

Local Government Association

Advice on FECs, SFCCs and HECs

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1. **INTRODUCTION**

- 1.1 We have been instructed by the Local Government Association to provide a brief report on the status of further education corporations ("FECs"), sixth form college corporations ("SFCCs") and higher education corporations ("HECs") as designated 'Scheme employers' within the Local Government Pension Scheme for England and Wales ("LGPS"). This advice covers their legal status (including the public or private sector nature of the corporations), their funding and the situation on termination both legally and in reality with regard to their liabilities, including liabilities built up in the LGPS.
- 1.2 This report is private and confidential and subject to legal professional privilege. The content and our duty of care extends only to the Local Government Association.
- 1.3 The advice in this report represents our interpretation of current law and guidance in England and Wales which is subject to change from time to time. We have not undertaken to update our advice in future or to advise you of any changes in the law, but we would be happy to do so at any point if you would like us to.

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2. EXECUTIVE SUMMARY

- 2.1 As a stand alone 'Scheme employer' in the LGPS, an FEC, an SFCC and an HEC are responsible for the funding of the LGPS membership liabilities relating to their current and former employees.
- 2.2 The question of whether FECs, SFCCs and HECs are to be regarded as in the public or private sector is a complex one and the answer depends on the particular legal context. For example, such corporations are regarded as public authorities for the purpose of EU procurement rules¹, and as sufficiently public that their decisions are subject to challenge on judicial review.
- 2.3 However, there are examples where FECs and HECs have been excluded from pensions guidance for public sector organisations, for example they are specifically excluded from new Fair Deal.²
- 2.4 The Education Act 2011 ("the 2011 Act") from 1 April 2012 removed most of the governmental controls on FECs. The National Audit Office ("NAO") accepted in 2012 that in the light of the changes made by the 2011 Act, FECs and SFCCs should once again be classified for public accounting purposes as non profit institutions serving households.
- 2.5 Until the changes made by the 2011 Act came into force in 2012, FECs and SFCCs, as statutory corporations, could only be terminated by order of the Secretary of State. There was not, and still is not, any machinery similar to that for liquidating companies, whereby a third party can secure termination of a statutory corporation. However, the 2011 Act removed this power, and provided that only a college corporation could dissolve itself, although the Secretary of State retains the power to give a corporation directions in an intervention situation. The Secretary of State also retains the sole power to create new FECs and SFCCs.
- 2.6 Until 31 March 2012 it was possible for an outstanding liability of a dissolving FEC or SFCC to be transferred to the Skills Funding Agency ("SFA") or Young People's Learning Agency ("YPLA") under s.27(3) (FECs) or 33N (SFCCs) of the Further and Higher Education Act 1992 (the "1992 Act") and this power was used on one occasion when the continuing college (which became City of Wolverhampton College) refused to accept all the liabilities of the dissolving college (Bilston College). However, s.27(3) and 33N were repealed by the 2011 Act.
- 2.7 The Department for Business, Innovation and Skills ("BIS") has confirmed to us their view that it is no longer possible for the debts of a dissolving FEC to be transferred to the SFA. It seems clear that government would, save in wholly exceptional circumstances, have no intention of underwriting such liabilities and that in the case of financial failure of an FEC its provision will instead be the subject of an open and competitive auction process, with purchasers being expected also to take on particular liabilities. However, in the case of K College (South and West College) such an auction in 2014 failed to secure a purchaser. We believe that ultimately two purchasers for different parts of the College were only secured on the basis that they would receive additional support from the SFA.
- 2.8 Unlike FECs and SFCCs an HEC cannot dissolve itself, an HEC can only be terminated by order of the Secretary of State under s.128 of the Education Reform Act (the "1988 Act"). As with FECs and SFCCs, however, there is no machinery similar to winding up a company whereby a third party can secure termination of an HEC.
- 2.9 Unlike with FECs and SFCCs, the 1988 Act's provisions (s.128(1)) still allow a dissolving HEC's assets and liabilities to be transferred to a funding council. Whether this power

¹ Although David Willetts, then Minister for Universities, suggested that the fact that universities now received more than 50% of their income from tuition fees paid by students (via a loan from the Student Loan Company) now meant they were outside the procurement regulations. See 4.1.4 below. We consider that this issue cannot be answered without consideration of the position of the particular university.

² FECs and HECs are not specifically mentioned in the new Fair Deal guidance. HM Treasury's intention to explicitly exclude these bodies is set out in a letter dated 17 March 2014 to Frances O'Grady at Trades Union Congress.

would be used, however, must be doubtful. In the most recent case where an HEC got into serious financial difficulty (Leeds College of Music) it was not suggested that this power would be used, and LCM was ultimately transferred to Leeds City College.

3. **FURTHER EDUCATION CORPORATIONS**

3.1 **Status of FECS and SFCCs**

- 3.1.1 Prior to 1993 most further education and sixth form colleges were simply part of the local education authority which maintained them and had no separate legal existence. Such colleges were established in 1993 as corporate bodies independent of their local authority by order (SI 1992 No. 2097) made under sections 15 and 16 of the 1992 Act. Further orders have been made subsequently in the light of college mergers. Most sixth form colleges have obtained designation as SFCCs under amendments to the 1992 Act made by the Apprenticeships, Skills, Children and Learning Act 2009 ("the 2009 Act").
- 3.1.2 The Office of National Statistics ("ONS") from 1992 to 2010 classified further education and sixth form colleges as "Non profit institutions serving households", i.e. not as part of government.
- 3.1.3 The question of whether further education and sixth form college corporations are to be regarded as in the public or private sector is a complex one and the answer depends on the particular legal context. For example, such corporations are regarded as public authorities for the purpose of EU procurement rules³, and as sufficiently public that their decisions are subject to challenge on judicial review. However, there are examples where FECs have been excluded from guidance for public sector organisations, for example FECs were specifically excluded from the Code of Practice on Workforce Matters in Public Sector Service Contracts issued in 2005 (now revoked).

3.2 **Impact of the Reclassification of FECs in 2010 and 2012**

- 3.2.1 In October 2010 the ONS reclassified FECs as being part of central government and SFCCs as part of local government for public accounting purposes. The reclassification was prompted by the 2009 Act. ONS took account of the various powers over FECs held by the Secretary of State and (at that time⁴) the Chief Executive of Skills Funding, and powers over SFCCs held by local authorities. These included the need for corporations to secure approval to borrowing or major disposals of assets, and the power to appoint members to corporations and to specify the detailed contents of corporations governing documents. As a result of the reclassification the NAO qualified the accounts of the SFA as it considered the SFA had insufficient control of FECs' financial affairs.
- 3.2.2 The reclassification of FECs and SFCCs as part of government would have required government to have taken over the detailed oversight of colleges in a way that was unacceptable both to the further education sector and to government. Accordingly the Education Act 2011 ("the 2011 Act") contained amendments to the 1992 Act which from 1 April 2012 removed most of the governmental controls that had led to the ONS decision. The only major control remaining is the long stop power of the Secretary of State to intervene in the affairs of a failing college by directing the corporation concerned to resolve to dissolve itself.
- 3.2.3 The NAO accepted in 2012 that in the light of the changes made by the 2011 Act, FECs and SFCCs should once again be classified for public accounting purposes as non profit institutions serving households.

³ See note 1.

⁴ The statutory role of the Chief Executive of Skills Funding was abolished and his powers transferred to the Secretary of State from 26 May 2015 by the Deregulation Act 2015.

3.3 **Status of FECs and SFCCs Within the LGPS**

- 3.3.1 FECs and SFCCs are listed as a part 1 'Scheme employer' in paragraph 14 of Part 1 of Schedule 2 to the Local Government Pension Scheme Regulations 2013 ("the Regulations"). This means that a FEC and SFCC automatically participates in the LGPS in respect of its employees who do not qualify for another occupational pension scheme.
- 3.3.2 The terms "further education corporation" and "sixth form college corporation" are defined by reference to section 90 of the 1992 Act as being (respectively) a "further education corporation established to conduct an institution" and "a body corporate designated as a sixth form college corporation under section 33A or 33B or established under section 33C".
- 3.3.3 Teachers at a FEC and SFCC are generally automatically eligible for the Teachers' Pension Scheme whereas non-teaching staff are generally automatically eligible to membership of the LGPS.⁵
- 3.3.4 As a stand alone 'Scheme employer' in the LGPS, an FEC and SFCC are responsible for the funding of the LGPS membership liabilities relating to their current and former employees.

3.4 **Funding of Further Education and Sixth Form College Corporations**

- 3.4.1 FECs and SFCCs receive much of their funding from public sources, of which the largest sources are the SFA (in respect of provision for those aged over 19) and the Education Funding Agency ("EFA") in respect of those aged 19 and under). Some colleges also receive funding from the Department for Work and Pensions and EU sources such as the European Social Fund.
- 3.4.2 Colleges, especially FECs, also receive funding from other sources such as fees paid by adult students and employers, and payments for commercial services. As FECs and SFCCs are charities, albeit exempt from registration with the Charity Commission, trading activities are often channelled through non-charitable subsidiary companies. Such non-public sources of income are increasing as public funding is falling in real terms, and in some larger FECs may actually exceed the public funding received. This potentially puts the corporation concerned in a similar position to that of HECs discussed below.

3.5 **Termination of Further Education Corporations**

- 3.5.1 Until the changes made by the 2011 Act came into force in 2012, FECs and SFCCs, as statutory corporations, could only be terminated by order of the Secretary of State. There was not, and still is not, any machinery similar to that for liquidating companies, whereby a third party can secure termination of a statutory corporation. However, the 2011 Act removed this power, and provided that only a college corporation could dissolve itself, although the Secretary of State retains the power to give a corporation directions in an intervention situation. The power extends to directing a corporation to pass a resolution to dissolve itself. Leaving such extreme situations aside, a corporation can voluntarily resolve to dissolve itself, e.g. in order to merge with another college. Dissolution must be undertaken in accordance with procedures set out in statutory instruments and BIS has also set out its policy expectations as to the additional procedures to be followed.
- 3.5.2 Where a college corporation dissolves itself it is under a duty to ensure that its assets and liabilities are transferred to the bodies authorised under regulations to receive them and that the assets are used so far as possible in accordance with the college's charitable objects. The Charity Commission would be the regulatory body with the power to ensure that these duties are carried out.

⁵ Regulation 3(1)(a) of the Local Government Pension Scheme Regulations 2013

- 3.5.3 Until 31 March 2012 it was possible for an outstanding liability of a dissolving FEC or SFCC to be transferred to the SFA or YPLA under s.27(3) (FECs) or 33N (SFCCs) of the 1992 Act and this power was used on one occasion when the continuing college (which became City of Wolverhampton College) refused to accept all the liabilities of the dissolving college (Bilston College). However, s.27(3) and 33N were repealed by the 2011 Act. BIS has confirmed to us their view that it is no longer possible for the debts of a dissolving FEC to be transferred to the SFA. It seems clear that, save in wholly exceptional circumstances, government would have no intention of underwriting such liabilities and that in the case of financial failure of an FEC its provision will instead be the subject of an open and competitive auction process, with purchasers being expected also to take on particular liabilities. This was the process initially used to resolve the position at K College. However, such an auction in 2014 failed to secure a purchaser. We believe that ultimately two purchasers for different parts of the College were only secured on the basis that they would receive additional support from the SFA.
- 3.5.4 While the legal position in respect of SFCCs is the same, it appears that the Department for Education seems to be readier to take the previous approach of finding a take-over partner institution willing to take on all the assets and liabilities of a failed SFCC. To date it has always proved possible to resolve the (rarer) crises in SFCCs in this way, although we consider that given the worsening financial position of some SFCCs this position may change in the foreseeable future. Meanwhile it has been reported in the education press that the Treasury has authorised a payment to Hampshire County Council in respect of the share of its LGPS deficit attributable to Totton College. This is to facilitate the takeover of the College by NACRO, a charity which has previously focused on assisting ex-offenders. The EFA had indicated that following the failure of the proposed merger of the College with another publicly funded college the only alternative to merger with NACRO was closure of the College.
- 3.5.5 From a LGPS perspective, where in the opinion of the relevant fund's administering authority there are circumstances which make it likely that an FEC or SFCC is to cease to be such at some point in the future, the administering authority may obtain from the fund's actuary a certificate specifying the percentage or amount by which, in the actuary's opinion the corporation contribution at the common rate should be adjusted or any prior individual adjustment should be increased or reduced⁶. This effectively allows the administering authority to crystallise the FEC's or SFCC's deficit in the fund as a statutory debt. A similar power also exists after the cessation event has happened. In the absence of any security that may have been put in place, having served the certificate, the administering authority would be an unsecured creditor of the FEC or the SFCC (as applicable).

3.6 Further Education Corporations in Wales

- 3.6.1 The position in Wales is essentially the same as that in England after the passing of the 1992 Act. There are no designated SFCCs in Wales. The 2011 Act changes did not extend to Wales. However, the Welsh Assembly has passed the Further and Higher Education (Governance and Information) (Wales) Act 2014 which has made similar changes in relation to college governance from September 2014.

⁶ Regulation 64(4) of the Local Government Pension Scheme Regulations 2013

4. HIGHER EDUCATION CORPORATIONS

4.1 Status of HECs

- 4.1.1 Prior to 1988 most higher education institutions other than universities (e.g. polytechnics and colleges of higher education) were simply part of the local education authority which maintained them and had no separate legal existence. Such institutions were established in 1988 as corporate bodies independent of their local authority by order under sections 121 or 122 of the Education Reform Act 1988 ("the 1988 Act"). A number of further orders have been made subsequently, for example as the result of institutional mergers.
- 4.1.2 A few local authority maintained institutions, particularly in Inner London, were established before 1988 as companies limited by guarantee and thus legally independent of their maintaining local authority. Such institutions retained that legal form after 1988 although from that date receiving their funding from the relevant funding body.
- 4.1.3 The question of whether higher education corporations are to be regarded as in the public or private sector is a complex one and the answer depends on the particular legal context. For many purposes, such as susceptibility of decisions to challenge by judicial review, application of the duty to promote equality under the Equality Act 2010 and the application of the Freedom of Information Act, they are public bodies. On the other hand, there are examples where HECs have been excluded from guidance for public sector organisations, for example HECs are specifically excluded from new Fair Deal.⁷
- 4.1.4 However, classification may change over time, in particular as institutions' sources of funds change. For example, HECs have until recently been regarded as public authorities for the purpose of EU procurement rules, but the Minister for Universities in 2012 stated that he considered that since universities now received the bulk of their teaching funding from students in the form of fees (most of which funding is regarded as not forming public spending under government accounting rules) they were not now subject to the procurement rules⁸.
- 4.1.5 The ONS has not classified HECs as part of government. The European Commission summarises the test as whether an organisation is "mainly financed and controlled" by government. The 1992 Act established the central funding bodies (the Higher Education Funding Council for England ("HEFCE") in England and the Higher Education Funding Council for Wales ("HEFCW") in Wales) at arms length from government and the 1992 Act prevents the Secretary of State from controlling the level of funding of a particular institution. The Secretary of State has never had the powers to intervene in HECs as he has had with FECs and SFCCs. However, HECs have financial memoranda with HEFCE/HEFCW under which the funder could withhold funding if the institution was in breach of its conditions of funding, for example if its provision was to be found to be of inadequate quality by the Quality Assurance Agency for Higher Education.

4.2 Status of Higher Education Corporations Within the LGPS

- 4.2.1 HECs are listed as part 1 'Scheme employers' in paragraph 14 of Part 1 of Schedule 2 to the Regulations. This means that a HEC automatically participates in the LGPS in respect of its employees who do not qualify for another occupational pension scheme.
- 4.2.2 The terms "higher education corporation" is defined by reference to section 90 of the 1992 Act as being:

⁷ See note 2.

⁸ See note 1.

"a body corporate established under [section 121](#) or [122](#) of the [Education Reform Act 1988](#), including those sections as applied by [section 227\(4\)](#) of that Act (application to Wales), or a body corporate which has become a higher education corporation by virtue of [section 122A](#) of that Act,"

4.2.3 Teachers at an HEC are generally automatically eligible for the Teachers' Pension Scheme whereas non-teaching staff are generally automatically eligible to membership of the LGPS.⁹

4.2.4 As a stand alone 'Scheme employer' in the LGPS, a HEC is responsible for the funding of the LGPS membership liabilities relating to its current and former employees.

4.3 **Funding of Higher Education Corporations**

4.3.1 Until September 2012 the bulk of HECs' funding for teaching, and also for basic research, came from public sources via the HECFE. However, as noted above such funding is now restricted to a limited number of strategically important subjects, with most funding for teaching coming to HECs from students in the form of tuition fees. However, HECs supplement this funding with funds from fees paid by employers for staff training, commissioned research, conference income and donations from alumni and others. Accordingly HECs are likely to receive less than 50% of their funding from public sources (as defined by government accounting rules.)

4.4 **Termination of Higher Education Corporations**

4.4.1 Unlike FECs and SFCCs an HEC cannot dissolve itself, an HEC can only be terminated by order of the Secretary of State under s.128 of the 1988 Act. As with FECs and SFCCs, however, there is no machinery similar to winding up a company whereby a third party can secure termination of an HEC. Unlike with FECs and SFCCs the 1988 Act's provisions (s.128(1)) still allow a dissolving HEC's assets and liabilities to be transferred to a funding council. Whether this power would be used, however, must be doubtful. In the most recent case where an HEC got into serious financial difficulty (Leeds College of Music) it was not suggested that this power would be used, and LCM was ultimately transferred to Leeds City College.

4.4.2 The provisions relating to FECs highlighted in paragraph 3.5.5 above equally apply to HECs. In the absence of any security that may have been put in place, having served such a certificate, the administering authority would be an unsecured creditor of the HEC.

4.5 **Higher Education Corporations in Wales**

4.5.1 The legal position of HECs in Wales is essentially the same as that in England save that the power of dissolution has been transferred to the Welsh Ministers under the Government of Wales Act 2006. In 2014 the Welsh Government (WG) introduced into the National Assembly a Higher Education (Wales) Bill intended to give HEFCW powers to regulate those higher education providers which did not receive HEFCW funding and to give HEFCW additional powers to ensure quality of provision and that equal access to higher education was prioritised. Following representations by Welsh universities, amendments were made to the Bill to ensure that these provisions did not adversely affect academic freedom and freedom of speech. The Bill was passed and became law in March 2015.

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⁹ Regulation 3(1)(a) of the Local Government Pension Scheme Regulations 2013