



Shetland Islands Council

and

Shetland Fisheries Training Centre Trust

1. **Scope of the report**

- 1.1. This report has been prepared on behalf of Shetland Islands Council and Shetland Fisheries Training Centre Trust for the purpose set out in the brief and for no other purpose or person. It cannot be relied on for any other purpose or by any other person and if it is so used, it is used at that person's own risk.
- 1.2. This report is based on the information provided to us. We have not sought to establish the reliability of the information and therefore we cannot be held liable in the event that any information is untrue, inaccurate or incomplete.
- 1.3. It is also based on our understanding of the importance of certain matters as explained to us.
- 1.4. We appreciate the hard work which goes into pulling together all of the information for a diligence exercise particularly when this is in addition to keeping the service operating. We would like to take this opportunity to thank the Project Manager and all of the staff in respect of the work they did to make the process as easy as possible for us. We could not have completed this report without that assistance.

2. **Introduction and overview**

- 2.1. A review has been ongoing in Shetland for some time in relation to tertiary education, research and training provision. The Shetland Tertiary Education, Research and Training (STERT) Project initially established a STERT Partnership Board to consider how best to deliver the services and functions carried out by
 - 2.1.1. Shetland Islands Council (SIC) through
 - 2.1.1.1. Train Shetland; and
 - 2.1.1.2. Shetland College (UHI) (Shetland College)
 - 2.1.2. Shetland Fisheries Training Centre Trust (SFTCT) using the operating name NAFC Marine Centre (UHI) (NAFC Marine Centre).
- 2.2. Shetland College and NAFC Marine Centre are members/academic partners within the University of the Highlands and Islands (UHI).
- 2.3. As part of the STERT Project, initial due diligence was carried out in relation to NAFC Marine Centre, Shetland College and Train Shetland. Following the due diligence exercise, SIC and SFTCT agreed to work together and appointed a joint Principal in respect of both colleges and Train Shetland was integrated into the reporting structure of Shetland College.
- 2.4. During this period of closer working, a Strategic Outline Case was developed in respect of the future of the tertiary education, research and training provision, which identified merger as the preferred way forward. The Strategic Outline Case also narrowed down the potential merger options to: either a host or phoenix model. SIC and SFTCT agreed to proceed to a Full Business Case for merger of Shetland College, NAFC Marine Centre and Train Shetland, prior to a final decision

being made towards the end 2018. As part of the decision making process, it was also agreed in view of the passage of time, to revisit the legal due diligence exercise carried out previously.

- 2.5. As a result we have undertaken a legal due diligence exercise. We have been provided with a number of documents for each organisation. These have been reviewed in the context of the potential merger options and also the practical and legal issues in delivering each of the options.
- 2.6. We have provided detailed due diligence reports for both SIC and SFTCT. However as the detailed reports include information which is commercially sensitive and which would include personal data, we have provided this summary report to enable circulation.

3. Models and Legal Process for the relevant Model

3.1. The two key merger models of Host or Phoenix have a number of issues which are associated with them:

Host Model	Council Host	As the Council is not a charity, SFTCT could not transfer any assets to the Council at nil and the Council would require to pay full market value if they were to be the Host.
	SFTCT Host	<p>NAFC Marine Centre has objects relating to the advancement of education and training, the courses offered by SC and TS have a far more diverse educational remit than those provided by NAFC Marine Centre whose services are relevant to the maritime industry only. If NAFC Marine Centre is used as the host model, it would be necessary for the objects and remit of SFTCT to be considerably widened to make provision for this.</p> <p>The new college would require either (i) to be a fundable body or (ii) assigned to the Regional Strategic Body (RSB) in order to avoid any issues with continued funding. As a result the Scottish Ministers would require to consult with the Scottish Funding Council (SFC) under section 7 of the Further and Higher Education (Scotland) Act 2005 (the “2005 Act”) (Fundable Body) and Section 7C of the 2005 Act (Assigned College). The SFC will review whether there are suitable provisions for (amongst others) the governance and management of the body which would include the application of the Code of Good Governance. There is an expectation that there should be student representatives and staff members on the board. As a result of this and the widened remit which would come about as a result of any merger we would strongly recommend that SFTCT considered updating its legal form to become a body with limited liability protection given the wide remit it would have, such as a charitable company limited by guarantee or a Scottish Charitable Incorporated Organisation or SCIO.</p>
Phoenix	Incorporated College	The Scottish Ministers could promote an order under section 13(1) of the Further and Higher Education (Scotland) Act 1992 (the “1992 Act”) in respect of Shetland College which states that on the appointed date Shetland College would cease to be under the management of Shetland Islands Council (SIC). The order promoting the

		<p>transfer of Shetland College would also establish, with effect from such date as the Secretary of state would prescribe a “Board of Management of” the new college and also apply such other provisions (subject to modifications) as are appropriate in respect of the transfer to the new college. This new college would be an incorporated college.</p> <p>An incorporated college would be considered as being a general government public sector body by the Office for National Statistics (ONS). The reason for this classification is the control held by Scottish Ministers over the corporate policy within the Colleges. In particular the fact that (i) an incorporated college would need consent from Scottish Ministers in order to borrow and (ii) the Scottish Ministers can remove the board, close of merge colleges has resulted in that classification. The impact of this classification means that incorporated colleges have had to align their budgeting, reporting and accounting practices to the practices which apply to non-departmental government departments. This includes that colleges have to control their expenditure so it does not exceed pre-set limits, even if expenditure is financed from borrowing it would still require “budget cover” which would mean that it would still be included within the Scottish Government budget and colleges cannot carry forward surplus funds to future years. This has a fundamental impact on the operation of a college.</p>
	<p>Unincorporated College</p>	<p>An unincorporated college can take a number of different forms including a company limited by guarantee or Scottish Charitable Incorporated Organisation (SCIO). Whilst the Further and Higher Education (Scotland) Act 1992 and the 2005 Act do not apply to the establishment of the board, the structure and governance of the new organisation should reflect the good governance guidelines to ensure that there are no problems with obtaining consent from the SFC to the assignation of the new college to UHI as regional strategic body. The new body would apply to OSCR as registration as a charity.</p>

- 3.2. When carrying out the due diligence exercise we have considered the risks based on the preferred models.
- 3.3. In order to adopt each of the models there is a very different process. In many previous college mergers, the route used was for the Scottish Ministers to promote the necessary orders using the powers under 3(1)(c), 25(1), (1A), (2) and (5) and 60(3) of the 1992 Act to transfer the staff, assets, rights and liabilities to the host and dissolved the other College(s) (Transfer order). However, it should be noted that sections 3(1)(c) and 25(1) apply to incorporated colleges and would not apply to SFTCT. As a result, no matter which model is adopted, the process will be novel for the SFC and also the Scottish Government and therefore we would recommend that there is early engagement with the SFC and Scottish Government in respect of the proposed merger model and also the merger proposal itself sets out the suggested process.

4. **Key Issues – Governance Issues, Legal Constitution, Powers of Governing Bodies, Partnership Board and Charity Issues**

From the information we have been provided, we have not identified any key issues in respect of Governance Issues, Legal Constitution, Powers of Governing Bodies, Partnership Board and Charity Issues which would legally prevent merger. However, we have identified a number of issues which would have (i) a potential impact on the structure or (ii) would require to be actioned to successfully merge.

- 4.1. As set out in relation to the merger models above, it is not recommended that a Scottish charity such as SFTCT transfers all/ part of its assets to a non-charitable entity for no financial consideration (or even for a nominal consideration) whether it takes place under a merger or under some other form of business transfer agreement. This is due in part to the nature of the duties and responsibilities that the trustees of SFTCT have under charity law. This includes a duty to safeguard and maximise the assets of SFTCT and to retain the independence of SFTCT. Therefore the only way for an SIC host model to work would be the sale of NAFC Marine Centre (UHI) to SIC at full market value. For these reasons, this makes it difficult from a Charity law perspective for SIC to be the host.
- 4.2. In respect of SFTCT being the host, whilst it has objects relating to the advancement of education and training, the courses offered by Shetland College have a far more diverse educational remit than those provided by NAFC Marine Centre whose services are predominantly relevant to the maritime industry. If SFTCT is used as the host, it would be necessary for the objects and remit of SFTCT to be considerably widened to make provision for this widened remit. SFTCT may also wish to consider amending their name to reflect their new role. Any amendment to the objects or name would require the prior approval of the Office of the Scottish Charity Regulator (OSCR). The trustees of SFTCT would also need to be satisfied that on balance having considered the business case in full and after taking all relevant advice, they consider that it is in the best interests of SFTCT to take on these wider activities which would necessitate SFTCT moving into some new areas, albeit that they are still connected to their current educational remit.
- 4.3. Whilst UHI could potentially seek to fund elements of an unassigned college, the basis of such funding is narrower and therefore in order to continue to be funded through UHI as the RSB in respect of all of its activities, the merged entity would require either (i) to be a fundable body or (ii) assigned to UHI as the RSB. As a result the Scottish Ministers would

require to consult with the Scottish Funding Council (SFC) under section 7 of the Further and Higher Education (Scotland) Act 2005 (the “2005 Act”) (Fundable Body) and Section 7C of the 2005 Act (Assigned College). The SFC will review whether there are suitable provisions for (amongst others) the governance and management of the body which would include the application of the Code of Good Governance. There is an expectation that there should be student representatives and staff members on the board. Therefore the constitution of SFTCT would require to be amended to ensure that the constitution was considered by SFC as complying with the application of the Code of Good Governance.

- 4.4. The SFTCT as a trust governed by a trust deed does not have the same separation as a legal “entity” in the way that a SCIO or company limited by guarantee is. For example, leases/formal contracts have to be entered into in names of trustees. Legal proceedings cannot be taken by the trust but only by individuals representing it and similarly, legal proceedings would be taken against the trustees rather than the organisation. Trustees could be personally liable for debts if the organisation were unable to meet its debts and liabilities out of its own resources. Whilst protections may be in place, we consider that this structure would be unattractive to staff and students to participate in. As a result of this and the widened remit which would come about as a result of any merger we would strongly recommend that SFTCT updates its legal form to become a body with limited liability protection given the wide remit it would have, such as a charitable company limited by guarantee or a Scottish Charitable Incorporated Organisation or SCIO.
- 4.5. In the event that SFTCT was to update its legal form, in effect it would change its legal status and would for the purpose of the process of merger become a phoenix.
- 4.6. If however SFTCT wished to continue with narrowed objects adopting the phoenix model from the outset may facilitate this option. In these circumstances the new phoenix college should be set up and an application would be made to OSCR at least three months in advance of intended vesting date of the new college to ensure that the phoenix has charitable status to facilitate the transfer from NAFC Marine. This approach would also allow for the organisation to be set up and the board/shadow board to be put in place. The process of setting up an unincorporated college would necessitate making an application to OSCR seeking their consent to enter the phoenix college onto the Scottish charity register and become a recognised charity with a Scottish charity number.
- 4.7. Consideration would need to be given to the information to be provided to OSCR as part of the application to set up the charity to justify both the business case and in order to meet both the charity test and public benefit test of setting up another college within the small geographic area of Shetland. OSCR would need to be satisfied that this would be of considerable public benefit.

5. **Key Issues - Material Contracts**

From the information we have been provided, we have not identified any material issues in respect of Material Contracts which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to successfully merge.

- 5.1. Any contracts that are in place between SIC and SFTCT and third parties in respect of the delivery of aspects which extend beyond the vesting date (i.e. the date when the new College will come into existence) would require to be transferred to the Host (except for the host’s own contracts) or alternatively to the phoenix or be terminated.

- 5.2. Having reviewed the contracts, in the event that these contracts are to be assigned, the consent of the other party is required.
- 5.3. This leads to the potential risk that:
 - 5.3.1. a third party could refuse to transfer; and/or
 - 5.3.2. the third party could seek to use the requirement for consent to seek to revise the commercial terms.
- 5.4. As set out above, generally in College Mergers, the Scottish Ministers would promote an order using the powers under 3(1)(c), 25(1), (1A), (2) and (5) and 60(3) of the 1992 Act to transfer the staff, assets, rights and liabilities to the host and dissolved the other College(s) (Transfer order). The effect of the Transfer Order is to change the contracts so that the new college would be treated as if they had always been a party to the contract in lieu of the old college. As a result, the contracts could be transferred without first obtaining consent.
- 5.5. However, it should be noted that sections 3(1)(c) and 25(1) apply to incorporated colleges and whilst there are provisions within the 1992 Act and the 2005 Act which would allow a Transfer Order to be promoted in respect of SIC, this would not apply to SFTCT. Therefore the contracts will require to transfer by way of agreement. As a result, consent will be required. Therefore where contracts are continuing you should seek to obtain consent in good time prior to vesting date.
- 5.6. We would also recommend in order to mitigate risk that any new contracts which are entered into between now and full merger the following should be considered:
 - 5.6.1. that when SIC procures goods/services, there may be the potential of procuring/setting up frameworks which the college could also use as this would ease the burden on the new college and still allow economies of scale.
 - 5.6.2. include provisions which enable the contracts to be assigned to any successor bodies to whom the functions of the relevant body are vested/transferred.
 - 5.6.3. allow a no fault break clause in favour of SIC (if possible although we appreciate that these can be difficult to negotiate) which would allow the contracts to be terminated at your behest on merger.
 - 5.6.4. check the change of control provisions (if any) to ensure that these would not permit/restrict a change of control envisaged by a merger situation; and
 - 5.6.5. the parties agree to set parameters that they would consult with each other before entering into a contract for a specified period or above a particular amount to enable the parties to enable any potential future requirements of a combined college to be discussed and fed into the requirements.

6. Key Issues – Property

From the information we have been provided, we have not identified any material issues in respect of Property which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to successfully merge.

- 6.1. The position in respect of the properties is complex. Any properties which are owned or leased by Colleges would require to be transferred to the host or alternatively to the phoenix.
- 6.2. Shetland College/Train Shetland currently operate out of separate premises. In Shetland College, Phases 1 and 2 are currently subject to leases from Shetland Leasing and Properties (SLAP) with Phase 3 (being the link building) we are advised being in the ownership of the Council. The Train Shetland Building is also subject to a lease from SLAP. In the event that the leases are still in place at the vesting date, consent of SLAP would be required to transfer the leases. The overall property costs across the three institutions are high and high property costs could have an impact on the financial sustainability of the college.
- 6.3. The position in relation to the property occupied by SFTCT is very complicated. However this complication is not brought about by the merger but relates to pre-existing issues.
- 6.4. From the information provided we understand that the SFTCT currently occupies North Atlantic Fisheries College, Port Arthur. We understand that the main building and hatchery at North Atlantic Fisheries College are (i) sub-leased to Shetland Islands Council ("SIC") and (ii) owned by SIC although we have not seen their heritable title to verify this. SFTCT are occupying this site in accordance with a Management Agreement (unsigned version).
- 6.5. The Crown Estate Scotland (Interim Management) (CES) own the sea bed which is leased for a period of 25 years to SFTCT under a lease dated 4 December 2015 and 12 January 2016. CES would require to provide consent to any assignment. Early dialogue with CES would be recommended.
- 6.6. We understand that the properties currently leased/transferred to SLAP have now been transferred back to the Council. On that basis, for the properties which are occupied by Shetland College/Train Shetland and NAFC Marine where SLAP was the landlord, SIC would now be in the position to grant a lease to the new college on new terms if SIC considered that appropriate.

7. Key Issues - Intellectual Property Issues

From the information we have been provided, we have not identified any material issues in respect of Intellectual Property Issues which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to assist with the successful merger.

- 7.1. We note that we have received limited responses to our due diligence questionnaire and we have identified areas that may require further investigation. We have provided some suggestions regarding intellectual property issues which you may wish to consider once the new college entity has been created.
- 7.2. We would recommend that a review should be undertaken of the parties intellectual property issues to determine how the parties would like to deal with their respective intellectual property matters after the merger has taken place and to ensure the necessary steps are taken to facilitate this.
- 7.3. Following the merger, we would recommend that trade mark protection be sought to protect the new entity's brand and reputation.

- 7.4. The parties should decide what to do with all old branding and branded goods and if they will continue to be used. The strategy going forward will depend on the model chosen and the branding chosen, following which the appropriate assignments should be put in place to assign the relevant assets to the new entity that is created.
- 7.5. There do not appear to be any website terms and conditions on a number of the websites and we would recommend putting these in place.
- 7.6. To ensure ownership of copyright in works created for NAFC or SIC by contractors, employees, students and third parties, NAFC should ensure that the related contractual agreement clearly sets out the arrangements in terms of ownership.
- 7.7. In moving forward to the new college, the new college should set up clear contractual agreements/policies to ensure that works created for the new college by contractors, employees, students and third parties are owned by the new college as follows:
 - 7.7.1. Third parties: contractual arrangements should provide for the assignment of copyright in any works created by third parties failing which a perpetual transferable licence to be granted.
 - 7.7.2. Employees: although copyright in works created by employees in the course of employment automatically vests in the employer, this should be set out expressly in contracts of employment.
 - 7.7.3. Students: ownership of IP created by students should be addressed in an appropriate policy document or in the student contract.
 - 7.7.4. Contractors: SIC should ensure that its contractual arrangements with contractors provide for the assignment to it of copyright in any works created for it.
- 7.8. Finally, we would recommend that SIC and SFTCT compile and maintain an inventory of IP assets including unregistered IP. This will assist in drafting any transfer agreement moving forward.

8. Key Issues - Borrowing and Funding Issues

From the information we have been provided, we have not identified any material issues in respect of Borrowing and Funding Issues which would legally prevent merger. However, we have identified a number of issues which would require to be actioned to assist with the successful merger.

- 8.1. At this stage in the exercise there are a number of material issues which require further consideration.
- 8.2. In terms of banking facilities Train Shetland and Shetland College do not have any separate banking facilities – it is the Council's facilities which are used. It is likely that the banking facilities for any new organisation moving forward would require to be reviewed.
- 8.3. One of the key issues is that the college is financially sustainable. It is therefore essential that the new college is able to be funded by the SFC through the RSB. This will be most likely achieved by the new college becoming an assigned college. See comments above in relation to governance. We would recommend that you seek to continue to engage with the SFC and UHI as their support will be required to ensure that any new body will be assigned.

9. Key Issues – Employment and Pensions

From the information we have been provided, we have not identified any material issues in respect of Employment and Pensions Issues which would legally prevent merger. However, you should continue to work to manage any potential pensions liability.

- 9.1. As is inevitable with such mergers, there is some disparity in the pay and benefits across the organisations that could create some difficulties post-merger.
- 9.2. Whichever model is taken forward, the TUPE Regulations will apply.
- 9.3. Experience tells us that one of the most significant factors for the successful project management of a merger such as this, is a well thought out and considered communication strategy. The more open and transparent the process is, the easier it is for staff and therefore the more positive and supportive staff and the trade unions are likely to be.
- 9.4. The LGPS is a funded multi-employer occupational pension scheme and is understood to be currently in deficit.
- 9.5. There is the potential that employees transferring to the new college would trigger a cessation valuation which may lead to a cessation payment of its share of the scheme deficit. In these circumstances the trigger is the date on which an employer ceases to employ a member of the LGPS. Depending on the model, this would potentially affect one or both of the Colleges. We recommend that there is ongoing dialogue with LGPS in order to identify and/or mitigate any payments due.

10. Key Issues - Litigation and Disputes

From the information we have been provided, we have not identified any material issues in respect of Litigation and Disputes Issues which would legally prevent merger.

- 10.1. We have not identified any material legal obstacles in the context of our review of the information made available to in respect of Litigation and Disputes.
- 10.2. There is one matter in respect of SIC and one in respect of SFTCT which we would hope would be resolved before the vesting date and therefore would be unlikely to be a liability moving forward.

11. Key Issues - Compliance

From the information we have been provided, we have not identified any material issues in respect of Compliance Issues which would legally prevent merger.

- 11.1. We have not identified any material legal obstacles in the context of our review of the information made available to in respect of Compliance.
- 11.2. However there are a number of steps in respect of licences which would require to be taken to ensure that the relevant licences transferred.

12. Conclusion

We have not identified any material issues which would legally prevent merger. There are however a number of actions to be taken to manage the risks between a decision being taken to merge until the vesting date.