

Report to	-	Cabinet
Date	-	14 May 2018
Report of the	-	Executive Director
Subject	-	Wholly owned local authority companies

Recommendation to COUNCIL: That

1. the setting up of a holding company be approved; and the setting up of a wholly owned local authority trading company limited by shares be retrospectively approved;
 2. an overdraft facility of up to £250,000 be made available to the above companies to enable the mobilisation of the operation to be undertaken, to be charged at a commercial loan interest rate;
 3. a budget of £75,000 be approved for the necessary specialist legal and financial advice required to be funded from the Medium Term Financial Strategy Reserve;
 4. the Executive Director be granted delegated authority, in consultation with the Leader, Portfolio Holder for Finance, Monitoring Officer and the Section 151 Officer, the power to:
 - a. Establish a holding company.
 - b. Agree the name for the company.
 - c. Draft, in line with this report, and approve Articles of Association as required.
 - d. Name the directors of the company.
 - e. Make governance arrangements for the companies including agreement to the scheme of delegation.
 - f. Decide on the relationship between the Council and the Companies.
 5. a Shareholder Board be established made up of five Councillors; and
 6. the Monitoring Officer be authorised to make the necessary amendments to the Council's Constitution to establish the Shareholder Board.
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Lead Cabinet Member: Councillor Lord Ampthill

Introduction

1. Elsewhere on this agenda, Members will consider the revised Property Investment Strategy (PIS) which reflects recent changes in legislation and the Council's regeneration ambitions. To support this strategy it is also necessary to consider the best structure to deliver this and other Council income earning investments in the most efficient way.

2. Previously it has been discussed that to support the Council's income generating ambitions that wholly owned subsidiary companies may need to be established due to current legislation governing such activity (CB17/45 refers). This in particular would be needed should the Council wish to invest in the surrounding area itself or in partnership with other local Councils.
3. This report proposes a possible structure to include a holding company and subsidiary companies to support activities that the Council is about to embark on. Before establishing such a structure, additional legal and financial advice will be required. However in order for the Council to move quickly the report requests that the Council authorises the Executive Director in consultation with the Leader of the Council, Portfolio Holder for Finance, Monitoring Officer and Section 151 Officer to approve the details of the companies.

Advantages and Disadvantages of setting up companies

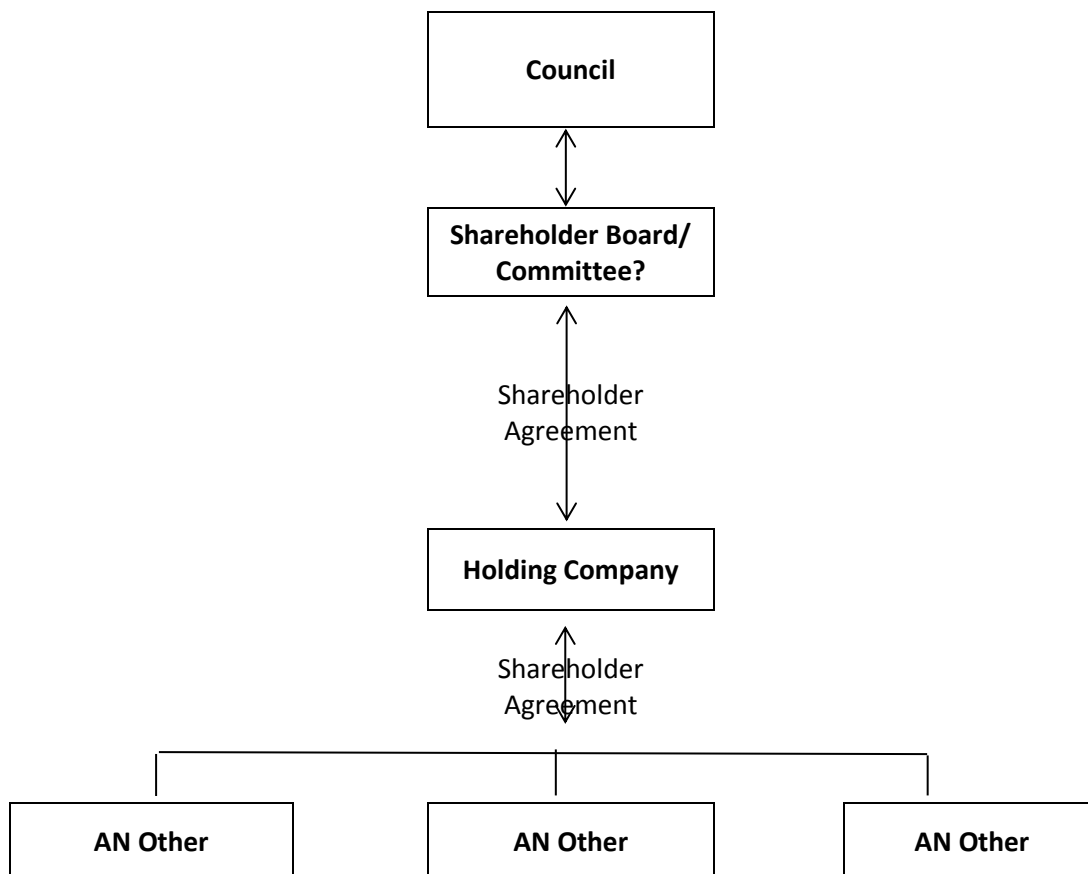
4. The following table highlights the advantages and disadvantages of the Council operating some of its activities through wholly owned companies:

Advantage	Disadvantage
Greater entrepreneurial freedom	Loss of direct control
Lower operating costs	Possible loss of revenue through corporate taxation
Ability to operate outside Rother geographical boundaries	VAT recovery may not be as efficient as with the Council
Commercial identity separate from the Council (could also be disadvantage as Rother is a trusted name)	Risk of commercial failure
Ability to sell as a going concern once established	Reputational damage if fails
Greater agility	

5. It is considered that the advantages outweigh the disadvantages but there will be a need to establish sound risk management and mitigation measures to reduce the financial and operational risks arising from the company operations.

Possible Company Structure

6. A possible company structure and its relationship to the Council is set out in the diagram opposite. The use of a holding company means it will be easier to set up further companies as required and will not require any changes to its relationship with the Council as this will be maintained through the holding company.



7. It is proposed to establish a holding company and thereafter other companies can be established to deal with the other Rother 2020 activities as required. This could include companies dealing with housing investment, commercial investment outside Rother and alternative energy. As proposals are developed these will be brought forward to Members for approval.
8. In January 2018, Members approved proposals to operate in house a café/restaurant from the Colonnade building following difficulties in securing a private operator. It is sensible that the Council consider operating this business through a subsidiary company in order to help reduce the operating costs and give the business the commercial freedom it will require to compete in the market. Due to the very tight timescales for a summer opening of the new café/restaurant, a trading company has been established in the name of Colonnade Bexhill Limited, which will allow the new Colonnade restaurant/café to be operated under a trading company rather than through the Council if Members approve these proposals. The company is not trading and can be easily closed should Members not support these proposals.
9. The name of the company is 'The Colonnade Bexhill Ltd'. The company is currently dormant but in order to set up, it required two interim company directors, these being Graham Burgess and Alison Spring. Prior to the company trading it is proposed these directors may include or change to the appointed Catering Manager and the new Head of Service for Acquisitions, Transformation and Regeneration.
10. Further information on the legal and financial considerations involved with establishing wholly owned companies are set out in Appendix A.

Resource requirements

11. In establishing the proposed company structure the Council will require specialist external legal and accounting advice and support. An initial budget of £75,000 is proposed to enable these services to be engaged. In addition there will be a need for on-going administrative/book-keeping support, initially just for the new trading company and holding company. It is expected that this support will be provided by the Council and recharged to the company.
12. It will also be necessary for the Council to provide in effect an overdraft facility of up to £250,000 to the new holding and trading companies. It is likely that any overdraft will need to be charged at commercial loan rates to avoid any state aid issues. Legal advice is being sort as the initial values are relatively low and may not be caught by this regime. This facility will be necessary to allow the business to mobilise its operations, including advance purchase of stock, equipment and to meet any early staffing costs. As income is generated the overdraft will be repaid to the Council. The draft business plan is currently being developed into a detailed business plan and will be presented to the Shareholder Board for approval.

Governance arrangements

13. As the Council will be the sole shareholder of all companies, it will need to appoint company directors to each. Officers propose that the Council delegates the appointment of directors to the Executive Director, in consultation with the Leader of the Council, relevant Portfolio Holders, Monitoring Officer and the Section 151 Officer. Based on the experience of other local authorities in setting up companies, it is proposed that each company has between two and five directors. To ensure that the directors understand their statutory duties under the Companies Act 2006 and that there are not real or perceived conflicts of interest relating to the dual role of being an officer of the Council and a director of a company, the Council will ensure that relevant training is provided to the directors and any other officers or elected Members who are closely involved with each company.
14. The Board of Directors will be responsible for delivery of the expected outcomes within the Business Plan of their respective company. They will have oversight of the performance, financial and operational management within the parameters agreed with the shareholder.
15. It is important that appropriate governance structures are in place to ensure proper supervision of the companies, thereby protecting the Council's financial and reputational investment in the company. The articles of association required for the setting up of the company will be drafted by legal to reflect the aims and objectives of the company. The governance and management structures will need to be included in the Articles of Association. It is recommended that the approval of the final articles of association for the company is delegated to the Executive Director in consultation with the Section 151 Officer, Monitoring Officer and the Leader of the Council following receiving legal advice.

Shareholder Board/Committee

16. To ensure good governance and to demonstrate there is clear separation between the Council's role as the municipal authority and the Council's role as shareholder, it is recommended that a Shareholder Board is created. This new Shareholder Board will be appointed by the Council and fulfil the Council's role as sole shareholder. It is suggested that the Board includes the Leader of the Council, relevant Portfolio Holders and Chairman of the Audit and Standards Committee. The size of the Board can be increased as the companies are formed.
17. The role of Shareholder should be administered separately from Cabinet business to evidence the Council acting as sole shareholder for the company (a private function) and is completely distinct from the Council acting as a Local Authority (public function).
18. The Shareholder Board will not be operational but will have powers to make decisions on behalf of the Council when it comes to company matters. The Shareholder Board will provide updates to the Overview and Scrutiny Committee (OSC) on performance of the new companies.

The relationship between the company and the Council

19. A key governance issue will be the relationship between the company's internal management and the Council, the sole shareholder. To this end, it will be advisable for a scheme of delegation to be drawn up structuring the relationship between the Council and the companies. In general, shareholders' key role is to ensure that directors do not exceed their powers. The scheme of delegation should set out in detail the powers and responsibilities of the Council's sole shareholding of the company, how it will exercise that power and how the directors of the company and the shareholder will interact. It will set out which decisions are made by the Council and which decisions are made by the directors of the company. For example, the Council as the sole shareholder will have certain powers such as removing a director from office or changing the name of the company.
20. All decisions regarding business development and any consideration of commercial /investment opportunities which may arise would be a matter for the Board of Directors. However, the Council as the sole shareholder is required to approve any decisions that have an impact on the shareholder's rights.
21. The day to day operation of the company, development of new business opportunities, staff terms and conditions (if applicable) and the development and implementation of internal procedures, will be the responsibility of the Board of Directors and will be detailed in the Articles of Association.
22. It is proposed that Cabinet establishes good governance arrangements to monitor the activities and performance of its subsidiary organisations and, as mentioned above, it is proposed that the OSC has oversight of the trading organisations and receives regular performance reports on the operation of the companies. Should any financial performance and strategies be commercially sensitive, the committee will need to review this in private. Any

budgets for providing loans to the companies will need to be approved by Full Council as part of the Council's budget framework.

Conclusion

23. Considering the above information it is proposed therefore that the Council approves the formation of a local authority trading company and a holding company and authorises the Executive Director, in consultation with the Leader, Portfolio Holder for Finance, Monitoring Officer and the Section 151 Officer, to:
 - a. Establish a holding company.
 - b. Agree the name for the company.
 - c. Draft, in line with this report, and approve Articles of Association as required.
 - d. Name the directors of the companies.
 - e. Make governance arrangements for the companies including agreement to the scheme of delegation.
 - f. Decide on the relationship between the Council and the Companies.
24. Further reports will be made to Members as the need to establish further companies arise.

Dr Anthony Leonard
Executive Director

Risk Assessment Statement

The risks associated with establishing wholly owned companies are set out in the report. Both the financial and reputational risks associated with operating companies will need to be managed by the Council as the sole shareholder of the companies. The governance arrangements between the Council and the companies need to be transparent so that the role of both officers and members is clear to the taxpayers of Rother.

Legal Considerations

Section 1 of the Localism Act 2011 provides local authorities with the power to do anything an individual may do, subject to a number of limitations. This is referred to as the 'general power of competence'. A local authority may exercise the general power of competence for its own purpose, for a commercial purpose and/or for the benefit of others i.e. this includes the setting up of a trading company. In exercising this power, a local authority is still subject to its general duties (such as the fiduciary duties it owes to its rate and local taxpayers) and to the public law requirements to exercise the general power of competence for a proper purpose.

A combination of powers (Section 1 Localism Act 2011 aforesaid, Section 95 Local Government Act 2003 and Section 111 Local Government Act 1972) permits the Council to trade commercially and lend monies to a trading company on a commercial basis.

The establishment of a local authority owned company creates a new legal entity under the Council's ownership but with the ability to charge for services in such a manner as to recover not only the cost of providing the services but at a profit. The surplus generated by the company will be available to the company to reinvest or may be made available to the Council to use as it chooses.

To set up a trading company, the Council must comply with the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009, as amended. This requires local authorities to consider and approve a suitable business case for establishing a company. The business case must include details about the objectives of the business, the investment and other resources required to achieve those objectives; any risks the business might face and how significant these risks are; and the expected financial results of the business together with any relevant outcomes that the business is expected to achieve.

The trading order also provides that any accommodation, services, staff or other support provided by the Council must be charged for by the Council at least covering the costs in full but potentially at market rate to demonstrate that the company is not being subsidised by the Council. Similarly, any financial assistance in the form of grants, loans or guarantees should be provided for a limited period and under the terms of a formal agreement entered for a commercial purpose. There are also state aid considerations to consider when making the final decision as to any support that is given to the wholly owned company.

The Council as the sole shareholder will have certain powers such as removing a director from office or changing the name of the company. In general, shareholder's key role is to ensure that directors do not exceed their powers. A scheme of delegation would need to be set out detailing the powers and responsibilities of the Council, how it will exercise that power and how the directors of the company and the shareholders will interact.

The governance arrangements need to be properly addressed to ensure there is a clear understanding about the control of the company and how key stakeholders will be involved, be accountable and make responsible decisions. It must be understood that directors must exercise their own judgement in their role as directors of the

company and that there is a clear understanding of the nature of the potential conflicts of interests and how these are to be avoided or mitigated.

Part 5 of the Local Government and Housing Act 1989 contains controls on local authority involvement in companies. This requires that local authorities ensure any directors appointed to a Local Authority Trading company are not disqualified from being a local authority member and information must be provided to the Local Authorities Auditor as well as being transparent to members of the public.

The Council will need to seek further advice on the legal issues associated with the establishment of the companies.

Financial considerations

The creation and existence of local authority owned companies will require the Council to prepare group accounts once they start to trade. This will cause additional administration for the Council's finance service to consolidate and report the financial results of the companies into the Council's accounts or a holding company.

It may be beneficial for the in-house finance team to undertake the accounting function for the companies, but additional resources may be required in the team to ensure correct accounting skills to deal with company accounts, as opposed to local government accounts, are available. This may include the purchase of additional on-going tax advice, group audit costs and additional costs in respect of consolidating the accounts in the Council's finance system. In addition, the council's accounting policies will also need to be updated to reflect the operations of the companies. Any provision of services to the companies will be charged to the companies through a commercial contract.

There will be revenue costs incurred for the initial set up costs of the company which includes financial, tax and legal advice and its registration with Companies House. These costs may be recharged to the company in due course.