumstances:

- (a) it may direct the company to provide such information about the company's finances, management and contracts to which the company is a party, as the supervising authority think necessary;
- (b) it may direct the company to take certain specified steps in order to comply with the Regulations;
- (c) it may direct a governing body of a maintained school, which is a member of the company, to reduce its involvement in the management of the company; and
- (d) it may direct a governing body of a maintained school, which is a member of the company, to resign as a member of the company.

25. A supervising authority will need to have evidence for its decisions, and will be bound by the general duty on LEAs to act reasonably. Before directing a school to resign from or reduce involvement in a school company, the authority must give 28 days notice in writing to the governing body and the company. A company that is dissatisfied with a supervising authority's decision can make representations to the supervising authority and if it is still dissatisfied it can complain to the Secretary of State.

26. The supervising authority will not intervene in the day-to-day running of a company and should only exercise its direction making powers over the company if there is evidence that a company is approaching or is in financial trouble. The authority is entitled to receive annual audited accounts, which companies will produce for themselves and Companies House anyway. In the first year of the company's operation it will provide two sets of six monthly accounts to enable closer supervision and faster action by the supervising authority in the initial set up period when the company has a higher risk of financial difficulties. The additional element of supervision i.e. requesting further information and directing governing bodies only becomes significant if the company is in financial difficulties, is acting illegally or if the schools of the governing bodies are in difficulties.

27. The other powers and duties of an LEA in relation to its schools are not affected by whether or not it is a supervising authority. Therefore, where the supervising authority is also the maintaining LEA for some or all of the schools in a company, it will continue to have available all its powers and duties in relation to the performance or state of those school(s) rather than that of the company. Where the supervising authority is not the maintaining LEA for a school in the company it supervises, it may become involved in such school matters only at the request of the LEA which maintains the school(s).

GUIDANCE ON SCHOOL COMPANIES

Appointment of directors and their interests

28. The articles of association of the company will set out the process for appointing a Board of Directors to run the company.

29. The members of the company will need to bear in mind that directors can bind the company contractually by acting as the company's agent and that they act effectively as trustees of the company's assets. They therefore need to appoint people with appropriate skills and character. It may be necessary for the company to arrange some training for newly appointed directors to ensure that they are familiar with their powers and duties in their role as directors.

30. At least 40% of the directors of a school company must be non-executive directors, that is directors who are not employed by or contracted to the company to provide services for payment. The company must also appoint a committee composed only of non-executive directors to consider the remuneration of any executive directors (who are employed by the company), for approval of the directors as a whole or by the remuneration committee. Directors are not allowed to vote when their own remuneration is being considered or to be present when their remuneration is being discussed. Directors may be present for discussion of common benefits such as pensions.

31. Companies must limit the circumstances in which they may enter contracts where directors have an interest. Goods and services must be required by companies and supplied at a reasonable cost. The requirements in the regulations to prevent directors from taking decisions in which they have an interest are in addition to the general obligations on directors under the Companies Acts and common law not to make a secret profit from their position as directors.

32. Companies would be expected to ensure that appropriate background checks are conducted on directors, members and employees of the company bearing in mind their possible access to school premises. Advice on such procedures can be sought from the supervising authority. Companies may wish to ask their members to make a Nolan declaration that they will maintain certain standards of behaviour. Further advice is available from <http://www.public-standards.gov.uk>

Profit

33. Any profit made by school companies may either be retained by companies to pursue objectives or distributed amongst members or a combination of both. If profits are to be distributed among members, it is imperative that the members agree at the outset, when they are establishing the company, how a distribution of profits is to be decided upon and how profit is to be divided between the members. Regulation 10(c) of The School Companies

GUIDANCE ON SCHOOL COMPANIES

Regulations 2002 provides that the company's constitution must set out either the proportions of profit to be distributed among the members or a procedure to determine how the profit should be distributed.

Power to borrow money

34. Companies can only borrow money with permission of the supervising authority, whether that borrowing is secured or unsecured. It is possible for a company to borrow against its own assets (with permission), but not against assets that belong to the school members of the company. The property of the members of the school company remains separate from that owned by the company itself.

Debt

35. Directors of the school company are obliged under company law not to trade whilst insolvent and if they need to borrow funds to see the company through a period of financial instability they are required to seek permission from the supervising authority. This will restrict debt being run up from excessive borrowing. Any significant debt incurred by a company should come to the attention of the supervising authority through its receipt and assessment of the company's accounts. The first obligation is on the company's management not to get into a position where the company cannot pay its debts but, as with any business venture, there is a risk that this can happen. If a company does get into debt, it will have to either borrow money to pay its creditors or trade its way out of the difficulties and arrange for time to pay its creditors. A company unable to pay its debts will face being wound up. Companies which are only purchasing goods and services for member schools should face the lowest risk of excessive debt because they will be buying the goods and services that the individual schools required previously and will not be taking the sort of risks involved in becoming a supplier of services themselves.

36. If the supervising authority becomes aware that a company has an excessive debt position, it should then notify the school members and the LEAs of the member schools of that position. The supervising authority could use its powers to direct the company to provide further information for the assessment of the company's position and could further direct the school governing body members to reduce involvement in or resign from the company as explained in paragraph 24.

The effect of the company having limited liability status

37. In the event of a school company failing financially, the liability of each company member would be limited either

GUIDANCE ON SCHOOL COMPANIES

- in the case of a company limited by guarantee to the size of the guarantee (usually a nominal figure of around £10), or
- in the case of a company limited by shares, to the unpaid amount outstanding on the shares.

38. Company members would determine the value of shares and the amount, if any, outstanding on shares, so would always have taken an informed decision at the outset about their potential liability.

39. In the unlikely circumstance of a school company becoming insolvent, there will be no risk to a school's assets or the employment of the staff at member schools, as the company does not own the member school's assets or employ its staff. Where a school company does become insolvent, then the staff employed directly by the company are likely to be made redundant and the company's assets would be sold.

Value Added Tax (VAT)

40. Under section 49(5) of the School Standards and Framework Act 1998, schools are acting as agents of the LEA when they spend their delegated budgets. This enables the LEA to reclaim VAT incurred by schools. Customs and Excise have confirmed that companies formed to purchase goods and services for their members will be acting as agents of the LEA by operation of this same section, when spending the member schools' delegated budgets. Therefore the formation of a company to purchase on behalf of the schools will not lead to an increase in the amount of VAT payable. Because the company will be acting as agent of the LEA, the LEA will continue to be liable for unpaid debts arising out of the spending of that budget, as is the case for individual schools spending their budget. Service delivery companies will not be acting as the LEA's agent because they will be spending income from fees paid for provision of services rather than purely money from the school's delegated budgets. Where service delivery companies are delivering services, normal trading VAT rules apply. School companies providing services will include VAT in their fees. If maintained schools are the recipients of these services, they will be able to reclaim VAT as above. If a school company were to fail, the delegated budget of individual member schools would not be at risk, because the company has limited liability and the most which a member can be obliged to pay is the amount of their guarantee or the amount outstanding on their shares. For more information, schools should consult their LEA or HM Customs <http://www.hmce.gov.uk/>

Withdrawing from the company

41. If the delegated budget of a member school is suspended, the supervising authority would direct that the school become dormant within a company until the delegation is returned, or resign from the company if that were the more

GUIDANCE ON SCHOOL COMPANIES

appropriate course. If a budget were only suspended for a short period, leaving the company may not be necessary. The intention here is to cause as little disruption as possible, whilst freeing the school to concentrate on rectifying the problems leading to the suspension of its delegated powers.

42. Should a member wish to leave the company, it will be required to provide 12 weeks notice.

Takeovers

43. School companies will be private companies and so shares in them will not be readily available. A takeover could only happen if school company members holding the majority of the shares agreed to sell their shares to a third party. Any member selling all of their shares would then leave the company. The risk of private sector takeover is therefore remote. Schools need to be aware of this risk and ensure that restrictions are placed on the sale of company shares through shareholder agreement or that the constitution of the company provides for doing so only after unanimous decision. Schools will be free – with the necessary agreement – to sell their interest since a school may want to leave the company at a later stage and take any profits for the benefit of the school. On a more positive note, a number of school companies could group together to operate across a network of schools, perhaps in a federation. Alternatively, the company of which a particularly successful school is a member could, by mutual agreement, take over a company whose members are less successful schools, as part of a package of support to them.

Provision of services

44. School companies will be limited to providing education services or supplying goods and services to other schools including their own members. It is also possible that services could be supplied to schools on behalf of an LEA. The Contracting Out (Local Education Authority Functions) Order 2002 means that LEAs can choose to contract out a much broader range of services to another organisation, including school companies. Examples of the sort of services school companies might provide are attached at **Annex B**. This is not an exhaustive list. School companies will want to assure themselves of the nature of the undertaking they are contracting to provide by ascertaining key facts such as staffing, liabilities and intellectual property rights.

45. School staff would not automatically transfer to a company upon its formation. Staff may transfer to a company if they wished and terms and conditions were agreed. This may be suitable for a short secondment, for example. Schools joining the company are able to provide staff to the company. Schools may wish to negotiate with staff to change the duties of school employees partly to carry out duties for the company. Schools may wish to second staff to companies for a period of time. Alternatively, schools may

GUIDANCE ON SCHOOL COMPANIES

consider transferring the employment of staff fully over to the company if the member of staff agrees and appropriate protections for their terms and conditions of employment are in place. Bearing in mind that the school's governing body can be directed to ensure that its staff are no longer engaged on company business, the school should make clear in its terms of employment that where staff are working on company business their duties may be changed if the governing body is directed to reduce its involvement in the management of the company or is directed to resign from the company. A school company may take over activities from the school's governing body which result in staff employed by the governing body or LEA transferring to the company by operation of the Transfer of Undertakings (Protection of Employment) Regulations 1981 (SI 1981 No.1794). If this is likely to be the case, the governing body or the LEA and the school company should seek specialist legal advice to ensure that they comply with their duties under employment law. In the case of staff seconded to a school company, the need may arise to appoint replacement or temporary cover. Responsibility for this will fall to the governing body or the LEA, depending on who is the employer.

The role of the Secretary of State in school companies

46. The Secretary of State will have no role in running or in the day-to-day supervision of school companies covered by this guidance. The Secretary of State's only roles will be deciding on the supervising authority when local agreement cannot be reached or dealing with any complaint made to him in relation to a school company.

47. The Secretary of State will have no financial involvement in school companies except where he is involved in joint venture companies to deliver PFI and similar schemes under the powers in Section 13 of the Education Act 2002, not covered by this guidance.

Further queries

48. If you have any further questions on school companies please contact:

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GUIDANCE ON SCHOOL COMPANIES

Relevant documents

The Education Act 2002 (sections 11 and 12)
The School Companies Regulations 2002 (SI No. 2978)
The School Companies (Private Finance Initiative Companies)
Regulations 2002 (SI No. 3177)
The Purchasing Guide for Schools (DfES publication available on the
DfES <http://www.dfes.gov.uk/vfm/pg.shtml>)

Copies of this publication can be obtained from:

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