

## SWT Scrutiny Committee

Wednesday, 2nd September, 2020,  
6.15 pm



Somerset West  
and Taunton

[SWT VIRTUAL MEETING WEBCAST  
LINK](#)

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**Members:** Gwil Wren (Chair), Libby Lisgo (Vice-Chair), Ian Aldridge, Sue Buller, Norman Cavill, Dixie Darch, Habib Farbahi, Ed Firmin, John Hunt, Dave Mansell, Derek Perry, Phil Stone, Nick Thwaites, Danny Wedderkopp and Keith Wheatley

### Agenda

**1. Apologies**

To receive any apologies for absence.

**2. Minutes of the previous meeting of the Scrutiny Committee held on 1st July 2020**

To approve the minutes of the previous meeting of the Committee.

**3. Declarations of Interest**

To receive and note any declarations of disclosable pecuniary or prejudicial or personal interests in respect of any matters included on the agenda for consideration at this meeting.

(The personal interests of Councillors and Clerks of Somerset County Council, Town or Parish Councils and other Local Authorities will automatically be recorded in the minutes.)

**4. Public Participation**

The Chair to advise the Committee of any items on which members of the public have requested to speak and advise those members of the public present of the details of the Council's public participation scheme.

For those members of the public who have submitted any questions or statements, please note, a three minute time limit applies to each speaker and you will be asked to speak before Councillors debate the issue.

(Pages 5 - 10)

### **Temporary measures during the Coronavirus Pandemic**

Due to the Government guidance on measures to reduce the transmission of coronavirus (COVID-19), we will holding meetings in a virtual manner which will be live webcast on our website. Members of the public will still be able to register to speak and ask questions, which will then be read out by the Governance and Democracy Case Manager during Public Question Time and will either be answered by the Chair of the Committee, or the relevant Portfolio Holder, or be followed up with a written response.

5. **Scrutiny Committee Forward Plan** (Pages 11 - 12)  
To receive items and review the Forward Plan.
6. **Executive Forward Plan** (Pages 13 - 14)
7. **Full Council Forward Plan** (Pages 15 - 16)
8. **Emergency Town Centre Recovery and back-fill of Economic Growth and Prosperity Fund** (Pages 17 - 24)  
This report is the responsibility for the Executive Member for Asset Management and Economic Development, Cllr Marcus Kravis.
9. **The creation of a Community Chest Fund** (Pages 25 - 30)  
This report is the responsibility for the Executive Member for Community, Councillor Chris Booth, and concerns a proposal to use retained Business Rates to create a Community Chest fund of £250,000 to help communities to recover from COVID19.
10. **Access to Information - Exclusion of the Press and the Public**

During discussion of the following item it may be necessary to pass the following resolution to exclude the press and public having reflected on Article 13 13.02(e) (a presumption in favour of openness) of the Constitution. This decision may be required because consideration of this matter in public may disclose information falling within one of the descriptions of exempt information in Schedule 12A to the Local Government Act 1972. The Council will need to decide whether, in all the circumstances of the case, the public interest in maintaining the exemption, outweighs the public interest in disclosing the information.

Recommend that under Section 100A(4) of the Local

Government Act 1972 the public be excluded from the next item of business on the ground that it involves the likely disclosure of exempt information as defined in paragraph 3 respectively of Part 1 of Schedule 12A of the Act, namely information relating to the financial or business affairs of any particular person (including the authority holding that information).

**11. Delivering Regeneration - Setting up a Special Purpose Vehicle**

(Pages 31 - 158)

This report is the responsibility for the Executive Member for Asset Management and Economic Development, Councillor Marcus Kravis.

**12. Tangier**

(Pages 159 - 168)

This report is the responsibility for the Executive Member for Asset Management and Economic Development, Councillor Marcus Kravis.



**JAMES HASSETT  
CHIEF EXECUTIVE**

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If you would like to ask a question or speak at a meeting, you will need to submit your request to a member of the Governance Team in advance of the meeting. You can request to speak at a Council meeting by emailing your full name, the agenda item and your question to the Governance Team using [governance@somersetwestandtaunton.gov.uk](mailto:governance@somersetwestandtaunton.gov.uk)

Any requests need to be received by 4pm on the day that provides 2 clear working days before the meeting (excluding the day of the meeting itself). For example, if the meeting is due to take place on a Tuesday, requests need to be received by 4pm on the Thursday prior to the meeting.

The Governance and Democracy Case Manager will take the details of your question or speech and will distribute them to the Committee prior to the meeting. The Chair will then invite you to speak at the beginning of the meeting under the agenda item Public Question Time, but speaking is limited to three minutes per person in an overall period of 15 minutes and you can only speak to the Committee once. If there are a group of people attending to speak about a particular item then a representative should be chosen to speak on behalf of the group.

Please see below for Temporary Measures during Coronavirus Pandemic and the changes we are making to public participation:-

Due to the Government guidance on measures to reduce the transmission of coronavirus (COVID-19), we will holding meetings in a virtual manner which will be live webcast on our website. Members of the public will still be able to register to speak and ask questions, which will then be read out by the Governance and Democracy Case Manager during Public Question Time and will be answered by the Portfolio Holder or followed up with a written response.

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**SWT Scrutiny Committee - 1 July 2020**

Present: Councillor Gwil Wren (Chair)

Councillors Libby Lisgo (Vice-Chair), Sue Buller, Dixie Darch, Habib Farbahi, Ed Firmin, Janet Lloyd, Mark Lithgow, Derek Perry, Phil Stone, Nick Thwaites, Danny Wedderkopp, Keith Wheatley and Loretta Whetlor.

Officers: James Barraah, Paul Harding, Alison North, James Hassett, Mark Leeman, Marcus Prouse, Andrew Randell, Andy Spragg, John Hanes, Malcolm Riches and Robert Downes.

Also Present: Councillors Chris Booth, Brenda Weston, Francesca Smith, Ray Tully and Alan Wedderkopp

(The meeting commenced at 6:15)

15. **Apologies**

Apologies were received from Councillors Cavill, Hunt, Mansell and D Wedderkopp,

Councillor Lloyd attended as a substitute on behalf of Councillor Mansell  
Councillor Whetlor attended as a substitute on behalf of Councillor Hunt  
Councillor Lithgow attended as a substitute on behalf of Councillor D Wedderkopp

16. **Minutes of the previous meeting of the Scrutiny Committee held on 3 June 2020.**

(Minutes of the meeting of the Scrutiny Committee held on 3<sup>rd</sup> June circulated with the agenda)

**Resolved** that the minutes of the Scrutiny Committee held on 3<sup>rd</sup> June be confirmed as a correct record following minor amendments.

17. **Declarations of Interest**

Members present at the meeting declared the following personal interests in their capacity as a Councillor or Clerk of a County, Town or Parish Council or any other Local Authority:-

Name	Minute No.	Description of Interest	Reason	Action Taken
Cllr L Lisgo	All Items	Taunton Charter Trustee	Personal	Spoke and Voted
Cllr M Lithgow	All Items	Wellington	Personal	Spoke and Voted
Cllr J Lloyd	All Items	Wellington &	Personal	Spoke and Voted

		Sampford Arundel		
Cllr L Whetlor	All Items	Watchet	Personal	Spoke and Voted
Cllr G Wren	All Items	Clerk to Milverton PC	Personal	Spoke and Voted

18. **Public Participation**

No members of the public had requested to speak on any item on the agenda.

19. **Signing of Charter for Compassion**

Councillor Booth introduced the item and welcomed John Haines and Andy Spragg to present the Charter of Compassion.

The Charter for Compassion is a document, linked to a world-wide movement, through which community groups, public bodies, faith organisations and individuals can commit to work together to find solutions to local issues, doing so in a way that is underpinned by values of compassion, fairness and respect, in order to alleviate suffering.

The Council was approached to sign the 'Charter for Compassion', which was due to take place at the Feelgood Festival, at Woodlands Castle, Taunton on 10th May 2020. Due to restrictions on public gatherings this event was postponed and no new date had been confirmed.

The Charter was compatible with, and supports our corporate priority objective to 'Develop and deliver effective communications, consultation and engagement which listens to and engages with our residents and stakeholders and is central to the delivery of our services, strategies and plans'.

During the discussion of the item the following comments and questions were made

- The signing for the Charter of Compassion had been written by Karen Armstrong.
- The vision set out for charter to be signed by towns and organisations.
- Members of the committee largely welcomed the charter although expressed concerns over unpopular decisions and fairness around this and how the concept of compassion fits certain areas of decision making.
- Working together and empathy in the organisation would fit what public sector organisations were trying to achieve within the existing constraints.
- The Charter provided the framework of values to have conversations around the process.
- Further views were expressed by the committee that acting in the best interests of the residents was not always the most popular decision.
- Conforming to the code of conduct as part of everyday life was already a requirement of elected members. Applying this to Interactions with other organisations already happened as part of the role.
- The benefits in signing the charter were questioned, further concerns were expressed that a similar charter may be required to be signed on another topic such as climate change further down the line.
- Further consideration was given to which religions and industries were represented as part of the charter.

- The committee further considered if a big organisation was required to sign the charter for credibility, concerns were expressed over the religious background of author.
- The ambitions were to be visible with the charter, which would not directed against individuals or religions, the charter aimed to follow common themes of all religions
- Individuals from all religions across the world would have signed the charter, which was inclusive of religions. It had no affiliations with particular scientific organisations.

**Resolved:-** The Scrutiny Committee recommend that the Council does not sign the Charter of compassion at Full Council.

## 20. **Hinkley Point C Housing Fund Strategy (Phase 3)**

Councillor Fran Smith introduced the report which was presented by Mark Leeman

The construction of the Hinkley Point C nuclear reactor is one of the largest construction projects in Europe, employing (at peak – anticipated during Spring / Summer 2021) 5,600 workers on site. A significant proportion of the workers are not Somerset residents (currently 57%), and so there is an impact on the local housing market as workers seek accommodation, particularly in the private rented sector. These pressures have predicted effects such as limiting availability of accommodation for locals, exacerbating rentals, and in some instances, the displacement of current tenants.

Through Section 106 planning agreements, EDF have made available funding contributions to mitigate the impact of the HPC project. Funding was first released in 2012 and other monies have been made available since. Previously, West Somerset Council and Taunton Deane Borough Council agreed funding strategies (Phases 1 and 2), using EDF money to mitigate the impact of the HPC construction on the local housing market. This mitigation took the form of creating new bed spaces and providing services for those who were struggling and needed advice and support.

This report presents the latest HPC housing funding strategy (Phase 3), using the current evidence to identify projects to mitigate impacts on the housing market. This will include taking forward activities that have worked well and adding in new ones to meet new emerging trends. We have in excess of £1.4M to invest that includes unspent funds from the previous strategy.

During the debate the following comments and questions were raised:-

- Taking into account the Equalities statement, the report indicated there would be negative impacts to a range of groups, a full assessment has been provided taking into account all those impacted.
- The Council had received funding for two officer posts. Utilising these posts for both previous areas of West Somerset and Taunton Deane was intended.

- Funding streams set out in the report allocated £470k for 50 affordable homes to rent owned by the Council, further details were requested around the allocated funding.
- EDF were supportive of the proposals set out in the report.
- Infrastructure pressures due to the number of additional employees working in the area were considered.
- The increased demand as a result of Hinkley activity was mainly around 1 and 2 bedroom properties.
- Funding had been received to tackle mitigation as part of the development consent order which set out that where there had been significant changes further funding was required.
- Further information was requested relating to social value gains to the voluntary and community sector. Commitment was given to provide this following the meeting.
- The peak point of employment at Hinkley Point was estimated to be 2021.
- The economic issues and housing need was considered across the district.
- Members encouraged further work on joint projects with EDF to engage in more initiatives. Sedgemoor had received investment for roads, housing and accommodation however Somerset West and Taunton had received less investment. Benefit from infrastructure was still received as a result of developments in Sedgemoor.
- A Covid-19 economic recovery plan was still in development in conjunction with all 5 Councils.
- The committee welcomed the recent opening of the accommodation located at the Canonsgrove facility and considered if there was still funding to continue this.
- Impact of increase of the increase in employees through the Hinkley development on local hospitals was discussed.
- The Scrutiny Committee encouraged continued dialogue with EDF on more joint ventures in relation to housing, alongside economic developments of Taunton as part of the recovery briefing from CEO.

**Resolved** that:- the Scrutiny Committee considered the proposed Hinkley Point C Housing Fund Strategy and supporting project activity, and noted the report.

## 21. **SWT Corporate Performance Report 2019/2020**

The Performance Report was introduced by Malcolm Riches.

As part of the Councils commitment to transparency and accountability this report provides end-of-year performance information for a number of indicators across a range of council services. The format of this report will be developed further from the start of the 2020/21 financial year in order to monitor progress of the Councils Corporate Strategy.

The table in Appendix 1 includes the councils Key Performance Indicators and shows how the council has performed for 2019/20 financial year.

The majority of indicators have are either met or exceeded the target. For the 2 indicators where performance is significantly below target, and the indicator is rated "Red", commentary is provided below:

Number of complaints responded to in 10 working days.

This has been an area of focus since last summer and has led to a restructure of the management of complaints. Jess McVie was recruited to manage the process (and

support Cllrs with their cases) which has led to significant improvements. However, some areas of the organisation have struggled to respond to complaints as quickly as needed.

Every complaint is assessed and any that are not actually complaints, such as requests for service and appeals against decisions, are reassigned to the specific process. The council does not want to discourage complaints as they are a valuable source of critical feedback, however, while the organisation has traditionally been effective at correcting mistakes (although sometimes not within the timeframes we would like) we have been less effective at implementing effective preventive action and learning from our mistakes to prevent repeat complaints. This is an area of development that has been receiving additional priority.

Prior to the Coronavirus outbreak we had been preparing a series of development workshops to coach teams in how to deal with complaints with a particular emphasis on effective responses and preventative action. This has been temporarily put on hold but will restart as soon as possible.

FOI requests responded to in 20 working days.

To help improve performance a dedicated case manager was recruited last autumn to manage the FOI process, and a new process for submitting FOI requests has been implemented. This had led to significant improvements in performance and for January, 81% of FOIs were responded to on time.

During the discussion of the item the following comments and questions were made:-

- Complaints were set out across the Council, these were broken down across the Council so particular attention could be made with training and staff awareness in the next steps in examining staff complaints.
- Complaints and freedom of information were the top two indicators.
- Recognised there was an issue around localities complaints.
- Clarity for Councillors and staff who are processing complaints.
- Monitoring figures as part of the financial outturn report was an ongoing piece of work to be brought to Councillors in the coming months.
- Members of the Committee welcomed a clearer picture of the ongoing figures.
- Report to reflect how staff have adapted and continued services provision as a result of the impact of Covid-19.
- A report to Councillors as part of the all Councillor briefing had been received. Keeping improving and results from each directorate to work with Councillors was an ongoing piece of work.
- Measure different factors that are important in the current trends and operation was an important direction to go in alongside more dynamic reporting.
- The Committee thanked officers for the report.

**Resolved** that:- The Scrutiny Committee noted the report.

## 22. **Scrutiny Committee Forward Plan**

(Copy of the Scrutiny Committee Forward Plan, circulated with the agenda).

Councillors were reminded that if they had an item they wanted to add to the agenda, that they should send their requests to the Governance Team.

An item of a DLO update was requested to be added to a future date on the forward plan.

**Resolved** that the Scrutiny Committee Forward Plan be noted.

23. **Full Council Forward Plan**

**Resolved** that the Full Council Forward Plan be noted.

24. **Executive Forward Plan**

**Resolved** that the Executive Forward Plan be noted.

(The Meeting ended at 8:24pm)

**SCRUTINY**

<b>Meeting</b>	<b>Draft Agenda Items</b>	<b>Lead Officer</b>	<b>Executive Report?</b>
<b>2nd Sept 2020</b>	Community Chest Report	Scott Weetch	Yes
	Emergency Town Centre Recovery and Economic Recovery (1st on)	Lisa Redston/G. Dwyer	Yes
	Tangier	Tim Bacon	Yes
	Firepool (SPV)	Tim Bacon	Yes
<b>30th Sept 2020</b>	Financial Strategy Review and MTFP Update	Paul Fitzgerald	Yes
	2020/21 Budget Monitoring Q1	Emily Collacott	Yes
<b>SPECIAL</b>	2019/20 Financial Outturn Report	Emily Collacott	Yes
	Q1 Performance Report	M. Riches	Yes
<b>7th Oct 2020</b>	Firepool	Tim Bacon	Yes
DH	Firepool LDO	Andrew Penna	Yes
	Everyone Active Performance Update	N. Green	Yes
	Future SWT Rough Sleeper Provision	Simon Lewis	Yes
<b>14th Oct 2020</b>	Coastal Works - Blue Anchor	Chris Hall	
DH	SWT Carbon Neutrality and Climate Resilience Action Plan	G. Thompson	Yes
<b>SPECIAL</b>	Somerset Climate Emergency Strategy	G. Thompson	Yes
	<b>No more items</b>		
<b>4th Nov 2020</b>	Client based approach to local Labour Agreements (LLA)	Colleen Blake/ B. Brown/ G Dwyer	Yes
WSH	2021/22 Budget Progress Update	Emily Collacott	Yes
<b>2nd Dec 2020</b>	2020/21 Budget Monitoring Q2	Emily Collacott	Yes
DH			
<b>6th Jan 2021</b>	Housing Strategy - Action Plan for SWT	M. Leeman	Yes
DH			
<b>27th Jan 2021</b>	General Fund Revenue Budget and Capital Programme 2021/22	Emily Collacott	Yes
WSH	HRA Revenue Budget and Capital Programme 2021/22	Emily Collacott	Yes
<b>BUDGET ONLY</b>			
<b>3rd Feb 2021</b>			
DH			
<b>3rd March 2021</b>	2020/21 Budget Monitoring Q3	Emily Collacott	Yes
DH			
<b>7th April 2021</b>			
WSH			
<b>TBC</b>	Parking Strategy for SWT	S. Weetch?	Yes
	Travellers Issues and Policy Update	Ann Rhodes & others	No
	Empty Homes Update	Steve Perry	Yes
	Future High St Fund - if approved	Kate Murdoch	No

	Multi-Purpose Venue	Tim Bacon/Joe Wharton	No
	Watchet Marina Update	Onion Collective?	No
	Social Value Strategy	Paul Harding	Yes
	Review of the Redundancy Policy	N. Rendell?	No
	Current State of the Council's Transformation Projects	A. North?	No
	Infrastructure Planning, Governance Arrangements and CIL Funding Update	Nick Bryant	No
	Coal Orchard Development Update	Joe Wharton	No

**EXECUTIVE**

<b>Executive Meeting</b>	<b>Draft Agenda Items</b>
<b>16 September 2020</b>	Small Scale Industrial Space LDO
<b>venue =</b>	Firepool (SPV)
ERD = 4 September	SWT Town Centre and High Street Recovery Plan
SMTRD = 29 July	<b>NO MORE ITEMS</b>
<b>23 September 2020</b>	Tangier
<b>venue =</b>	Community Chest Report
ERD = 11 September	Shared Legal Service
IERD = 11 August	Unitary Authority Response Fund
SMTRD = 29 July	National Living Wage
<b>EXTRA MEETING</b>	<b>NO MORE ITEMS</b>
<b>FOR NON FC REPORTS</b>	
<b>20 October 2020</b>	Coastal Protection Works
<b>possible extra meeting</b>	Somerset Wide Climate Emergency Strategy
ERD = 9 October	SWT Carbon Neutrality and Climate Resilience Action Plan
IERD = 15 September	Interim Policy Statement on Planning for the Climate Emergency
SMTRD = 2 September	Somerset EV Charging Strategy
<b>21 October 2020</b>	Firepool (Infrastructure Approval)
	Firepool (Commencement of Detailed Planning)
ERD = 9 October	Everyone Active Update
IERD = 15 September	Future SWT Rough Sleeper Provision
SMTRD = 2 September	Monkton Heathfield Phase 2 Masterplan: Feedback
	Firepool LDO
	Obridge
<b>28 October 2020</b>	2020/21 Budget Monitoring Q1

<b>Finance Reports Only</b>	Financial Strategy Review and MTFP Update
ERD = 16 October	2019/20 Financial Outturn Report
	Q1 Performance Report
<b>18 November 2020</b>	Social Value Strategy (linked with LLA)?
<b>venue =</b>	Financial Assistance for Low Income Owner Occupiers in Priority Areas
ERD = 6 November	2021/22 Budget Progress Update
IERD = 13 October	
SMTRD = 30 September	
<b>16 December 2020</b>	Commercial Investment Portfolio Review

**FULL COUNCIL**

<b>Meeting</b>	<b>Report Deadline</b>	<b>Draft Agenda Items</b>
<b>25 August 2020</b>	<b>13 August 2020</b>	Hinkley Phase 3 - Housing Funding Strategy
<b>SPECIAL/EXTRA</b>		Business Rates Decision
		Leisure Contract (confidential)
		<b>NO MORE ITEMS</b>
<b>10 September 2020</b>	<b>01 September 2020</b>	FOLGIS
<b>SPECIAL MEETING</b>		<b>NO MORE ITEMS</b>
<b>29 September 2020</b>	<b>17 September 2020</b>	Small Scale Industrial Space LDO
		Firepool (SPV)
		Blue Anchor Emergency Works
		SWT Town Centre and High Street Recovery Plan
		PFH Reports
		<b>NO MORE ITEMS</b>
<b>03 November 2020</b>	<b>22 October 2020</b>	Firepool (Infrastructure Approval)



# Somerset West and Taunton Council

## Executive Committee – 16<sup>th</sup> September 2020

### Emergency Town Centre Recovery and back-fill of Economic Growth and Prosperity Fund

This matter is the responsibility of Executive Councillor Kravis

Report Author: Gordon Dwyer, Economic Development Specialist

#### **Statement of Climate Change**

Prior to taking forward actions, consideration will be given to the Council's declaration of a Climate Emergency to ensure that the services delivered through this funding will not adversely affect Carbon Reduction targets, including consideration of travel, infrastructure, waste and preservation of the environment.

#### **1. Executive Summary / Purpose of the Report**

- 1.1. Following Covid-19 Lockdown, £535,000 has been made available for the purposes of Emergency Town Centre Recovery by repurposing the Council's existing Economic Growth and Prosperity Fund earmarked reserve. This has been carried out to put in place short-term impactful interventions in our Town Centres to provide an urgent response to attracting footfall back in to the high street to support businesses located in these areas.
- 1.2. It is proposed to back-fill the repurposed budget by £500,000 from General Reserves, thereby ensuring that the Council is able to continue to deliver its adopted Economic Strategy and provide longer term support for economic recovery.
- 1.3. The purpose of this report is to seek Member support and approval for the measures proposed.

#### **2. Recommendations**

- 2.1. The Executive notes that £535,000 has been repurposed for Emergency Town Centre Recovery following Covid-19 Lockdown utilising the Council's Economic Growth and Prosperity Fund held in earmarked reserves.
- 2.2. To recommend that Full Council approves a budget allocation of £500,000, funded from General Reserves, to back-fill the Economic Growth and Prosperity fund.

2.3. To delegate authority to approve expenditure of both funds to the Director of Development and Place in consultation with the Economic Development Portfolio Holder.

### **3. Risk Assessment (if appropriate)**

3.1. The provision of Emergency Town Centre Recovery funds, (announced in a Press Release of 15 July 2020 as the Council's commitment to recovery, investment, jobs and opportunity), has diverted the Economic Growth and Prosperity Fund earmarked reserve into emergency Town Centre recovery.

3.2. If additional funds are not now made available it will be difficult for the Council to deliver its adopted Local Economic Development Strategy and take advantage of economic recovery opportunities to further stimulate the local economy following Covid-19. The likely consequences would be the slow-down of recovery and greater increase in economic stagnation/business closure with resultant overall increase in unemployment within the District in the medium to long term.

3.3. To ensure risk is minimised and best value obtained, all funds will be administered either directly by the Council or indirectly through agreed service level agreements in line with Council procurement procedures.

### **4. Background and Full details of the Report**

4.1. Since the announcement of 'Lockdown' in March 2020, Somerset West and Taunton Council has provided the administrative function for the business support made available by Central Government in the form of Business Rates Holidays, Small Business Grants, Retail and Hospitality Grants and has delivered a Discretionary Grant Scheme. The Council has also accessed the ERDF Reopening Town Centres Safely Fund to deliver interventions to facilitate the re-opening of key service centres in a Covid-19 safe manner.

4.2. During the Lockdown period, Covid-19 restrictions have had a severe impact on the way Town Centres, Service Centres and Town Centres across the District have been able to function. The discouragement of face-to-face services in order to curtail the spread of the virus has adversely affected businesses trading within these traditional service centres.

4.3. Whilst some businesses have been able to adapt how they interact with their customers, the negative impact on the majority of businesses based in these areas has been significant and is well documented in the national media. This is also reflected in local Town Centre footfall statistics which dropped dramatically during the Lockdown period.

4.4. As Covid-19 restrictions have eased, public habits and public confidence in visiting services in a traditional face-to-face means has not returned to its previous levels, nor is it expected to do so for some time (if at all).

4.5. Whilst there is an immediate need to support existing businesses in the Town Centre to sustain the economy, there is also a wider recognition that Town Centres and

Neighbourhood Service Centres as a whole may also need a re-think of their services and their functional role within the local economy if they are to continue to attract the public to the services that they offer.

4.6. To provide immediate support required to stimulate local town and service centres the Council has made available £535,000 from the balance of the Economic Growth and Prosperity Fund currently held in earmarked reserves. This Fund is funded from increased business rates retained income received in 2019/20 through the 75% Business Rates Retention Pilot.

4.7. Focussing these resources for the purposes of Emergency Town Centre Recovery for immediate actions to stimulate Town Centre economies is in line with the intent of supporting the local economy. In principle allocations are to be made available to settlements in proportion with their size and function throughout the District as follows:

<b>In Principle Allocations</b>	<b>£</b>
£200,000 x 1 for Taunton	200,000
£100,000 x 2 for Minehead and Wellington	200,000
£135,000 for Neighbourhood Service Centres of Watchet, Dunster, Porlock, Dulverton and Wiveliscombe and Williton	135,000
<b>Total</b>	<b>535,000</b>

4.8. Work to develop plans for emergency recovery is well underway and in July and August 2020 workshops were held with each community to identify need and commence development of local Town Centre Recovery Plans.

4.9. Town Centre Recovery Plans focus on immediate actions to stimulate High Street economies. Each differs depending on community priorities, however there is a general emphasis on actions which ensure that the town remains welcoming to visitors. For example ensuring that the public realm is well maintained and presented, that there is vibrancy through stimulating outdoor markets and entertainment and that the centre and its activities and attractions are well marketed.

4.10. Funds from the Emergency Town Centre Recovery Fund will be devolved through service level agreements, to an appropriate financially accountable authority/body within each community. During 2020/21 officers will be working closely with all grant recipients to ensure outputs are set and grants are offering value for money.

4.11. The purpose of the recommended £500,000 is to back-fill the Council's Economic Growth and Prosperity Fund. Covid-19 has had a devastating effect on the local economy. This budget will support the delivery of medium and long term proposals to stimulate the economy through delivery of the adopted Economic Development Strategy and refreshed activity appropriate for a time of Covid recovery.

4.12. The budget needs to remain flexible in order to take advantage of partnership opportunities as they develop. However the types of activity that the fund could potentially enable include:

- Development of retail/leisure/housing zoning plans for town centres and development of place plans to identify the unique narrative for each town

- Activity to strengthen local business networks, clusters and town centre partnerships
- Business skills support for the adoption of new digital technologies (such as Shop Appy)
- Activity supporting Inward Investment within the District

There is also cross over with other strategic ambitions of the Council such as Garden Town, Climate Change, Coastal Productivity Plans, Heritage and Cultural plans and potential to support economic aspects of these from this proposed budget.

## Administration of Funds

4.11. It is proposed that the **Emergency Town Centre Recovery Fund of £535,000** will be devolved through a grant agreement to an appropriate financially accountable business group or local authority within each community as follows:

Taunton - Devolved to Taunton Chamber of Commerce

Minehead and Wellington - Devolved to Minehead BID and Wellington Town Council

Watchet, Dunster, Porlock, Dulverton, Wiveliscombe and Williton - To be discussed with local Town and Parish Councils

4.12. It is proposed that the **£500,000** to back-fill the Council's Economic Growth and Prosperity Fund will be administered directly by the Economic Development Team in line with Council procurement procedures.

## 5. Links to Corporate Strategy

5.1. The proposals link to the priority strategic themes and outcomes as follows:

Strategic Theme: Our Environment and Economy

The proposals clearly link to:

- Objective 6. Support the town centres throughout the District to meet the challenge of changing shopping habits.

The action plans that are under development also incorporate aspects of the use of arts and culture, improving the skills of the local workforce, enhancing public spaces and therefore also help support the following objectives of this strategic theme:

- Objective 3. Encourage wealth creation and economic growth throughout the District by attracting inward investment, enabling research and innovation, improving the skills of the local workforce and seeking to ensure the provision of adequate and affordable employment land to meet different business needs.
- Objective 5. Provide and maintain green open spaces and parks, enhanced public spaces, as well as additional opportunities to safely walk or cycle in order to encourage active and healthy lifestyles.
- Objective 8. Support the enhancement of arts and culture provision within the District.

**6. Finance / Resource Implications**

- 6.1. This reports sets out two significant levels of investment focussed on supporting recovery in the local economy. Part of the funding for this already exists within an earmarked reserve set aside for economic initiatives, and part will require Full Council to approve a supplementary increase to the General Fund Revenue Budget, funded from General Reserves.
- 6.2. The Council approved the allocation of £1.2m to an Economic Growth and Prosperity Fund within the 2019/20 Revenue Budget, based on the projected additional retained income through the 75% Business Rates Retention Pilot. A prudent approach to allocating these funds was taken as the actual income projected was not confirmed until the end of last financial year. Commitments were made from this fund towards the Coal Orchard and Firepool schemes, leaving a balance of £577k available to support economic initiatives this year. It is proposed the majority of this funding is prioritised to support the activities planned in the Emergency Town Centre Recovery Fund, through existing delegated budget authority of the Director of Development and Place.
- 6.3. The proposed Economic Recovery Fund is a new one-off budget requirement this year. It therefore needs to be approved by Full Council as a supplementary budget allocation, and is proposed to be funded by an allocation from General Reserves. The expected balance of General Reserves at the start of the financial year is £4.5m (see separate report to the Executive regarding the 2019/20 financial outturn). The Director of Development and Place will be accountable for this new budget, and have delegated authority to distribute funds through normal budget management procedures.

Summary of Budgets:

£		Funded By	Approval
535,000	Emergency Town Centre Recovery Fund	Earmarked Reserve	Approved in 2020/21 Original Budget, with balance held in earmarked reserve until fully spent.
500,000	Back-fill of Economic Growth and Prosperity Fund	General Reserve	Full Council approval needed for Supplementary Budget.
1,035,000	TOTAL		

- 6.4. It is assumed the cost of administration will be absorbed within existing resources, and similarly for devolved funds it is assumed administration will be managed within the existing resources of the devolved body.

**7. Legal Implications (if any)**

- 7.1. In the case of the Emergency Town Centre Recovery Fund, funds will be devolved to the relevant organisation for which each recipient will enter into a legally binding agreement with the Council.

7.2. The Council is obliged to give 3 months' notice in writing to terminate any funding agreement or to notify of a change to levels of funding provided.

7.3. In the case of the Economic Recovery Fund, this fund will not be devolved and so there are no specific legal implications. The fund will be managed by SWT.

## **8. Climate and Sustainability Implications (if any)**

8.1. In the case of the Economic Growth and Prosperity Fund, prior to taking forward actions, consideration will be given to the Council's declaration of a Climate Emergency to ensure that the services delivered through this funding will not adversely affect Carbon Reduction targets, including consideration of travel, infrastructure, waste and preservation of the environment.

8.2. In the case of the Emergency Town Centre Recovery devolved funds, the same will apply and consideration of the above will be written into the grant funding agreements.

## **9. Safeguarding and/or Community Safety Implications (if any)**

9.1. In the case of the Economic Growth and Prosperity Fund, officers will ensure that any companies commissioned to provide services have in place appropriate Health and Safety Policies.

9.2. In the case of the Emergency Town Centre Recovery devolved funds, the same will apply and consideration of the above will be written into the grant funding agreement.

## **10. Equality and Diversity Implications (if any)**

10.1. In the case of the Economic Growth and Prosperity Fund, officers will assess impacts and methods of delivery any services provided to ensure that they eliminate discrimination, advance equality of opportunity for disadvantaged groups and individuals and support cohesive communities.

10.2. In the case of the Emergency Town Centre Recovery devolved funds, the same will apply and consideration of the above will be written into the grant funding agreement.

## **11. Social Value Implications (if any)**

11.1. By the nature of the proposals any actions delivered, or services commissioned are intended to create positive implications for the community, for example in terms of up-skilling of the local workforce through business support workshops, or through creating more vibrant communities, indirectly safeguarding jobs.

## **12. Partnership Implications (if any)**

12.1. The proposals involve working in partnership with nine communities across the District to deliver emergency and recovery plans. Working in this way will ensure the

benefit of the funding is maximised for the community. It also ensures that any services / infrastructure improvements delivered link closely and/or align with the Council's services and ambitions for the District.

- 12.2. Partners who are utilising Council funds to forward these projects will be obliged through Service Level Agreements to acknowledge support of Somerset West and Taunton Council and agree communications messages with SWT prior to any event taking place.

### **13. Health and Wellbeing Implications (if any)**

- 13.1. The proposals aim to ensure that service centres across the District remain thriving and more resilient. Indirectly therefore, the proposals support safeguarding jobs, developing skills and safeguarding and improving places for people to engage other people in their community.

### **14. Asset Management Implications (if any)**

- 14.1. No asset management implications have been identified within proposal developed to date. There may be asset management considerations for activity such as outdoor events (if on Council land). Should these arise, these protection and best use of our assets will be a consideration during any further development of the proposals.

### **15. Data Protection Implications (if any)**

- 15.1. Many of the services the Council currently funds hold and maintain sensitive information regarding customers and clients. Recipients of grant funding will be obliged to following regulations and guidance in relation to GDPR.

### **16. Consultation Implications (if any)**

- 16.1. The majority of delivery will support the delivery of actions identified within the adopted Economic Development Strategy which was developed through extensive consultation.
- 16.2. Proposals for the shorter-term emergency actions are being worked up through consultation with the business and residents of each community concerned. To date this has included surveys and online workshops throughout in July and August 2020.
- 16.3. Further consultation will be carried out with key organisations, groups and individuals within the community to help shape and refine the priorities further.

### **17. Scrutiny/Executive Comments / Recommendation(s) (if any)**

TBA

**Democratic Path:**

- **Scrutiny – Yes**
- **Executive – Yes**
- **Full Council – Yes**

**Reporting Frequency:**  **Once only**

**List of Appendices (delete if not applicable)**

Appendix A	
Appendix B	
Appendix C	

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# Somerset West and Taunton Council

## Scrutiny Committee – 2<sup>nd</sup> September 2020

### The creation of a Community Chest Fund

This matter is the responsibility of Executive Councillor Member for Community, Cllr Chris Booth

Report Author: Scott Weetch, Community Resilience Manager

#### 1. Executive Summary / Purpose of the Report

A proposal to use retained Business Rates to create a Community Chest fund of £250,000 to help communities to recover from COVID19.

#### 2. Recommendations

- 2.1 The Executive is recommended to approve a supplementary budget of £250,000 for the Community Chest, to be funded from Business Rates Retention Pilot surplus income due to be received in 2020/21.
- 2.2 Delegate authority to the Communities Portfolio holder to make decisions relating to the spend of this fund.
- 2.3 The Communities Portfolio holder will engage with ward members on proposed spending within their wards.

#### 3. Risk Assessment (if appropriate)

- 3.1 This relates to the specific risks associated with COVID19 and the ability of our communities to respond to and recover from the effects of COVID19.
- 3.2 There is a risk of misuse of awarded funds by a third party organisation or intended initiatives proposed not being successful or hitting issues during delivery. This is mitigated by the maximum value of grant being £5,000 and through the application process which will define criteria against which monies can be spent (covered in 6.3, below)

#### 4. Background and Full details of the Report

- 4.1 The proposed Community Chest is to be used for projects within the community that aid community cohesion, response to COVID19 and recovery of the community. This is by definition a wide remit but the aspiration is that groups of varying size are able to access a timely boost to support their activities. This funding will complement the extensive awards made available and Page 25 to many businesses in our area and is

very much targeted at recovery to provide more enabling funding to the Voluntary and Community Sector and wider community groups. These are grants to help the community and are separate from business grants, which have been widely promoted and accessed elsewhere.

4.2 The Community Chest Scheme will support one-off initiatives that are:

- supporting COVID19 recovery
- seen as valuable to the area
- are not able to secure mainstream funding from the Council or other sources

One-off grants of up to £5,000, usually not exceeding 75% of the total actual costs are available, i.e. the group will need to find at least 25% from their own or other sources, which can include in kind contribution e.g. volunteer hours.

Consideration are given to:

- projects submitted by small community groups, defined as having an income of less than £10,000 per year and no paid staff
- initiatives that will help community groups to become sustainable in the longer term
- initiatives that will help the community to recover from the effects of COVID19
- groups who have not received a grant/other funding from the Council
- projects aligned to SWT Corporate Priorities

4.3 Retrospective funding applications will be considered on a case by case basis but will not normally be supported.

4.4 Examples of projects that may be funded include signage or screens to allow a community café to operate safely; funds to allow community activities to take place and restore community life; match funds to enable groups to start up and reinvigorate an area from the varying effects of COVID19.

4.5 It is intended that there is an application process through a simple Firmstep form. Applications are up to the value of £5,000 and must not have been previously funded by the Council (e.g. through a business grant). Applications will be automated and then the Community Resilience Team will assess them for suitability.

4.6 A dashboard will be created and used to understand expenditure over time. In addition, the portfolio holder will receive a weekly summary of how funds have been allocated. They must be spent by 31<sup>st</sup> March 2021.

4.7 The scheme will be widely promoted and therefore we expect applications from across the SWT area. However, the Community Resilience Team in consultation with the portfolio holder will monitor to ensure that there is a geographic spread to the funding allocation. Where it is felt that an area is under represented, further promotion will take place to try to encourage participation.

4.8 Ongoing monitoring of spend and activity will be completed within the Community Resilience Team.

- 4.9 Members will be able to access a summary of spend on a monthly basis and the Community Resilience Manager will bring a report at the closure of the scheme as to how monies were spent and where benefits were realised.

## **5. Links to Corporate Strategy**

- 5.1 This initiative links to the aims of the Corporate Plan 20/21 in further responding to the effects of COVID19 and supporting our community to respond and recover.

## **6. Finance / Resource Implications**

- 6.1 The budget requirement proposed for the Community Chest is £250,000, which if approved will be a one-off increase to the General Fund Revenue Budget in 2020/21. The budget will be managed within the Housing and Communities directorate, held by the Community Resilience Manager.
- 6.2 It is recommended to utilise a one-off surplus from county-wide productivity initiatives budget, that was funded by increased retained revenues from the 75% Business Rates Retention Pilot in 2019/20 financial year. The overall performance of the Pilot has exceeded expectations, with a surplus available for sharing between the county and four districts in 2020/21. The SWT share of the surplus is £375,000, which is more than sufficient to support this additional budget request, and leave £125,000 additional income to mitigate other financial pressures and priorities during the year.
- 6.3 It is recommended that appropriate safeguards and due diligence are built into the process to minimise the risk of fraud. The strengths of the counter-fraud measures applied to business grants will be helpful in this regard.
- 6.4 It is assumed administration overheads for the scheme will be met within existing budgets.

## **7. Legal Implications (if any)**

### **State Aid**

- 7.1 State Aid is the granting of resources, by the state, to an economic undertaking which places that undertaking in an advantageous position and distorts or threatens to distort competition. The Council is the state and it's likely that most, if not all, VCS groups would be considered economic undertakings. However, the fact that this is an open scheme available to all VCS groups across the district means that state aid is not a consideration. Such schemes may be restricted to a sector such as the voluntary and community sector without invoking state aid because that's the entire sector that these organisations work under. It is also allowed to restrict it to those operating within the district – otherwise the scheme wouldn't be indirectly benefiting residents and visitors. Provided that your scheme is transparent, objective, openly publicised to all eligible groups with published criteria for applying and evaluation state aid should not apply.
- 7.2 Even were it found that State Aid could apply to any one grant being offered to an organisation, the fact that the grant will not be more than £5000 means that it's permitted even if it is State Aid. That's subject to a proviso that the organisation in question has not received more than about £180,000 from the Council in financial

support in the last three years – which is the upper limit for such permissible aid. However if only organisations which have had no funding from the Council previously are eligible, that won't be an issue. If a decision was taken to allow an application from an organisation that had direct funding previously (and again that's funding which would be considered State Aid; not any funding applied for through an open scheme or in payment for services received), checks would need to be made about whether the limit had been reached.

7.3 On the basis of the scheme as detailed, however, there are no state aid implications to be concerned about.

## **8. Climate and Sustainability Implications (if any)**

8.1 There are no anticipated climate and sustainability implications as this is a one-off funding initiative to help drive recovery from COVID19

## **9. Safeguarding and/or Community Safety Implications (if any)**

9.1 None

## **10. Equality and Diversity Implications (if any)**

10.1 The scheme will aim to assist projects from a range of providers, mostly community based. There should be a positive aspect to any equality and diversity implications.

## **11. Social Value Implications (if any)**

11.1 Not applicable

## **12. Partnership Implications (if any)**

12.1 None

## **13. Health and Wellbeing Implications (if any)**

13.1 The scheme is intended to positively impact health and wellbeing by allowing communities to deliver projects and recover from the effects of COVID19. This could take the form of breakfast clubs, walking groups, litter picks or other activities that add social value and bring cohesion.

## **14. Asset Management Implications (if any)**

14.1 None

## **15. Data Protection Implications (if any)**

15.1 Data will be stored in line with Data Protection legislation through use of Firmstep forms to manage the data. It will only be used to administer the scheme.

**16. Consultation Implications (if any)**

16.1 None

**17. Scrutiny/Executive Comments / Recommendation(s) (if any)**

17.1 Not applicable

**Democratic Path:**

- **Scrutiny – Yes (2<sup>nd</sup> September 2020)**
- **Executive – Yes (23<sup>rd</sup> September 2020)**
- **Full Council – No**

Reporting Frequency:  Once only       Ad-hoc       Quarterly  
 Twice-yearly       Annually

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# Somerset West and Taunton Council

[Full Council: 29<sup>th</sup> September 2020]

## Delivering Regeneration – Setting up a Special Purpose Vehicle

This matter is the responsibility of: Councillor Marcus Kravis Portfolio Holder for Asset Management and Economic Development

Report Author: Tim Bacon

*It is important to stress that Appendix 1 of this report is commercially sensitive and must remain confidential. Appendix 1 is solely for Members of Somerset West and Taunton Council. Details must not be disclosed to any other person.*

### 1 Purpose and Executive Summary

- 1.1 The purpose of this report is to propose the establishment of a local authority trading company (**Name to be decided**), and specifically to seek approval for the creation of the SPV. This follows the All Members presentation from Monday 17<sup>th</sup> August 2020 and the presentation is attached at Appendix 1.
- 1.2 The reason why a SPV (Special Purpose Vehicle) is required is to deliver first and foremost Town Centre Regeneration projects that would not likely be delivered by the open market. This is the way that the Council can intervene in the market place and bring forward the regeneration projects that, have in the main, been talked about in policy documents but seldom delivered in the ground. The SPV will be a considerable step change in the pace and certainty of turning plans into reality. The SPV will be a limited company.
- 1.3 The Council has received independent legal advice in connection with the creation of the SPV. and this will be provided at Appendix 2 once received. Financial advice is still awaited and the scope of this advice is provided at Appendix 3.
- 1.4 The SPV will be established as a Company wholly owned by the Council at the head of a group of subsidiary companies designed primarily to support the

delivery of regeneration ambitions and the strategic priorities of the Council but which could also deliver other objectives as the Council may require. The SPV will provide an overarching governance mechanism for all subsidiary **SPVs**, where there is a commercial need for them being established. References to the **Group** are to the parent SPV and any subsidiary SPVs underneath the parent from time to time. Projects and services will be added to the Group on a business case by business case basis as approved by Full Council.

- 1.5 The Council will guide the functions of the SPV through an SPV Steering Group.
- 1.6 Council control of the SPV will be via shareholder agreements, land agreements and, where needed, funding agreements.
- 1.7 This report summarises why the SPV is required (by reference to independent legal and financial advice where that is appropriate). The report reviews what the Group structure will do and function, and how it will achieve the Council's goals.
- 1.8 The costs of setting up the Group structure have already been approved in earlier decisions in Council approvals in June 2019, January 2020 and March 2020. In context minute 2.1 from the January 2020 Council report specifically included the possibility of developing the site through a Special Purpose Vehicle and set aside project team costs for the same. All Members briefings were held on the 2<sup>nd</sup> March 2020 where the SPV was the sole subject of Members Briefings and 43 Members attended those briefings.
- 1.9 The governance and business case approach for future projects/SPV's is set out at Appendix 4. It is important to note that this approval is only for the principle of setting up a SPV. The SPV is delivery tool for the Council that will only have projects to pursue only after individual projects are approved by Full Council. The business cases for Firepool and other regeneration projects will be presented to Full Council in November 2020. Subsequent business cases will follow as needed thereafter. The Council owns the business cases and each will set performance requirements to be delivered by the SPV.

## **2 Recommendations**

It is recommended:

- 2.1 Approve the creation of (name to be confirmed) as a company limited by shares and wholly-owned by the Council in accordance with the principles of future business cases set out in this report;
- 2.2 Delegate authority to the Director of Place (in consultation with the Executive) to register the name of (the SPV) and complete all practical, financial and legal matters to enable (the group SPV) to be established including approval of the

final form of all necessary legal documentation and thereafter oversee operations of the Council.

2.3 That Projects and services are added to the Group on a business case by business case basis as approved by Full Council and performance monitored through the Shareholder Agreement.

**3 Risk Assessment** – SPV based risks in non- bold text 1-5 and venture risks in bold 6 and on

	<b>Risk Description</b>	<b>Likelihood</b>	<b>Impact</b>	<b>Overall</b>	<b>Risk Mitigation Measures</b>	<b>Likelihood</b>	<b>Impact</b>	<b>Overall</b>
I	Failure to act commercially and recover expenditure and fees, if unable to deliver the plan set out in business case.	3	3	9	<i>The full business case was developed and further inputs from an independent Property advisor and Quantity Surveyors will be sought, showing a positive overall return on investment.</i>	2	2	4

	Risk Description	Likelihood	Impact	Overall	Risk Mitigation Measures	Likelihood	Impact	Overall
2	Insufficient through-put of business to justify separate SPVs	2	2	4	<p><i>Group to be actively considered as owner/ developer of appropriate property, with suitability, viability to be established on a case by case basis.</i></p> <p><i>Underlying administration cost of Group low with lean resourcing model, so overheads kept to a minimum unless potentially viable cases are brought forward. At least initially, the costs of early stage business case development will be borne by the Council rather than Group, with costs of approved business cases being on-charged to Group as part of the financial model.</i></p>	1	1	2
3	Dependencies (resourcing, staffing, etc.) still located within the Council – this is the downside of a "lean" model.	2	3	6	<p><i>Group SPVs (and subsidiary SPVs in time) to enter into Group-wide Resourcing Contract to regulate drawdown of resources as needed.</i></p>	1	1	2

	Risk Description	Likelihood	Impact	Overall	Risk Mitigation Measures	Likelihood	Impact	Overall
4	<i>Directors' duties owed by those on the Group Boards</i>	2	2	4	<p><i>Clarity of governance structure under Shareholder Agreement and Articles.</i></p> <p><i>Ensuring directors are those with the appropriate mix of skills and experience (i.e. they know what they are doing and why they need to make decisions).</i></p> <p><i>Regular review to ensure governance processes are working efficiently and properly.</i></p> <p><i>Training for potential Board members.</i></p>	1	1	2
5	Administrative burden increases with additional corporate structures such as the proposed SPV.	2	2	4	<i>See above regarding administration costs.</i>	1	1	2
6	<b>Climate Change - If the Council does not lead from the front in delivering zero carbon developments no one else will</b>	3	3	9	<b><i>That the Council prioritises a zero carbon policy in regards to all of its projects</i></b>	1	2	2

	Risk Description	Likelihood	Impact	Overall	Risk Mitigation Measures	Likelihood	Impact	Overall
7	Risk that the status quo continues and the Town Centre will not deliver the desired regeneration without intervention from the public sector (SWT). As a result the Taunton economy will suffer.	3	3	9	<i>That the Council embarks in a level of measured intervention sufficient to generate the required levels of change to protect jobs and the wider economy.</i>	1	2	2
8	That the Council overstretches its finances in delivering direct development in a risky economic environment	3	3	9	<i>That the risk is offset by using a Special Purpose Vehicle and securing third party funding with as limited impact on the Council's finances as is possible</i>	2	2	4
9	Failure to attract purchasers/tenants to the site	3	3	9	<i>The sites are considered prime site for mixed use redevelopment quality accommodation will be provided and the option of the use of an SPV enables part exchanges, rent or price concessions. An SPV will also allow opportunities to provide finance/loans to stimulate sales as needed. There is a national housing shortage and if people are not buying they are likely to be renting.</i>	2	1	1

	Risk Description	Likelihood	Impact	Overall	Risk Mitigation Measures	Likelihood	Impact	Overall
10	The economic impact of Covid and Brexit lead to a deep recession greatly impacting on the business cases for each of the projects to be delivered by the SPV/Group	3	3	9	<i>That any capital value contagion is managed on the balance sheet by seeking to rent all completed accommodation. Adverse conditions to be offset by committing to projects block by block and reviewing the state of the market and slowing down or speeding up as required. The accommodation built must be best in class to be ultra-competitive in the local economy.</i>	2	2	4
11	The Council does not have the necessary skills in-house to undertake the build management and letting.	2	3	6	<i>Council have an internal team with the skills to manage the site initially and a suitable recruitment policy will be enabled at the appropriate market rates to employ a high quality and independent team within the SPV/Group</i>	2	2	4
12	Impact of Unitary Status	2	3	6	<i>The intention is to deliver the level of regeneration required in the Town Centre and the need for that intervention remains the same for any future successor Council. Any new Council will have the authority to exit the SPV as set out in the Shareholder agreement</i>	2	2	4
	Mean score	2.5	2.8	7		1.4	1.5	2.1

## **4 Group SPV and future Business Cases**

- 4.1 The purpose of this report is simply to set up an SPV as the head company within the Group as it grows over time. It will be dormant until business cases are approved for future projects. The first will likely be Firepool and others as and when needed. Each business case will be accompanied by a consideration of delivery options
- 4.2 The following business cases for any regeneration development must analyse the appropriate business model for the initiative, which may or may not be through a company. Where a local authority is relying on section 95 Local Government Act 2003 (and arguably this reflects a wider fiduciary duty even where that power is not being relied upon), it must prepare and approve a business case pursuant to the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009. This requires the local authority to consider and approve a suitable business case for establishing a trading company, which 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.
- 4.3 Because a company is required, the level of management support required by the company from the Council will be set out on case by case basis.
- 4.4 The Council will ensure that it receives a commercial rate of return on any funding, supplies, services or assets provided to the company, or at least covering its costs in the provision of services or support. The Council may seek to directly support companies through offering these services at the appropriate and State-aid compliant price.
- 4.5 It is expected that a variety of property and development opportunities will be presented, to be delivered by an existing or new subsidiary SPVs with each opportunity needing a separate business case before commencing. As the "inputs and outputs" of development, the risks associated with specific developments and the expected financial results are only going to be known as and when opportunities are brought forward, those subsequent business cases will need to cover the majority of the points above.
- 4.6 The Councils principal powers to set up a SPV are summarised within Appendix 2.

## **5 Objectives - Regeneration of the Town Centre area**

- 5.1 There are a range of stalled sites that need to be unlocked in the Town Centre area. Developers will generally prefer to build new housing on the 7,000 or so consented plots on green field consented sites outside the Town Centre area. More people living in the Town Centre is the optimum sustainable solution as more people living close to the Town Centre will deliver more retail and leisure spend to help protect and support the economy and the growth ambitions of the town and the wider district.
- 5.2 The Taunton Town Centre Area Action Plan considered various sites and allocated circa 2,500 new residential units. Of these only 20% have been delivered and major sites such as Firepool and others remain undeveloped. Town Centre sites in the region are expensive to develop as they are often constrained sites that require urban solutions. They provide a lesser commercial return for mainstream residential developers whom prefer to develop greenfield sites for predominantly houses which are easier to fund, build and sell.
- 5.3 There are a number of options for the Council to consider in taking forward these schemes and these are referred to in paragraph 5.12 below. As an alternative to any of these delivery options, the Council can pursue a "do nothing" option and let the market come forward to deliver these difficult sites. The downside to this option is that it is almost certain that nothing will be delivered at Firepool, which has been the case for the last 10 years and market conditions are hardly more favourable with Brexit lurking in the background whilst Covid 19 dominates the foreground. New home starts were down by 18% in the last quarter of 2019 purely because of Brexit. It is now much harder for developers to make decisions about tough urban sites. The do nothing option is not considered in any detail as it clearly does not meet the Council's objectives which have been set out in parameters in order to test the options.
- 5.4 The Council's emerging strategy is to find ways to encourage business for the Town Centre. Two main initiatives have been identified: firstly to bring more leisure uses into the Town Centre and secondly to encourage 2,500 or more new residential units of accommodation into the Town Centre. Doing nothing on Firepool or other regeneration sites do not help either initiative.
- 5.5 Using Firepool as a case study for the rationale and benefits of an SPV, the whole site has been appraised and tested against the following parameters. which have been considered in earlier Council briefings and meetings.
- Financial – viability
  - Delivery
  - Regenerative

- Sustainability
- Financial Risk

Each is scored out of 3. 1 is low and 3 is high. The delivery approach as a principle is appraised on the table at Appendix 1 page 8. This scores the options and concludes direct development or developing in an SPV as the highest scoring option.

Sustainability has been added as an assessment criteria in its own right.

- 5.6 Financial - There is a balance between viability (does it meet minimum criteria to warrant delivery) versus profitability (the ability to generate a surplus that can be reinvested into delivery of other projects, such as a multi-purpose venue on Firepool). Clearly both are quite different. For example it may well be that we term certain blocks of Firepool as regeneration drivers that need to achieve viability and others as revenue generators that must deliver profitability.
- 5.7 This balance will be reviewed by the Council, as the Firepool programme progresses. This would also include revenue benefits such as Council Tax and Business Rates as new income to the Council.
- 5.8 Deliverability - This assesses the deliverability in the following measures:
- Likelihood of planning success
  - Covenant – ability of occupier to deliver, track record, etc.
  - Funding – proof of funding and level of conditionality of that funding
- 5.9 Regeneration - Key drivers are uses that produce highly skilled jobs, general jobs, complementary commercial and leisure space (complementary to the Town). This would also allow for design and quality reflecting the Garden Town design guidance.
- 5.10 Sustainability - All schemes must deliver Council policy at all costs and that means achieving zero carbon, including:
- Photovoltaics and other micro generation options
  - Air source heat pumps
  - Triple glazing
  - Increased insulation
- 5.11 Financial Risk - This is simply the financial risks contained within each project or element of the SPV
- 5.12 Delivery Options
- These are considered in more detail in Appendix 1.
- Site by site sale

- Non Council funded Joint Venture with Developer
- Council funded Joint Venture with Developer
- Direct development
- SPV Options – Stand-alone new vehicle wholly or partly owned by Council. This option allows development to be taken off balance sheet and limits the financial risk.

5.13 These delivery options are summarised at Appendix 1 and the highest scoring options that best achieve the Council's objectives are Direct development as with Coal Orchard or development through an SPV.

5.14 Direct development is a good solution. However it means that all of the risk sits with the Council and ultimately the tax payer. No property development is without risk and with ambition for schemes that may require a total investment of circa £200m, the borrowing will add additional pressure to the business debt. One key aspect is the need to make MRP (Minimum Revenue Provision) within the Council's accounting regime. This means the Council has to take out a repayment loan over up to 50 years whereas many businesses can borrow interest only to maximise revenue surpluses now.

5.15 One additional benefit of an SPV is that it can secure third party funding with limited recourse to the Council if an occasion of loan default were to occur.

5.16 The sensible option of those presented options to maximise the return to the Council is the SPV model. This model is a well-trodden path for local authorities with a considerable number of Local Authorities having a local housing Company which is another form of SPV.

5.17 The key reasons for developing in an SPV are as follows:

<b>Issue</b>	<b>Benefits</b>	<b>Impacts</b>
Financial Risk	The ability to contain development risk with the Company and not the Council	There is likely to be some residual risk on the Council as not all of the development funding can be borrowed. The Council also has risk as an investor
Development Funding	The SPV can access third party funding with little or no recourse to the Council and that funding can be more flexible potentially without impacting on MRP (more on	FRS10 and dealing with consolidating the SPV's accounts in the Council's accounts but not likely to impact on MRP (minimum revenue provision)

	this is in Appendix 3.	
Long term funding	The SPV can access long terms competitive interest only finance without the need to repay capital. Capital repayment plan is serviced by long term increasing capital values especially for the PRS model. This maximises surpluses	As a result a slightly higher interest rate over and above PWLB will be payable but less overall that the repayment costs
Surpluses	<p>There are 5 mechanisms to return surpluses to the Council:</p> <ol style="list-style-type: none"> <li>1. Profit rent</li> <li>2. Loan Interest</li> <li>3. Payment for services</li> <li>4. SPV can pay for some services that relate to the SPV that otherwise may have to be funded by the Council such as meeting the capital and revenue costs of a venue</li> <li>5. Dividend</li> </ol> <p>Crucially dividends are solely revenue income for the Council which are immediately available to support services as needed.</p>	<p>Items 1 to 4 are before tax payments.</p> <p>Item 5 is post corporation tax is currently 19% but there are a range of capital and other allowances available.</p> <p>The Council is not subject to corporation Tax. This is an extra over cost.</p> <p>Corporation Tax may well be off set by driving commercial efficiencies and speed of response</p>
Commerciality	The SPV can operate with a light touch approach and is able to make much quicker decisions and respond to market conditions without a 3 month Full Council decision process	The SPV could make decisions on a day to day basis outside of the control of the Council. However, all activities will be subject to business case which is approved by the Council
Venue or other non-commercial regeneration	The SPV can deliver at its own expense non profit making activities on behalf of the Council paid for by its	The Council may lose some direct control of such ventures. Any tax efficiencies would need

driving uses	operating surpluses. Such activities would not be at the direct expense of the Council and tax payers. Such activities would then be run on an efficient commercial basis	careful advice
External activities and partnering opportunities	The SPV will be solely focussed on delivering Council objectives but there is nothing to stop the SPV pursuing regeneration activities inside or outside of the area as additional surplus generating opportunities	This external activity will need to be carefully managed so as not to change the focus away from the core SWT administrative area

## **6 Governance and Control**

- 6.1 The SPV must deliver the Councils' objectives. The SPV is nothing more than a delivery mechanism for and on behalf of the Council. The Council though needs to have the governance structure in place to make sure the SPV is delivering the Council's objectives in a way that the Council is content with. Ultimately the Council owns the SPV but as the SPV is an independent legal structure the Council needs control and governance mechanisms in place. The following table demonstrates the principal layers of governance and control that the Council will exert on the SPV and will be generally subject to.
- 6.2 It is also important to note that through controls exerted over group SPV, the subsidiary SPV's will in time have the same levels of control passed to them

<b>Governance</b>	<b>Description</b>	<b>Impact</b>
Shareholder Agreement	This is the basis under which the Council manages its shareholding and the more commercial elements of the corporate relationship between the Council, the Group SPV and any subsidiary including how decisions are made, the matters reserved to the Council as ultimate owner of the Group, how profits are treated, funding and other Council controls	This is the most important of the layers of control exerted over the SPV
Articles of Association	The Articles of association set out how the company is run, from an administrative perspective to the extent not included in the Shareholder agreement, the Articles of Association would normally include the SPV's objects This would also include clear and demonstrable policies to deliver equality and zero carbon amongst many other clear objectives	This will provide a headline measure of control over the activities of the SPV
Business Plan	This will set key performance indicators to measure the success and effectiveness of activities. This will likely be an initial plan reviewed annually	This will inform and direct the day to day activities of the SPV

Loan Agreements	This sets out and records all sums loaned to the SPV together with interest, repayments and all other usual loan agreements. This will also include recovery action and step in rights if the SPV was to default on payments or any terms and conditions	This will control how monies are spent by the SPV
Freehold Retention	All disposals to the SPV should, wherever possible be in the format of long leases which provide maximum control to the Council. All transactions will be S123 compliant format to guarantee the Council receives value for money from its assets	Provides the Council with control over the use of Council assets and sets a profit rent to ensure the Council is properly paid for assets utilised before corporation tax is levied
Nominations to the Board	The Council would retain control of key appointments such as Chairperson and Chief Executive	Ensures the Council has a key role in the make up of the Board
Steering Group	This is likely to be the Full Executive that will meet on a quarterly basis or more as is needed where the SPV will report to the SPV on progress and key issues	The Steering Group will report to Full Council and feedback key issues as required and recommend any formal action to be taken if required
Companies Act	This places obligations on the Company to conduct its activities in accord with company law. This will include confirmation statements and submission of accounting information	This ensures the Company complies with all relevant legislation

Audit/Accounting	It is a key component of the Shareholder Agreement and or Arts and Memos to ensure the SPV maintains high quality financial records which will be maintained in a professional manner and prepared by a firm of Auditors	This demonstrates the SPV's good and proper financial management in an open and transparent format
Exit Arrangements	The Council will retain the ability to wind up the SPV should it need to. It also has the options to sell all or part of its shares to third party investors or indeed to the SPV.	Any exit arrangements would be time consuming for example a full review would need to be undertaken
Meeting Financial commitments of the Council	The Council would reserve the right to call in super dividends as the Council's finances may dictate	The SPV may need to sell key assets as and when needed to raise distributable funds to meet the needs of the Council
Step In Rights	The Council will reserve the right to step into any activity being undertaken. This is an option which the Council can choose to exercise but will not be an absolute undertaking	This may have far reaching impacts such as SDLT and tax but will give the Council the surety that projects started will always be finished

## 7 Proposed SPV structure

- 7.1 The Council has received independent financial and legal advice in connection with the creation of the Group SPV, copies of which are contained at Appendix 2 and 3.
- 7.2 On the basis of that advice, the Council has assessed that the most appropriate route would be to establish the Group SPV as a company limited by shares. All other options are considered from a legal perspective in Appendix 2. A

summary of the key advantages and disadvantages of this model are set out below:

<u>Advantages</u>	<u>Disadvantages</u>
<p>"Tried and tested" – a flexible and familiar structure which is still the most popular form of corporate vehicle. Limited liability for Council in capacity of shareholder for the debts and obligations of the company.</p> <p>Over 50% of local authorities in England have set up companies to support their corporate ambitions. Some are developing homes and commercial properties, some are supporting homelessness, IT or energy initiatives. Some have multiple companies which support different business streams and although they may be pulled together under one holding company which is the recommended solution here as this helps support multiple commercial activities.</p>	<p>Annual and event driven reporting to Companies House means a reasonably high degree of publicity regarding the company.</p>
<p>Simple mechanism for introduction of new equity/transfers of existing equity, although transfers of shares subject to potential 0.5% stamp duty charge. The share capital structure means the shareholder(s) can hold different numbers of shares (or different classes) and therefore, if there is more than one shareholder in the future, hold varying levels of influence.</p>	<p>Directors subject to statutory and common law duties, which will be of particular concern (to those directors) if the company is insolvent or is nearing possible insolvency.</p>
<p>Nature of shares as an investment gives possibility of future "exit" as well as income return for shareholders, subject to there being sufficient profits available for the purpose of distribution.</p>	<p>Company treated as a separate taxable entity from its shareholders.</p>
<p>Company can be established with a sole shareholder, so capable of being owned outright by the Council.</p>	<p>Potential issues surrounding valuation of shares on exit.</p>
<p>Can borrow in its own right and grant security over its assets.</p>	
<p>Can act as a vehicle to deliver Council's commercial trading ambitions (e.g. to sell services to third parties).</p>	

7.3 It is recommended that the Group SPVs objectives are established on a broad basis, so as not to exclude any particular opportunity. Accordingly, it is proposed that the SPV's objectives will, broad terms, be:

- To acquire, lease, invest in, finance, develop, hold, manage and/or dispose of housing property of various tenures and classes.
- To stimulate and accelerate property development in the Council's administrative area and wider.
- To provide services of any description to any person.
- To undertake any and all activity which from time to time may be considered necessary, connected with or ancillary, or in any way conducive to attaining the above objectives

7.4 The principles above would be fleshed out in each SPV's business case.

7.5 At present, the Group SPV will be a dormant "shell" with no assets or business plans/cases to deliver. The corporate and resourcing relationships between the Council, Group SPV and subsidiary SPVs would be governed at a high level by four principal documents:

- A Shareholder Agreement setting out the more "commercial" elements of the corporate relationship between the Council, Group SPV and any subsidiary SPVs, including how decisions are made, the matters reserved to the Council as ultimate owner of the group, how profits are treated, funding, and other Council controls. Any SPV created in the future would undertake to adhere to its terms, thereby creating a more unified governance structure across the corporate group.
- Articles of Association for the Group SPV are a requirement from a corporate law perspective and set out more "administrative" provisions. The Articles dovetail with the Shareholder Agreement.
- A Resourcing Contract setting out how the Group SPV would "call down" support from the Council or other members of the corporate group when required. As with the Shareholder Agreement, any subsidiary SPV created in the future would undertake to adhere to its terms, thereby aligning the way in which the Council enables each SPV to operate. The nature of the resourcing (for example, physical assets, property, IPR, personnel) needs to be priced in a way which complies with State aid principles.
- A Funding Agreement setting out how the Council would fund the Group SPV, to the extent the Council is not investing by way of equity subscription and/or third party debt is not sought. An SPV's funding arrangements would be agreed through its business case/business plan

(the adoption of which is a Council reserved matter).

- 7.6 The Group SPV would be managed by a board of directors (albeit the board would operate in adherence to the documents listed above and therefore certain decisions would be reserved to the Council as ultimate owner of the Group). For incorporation purposes, it is proposed that an independent candidate is appointed as director. Upon approval of the first SPV business case, it is proposed that further directors of the Board be nominated.
- 7.7 As noted above, in addition to approving the appointments to the Group SPV/SPV Boards, the Council retains a significant level of control through the reserved matters set out in the Shareholder Agreement.
- 7.8 There are no immediate staffing requirements for the Group SPV. Staffing requirements for each SPV will be identified from individual business cases. There will be a need for Group SPV/an SPV to administer its own internal administration and compliance with company requirements. It is envisaged that this will be managed in the first instance at least through secondment or the provision of services by the Council to the Group SPV.
- 7.9 As the Group SPV would be 100% owned by the Council it would be a local authority controlled company for the purposes of the Local Authority (Companies) Order 1995. This places a number of administrative, disclosure and financial obligations on controlled companies.
- 7.10 Whilst the corporate form of the Group SPV has been determined, the corporate form of the SPVs will be the subject of further analysis as opportunities come forward and Executive approval will be required at the appropriate time.

## **8 Investment and other resources required to achieve those objectives**

- 8.1 The investment and other resources required to establish the Group SPV are low. The form of Shareholder Agreement and Articles of Association are near finalised and the Group SPV will need to undertake various formalities to approve and adhere to them.
- 8.2 As an opportunity arises, it will be subject to:
- Commercial, financial and legal due diligence
  - External commercial advice where that is considered appropriate
  - A separate business case
  - Executive approval
- 8.3 At this stage, it is anticipated that the Group SPV /SPVs would require finance and external support to demonstrate that functions are within budget:

- Business planning and financial modelling
  - Market research
  - Legal matters
  - Tax advice to ensure the most tax efficient structure is pursued
- 8.4 The borrowing requirements of the Group will be identified in the detailed business cases when opportunities are identified. The State aid implications of this will also be considered on a case by case basis.
- 8.5 Taxation will likewise be looked at in each SPV business case. This will allow proper consideration of the issues affecting each SPV (for example capital allowances, SDLT, corporation tax, options to elect to tax for VAT purposes and lease arrangements). In principle, due to the establishment of the Group approach, this should enable the Council to take advantage of more tax efficient group company arrangements in appropriate circumstances.
- 8.6 Opportunity-specific risks, as well as the wider risks, are to be considered on a case by case basis with the Executive approving any opportunities and the relevant business cases going forward.

## **9 Expected financial results of the business**

- 9.1 These are to be assessed as opportunities arise. At present, the Group SPV will be a dormant "shell" with no assets or business plans/cases to deliver. However, it is intended that the SPV will deliver distributable surpluses in excess of £3m per annum from Year 5

## **10 Links to Corporate Strategy**

- 10.1 Shape and protect our built and natural environment
- 10.2 Encourage wealth creation and economic growth throughout the District
- 10.3 Support the town centres throughout the District to meet the challenge of changing shopping habits
- 10.4 Facilitate the development of the commercial parts of the Firepool site in Taunton
- 10.5 Ensure our land and property assets support the achievement of the council's objectives (including service delivery, regeneration projects and community initiatives).

## **11 Finance / Resource Implications**

11.1 Considered in Appendix 3

## **12 Legal Implications**

12.1 Considered in Appendix 2.

## **13 Climate and Sustainability Implications**

13.1 Zero Carbon is the strict policy.

## **14 Safeguarding and/or Community Safety Implications**

14.1 None related directly to this report.

## **15 Equality and Diversity Implications**

15.1 None related directly to this report.

## **16 Social Value Implications**

16.1 At this stage we have not carried out a detailed analysis in this area but the regeneration benefits will be significant and the provision of much needed affordable rented accommodation will be considerable.

## **17 Partnership Implications**

17.1 None related directly to this report.

## **18 Health and Wellbeing Implications**

18.1 No known implications in this report.

## **19 Asset Management Implications**

19.1 The Asset Management Team will be involved and have acted as advisors throughout the production of the proposal to make this investment.

## **20 Data Protection Implications**

20.1 None related directly to this report.

## **21 Consultation Implications**

21.1 None related directly to this report.

## 22 Scrutiny Comments / Recommendation(s)

### Democratic Path:

- Scrutiny Committee – Yes
- Executive Committee – Yes
- Full Council – Yes –

Reporting Frequency: Once only

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A  
of the Local Government Act 1972.

Document is Restricted



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18 August 2020

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**SOMERSET WEST & TAUNTON COUNCIL**

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**REGENERATION DELIVERY STRUCTURE – INITIAL  
LEGAL ADVICE**

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## SOMERSET WEST & TAUNTON COUNCIL

### REGENERATION DELIVERY STRUCTURE – INITIAL LEGAL ADVICE

#### INTRODUCTION – BACKGROUND AND ADVICE REQUESTED

- 1.1 The Council is considering the establishment of a local authority trading company (currently proposed to be named "RegenSWT"). The purpose behind RegenSWT is set out in the report to be taken on 29 September 2020m namely that it will deliver town centre regeneration projects which would not otherwise be delivered on the open market. The Council would thereby intervene in the market and bring forward those projects.
- 1.2 The Council has decided that RegenSWT will be a limited company, wholly-owned by the Council and at the head of a range of subsidiary companies established primarily to support the delivery of the Council's regeneration ambitions and the strategic priorities of the Council but which could also deliver other objectives as the Council may require.
- 1.3 RegenSWT will provide an overarching governance framework for all subsidiary vehicles.
- 1.4 In this context, the Council has requested some initial legal advice. Accordingly, this Paper is structured as an executive summary report which compares and contrasts various models, with further detail contained in the Schedules. The basis of our advice is set out in Schedule 1.
- 1.5 Whilst (as noted above) the Council has decided on the form of RegenSWT, in the interests of brevity, we have often referred to a "company" in this Paper and by this we mean a separate vehicle for the delivery of a particular activity. Many of the issues raised in this Paper are applicable to other corporate vehicles, subject to necessary amendments to reflect the law in relation to those other vehicles. It should be noted from the outset that we have based our advice on the assumption that the council will, at this stage, be establishing those vehicles on a wholly-owned basis.

**Bevan Brittan LLP**  
**18 August 2020**

## EXECUTIVE SUMMARY REPORT

The first task for the Council is to define its "commercial programme" of development, and to think more widely about all related activities which would be required to support development and regeneration delivery or issues which might arise. Once the commercial underpinning of the development and delivery programme has been fleshed out the Council, in conjunction with its commercial advisors, will need to consider the practical steps to be taken in terms of: the purpose (or outputs) behind specific developments; how it will proceed to develop its assets (including the most tax efficient way of doing so); the order of development; and the preferred timescale for bringing forward development. The position on vires, procurement, structuring, governance, etc. for individual proposals can then be firmed up.

Nevertheless, our advice can be summarised as follows:

- The Council has wide ranging powers to set up companies. Local authority use of wholly-owned companies for regeneration and development is reasonably common and is a legally viable model for the Council to use to meet its objectives. The model enables multiple businesses to be undertaken by the same vehicle or group, so additional developments and/or services could be added in the future.
- RegenSWT can be set up with broad objectives, so as not to exclude any particular opportunity. The current proposed objectives are permitted:
  - To acquire, lease, invest in, finance, develop, hold, manage and/or dispose of housing property of various tenures and classes.
  - To stimulate and accelerate property development in the Council's administrative area and wider.
  - To provide services of any description to any person.
  - To undertake any and all activity which from time to time may be considered necessary, connected with or ancillary, or in any way conducive to attaining the above objectives.
  - Incorporate climate change goals into the objectives of the Group.
- The constitutional documents of RegenSWT can be drawn up to embed maximum flexibility but also key Council controls. If RegenSWT is established as a company limited by shares (which would be preferable from a governance and incorporation perspective to a community interest company, for example), then there is no set form of articles of association or shareholder agreement. The latter would contain the more "commercial" elements of the relationship between the Council, RegenSWT and any subsidiaries, including how decisions are made, the matters reserved to the Council as ultimate owner of the group, how profits are treated, funding, information rights and other Council controls, and termination. Each new subsidiary established after the Agreement was signed would undertake to adhere to its terms, thereby creating a more unified governance structure across the corporate group.
- A company's operation would be overseen by a board of directors, but with strategic control retained by the Council. The Council should consider potential conflicts for officers and members appointed as company directors. There are advantages in using a group holding company (which is the role RegenSWT would take). Such a structure could embed the RegenSWT board's oversight role for the group's activities, enabling the group to operate with commercial freedom.
- RegenSWT can be established to be either a contracting authority (in which case it is caught by the EU procurement rules but the Council can potentially award contracts to it under the "Teckal" exemption) or not a contracting authority (which we understand is the Council's preference and would enable the company to award contracts otherwise caught by the EU procurement rules without competition).

- The State aid rules can be satisfied in relation to RegenSWT (and indeed any other development subsidiary in the future) by charging market rates for loan funding and services and investing in its equity on market terms. There are The State aid rules can be satisfied in relation to any subsidiary holding affordable housing assets by relying on the exemption for services of general economic interest. These will allow the Council to provide loan and equity funding on below-market terms as well as provide services for a below-market charge. An act of entrustment will be required to rely on this exemption.

The remaining paragraphs in this Executive Summary Report deal with key themes for the Council to consider.

## 1 COUNCIL POWERS

Please refer to the following Schedules for further detail: Schedule 2 (*Council powers*), Schedule 4 (*Common corporate vehicles*) and Schedule 7 (*Controlled and influenced companies*).

### Council powers

- 1.1 Local authorities can do what they are statutorily empowered to do and what may be inferred by the language of an Act of Parliament. The Council's vires to participate in the development proposals need to be rooted in a specific power, otherwise the Council's actions will be open to challenge. This is particularly important if the proposed course of action is potentially contentious or novel, or moving into commercial territory where competitors may be ready to question the Council's basis for the enterprise. The position in relation to local authority vires has changed significantly with the introduction of the general power of competence in the Localism Act 2011 (**LA 2011**), being the power to do anything an individual may do provided it is not constrained by other legislation.
- 1.2 If a statutory power is exceeded or used for an improper purpose, then its use can be challenged in the courts. A decision to enter into arrangements will be tainted if there is an improper purpose which is the sole, dominant or primary purpose. A decision may also be tainted if the improper purpose had a material influence. However, an incidental or collateral benefit from the use of a statutory power within its limits and for a proper purpose can nevertheless be lawful.
- 1.3 An authority's purposes or motivation is important in determining whether or not it can use any particular power, because matters pursued for certain objectives will be lawful, but if pursued for other objectives may be unlawful. We usually say that "powers follow purposes" and the primary motives/ purposes are the most important in determining the use of powers.
- 1.4 However, before considering the effect of the LA 2011 provisions on local authority vires, it is important to note that local authorities already had (and have) wide ranging powers in relation to property, to facilitate their responsibilities to deliver services and to provide assets for their areas. These powers include the following:
  - 1.4.1 sections 120 to 123 of the Local Government Act 1972;
  - 1.4.2 sections 2, 3 and 5 of the Local Authorities (Land) Act 1963;
  - 1.4.3 Part 2 of the Housing Act 1985;
  - 1.4.4 sections 24 to 26 of the Local Government Act 1988;
  - 1.4.5 sections 227 and 233 of the Town and Country Planning Act 1990; and
  - 1.4.6 miscellaneous other powers.
- 1.5 A combination of these specific powers would usually be sufficient for a local authority to undertake any property acquisition, financing, development, sale, rental or related project in its area where at least part of the motivation was connected with the broad benefit or improvement of its area. There may be additional powers related to specific activities which the Council can rely upon and these should be confirmed once the development and delivery proposals are refined.

- 1.6 In addition:
- 1.6.1 section 95 of the Local Government Act 2003 enables Best Value authorities to provide on a commercial basis anything that is related to a function of the authority or is ancillary, conducive or facilitative to the exercise of that power;
  - 1.6.2 the LA 2011 creates a general power of competence, as a much broader "power of first resort"; and
  - 1.6.3 the Council has various additional ancillary powers (for example, section 1 of the Local Government (Contracts) Act 1997 and section 111 of the Local Government Act 1972) which it can deploy to augment the other powers referred to above.
- 1.7 The Council should therefore be able to root specific development and delivery proposals in specific powers and to form and fund appropriate corporate vehicles (for example, a company or an LLP, as a wholly-owned vehicle), whether for the better discharge of its functions or for some other purpose.

### **Exercise of powers**

- 1.8 In exercising any power or duty local authorities must act for proper purposes, in good faith and must exercise the powers properly, following proper procedures in a "Wednesbury reasonable" manner. In other words the Council must act for proper motives, taking into account all relevant considerations, ignoring irrelevant matters, not acting irrationally and balancing the risks against the potential rewards. Additionally, the Council must consider its overarching duty, the duties of best value, crime and disorder reduction, equalities, health and wellbeing and other relevant duties which must be taken into account when making decisions, as well as any explicit requirements placed on a specific power.
- 1.9 Part V of the Local Government and Housing Act 1989 introduced controls on local authority involvement in companies and these include a number of propriety controls that must be followed in connection with any company established that is controlled by local authorities or has a personnel association of more than 50% or more than 20% and a business relationship between the authorities and the company (as defined in the Local Authorities (Companies) Order 1995). Controls under that Order include that directors would not be disqualified from being a local authority (elected) member; remuneration and expenses for councillor directors do not exceed levels that the local authority could pay as comparative members' allowances; information must be provided to the local authority's auditor; and letterheads must show the relationship with the company.

## **2 CHOICE OF CORPORATE VEHICLE**

Please refer to Schedule 4 (*Common corporate vehicles*) for further detail.

### **Common choices of corporate vehicle for regeneration and development**

- 2.1 The most appropriate form of vehicle is likely to be driven by a number of factors including:
- 2.1.1 the purpose(s) of the vehicles;
  - 2.1.2 sources of funding for different tenures;
  - 2.1.3 planning requirements; and
  - 2.1.4 tax (which is the subject of separate advice).
- 2.2 We have concentrated on the most common forms of corporate vehicle considered or established by local authorities, namely:
- 2.2.1 a private company limited by shares (**CLS**);
  - 2.2.2 a private company limited by guarantee (**CLG**);

- 2.2.3 a community interest company limited by shares (**Share CIC**);
- 2.2.4 a community interest company limited by guarantee (**Guarantee CIC**);
- 2.2.5 a limited liability partnership (**LLP**); and
- 2.2.6 a community benefit society (**Society**).

2.3 We have not included less common corporate vehicles (such as charitable companies), joint ventures, or unincorporated arrangements (such as a contractual joint venture, limited partnership or traditional partnership), but can include these if requested.

2.4 A summary of the key features of the common corporate vehicles can be found in Schedule 4 and we have set out a synopsis of the advantages and disadvantages of those vehicles below in this section for ease of comparison. However, they all share one feature in common – each vehicle has a separate legal personality independent of its "owner". Subject to the rules governing the form of vehicle, it may hold assets in its own name and invest funds. It may sue and be sued in its own name and owe liabilities to others on the same basis. The "owner" will benefit from limited liability in its capacity as owner, although it may of course owe additional obligations to the vehicle or to third parties in respect of the vehicle in other capacities (such as guarantor or funder). It is open to the Council to contractually restrict the vehicle in its business (to what is often called its "objects" or "mission statement") or what it can do (its "powers").

CLS	
Advantages	Disadvantages
"Tried and tested" – a flexible and familiar structure which is still the most popular form of corporate vehicle.	Annual and event driven reporting to Companies House means a reasonably high degree of publicity regarding the company.
Simple mechanism for introduction of new equity/transfers of existing equity, although transfers of shares subject to potential 0.5% stamp duty charge. The share capital structure means shareholders can hold different numbers of shares (or different classes) and therefore hold varying levels of influence.	Directors subject to statutory and common law duties, especially if the company is or is near insolvency.
Nature of shares as an investment gives possibility of future "exit" as well as income return for shareholders, subject to there being sufficient profits available for the purpose of distribution.	Company treated as a separate taxable entity from its shareholders.
Company can be established with a sole shareholder, so capable of being owned outright by the councils.	Potential issues surrounding valuation of shares on exit. Also shares, once created, can't be extinguished except through mechanisms in the Companies Act 2006. This means that if a shareholder leaves, that share (and the associated rights attaching to it) need to be transferred to another shareholder, creating potential imbalances in the ownership structure and control.

CLG	
Advantages	Disadvantages
Often used as a vehicle for embedding "social" values (e.g. social objects and no profit distributions to members), without the need to use a CIC, a Society or a charitable company.	Guarantee given by each member represents a future, albeit usually nominal, liability.
Membership easily changed by members being admitted or resigning from membership. No issues surrounding valuation on exit.	Annual and event driven reporting to Companies House means a reasonably high degree of publicity regarding the company.
Company can be established with a sole member, so capable of being owned outright by the councils.	Directors subject to statutory and common law duties, especially if the company is or is near insolvency.
	Company treated as a separate taxable entity from its members.
	Not as easy to distribute profits as with a CLS (but it is possible so long as there are no restrictions on doing so in the articles of association).
	Cannot issue shares as a means of raising finance.

Share CIC	
Advantages	Disadvantages
Vehicle has automatically embedded "social" objects and requirement to use assets towards that social purpose. The creation of a CIC emphasises both its social character and local focus.	Alongside publicity requirements for a CLS, a Share CIC has additional publicity obligations towards the CIC Regulator.
Simple mechanism for introduction of new equity/transfers of existing equity, although transfers of shares subject to potential 0.5% stamp duty charge. The share capital structure means shareholders can hold different numbers of shares (or different classes) and therefore hold varying levels of influence.	CIC Regulator has wide powers of inspection and intervention, albeit these would most likely be used in serious cases only.
A Share CIC can raise finance through the issue of new shares.	Returns to equity and debt investors are limited. Surplus assets on dissolution will not go to the shareholders of a Share CIC automatically (unlike the shareholders in a CLS).
Nature of shares as an investment gives possibility of future "exit" as well as income return for shareholders, subject to there being	Directors subject to statutory and common law duties, especially if the company is or is near insolvency.

sufficient profits available for the purpose of distribution.	
Company can be established with a sole shareholder, so capable of being owned outright by the councils.	Company treated as a separate taxable entity from its shareholders.

Guarantee CIC	
Advantages	Disadvantages
Vehicle has automatically embedded "social" objects and requirement to use assets towards that social purpose. The creation of a CIC emphasises both its social character and local focus. A Guarantee CIC is also "not for profit", given it cannot distribute profits to its members.	Alongside publicity requirements for a CLG, a Guarantee CIC has additional publicity obligations towards the CIC Regulator.
Membership easily changed by members being admitted or resigning from membership.	CIC Regulator has wide powers of inspection and intervention, albeit these would most likely be used in serious cases only.
Company can be established with a sole member, so capable of being owned outright by the councils.	No ability to distribute profits to members.
	Directors subject to statutory and common law duties, especially if the company is or is near insolvency.
	Company treated as a separate taxable entity from its members.
	Asset lock so that assets may not be returned to the Council except for value.

LLP	
Advantages	Disadvantages
Not generally treated as a separate taxable person, so no "double tax" on profits generated, then distributed, to members.	Annual and event driven reporting to Companies House means a reasonably high degree of publicity regarding the LLP.
Flexible vehicle – no Companies Act directors, so no directors' duties (albeit these can be imposed by contract and underlying fiduciary duties probably exist for any LLP management)	Requirement for an LLP agreement to avoid default provisions under the LLP Regulations applying.
	Requires a minimum of two members – a company can be incorporated with one. This means that if the founding council were to invest through another corporate entity, rather than individually, they would need to establish a second member of the LLP, usually a

	nominee company wholly-owned by the councils.
	Restrictions on councils using LLPs where their purpose is commercial/trading.

Society	
Advantages	Disadvantages
Lower level of annual and event driven reporting to the Financial Conduct Authority ( <b>FCA</b> ) than for companies, CIC and LLPs.	FCA-regulated, which is not as straightforward as dealing with Companies House
Vehicle has automatically embedded "social" objects and requirement to use assets towards that social purpose. A Society is also "not for profit", given it cannot distribute profits to its members.	Requires a minimum of three members (or two if both members are themselves Societies) – although can still be formed as a subsidiary. The additional shareholders can be individuals who are controlled by the parent.
Mechanism for introducing new members can be straightforward, through issue of new shares.	Shares do not represent an investment in the Society. Assets cannot be distributed to members, either as profit or on a winding up.
	Less well-known/used, so less familiar structure than companies, CICs and LLPs.
	Society treated as a separate taxable entity from its members.

### Use of a holding company

- 2.5 A holding company operates as a company wholly-owned by the Council that in turn owns all or a number of the delivery companies, whether trading or Teckal. The result is that the Council can have a reduced number of direct relationships, dealing only with the holding company(/ies). On the other hand, the holding company has multiple direct relationships with the various individual companies. The holding company does not typically deliver services but rather acts a strategic board on behalf of the Council managing the different companies.
- 2.6 There are usually two main factors influencing the decision as to whether to use a holding company:
- 2.6.1 **Governance:** where there are multiple subsidiary companies, then a holding company allows the Council to have one single "ownership" relationship in respect of the group structure. The simplicity of this from the Council's perspective can be an advantage. The Council may of course have other direct relationships with delivery vehicles (for example, through service delivery contracts/SLAs, funding and security, and resourcing arrangements). Equally, the holding company could act as a filter between the strategic control of the Council and delivery of operational matters by the subsidiaries. If this model is used, there would be scope for a different type of board than may be appropriate for trading/delivery vehicles, with more of a focus on strategic oversight for senior members and officers. However, care needs to be taken if a subsidiary is a Teckal company: Council control should still flow through the holding company.
- 2.6.2 **Tax:** tax is often a significant factor for determining the use of a holding company in local authority company structures. For example, a holding company can allow subsidiary companies to benefit from group tax relief which can be a significant advantage. However, in some circumstances use of a holding company can have disadvantages, e.g. precluding

the ability of a Teckal company to benefit from the mutual trade exemption from corporation tax. We note that the Council is taking separate and specific tax advice in respect of its company structure.

- 2.7 The exact remit and make-up of a holding company will vary depending on the Council's rationale for implementing a holding company model.
- 2.8 Where the decision is for the holding company to have a more significant governance role, the company could have greater discretion over the management and operation of subsidiary companies, probably still working to a broad agreed strategy. For example, the Council could agree an overall strategic plan with the holding company and have certain high level reserved decisions. It would then be for the holding company to manage the companies and exercise its rights as shareholder in those subsidiaries in line with that framework. To give this role more substance, the contracts for services and any funding from the Council could be made to the holding company that would in turn contract with the subsidiaries and therefore be responsible for managing their performance against such contracts. Even where this approach is taken, there are sometimes tax reasons for making a supply direct from the authority to the ultimate recipient, i.e. the delivery company.
- 2.9 Where the company is used primarily for tax purposes, the holding company could have a more limited role, with a board principally concerned with exercising shareholder decisions in respect of its subsidiaries such as approval of business plans and deciding reserved matters. In this model, the holding company may have a direct mirror of decisions that it has to refer to its shareholder (i.e. the Council continues to have a similar role in terms of governance / decision making as it would without the holding company). Contracts for services could continue to be direct between the relevant company and the Council rather than going through the holding company.
- 2.10 There are also disadvantages with a holding company structure. First, an additional company will have resource and cost implications (for example, putting in place the constitutional documents and management arrangements). Second, it will create an additional layer through which the Council's governance will need to be operated. The decision to establish a holding company (and associated governance) rarely hinges on the additional cost, but rather reflects the existence (or otherwise) of tax benefits and how the Council envisages that it would govern its group.

### **3 GOVERNANCE**

Please refer to the following Schedules for further detail: Schedule 5 (*Governance issues*) Schedule 6 (*Duties and liabilities of directors and company secretaries*), Schedule 7 (*Controlled and influenced companies*) and Schedule 9 (*Sample reserved matters list*).

- 3.1 The governance structure for subsidiaries structured as companies limited by shares will be based around the two roles of shareholders and directors and these are considered below (other common forms would also have similar requirements).

#### **Shareholders**

- 3.2 The shareholders are the owners of a company. Shareholders control a company through the appointment and removal of directors and certain statutory rights. In addition, shareholders may exercise control in accordance with rights given to them either in the articles or a separate contract with the company: a shareholder agreement. It is common for a shareholder agreement to be put in place to provide a local authority owner with strategic control over the operation of the company through the right to approve a business plan and the requirement that certain decisions, referred to as "reserved matters", must be referred back to it as shareholder rather than being within the discretion of the board of directors.
- 3.3 The approach to a shareholder agreement and the level of control that is appropriate is likely to vary depending on whether the company is being structured as a Teckal or a trading company, and (more generally) subject to, or outside of, the procurement rules.
- 3.4 The overall position typically achieved is that the authority approves the business plan and the board of directors then have the remit and discretion to implement it, subject to the reserved matters. The

level of discretion given to the board depends on the framing of the business case – i.e. how prescriptive or flexible it is – and what the reserved matters are.

- 3.5 As well as considering how prescriptive or flexible an approach it would prefer, the Council would need to decide how it wishes to exercise its shareholder function. Given the function is about the strategic control over the company's activities, it is usual for it to be exercised by members. This could be: through all shareholder decisions going to Cabinet; a committee of Cabinet being established to undertake some or all decisions; or certain decisions being delegated to senior officers with consultation with relevant portfolio holders.

### **Board size and composition**

- 3.6 Directors will control the operation and management of the vehicle. The Council will usually be able to appoint, remove and replace the directors by notice in writing to the vehicle. There is no set size or composition of a board of a local authority company. However, there are a number of issues that the Council will need to consider thoroughly:
- 3.6.1 the appropriate size of the board for the circumstances so that it is not unwieldy and can make decisions quickly where appropriate to do so;
  - 3.6.2 the appropriate mix of skills and experience required;
  - 3.6.3 the extent to which the board will be executive or non-executive – executive being directors who are employees of the company, and non-executive being those not employed, being either officers or members from the Council and/or independent directors;
  - 3.6.4 the need to demonstrate sufficient control when required for a Teckal company, or independence if required to achieve non-contracting authority status;
  - 3.6.5 the potential conflicts which could hinder the effective operation of the board or present issues for individuals when acting within the Council.

### **Conflicts of interests: general**

- 3.7 As part of its decision as to board composition, the Council must consider conflicts of interests. The potential for conflicts most commonly arises because officers or members appointed as directors of a company will have separate duties and interests (1) as company directors, and (2) as Council employees or members. This needs to be considered in respect of decisions within the company and within the Council.

#### *Decisions within the company*

- 3.7.1 The duty under company law to avoid conflicts of interests requires a director to avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or may conflict, with the interests of the company. The fact that a director is appointed by, and may also be a member or officer of, the Council is likely to place him or her in a position of potential conflict between his or her loyalty to the Council and his or her duties to the company.
- 3.7.2 This can be dealt with by drafting the company's articles to allow any conflicts of interest arising purely by virtue of a director being a member or officer of the Council to be automatically authorised, and for that director to be able to participate in discussions on the matter in question and to vote on decisions concerning the matter.

#### *Decisions within the Council*

- 3.7.3 The issue of conflicts is more acute in relation to decisions made within the Council. An officer has a duty to his or her employer and a member has a duty to the Council. Both have duties in terms of appropriate decision making within a public body – for example, not being biased or predetermined.

### **Conflicts of interests: officers**

- 3.8 The Council can agree to officers continuing to act despite potential conflicts; agree not to take action against them where they are required to act contrary to the interests of the Council due to their role as director; and agree to their remuneration as a director.
- 3.9 Managing conflicts is more problematic for officers if they are involved in making material decisions about the company wearing their Council officer "hat". This can create a risk of challenge on the basis that the decision is influenced by bias because of their role at the company, and/or by pre-determination i.e. that they have made their mind up because of the company role and are not making the decision objectively and fairly.
- 3.10 This risk is best mitigated by not putting Council officers who are responsible for material decisions relating to a company as directors of the company. If such officers are required to be on the board, steps should be taken to mitigate the impact within the Council. For example, this could be done by carving out responsibility for decisions that relate to the company from the remit of the officer and a suitable alternative role having such responsibility.
- 3.11 We would typically advise against statutory officers (monitoring officer, s.151 officer and the head of paid service) being appointed as directors as they may be required to undertake their statutory roles in relation to the company at some point, which would raise difficult conflicts.
- 3.12 The Council should also consider the "retained client" role i.e. if all officers who know anything about the services being delivered are either seconded or transferred to the company to run them and/or on the company board as a director, who is left to advise the Council on decisions about the company, and about decisions in relation to the company in their capacity as owners.
- 3.13 It is a criminal offence for officers, under colour of their office, to accept anything other than their proper remuneration. Consequently, where officers are appointed as directors by reason of their post within the Council, they may not accept any payment from the company for services as a director, unless the Council agrees that the additional payment shall form part of their proper remuneration. It is therefore recommended that officer directors should formally notify the Council (the chief executive and the monitoring officer or any alternative requirements of the Council) of their interest, and this should be kept on the officer declaration file. An alternative approach that is sometimes taken where there is a desire for the director role to be remunerated is for the officer to have a separate contract with the company (i.e. not as part of the officer's contract of employment with the authority) and receive remuneration through this. In these cases, the employing authority will need to provide approval for the individual to take on the separate role.

### **Conflicts of interest: members**

- 3.14 The conflicts issues for members relate to the code of conduct, as well as the broader risk of decisions made by members who are also directors being challenged on the basis of bias or predetermination.
- 3.15 Directors who are members must disclose any potential conflicts of interests and observe the requirements of the code of conduct of the Council required under the Localism Act 2011. Such directors must also be careful (when undertaking their Council role) to behave in ways which avoids suggestions of bias or predetermination. This can be difficult and more so for more senior members, for example the Cabinet members. Despite the potential for the Council to approve dispensations to effectively authorise the conflict from a councillor standards perspective, it could remain difficult in practical terms for the member to deal with a matter in a satisfactory way and it could lay both the member and the Council open to allegations of bias and potential challenge.
- 3.16 Where the Council is seeking to establish a company that is not caught by the procurement rules, the position would typically be stronger without members on the board. This is because it would help create greater distance between the company and the Council and reduce the perception or risk that the vehicle has a policy purpose rather than being purely an investment/financial purpose.
- 3.17 Directors' remuneration (if any) for members is restricted in law. This means that they cannot receive any additional remuneration from the company for acting as a director which is beyond the special

responsibility allowance they would have received had the activities of the company been discharged by the Council. Any remuneration they receive will be deducted from the special responsibility allowance that they receive within the Council and they may only claim mileage and subsistence at the rates that apply to members.

### **Directors' and officers' liability insurance**

- 3.18 Directors are subject to a large number of duties and obligations as set out in the articles of association of the company, statute and common law. These fall into the following three broad categories:
- 3.18.1 general duties under the Companies Act 2006;
  - 3.18.2 duties under other legislation;
  - 3.18.3 insolvency legislation.
- 3.19 A director can in certain circumstances be personally liable under these duties, for example, in relation to wrongful or fraudulent trading. The Council should therefore consider indemnity arrangements for officers and members acting as directors to decide how best to protect those it appoints to this role.
- 3.20 There is a general statutory indemnity under Public Health Act 1875 that will be available where the officers or members have acted in good faith. In addition, local authorities sometimes provide specific indemnities for officers or members appointed to external bodies.
- 3.21 Insurance can also be obtained by the company or by the Council (assuming cover is not included as part of its existing corporate policy).

### **Documenting the corporate structure**

- 3.22 The corporate and resourcing relationships between the Council and its subsidiaries from time to time would be governed at a high level by four documents:
- 3.22.1 A **Shareholder Agreement** setting out the more "commercial" elements of the corporate relationship between the Council and a given subsidiary, including how decisions are made, the matters reserved to the Council as ultimate owner of the group, how profits are treated, funding, information rights and other Council controls, and termination. Each new subsidiary established after the Agreement was signed would undertake to adhere to its terms, thereby creating a more unified governance structure across the corporate group.
  - 3.22.2 **Articles of Association** for each subsidiary (where structured as a company) are a requirement from a corporate law perspective and set out the more "administrative" provisions in the Council/subsidiary relationship and need to dovetail with the Shareholder Agreement.
  - 3.22.3 A **Resourcing Contract** setting out how a subsidiary would "call down" support from the Council when required. It should be noted that one or more subsidiaries may in the future enter into agreements between each other. This would need to be considered and agreed at the time and would be a matter reserved for the Council under the Shareholder Agreement. As with the Shareholder Agreement, each new subsidiary established after the Resourcing Contract was signed would undertake to adhere to its terms, thereby aligning the way in which the Council enables each subsidiary to operate. The nature of the resourcing (for example, physical assets, property, IPR, personnel) needs to be priced in a way which complies with state aid principles.
  - 3.22.4 A **Funding Agreement** setting out how the Council would fund a subsidiary, to the extent the Council is not investing by way of equity subscription and/or third party debt is not sought. In any case, the funding arrangements would be agreed through the business plan for each Company.

These relationships would provide a structure by which the group is governed. Within that structure, each subsidiary would have an agreed **business plan** setting out what its purpose and immediate goals are. A business plan would also consider the nature and level of required Council resources as well as any external resources and funding. Where services are being provided to the Council, these would be governed by a **Services Agreement** between the relevant subsidiary and the Council. This would set out what the subsidiary was providing to the Council, what the Council was paying, how performance would be measured and the implications for non-performance.

### Features of Council control over its group

- 3.23 Whilst each subsidiary is a separate legal entity with its own business interests, the Council retains an interest in all of its subsidiaries. To do this, the Council would need to be able to exercise effective control (to varying degrees depending on the nature of a given subsidiary's business). The following bullet points summarise some of the key control mechanisms for the Council:
- 3.23.1 The Council will need to approve a subsidiary's business plan and otherwise approve any deviation from that plan.
  - 3.23.2 A subsidiary will need to provide information to the Council, both on a specified periodic basis (e.g. annual accounts and monthly/quarterly management accounts) and on an "as needed" basis.
  - 3.23.3 At least one Council nominee will sit on the board of each subsidiary. In some cases, there will be more Council nominees.
  - 3.23.4 Certain strategic matters will be reserved to the Council and a subsidiary cannot proceed with any of them unless prior approval is sought. A sample list of reserved matters can be found in Schedule 9.
  - 3.23.5 Even if a decision is not reserved to the Council, in some cases it may be appropriate to enable any board member on a subsidiary board to refer a matter to the Council for determination (i.e. creating a second layer of reserved matters). This is a common feature in "Teckal" company governance arrangements.
  - 3.23.6 Ultimately, if the Council is the recipient of services from the relevant subsidiary, it will retain a considerable level of control over that subsidiary through the Services Agreement.

## 4 PROCUREMENT IMPLICATIONS OF THE STRUCTURES

Please refer to the following Schedules for further detail: Schedule 3 (*Procurement*).

- 4.1 The Public Contracts Regulations 2015 (as amended) (the **Regulations**) apply to companies which are "contracting authorities". Companies which are held to be contracting authorities are subject to the application of EU procurement rules when they award contracts for goods, services and works where the estimated value of the relevant contract is above certain EU thresholds or if the opportunity has a realistic prospect of cross border interest.
- 4.2 Nevertheless, there are several ways it may nevertheless be able to award a contract directly (i.e. without an EU advertised competition), including:
  - 4.2.1 awarding directly and without competition any contract that is below the relevant financial threshold(s) permitted under the Regulations (in the absence of cross-border interest);
  - 4.2.2 structuring a particular project as a land disposal (with no enforceable obligations to build) that is excluded from the application of the Regulations. This may also involve commercial incentives to build (for example leases which are terminated if construction is not commenced within a particular timeframe but falling short of an enforceable obligation to build);
  - 4.2.3 utilising the "Teckal" exemption to the Regulations.

- 4.3 At the same time, we understand that the Council wishes to establish RegenSWT as a non-contracting authority. This could be done by ensuring that RegenSWT had an industrial/commercial character and operated on the market, taking commercial risk. Three principal implications flow from this:
- 4.3.1 The Council would not be able to award contracts for goods, services and works where the estimated value of the relevant contract is above EU threshold of if the opportunity had a realistic prospect of cross border interest without competition.
  - 4.3.2 As RegenSWT would not be a contracting authority, it would be able to award contracts for goods, services and works without being subject to the application of EU procurement rules.
  - 4.3.3 It would be very difficult to structure any subsidiary of RegenSWT as a Teckal vehicle. The Council could nevertheless establish a separate Teckal group as a "sister" to RegenSWT at the relevant time if that was appropriate.

## 5 STATE AID

Please refer to the following Schedules for further detail: Schedule 8 (*State aid*).

- 5.1 The State aid rules will be engaged when the Council uses its resources to provide selective financial support to a third party operating on a market. It is important to comply with the rules because breach can result in an order to repay the aid plus interest, or a damages claim from a competitor. There are a number of different levels at which aid could potentially be provided:
- 5.1.1 by the Council investing in a company as owner;
  - 5.1.2 by the Council providing working capital funding to a company;
  - 5.1.3 by the Council transferring assets to a company; or
  - 5.1.4 by the Council purchasing goods or services from a company.
- 5.2 Various exemptions to the State aid rules exist which could potentially be relied on to ensure State aid compliance. These will need to be considered in detail in light of the specific proposals/projects to be taken forward. However, we would expect the following to be applicable.

### MEIP

- 5.3 First, the simplest method is utilising the "market economic investor principle" or MEIP. In broad terms, if any loan, equity investment, payment for goods or service or provision of resources is on market terms, then it is very unlikely that there would be any aid. The rationale for this exemption is that there will be no form of subsidy from State resources and therefore no selective advantage. To rely on the MEIP, the Council must be able to demonstrate that the support is on market terms. This can be done by:
- 5.3.1 in the case of buying goods or services, doing so from a provider appointed under a competitive tender under the Public Contracts Regulations 2015, or benchmarking the payment terms against those typically charged on the market (this would be required if the Council directly awarded a contract by relying on the Teckal exemption);
  - 5.3.2 in the case of lending, benchmarking the financial terms against what could be provided by a market lender operating under similar conditions, or calculating what rate of interest would be charged under the EC proxy methodology;
  - 5.3.3 in the case of investing, preparing a business case and taking financial advice as to whether it would generate enough return to be attractive to a private investor in similar circumstances; and

- 5.3.4 in the case of allowing a company to use Council staff and resources, charging a market rate after benchmarking what would be charged on the market by a private entity in similar circumstances.

#### **Services of General Economic Interest (SGEI)**

- 5.4 SGEI are services not provided by the market or not provided to the extent required, and there may be scope to rely on the rules allowing aid for SGEI. Affordable housing is recognised by the European Commission and courts as capable of classification as SGEI. To rely on them, an act of entrustment would have to be put in place between the parties.

#### **De minimis aid**

- 5.5 Small amounts of aid (up to €200,000 over a rolling period of three fiscal years, or €500,000 if SGEI for affordable housing is relied upon) can be provided under the de minimis rules, and these may be relied on as long as the detailed conditions can be met.

## **SCHEDULE 1 – BASIS OF OUR ADVICE**

### **1 SCOPE**

- 1.1 The scope of our advice was set out in our scope prepared on 23 July 2020. Further advice on the issues covered by this Paper as well as on other issues may be required as the Council develops its proposals and prepares its business case(s).
- 1.2 We know only as much about the Council's proposals as was relayed to us in conversation and email correspondence to date. Accordingly, if any of our advice in this note betrays a lack of knowledge regarding the current factual matrix, please do let us know. We would be happy to review our advice in light of the most up to date information.
- 1.3 Given the proposals to establish one or more delivery vehicles are at a very high level, this advice is similarly couched at a high level and is not an exhaustive list of the issues which the Council should consider in connection with specific housing delivery proposals (for example, property matters and obligations imposed on the Council or one of those vehicles if either of them becomes a private landlord, funding models, land disposal consents, employment and resourcing). Again, we would be happy to review our advice and provide definitive views when concrete proposals are brought forward. In accordance with our instructions, this Paper sets out the "art of the possible"; the "art of the probable" is something which can be explored following receipt of commercial and tax advice on what is achievable and the most tax efficient means of delivery.

### **2 TAX**

- 2.1 Whilst we have made some high level comments in relation to tax, we are not advising the Council on tax matters and understand that the Council is procuring its own tax advice. There may well be particular circumstances relating to the delivery proposals themselves which give rise to the availability of particular tax issues and/or reliefs. Accordingly, the Council should seek confirmation of the tax position as part of the planning/structuring phase of this project.

## SCHEDULE 2 - COUNCIL POWERS

### 1 POWERS FOR HOUSING, REGENERATION AND DEVELOPMENT

- 1.1 Local authorities have wide ranging powers in relation to property, to facilitate their responsibilities to deliver services and for the benefit, improvement or development of their areas. These powers include the following:
- 1.1.1 sections 120 to 123 Local Government Act 1972 (**LGA 1972**);
  - 1.1.2 sections 2, 3 and 5 Local Authorities (Land) Act 1963;
  - 1.1.3 Part 2 Housing Act 1985;
  - 1.1.4 sections 24 to 26 Local Government Act 1988 (privately let housing);
  - 1.1.5 sections 227 and 233 Town and Country Planning Act 1990; and
  - 1.1.6 miscellaneous other powers.
- 1.2 A summary of these powers is set out below. A combination of these specific powers would usually be sufficient for a local authority to undertake any property acquisition, development, sale, rental or related project both inside and outside the area where the motivation was connected with the broad benefit or improvement of its area.

#### **LGA 1972**

- 1.3 Section 120 LGA 1972 allows local authorities to acquire land for the purposes of any of their functions, or *"the benefit, improvement or development of their area ... whether situated inside or outside their area"*. The section goes on to state that the land need not be immediately required for the purpose for which it is acquired (so that a long term view may be taken) and land may be acquired by agreement or compulsorily. Pursuant to section 120(4), local authorities may act together in purchasing land and may make arrangements for joint use and occupation whether one authority buys the land or they join together and purchase it.
- 1.4 Section 121 allows local authorities to acquire land compulsorily for the purposes of section 120, the Local Authorities (Land) Act 1963 or for any purpose where they could acquire by agreement. This is just one power to acquire land compulsorily and, whilst it requires the consent of a Minister, not all of the other powers require such consent.
- 1.5 Section 122 allows local authorities to appropriate land which they hold for any purpose – to all intents and purposes this is an internal transfer of land. This may be relevant where land is no longer required for one purpose but could be transferred to general purposes (for example, with public notice advertising to free the land from constraints of any trust which might have applied under the Public Health Act 1875 or the Open Spaces Act 1906). Alternatively when land is appropriated for planning purposes it may be disposed of under section 203 Housing and Planning Act 2016, which can help to facilitate development by converting rights in easements, covenants, to light etc. into monetary consideration that can be dealt with separately. Further advice on appropriation can be provided if required.
- 1.6 Section 123 allows local authorities to dispose of land *"in any manner they wish"* provided that best consideration is obtained, for any interest for a term exceeding 7 years (or an assignment which still has more than 7 years to run). Disposals of land for more than 7 years for less than best consideration require the consent of the Secretary of State and there is a general consent where land is disposed of for wellbeing purposes which (subject to State aid and other relevant considerations) may be useful in disposing of land for community purposes (for example, open space must be advertised and any objections considered before disposal).

### **Local Authorities (Land) Act 1963**

- 1.7 Section 2 enables local authorities to erect any building and construct or carry out works on and *"for the benefit or improvement of their area"*. A local authority may also repair, maintain and insure any building or works erected, constructed or carried out and generally may *"deal with any such building or works in the proper course of management"*.
- 1.8 Section 3 enables local authorities to advance money to others to acquire land or to erect any building or carry out any work on land. Any advance needs to be secured by a mortgage for a period not exceeding 30 years (and there are other detailed provisions, some of which apply to builders under section 4).
- 1.9 Section 5 enables local authorities to provide garage accommodation, hard standing and other off street accommodation for keeping motor vehicles.

### **Housing Act 1985**

- 1.10 There are separate powers in relation to land held for housing purposes pursuant to Part 2 of the Act.
- 1.11 Section 9 allows a local authority to erect houses or convert buildings into houses for the purposes of Part 2 of the Act or acquire houses to provide housing accommodation. The authority may also alter, enlarge, repair or improve a house which is erected, converted or acquired or which is disposed of under the section. Land may be disposed of to others to provide housing accommodation (although a local authority may not provide a cottage with a garden of more than one acre under this power).
- 1.12 Section 12 gives incidental powers to provide shops, recreation grounds and other buildings considered beneficial with the Minister's consent. Roads, streets and open spaces may be provided in connection with the development housing and similarly the authority may contribute towards the expenses of developing the land where other persons provide housing accommodation on land disposed of by the authority.
- 1.13 Under Section 14, local authorities may *"for supplying the needs of their district"* exercise the previous powers mentioned outside of their area but in advance of so doing need to notify the County Council in whose area their district is situated (or if outside the immediate county, the Council in whose area the authority propose to exercise the power – but failure to notify does not invalidate exercise of the power).
- 1.14 Section 17 is a power to acquire land for developing housing or to allow others to develop housing or to alter, enlarge, repair or improve housing accommodation. Land may also be acquired for disposal to provide housing and may be acquired compulsorily with the consent of the Secretary of State.
- 1.15 Section 19 is a power to appropriate housing land for other purposes which requires the Secretary of State's consent if there are houses on the land (although there are some general consents which might also apply).
- 1.16 Section 31 enables local authorities to sell, exchange or lease land for providing housing of any description at such price, or for such consideration, or for such rent as having regard to all the circumstances is the best that can reasonably be obtained, notwithstanding that a higher price, consideration or rent might have been obtained if the land were used for purposes other than housing.
- 1.17 Section 32 is a power to dispose of land held under Part 2 of the Act (without prejudice to the right to buy) and such disposals require the consent of the Secretary of State, although there are a number of general consents that are updated periodically.
- 1.18 There are also powers to dispose of land at less than best consideration for housing purposes (there is an annual cap on the amount which a local authority can pay by way of financial assistance of £3 per head of population).

## Local Government Act 1988

- 1.19 Sections 24 to 26 allow local authorities to set up or participate in companies or to assist persons to develop housing for private letting. This includes providing financial assistance (defined as including making grants or loans; guaranteeing the performance of any obligation owed; indemnifying a person in respect of any liabilities, loss or damage; or if that person is a body corporate, acquiring share or loan capital in that body). There may be State aid implications of providing financial assistance. However, disposal of land by the Council to a body corporate under this power must be at best consideration to meet the criteria in the general consents issued by the Secretary of State. The exercise of this power is not limited to the Council's area.

## Town and County Planning Act 1990

- 1.20 Where land has been acquired or appropriated for planning purposes, then it may be sold under section 233 for the best consideration that can reasonably be obtained to secure a particular development required for the proper planning of the area (which may not be its most profitable purpose).

## 2 POWERS TO BORROW AND INVEST MONEY IN LAND AND PROPERTY

- 2.1 Under the prudential financial regime in Part 1 Local Government Act 2003 (**LGA 2003**), section 1 states that a local authority may borrow money:

*"(a) for any purpose relevant to its functions under any enactment, or*

*(b) for the purposes of the prudent management of its financial affairs".*

- 2.2 Borrowing must be within the Council's affordable borrowing limit (which is set by full Council under section 3) and within any limits set by regulations or direction issued by the Secretary of State under section 4.

- 2.3 A local authority has the power to invest monies under section 12 LGA 2003 either for:

*"(a) any purpose relevant to its functions under any enactment, or*

*(b) for the purposes of the prudent management of its financial affairs".*

- 2.4 Any investment must have regard to proper accounting practices and relevant CIPFA guidance. The Council has a number of different powers which enable it to acquire, develop and sell land, should it so wish, as set out above, and so they form part of the Council's functions for the purposes of the powers above. "*Functions*" has been interpreted to include all of the Council's powers and duties in *Hazell v Hammersmith & Fulham LBC* [1992] 2 AC 1.

- 2.5 Section 21 LGA 2003 empowers the Secretary of State to make regulations and to issue guidance about the accounting practices to be followed by a local authority. The principal regulations are the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended). Regulation 31 specifies the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom and Service Reporting Code of Practice for Local Authorities as the proper practices. The current edition of the former is the 3rd edition; the latter is published annually. Local authorities should also have regard to CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.

- 2.6 Local authority investments are split into two types: specified and non-specified.

- 2.6.1 **Specified investments** are those invested in institutions offering high security and high liquidity. Such investments must be in sterling, must mature within one year and must be made in high credit-rated financial institutions, as measured by the three credit rating agencies: Fitch, Standard & Poor's and Moody's.

2.6.2 **Non-specified investments** are riskier investments that mature after any period longer than 365 days. The reason for splitting the two types of investments is to manage risk, the first type being deemed to be safer than the second. The informal commentary on the Government guidance does not itself impose limits, but states that local authorities themselves should define the limits to be held in such investments at any time of the year.

2.7 It will be important for the Council's Chief Finance Officer to confirm that the size, duration and scope of any proposed investment will fit within the Council's own Medium Term Financial Strategy, its Investment Strategy and the CIPFA Code. The Council's investment strategy should look at security, liquidity and yield, in that order. The strategy should be balanced and not result in over- investment of funds in more risky ventures.<sup>1</sup>

2.8 Section 15(1) LGA 2003 requires a local authority *"to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify..."*.

2.9 The Guidance from the Secretary of State on Investments entitled *"Statutory Guidance On Local Government Investments (3rd Edition) issued under section 15(1)(a) of the Local Government Act 2003"* and effective for financial years commencing on or after 1 April 2018 is available at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/320206/1501971.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/320206/1501971.pdf) Attention is specifically drawn to the paragraphs that refer to borrowing in advance of need, as follows:

*"46. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.*

*47. Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:*

- *Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and*
- *The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing."*

2.10 The reference above to borrowing in advance of need for a commercial return appears to be in addition to investment contemplated within the Council's Investment Strategy, where the Council would set out its prudent approach to investment.

### **Exercise of powers**

2.11 In exercising any power or duty, local authorities must act for proper purposes, in good faith, and must exercise their powers properly, following proper procedures in a "Wednesbury reasonable" manner. In other words the Council must act for proper motives, taking into account all relevant considerations, ignoring irrelevant matters, not acting irrationally and balancing the risks against the potential rewards. Additionally, local authorities must consider the usual fiduciary, best value, crime and disorder reduction, equalities, health and wellbeing and other relevant overarching duties to take into account when making decisions, as well as any explicit requirements placed on a power.

2.12 An authority's motivation is important in determining whether or not it can use any particular power, because matters pursued for certain objectives will be lawful, but if pursued for other objectives may be unlawful. For example if the Council wished to assist in alleviating the housing crisis by setting up or participating in a company to develop housing for private letting under sections 24/26 Local Government Act 1988 it would be lawful; as it would be to develop housing of a particular type for rent to meet market demand through a regeneration company set up to create jobs, improve the area and invest in training; whereas if it set up such a company with the primary objective to develop housing for rent but through a company in order to avoid the right to buy and secure tenancies, then it would

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<sup>1</sup> *Hazell v Hammersmith & Fulham LBC* [1992] 2 AC 1 in relation to interest rate swaps

be unlawful, because it would be seeking to use a company to avoid explicit provisions and restrictions placed upon the Council. We usually say that "powers follow purposes" and the primary motives/purposes are the most important in determining the use of powers.

- 2.13 In addition, local authorities can do what is necessarily implied by a statutory power and also what is "*calculated to facilitate or conducive or incidental*" to the exercise of any of their powers and duties pursuant to section 111 Local Government Act 1972.
- 2.14 In considering the purposes of any acquisition the Council will need to consider the extent to which there could be reasons to acquire the property for the benefit of the area (if any) either in the short or longer term as it may be a strategic acquisition; for the purposes of any of the Council's functions; or whether this is an investment decision (which is based primarily on anticipated financial returns and is not dependent upon being located in or near the Council's area). The appropriate due diligence will need to be made on the title to any property, its tenants, the ease with which any voids may be let, the long term local plan position, alternative uses as well as any other relevant considerations.
- 2.15 When acquiring an investment the location of the investment is not the key issue, but the investment returns and the security of the investment are the key issues. No particular form of investment vehicle is required: what is important is that the investment must fit with the Council's prudential borrowing and investment requirements (including the Council's Medium Term Financial Strategy and Investment Strategy) adopted from time to time. Should the investment not fit with the current strategies, then it may be appropriate to take a report to the Council to authorise a new investment strategy or to add a form or proportion of investments into the existing strategy. However, the Council's investment strategy must still have regard to the values involved, the need for diversification of the portfolio, the likely cash flow implications (both for revenue and capital), the principles of security, liquidity and yield (in that order), and the impact on borrowing as well as any other relevant considerations.
- 2.16 The management of the Council's finances, in accordance with the prudential financial regime is a non-executive function. Once the funds have been made available by Council decisions about specific investment acquisitions would be made either by the Chief Finance Officer or by the Leader or Cabinet, provided funds have been made available by Council. The Council should already have a framework for managing property investments and reporting to members on outcomes.
- 2.17 The Council's Chief Finance Officer should keep under review the performance of the Council's investments in accordance with the anticipated progress. If for any reason performance is not proceeding as anticipated, then it may be that the Chief Finance Officer will recommend alternative action to be taken by the Council. Exit strategies should also be considered as part of the the process of entering into the arrangements.

### **Prudential Indicators**

- 2.18 Local authorities have to determine the value of a number of prudential indicators under the Prudential Code. Minimum Revenue Provision (**MRP**) is an annual amount required to be set aside from the General Fund to meet the cost of capital expenditure funded by borrowing or through credit arrangements (in that year or previous financial years), such as on balance sheet leasing arrangements. Its purpose is effectively a requirement to say how the Council will repay debt over a reasonable period of time. Local authorities are required (under regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003) to determine an amount of MRP to charge to their revenue account in each financial year. Under regulation 28 the authority must determine an amount that is prudent.
- 2.19 The Capital Finance Requirement (**CFR**) is the total outstanding capital expenditure that has not yet been funded from either capital or revenue resources – effectively the borrowing need. The CFR is also a Prudential Indicator. Plans to expend more capital (or potentially the timing of such expenditure) may increase the borrowing need and therefore the CFR. "*Non-housing CFR*" has the meaning given in regulation 28(11) of the 2003 Regulations, before this was amended. This is the total CFR for a local authority less the Housing Revenue Account CFR, where a local authority has a Housing Revenue Account.

- 2.20 The Government's *"Statutory Guidance on Minimum Revenue Provision"* explains that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudential provision is to require local authorities to put aside revenue over time to cover their CFR. In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits.
- 2.21 The Government recently updated the statutory guidance on Minimum Revenue Provision and the updated guidance is effective from 1 April 2019. The guidance is issued under section 21(1A) LGA 2003 and is therefore guidance to which local authorities are required to *"have regard"*. The guidance is stated to apply to accounting periods starting on or after 1 April 2019, except in relation to *"changing methods for calculating MRP"* which apply to accounting periods starting on or after 1 April 2018.
- 2.22 Under paragraphs 18 and 19, local authorities are required to prepare a statement of policy on making MRP in respect of a financial year and submit it to full Council for approval. The guidance makes it clear that local authorities can vary the methodologies that they use to make prudent provision for the year. If they do so they are required to present a revised statement to the next full Council. Where a change in MRP would impact on the value for money assessment of non-financial investments the updated statement is required to summarise the impact.
- 2.23 Paragraph 21 states that an underpinning principle of the prudential financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income.

### **3 CHARGING AND TRADING – VARIOUS POWERS**

- 3.1 Charging and trading are not mutually exclusive and so it may often better to refer to income generation or commercial returns. There is no statutory definition of charging or trading for all purposes. One person's charging may be another person's trading, particularly where the same services are concerned.
- 3.2 There are a number of "urban myths" around charging and trading, such as local authorities cannot trade with the private sector; local authorities can only trade through a company; they can only ever charge the cost of providing services and not make a profit; and local authorities can only do things in their own areas. We explore some of these themes below, but there are four basic levels:
- 3.2.1 explicit charging and trading powers that may or may not use the expressions charge or trade;
- 3.2.2 common law implied or incidental powers to use surplus capacity where consistent with the Council's fiduciary duty or specific opportunities arise on an ad-hoc basis, incidental to the delivery of the Council's functions;
- 3.2.3 general charging powers, such as charging under section 93 LGA 2003 in relation to function-related activity and then the general power of competence, where the Council does not have any existing powers, or to complement or "expand" existing powers (provided there are no explicit restrictions and limitations); and
- 3.2.4 finally consider trading powers under section 95 LGA 2003 where the trading is in function-related activities or the general power of competence (section 4 LA 2011 where the Council does not have any existing powers) - provided that undertaking the work/services is "all about the money" i.e. a commercial purpose - rather than for any other justifiable reasons relevant to the circumstances, such as regeneration or the benefit or improvement of the area for land and development.
- 3.3 There are numerous explicit powers to charge and trade under which local authorities are able to make a profit, a number of which are set out below.

## **Local Authorities (Goods and Services) Act 1970**

3.3.1 This Act enables local authorities to:

- (a) supply goods or materials;
- (b) provide any administrative, professional or technical service;
- (c) use vehicles, plant or apparatus and appropriate staff; and
- (d) undertake works of maintenance,

for other local authorities, some health bodies and a whole list of other organisations designated as public bodies by further Acts of Parliament and Statutory Instruments. The list covers thousands of bodies, including the governing bodies of educational establishments, including academy schools, housing associations, "community associations" and others.

3.3.2 Section 1(3) goes on to state that "*any agreement... may contain such terms as to payment or otherwise as the parties consider appropriate*". This has been interpreted by the courts in the *British Education Supplies v Yorkshire Purchasing Organisation* case (1988) ELR 195 to mean that a profit can be generated from those activities. A separate account must be kept of income generated under the Act. This does not mean that a separate fund needs to be created.

3.3.3 Clearly the public body commissioning the service supplies or maintenance works may need to procure; however, this may be less of a concern for the providing local authority.

### **Other powers**

3.3.4 Examples of other explicit powers to charge and trade include:

- (a) powers to sell surplus computer capacity, (e.g. to enable electronic billing by other utilities and service providers) under section 38 Local Government (Miscellaneous Provisions) Act 1976, such sales must be undertaken at commercial rates;
- (b) sponsorship – power to accept gifts of real and personal property under section 139 LGA 1972 and to do incidental works associated with that acceptance;
- (c) the ability to do works outside the area under section 32 Local Government (Miscellaneous Provisions) Act 1976, where there is a power to undertake works inside the area;
- (d) an ability to second staff to other local authorities under section 113 LGA 1972 on such terms (including as to payment) as may be agreed (e.g. as consultants); and
- (e) the power to sell electricity from renewable sources under an order pursuant to section 11 Local Government (Miscellaneous Provisions) Act 1976 and 2010 regulations.

## **4 CHARGING AND TRADING – LGA 2003 AND LA 2011**

### **Section 93 LGA 2003 - charging**

4.1 In addition to explicit powers like those above, the LGA 2003 introduced powers to charge and trade in function-related activities. These powers enable authorities to charge whenever they have a power to provide a service and are not under a duty; likewise to trade for a commercial purpose in that function. If there are other explicit powers like those set out above, then the LGA 2003 would direct

the Council to use those other powers to charge and trade respectively, before relying on the 2003 Act powers.

- 4.2 The downside of using the charging power in the LGA 2003 is that, *"taking one year with another"* the income should not exceed the costs of the activity. That is not marginal costing i.e. the extra costs of providing the supply, (see below), but includes the total cost of the service (i.e. all overheads including corporate and democratic core as well as service enhancements).
- 4.3 The authority can choose the definition of "service" so this could include a number of services, some of which may be more self-financing than others, as long as there is some reasonable justification for the mix of services chosen, that would withstand scrutiny and has taken into account all relevant matters. The legislation also permits differential charging, so perhaps the elderly or another needy group could pay less or nothing at all, whereas better off people could pay more.

#### **Section 95 LGA 2003 – power to trade in function related activities**

- 4.4 A local authority has the following power under section 95 LGA 2003:

*"95 Power to trade in function-related activities through a company*

*(1) The appropriate person may by Order—*

*(a) authorise [relevant authorities] to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions, and*

*(b) make provision about the persons in relation to whom authority under paragraph (a) is exercisable.*

*(2) No order under this section may authorise a [relevant authority] —*

*(a) to do in relation to a person anything which it is required to do in relation to him under its ordinary functions, or*

*(b) to do in relation to a person anything which it is authorised, apart from this section, to do in relation to him for a commercial purpose.*

*(3) An order under this section may be made in relation to—*

*(a) all [relevant authorities], particular [relevant authorities] or particular descriptions of [relevant authority];*

*(b) all things authorised to be done for the purpose of carrying on a particular function, particular things authorised to be done for that purpose or particular descriptions of thing authorised to be so done.*

*(4) Power conferred by an order under this section shall only be exercisable through a company within the meaning of Part 5 of the Local Government and Housing Act 1989 (c. 42) (companies in which local authorities have interests)."*

- 4.5 Unless a specific statutory power is being relied upon, trading and doing things for a "commercial purpose" - must be performed through a company within the meaning for section 1(1) Companies Act 2006 or a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014 or a society registered or deemed to be registered under the Industrial and Provident Societies Act (Northern Ireland) 1969.
- 4.6 The underlying rationale for this approach is to ensure a level playing field with others in the same market. For that reason, all forms of partnership (including general partnerships, limited partnerships

and limited liability partnerships) were excluded from the list of permitted forms of local authority trading company.

### **The Trading Order**

4.7 Where a local authority is relying on section 95, it must prepare and approve a business case pursuant to the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (the **Trading Order**). This requires the local authority to consider and approve a suitable business case for establishing a trading company, which must include details about:

4.7.1 the objectives of the business;

4.7.2 the investment and other resources required to achieve those objectives;

4.7.3 any risks the business might face and how significant these risks are; and

4.7.4 the expected financial results of the business,

together with any relevant outcomes that the business is expected to achieve.

4.8 The local authority must also ensure that it receives a commercial rate of return on any funding, supplies, services or assets provided to the company, at least covering its costs in the provision of services or support. There should be an audit trail for the calculations and we would recommend entry into an agreement between the local authority and the company detailing any such support, to avoid any subsidy to the company (which could potentially breach State aid and/or competition law).

### **Section 1 LA 2011 - general power of competence**

4.9 The LA 2011 introduced a general power of competence, intended to be a much broader "power of first resort". The introduction of the general power of competence replaced the wellbeing power in England in 2012 allowed local authorities even wider scope to do anything that an individual may do, being much wider than in relation to their functions, even "*things... unlike anything that public bodies do*".

#### *"1 Local authority's general power of competence*

*(1) A local authority has power to do anything that individuals generally may do.*

*(2) Subsection (1) applies to things that an individual may do even though they are in nature, extent or otherwise—*

*(a) unlike anything the authority may do apart from subsection (1), or*

*(b) unlike anything that other public bodies may do.*

*(3) In this section "individual" means an individual with full capacity."*

4.10 The general power of competence is particularly useful for commercial activities such as the provision of services to third parties. The power authorises a local authority to undertake any activity which it is not under a duty to undertake, nor prohibited from undertaking, and to do so simply because it will make a profit for the authority.

4.11 The general power of competence is not geographically restricted:

*"1(4) Where subsection (1) confers power on the authority to do something, it confers power (subject to sections 2 to 4) to do it in any way whatever, including –*

*(a) power to do it anywhere in the United Kingdom or elsewhere,*

*(b) power to do it for a commercial purpose or otherwise for a charge, or without charge, and*

*(c) power to do it for, or otherwise than for, the benefit of the authority, its area or persons resident or present in its area."*

- 4.12 For charging and trading, the requirements are similar to those found in the LGA 2003. However, existing statutory restrictions continue in force. Where the general power of competence overlaps an existing statutory power, any limitations, restrictions and prohibitions which apply to the existing power also apply to the use of the general power of competence.
- 4.13 The Secretary of State retains the ability to constrain the use of the general power through regulations but equally is able to amend, repeal or revoke legislation which restricts its exercise. Any post-commencement legislation will not limit the exercise of the power unless there is an express restriction. The general power of competence does not permit any wider delegation of functions than is permitted under local government legislation.
- 4.14 In addition where, in the exercise of the general power, a local authority does things for a "commercial purpose", it must do them through a company within the meaning for section 1(1) Companies Act 2006 or a registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014 or a society registered or deemed to be registered under the Industrial and Provident Societies Act (Northern Ireland) 1969. The rationale for using a company or a registered society is the same as for the use of those vehicles in relation to section 95 LGA 2003. No requirements equivalent to those found in the Trading Order (and relating to section 95 LGA 2003) have been established. Nevertheless, we would advise that a similar approach be adopted, as the matters required to be included in a business case under the Trading Order all appear to be very relevant considerations in the establishment of a company.

#### **Ancillary powers**

- 4.15 Section 1 Local Government (Contracts) Act 1997 allows local authorities to contract out their functions, including all of the powers and duties of an authority, and this could be to a related body such as a wholly-owned subsidiary or a joint venture:

*"Functions to include power to enter into contracts.*

*1 Every statutory provision conferring or imposing a function on a local authority confers power on the local authority to enter into a contract with another person for the provision or making available of assets or services, or both, (whether or not together with goods) for the purposes of, or in connection with, the discharge of the function by the local authority.*

*2. Where:*

*(a) a local authority enters into a contract such as is mentioned in subsection (1) ("the provision contract") under any statutory provision, and*

*(b) in connection with the provision contract, a person ("the financier") makes a loan to, or provides any other form of finance for, a party to the provision contract other than the local authority, the statutory provision also confers power on the local authority to enter into a contract with the financier, or any insurer of or trustee for the financier, in connection with the provision contract.*

*3. The following are local authorities for the purposes of this Act:*

*(a) any authority with respect to the finances of which Chapter 1 of Part 1 of the Local Government Act 2003 (capital finance) has effect at the time in question....*

*4. In this Act "assets" means assets of any description (whether tangible or intangible), including (in particular) land, buildings, roads, works, plant, machinery, vehicles, vessels, apparatus, equipment and computer software."*

4.16 Additionally, section 111(1) LGA 1972 provides that:

*"Without prejudice to any powers exercisable apart from this section but subject to the provisions of this Act and any other enactment passed before or after this Act, a local authority shall have power to do any thing (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions".*

4.17 In *Hazell v Hammersmith & Fulham LBC*, the House of Lords held that for the purpose of section 111, the word "functions" embraces all the duties and powers of a local authority. Accordingly, the power in section 111 is available in support of any of the statutory powers set out in this Schedule.

4.18 A local authority therefore has the power (through section 111 1972 Act and section 1 LA 2011) to form an appropriate corporate vehicle (for example, a company or an LLP, as a wholly-owned vehicle), whether for the better discharge of its functions or for some other purpose.

#### **Can a local authority make a profit using powers other than section 95 LGA 2003 and/or section 4 LA 2011?**

4.19 There are many specific statutory powers available to local authorities, the exercise of which may - completely legitimately - produce a profit for an authority. Thus, the powers to buy, improve and develop land, and then dispose of land either by leasehold or freehold sale can be used to produce a profit for an authority. However, an often-asked question is whether the local authority's activity is being carried on solely or primarily for a commercial purpose. If so, then a company or registered society must be used in accordance with the LGA 2003/LA 2011 provisions.

#### **What is a "commercial purpose"?**

4.20 Both the LGA 2003 and the LA 2011 use the term "*commercial purpose*" as the criterion for deciding whether or not a local authority is trading. Section 95 LGA 2003 is entitled "*Power to trade in function-related activities through a company*", as is the relevant section in the related statutory instrument before using the term "commercial purpose" within the text of the relevant provision. In broad terms, "commercial purpose" and "trading" are often treated as having a similar meaning. However, as neither "commercial purpose" nor "trading" is defined in the Acts, they will therefore fall to be interpreted in accordance with their ordinary meaning and in the context of those Acts.

4.21 Local authorities are being encouraged to act more commercially but this can mean different things to different authorities. For example, the ordinary meaning of "trading" (which is often synonymous with acting for a commercial purpose) could cover a range of arrangements which local authorities might wish to enter into to make efficiencies through reducing costs, improving services for the benefit of users and, potentially, to generate profits. These may involve establishing new business relationships with other local authorities and public bodies or with the private sector, voluntary and community sector and individuals. At the same time, the word "commercial" would appear to encompass all forms of purchase and trade in goods and services.

4.22 Acting more commercially can mean councils operating in a more commercial way through internal trading or incentivised performance or reducing costs and increasing income whether through charging or trading, or just acting in a more business-like manner. Alternatively it could mean acting purely for profit in a commercial business in the same way as the private sector. We would interpret the latter as primary purpose commercial trading, not necessarily the former, particularly where pursued for other purposes. The primary driver must therefore be commercial profit, rather than other primary purposes.

4.23 This approach has been confirmed in the case of *Gordon Peters v London Borough of Haringey with Lendlease Europe Holdings Limited as an interested party* [2018] EWHC 192 (Admin) which questioned the vires of Haringey Council to enter into a corporate joint venture (JV) structured as a limited liability partnership (LLP) if the JV was established for a commercial purpose, in which case the vehicle should have been a company. The High Court ruled on 8 February 2018 that LLPs can

lawfully be used where the local authority's primary or dominant purpose is not a "commercial purpose", even where profits or surpluses would be generated.

4.24 Mr Justice Ouseley held, amongst other things, that:

4.24.1 if the power being exercised by a local authority can only be undertaken through a company, it is ultra vires for it to be done through an LLP;

4.24.2 in passing the LA 2011 – a deregulatory Act – Parliament would not have intended to restrict profit-making activities undertaken for non-commercial purposes to being undertaken solely through a company, when prior to the LA 2011 such activities could have been undertaken using various vehicles;

4.24.3 section 4(2) LA 2011 requires an overall view to be taken of "the thing" being done and of the overall purpose for which it is done;

4.24.4 of real importance is the question of what the local authority's purpose is in entering into the commercial arrangements; it was recognised that the purposes of a JV vehicle and of a council's JV partner are likely to be different;

4.24.5 if the purpose which is said to be commercial is simply an incidental or ancillary purpose to the non-commercial purpose, it should be seen as part of the non-commercial purpose and not as a commercial purpose at all;

4.24.6 the mere fact that a profit may be made does not of itself show that the activities have any commercial purpose given the obligations of financial prudence imposed on local authorities;

4.24.7 the fact that a profit or return is hoped for, to be reinvested in policy objectives, does not turn a local authority's decision to enter into commercial arrangements into being for commercial purposes – acting in a commercial manner does not equate to acting for commercial purposes; and

4.24.8 it was clear that the Council's purposes in entering into the arrangements were non-commercial and so it was open to the Council to establish the Haringey Development Vehicle as an LLP.

4.25 The applicants also argued that the Council:

4.25.1 had failed in its statutory duty of consultation under section 3 Local Government Act 1999;

4.25.2 had failed in its Public Sector Equality Duty (PSED) under section 149 Equality Act 2010; and

4.25.3 could only take this decision in full Council and not by Cabinet alone, by virtue of regulation 4(1)(b) of the Local Authorities (Functions and Responsibilities) (England) Regulations 2000 (SI 2000/2853) (the Functions and Responsibilities Regulations).

4.26 The court refused permission on all grounds.

4.27 We would suggest that following the approach in *Peters v Haringey*, councils may be acting commercially in the way that services are provided (and charged for) without acting primarily for a "commercial purpose".

4.28 Considering both the terms and the headings together in the LGA 2003 and LA 2011 suggests that "commercial purpose" should be defined by reference to the sole/primary purpose of the authority in question.

4.29 Therefore, to summarise the position:

4.29.1 If the ***sole/primary purpose of the activities in question is to make profit***, either immediately or in the near future, and there is no other explicit powers that would authorise that commercial activity, then it may be reasonable to conclude that those activities are being performed for a commercial purpose and the use of a company is required. This might also encompass activities which are not even ultimately profitable, provided that that is still the purpose. In simple terms, profit will be earned where revenue exceeds the costs of provision, which means an authority is likely to have a business case demonstrating how this will be achieved, regardless of the legal obligation to prepare a business case pursuant to the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009. In other words, it is "all about the money".

4.29.2 Alternatively, ***if the sole/primary purpose of those activities is to deliver a service which is believed to be in the public good but which it is not under an obligation to provide***, then this could instead be classified as a discretionary service. Trading is also to be distinguished from charging (i.e. recovering up to the cost of providing the service) for a discretionary service under section 93 of the LGA 2003 and section 3 of the LA 2011. A discretionary service can be delivered without using a company and for a charge (but on a cost recovery basis only) if the recipient is willing to pay for it. Alternatively there may be explicit powers that allow an authority to charge and make a profit (such as the 1970 Goods and Services Act).

4.30 In practice, formal trading by way of a company involves a reasonable cost, and many authorities start by relying on the power to provide discretionary services, subject to the duty to secure that, taking one financial year with another, the income from charges does not exceed the costs of provision. There is no fixed means of determining "cost" although government and CIPFA guidance requires all overheads including corporate and democratic core as well as service enhancements to be included.

4.31 However, if the primary purpose of the activities in question is the furtherance of other aims where the local authority in question can rely on other powers, then this will not constitute primary purpose trading or undertaking those activities for a commercial purpose. This will be so even if they generate a profit.

4.32 But what of the ancillary powers in section 111 LGA 1972 and section 1 LA 2011? Again, these are permissive rather than restrictive so long as they are exercised for a proper purpose (for example, for the better discharge of a local authority's functions). Neither of these provisions contains any express restriction on the type of corporate vehicles which an authority may form or participate in. Accordingly, the choice of corporate vehicle is governed not by those statutes but by the broader fiduciary duty which every authority owes to council tax payers namely that, in selecting the appropriate form of corporate vehicle, the authority must secure a reasonable balance of risk and reward.

## 5 GOVERNANCE AND CONTROLS ON LOCAL AUTHORITY INVOLVEMENT IN COMPANIES

5.1 Part V of the Local Government and Housing Act 1989 introduced controls on local authority involvement in companies. Companies were categorised into:

5.1.1 controlled;

5.1.2 influenced (private sector led or public sector); and

5.1.3 minority interest.

5.2 Whilst initially there were financial consequences of a company being public sector influenced or controlled, the financial controls were removed with the introduction of the Prudential finance regime in 2004. Only propriety controls remain, which require local authorities to ensure for example that any directors appointed would not be disqualified from being a local authority member; remuneration and expenses for councillor directors do not exceed the levels that the local authority could pay as allowances for a comparable duty (less any amount provided for that duty by the authority); information must be provided to the local authority's auditor (controlled companies must obtain the consent of the Audit Commission (we assume now the NAO) to the appointment of an auditor); and letterheads must show the relationship with the company. A further more detailed note can be supplied on Part V as required. It was intended that Part V would be replaced by Part 12 Local Government and Public

Involvement in Health Act 2007, which would capture a wider range of legal forms. However, that has not been implemented. Further details on controlled and influenced companies are contained in Schedule 7.

- 5.3 We would usually recommend that statutory officers, such as the monitoring officer, s.151 officer and the head of paid service, are not appointed as Directors of local authority companies, nor cabinet members who would otherwise make council decisions about the company to avoid conflicts of interest. Directors have duties to promote the success of the company and that may come into conflict with council interests – also there is a company law duty to seek to avoid such conflicts. There may be a presumption of bias or pre-determination where a council member or officer takes decisions within the Council about a company in which the Council is involved and is also a Director, and therefore such conflicts are best avoided.
- 5.4 The Local Audit and Accountability Act 2014 enables council auditors to issue a public interest report on companies in which the Council is involved. For a one highlighting governance issues in connection with a trading company see the report on City of York Trading Ltd at: <http://www.psa.co.uk/2016/02/16247/>.
- 5.5 Clear channels of responsibility and accountability should be established for dealing with council companies and appropriate documentation put in place to manage the arrangements and demonstrate transparently how the organisation operates, e.g. who will scrutinise actions and how frequently there will be reporting and to whom, as well as the charging arrangements for provision of services.

## SCHEDULE 3 – PROCUREMENT

### 1 STATUS OF COMPANIES AS CONTRACTING AUTHORITIES

- 1.1 The Public Contracts Regulations 2015 (as amended) (the **Regulations**) apply to "*contracting authorities*". Companies which are held to be contracting authorities are subject to the application of EU procurement rules when they award contracts for goods, services and works where the estimated value of the relevant contract is above certain EU thresholds or if the opportunity has a realistic prospect of cross border interest.<sup>2</sup>
- 1.2 From 1 January 2020 the EU procurement thresholds impacting on local authorities are as follows:
- 1.2.1 Supplies and services - local authorities - £189,330
  - 1.2.2 Works and concessions<sup>3</sup> - all contracting authorities including local authorities - £4,733,252
  - 1.2.3 Light touch regime for services - all bodies including local authorities - £663,540
  - 1.2.4 Concessions - all bodies including local authorities - £4,733,252
- 1.3 The Council (and also a company if it is also a contracting authority) will need to consider procurement law when it needs to engage with external organisations for works, supplies or services to further the delivery of public services. Procurement law considerations would apply as to whether the Council can award the company a contract for services to carry out that project. The same considerations would apply to that company if it too is bound by procurement law in following some advertised process to secure external support.
- 1.4 Where a company involves private sector participation to invest in and deliver the scheme then that too is like to need to be procured, if it is likely to be some form of works contract opportunity or works concession contract.

#### **What is a contracting authority?**

- 1.5 Under Regulation 2 of the Regulations contracting authorities means "*the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law, and includes central government authorities, but does not include Her Majesty in her private capacity*". This is a wide definition intended to include government bodies as well as certain bodies they control and influence. This is to prevent the purpose of the procurement rules (to ensure EU-wide competition) being thwarted by government bodies acting through other organisations so they too are caught by the procurement rules when certain conditions apply.

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<sup>2</sup> In relation to the point on cross-border interest, there are some circumstances in which a sub-threshold contract should be advertised across the EU and a competitive process should be run. The key consideration is whether or not a sub-threshold contract is likely to be of interest to economic operators located in other member states. If the contracting authority concludes that there would be cross-border interest, some form of advertised competitive process should be held but need not necessarily be through an advertisement in the OJEU. The likelihood of cross-border interest is for the contracting authority to assess, based on an evaluation of each scenario. Considerations such as the subject-matter of the contract, its estimated value, the specifics of the sector concerned and the geographic location of the place of performance should all be taken into account. It should also be noted that there are obligations for contracting authorities to advertise sub-threshold contracts in *Contracts Finder* in certain circumstances in accordance with Section 109 of the Regulations.

<sup>3</sup> Concession Contracts are regulated by the Concession Contracts Regulations 2016 (**CCR 2016**). These can be works or services. The essential feature of a concession contract involves real exposure to the vagaries of the market such that any potential estimated loss incurred by the concessionaire is not merely nominal or negligible. This classification may be relevant where the works contractor takes on investment and demand risk for onward sale of developed assets such as intellectual property rights. The CCR 2016 provides a great deal of procedural flexibility of the conduct of procurement exercises subject to some general rules.

- 1.6 A company would not be a state, regional or local authority or a central government authority. For a company to be a contracting authority, it would therefore need to be a body which is governed by public law. Again, Regulation 2 sets out the relevant definition:

*"bodies governed by public law" means bodies that have all of the following characteristics:-*

*(a) they are established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;*

*(b) they have legal personality; and*

*(c) they have any of the following characteristics:-*

*(i) they are financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law;*

*(ii) they are subject to management supervision by those authorities or bodies; or*

*(iii) they have an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law;"*

- 1.7 All three limbs (a)-(c) must be present for a company to be a body governed by public law, although limb (c) can be satisfied if only one of the subsidiary limbs (i)-(iii) is present. A company would have separate legal personality, so limb (b) would be satisfied and we have not considered it further in this section.

*"they are established for the specific purpose of meeting needs in the general interest, ..."*

- 1.8 In relation to this first part of limb (a), it is settled case law that needs in the general interest, **not having an industrial or commercial character**, are *"generally needs which are satisfied otherwise than by the availability of goods and services in the market place which, for reasons associated with the general interest, the State chooses to provide itself or over which it wishes to retain a decisive influence"*.<sup>4</sup> Where an activity is regulated, then the presence of such regulation indicates that the underlying activity relates to needs in the general interest.<sup>5</sup>

- 1.9 There is a low threshold to meeting this test and the Court of Justice of the European Union (CJEU) has found there to be public interest needs being performed in stimulating trade and economic development in activities which, on their face, appear to be commercial in nature.<sup>6</sup> Therefore, any clear public-serving activity would be caught but it is also likely that commercial activities will be caught where they have a direct or indirect positive economic benefit. It should also be noted that the size of the general interest activity within the entity is immaterial and contracting authority status is not dependent on the relative importance within its business as a whole.<sup>7</sup>

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<sup>4</sup> *Arkkitehtuuritoimisto Riitta Korhonen Oy and Others v Varkauden Taitotalo Oy* (Case C-18/01)

<sup>5</sup> This was accepted by the parties in C-380/98, *The Queen v H.M. Treasury, ex parte The University of Cambridge* [2000] E.C.R. I-08035, paragraph 19

<sup>6</sup> For example: (a) *Arkkitehtuuritoimisto Riitta Korhonen Oy v Varkauden Taitotalo Oy* (Case C-18/01) in which the CJEU held that the activities of a company engaged in a building project for the construction of office blocks in a town centre was meeting needs in the general interest since they were likely to give a stimulus to trade and the economic and social development of the local authority concerned and this could lead to creation of jobs, increase of tax revenue and improvement of the supply and demand of goods and services; (b) C223/99 *Agora* (2001), in which organising exhibitions and fairs to bring together providers of goods and services was deemed to meet the needs of the general interest because of the general stimulus to trade; and (c) *Alstom Transport v Eurostar International Ltd* (Ch) [2012] EWHC 28 in which it was noted that the operation of the Eurostar service by the defendant clearly served a wider interest than simply that of Eurostar's customers given that it brought various economic benefits (e.g. for towns such as Ashford and Ebbsfleet) with it. It was therefore accepted that the condition of *"needs in the general interest"* was satisfied.

<sup>7</sup> Case C-360/96 *Arnhem and Rheden v BFI Holding* [1998]

1.10 Even though there is a low threshold, it doubtful whether investment in property and development would satisfy this limb of the test.

*"... not having an industrial or commercial character"*

1.11 Turning to the second part of limb (a), if a company has *"an industrial or commercial character"*, then it will not be a body governed by public law and therefore **not** be a contracting authority.

1.12 The CJEU has stated that this is an issue for the national courts to assess taking into account all the relevant legal and factual circumstances in each case.<sup>8</sup> It is therefore difficult (in general terms) to provide a definitive view on how a court would view the character of an entity.

1.13 As a starting point, if a company operates in normal market conditions, aims to make a profit and will be exposed to risk of financial loss in its activities, then it would arguably have an industrial or commercial character.<sup>9</sup> However, being exposed to the risk of incurring financial losses is not sufficient to categorically remove the possibility of state influence, since an entity might consider it appropriate to incur financial losses in order to follow a particular purchasing policy of a controlling contracting authority.<sup>10</sup>

1.14 Another factor in determining the character of a company is the existence (or otherwise) of significant competition. In particular, the fact that an entity concerned is faced with competition in the marketplace may be indicative of the absence of a need in the general interest not having an industrial or commercial character (i.e. failing to satisfy the first part of limb (a)).<sup>11</sup> However, this is not a conclusive factor, since it is possible that the existence of significant competition does not, of itself, alleviate the issue of the possibility of state influence being exerted. Conversely, in a recent case relating to Eurostar, the courts have held that even though Eurostar did not at the *"relevant time face any competition in its market and had received substantial state aid, it would in the future face competition and would be expected to take procurement decisions on economic grounds"*. In all the circumstances, Eurostar was *"of a commercial character"* and was not a contracting authority.<sup>12</sup>

1.15 As a result, it is necessary to consider all facts and circumstances "in the round" in order to come to a view of a company's character. To the extent a company will:

1.15.1 borrow from the council to acquire substantial assets (e.g. real property) at a rate compliant with State aid requirements (see Appendix below);

1.15.2 pay a market rate for the use of any council assets and services;

1.15.3 aim to make a profit from its activities;

1.15.4 be competing with other providers in the wider market;

1.15.5 be subject to fluctuations in that market (and therefore could fail if it cannot manage those fluctuations against its costs, including the costs payable to the council for any debt finance and use of assets); and

1.15.6 not be able to rely on the possibility of a council "bail-out" in the event of the company failing,

then the company will be subject to the same commercial pressures and market risk as any other private sector entity competing in that market and which itself has an industrial or commercial character.

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<sup>8</sup> C-373/00 *Adolf Truley* [2003]

<sup>9</sup> *Arkkitehtuuritoimisto Riitta Korhonen Oy and Others v Varkauden Taitotalo Oy* (Case C-18/01)

<sup>10</sup> Case C-360/96 *Arnhem and Rheden v BFI Holding* [1998]

<sup>11</sup> Case C-360/96 *Arnhem and Rheden v BFI Holding* [1998]

<sup>12</sup> *Alstom Transport v Eurostar International Limited* [2012] EWHC 28 (Ch)

- 1.16 In reverse, the less an entity is subject to commercial preferences and market risk, the less it is likely to have an industrial or commercial character. So the commercial relationship between the Council and the company will be key if the Council is seeking to establish a company to which procurement law would not apply to its contracting activities.
- 1.17 Whilst, on the face of it this may appear desirable to create commercial conditions so that the company is not constrained by such regulations in its operations, it would involve a number of compromises. The first, as discussed above, is that the company would need to be commercially and financially viable in an independent way. The second is that if it does not have contracting authority status, it would not be eligible to participate in "Teckal" arrangements which provides a procurement law exemption to enable the council to award contracts to the company in certain circumstances.

*"...financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law"*

- 1.18 The meaning of "*financed*" by a contracting authority for the purpose of the definition of body governed by public law was considered by the CJEU in some detail in the case of University of Cambridge case.<sup>13</sup> The case concerned the question of whether UK universities are covered by the EU directives. The CJEU determined that the provision only covers financing provided to an institution without any "*specific consideration*" being provided in return by that institution (for example, contractually agreed goods or services to be provided by the institution). The CJEU considered that in the latter instance the nature of the relationship of the institution with the government is a normal commercial one, rather than the kind of dependent relationship intended to be within the EU directives. This indicates that, in general, when funding is provided by government to a body through a normal commercial contract for services, that funding does not count as financing of the body for the purposes of the definition of body governed by public law.
- 1.19 The CJEU in this case also concluded that the phrase "*for the most part*" means "*more than half*" and that all sources of income – including income from commercial sources - must be included in determining the institution's total income that will be used for calculating whether financing is for the most part from the state. Separately, the CJEU has also stated that the "financing" in question does not have to be direct.<sup>14</sup>
- 1.20 This issue goes to the financing and funding of the company as to whether it is supported by the council or whether the arrangements are commercially at arm's length in the council's dealing with the company.

*"they are subject to management supervision by those authorities or bodies"*

- 1.21 The CJEU has stated that it is necessary to consider whether the controls to which entities are subject render them "*dependent on the public authorities in such a way that the latter are able to influence their decisions in relation to public contracts*".<sup>15</sup> The supervision exercised must give rise to dependence on the public authorities equivalent to that which exists when one of the other criteria (financing or appointment) are met. As noted in the context of the financing criterion above, the relevant consideration is whether there is a general dependency on a contracting authority; it is not necessary that financing should be of a form that allows influence over specific contracts in order to be counted as public financing. Similarly, it does not appear necessary to show that any management supervision which exists is concerned specifically with the process for awarding contracts. In general, it seems clear that a power actually to intervene in the management decisions of an entity can constitute management supervision.
- 1.22 In addition, management supervision does not have to involve a power actually to intervene in the management decisions of an entity, at least when there are "detailed" rules of management that the entity must follow. In such circumstances, supervision over whether the entity complies with the rules

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<sup>13</sup> Case C-380/98, *The Queen v H.M. Treasury, ex parte The University of Cambridge*

<sup>14</sup> Case C-337/06, *Bayerischer Rundfunk and others v GEWA Gesellschaft für Gebäudereinigung und Wartung*, in which the CJEU indicated that broadcasting authorities funded through a state-imposed licence fee paid by all those with receivers, regardless of the actual broadcasting services each receives, is financed by the state.

<sup>15</sup> Case C- 237/99, *Commission v France*

may be sufficient to establish significant influence. For example, this could be demonstrated where the contracting authority has ultimate powers to wind-up the entity, suspend management and appoint an administrator. It also seems that, if observance of compliance with pre-set rules can be sufficient, a general power to scrutinise the management activity of an entity should also be sufficient, even when the management is not conducted according to pre-set rules – again, at least if accompanied by some ultimate powers of redress and/or sanction.

- 1.23 These principles are not necessarily easy to apply in practice. In particular, it is not clear exactly what sort of intervention in management decisions is required, nor on the sort of rules or supervision and accompanying powers of redress/sanction that are necessary to establish management supervision without direct intervention in management decisions.
- 1.24 However, it is likely that the Council would want to be able to control the company that it establishes as an independent trading company model.

### **Advertised competition**

- 1.25 Where the EU procurement rules are engaged for above threshold contracts then an advertised competition needs to be conducted under the relevant procurement rules.<sup>16</sup>
- 1.26 Where the full scope of the Regulations applies then there are various procedures<sup>17</sup> which would need to be followed in order to award a contract. A common form of competition is to use the **restricted procedure** which involves 30 day OJEU advertising period, followed by a shortlisting of bidders to participate in a tender stage. The shortlisted bidders would then normally have at least 30 days<sup>18</sup> to prepare a tender. Once an award decision has been reached then the unsuccessful bidders are debriefed and a 10 standstill period needs to be observed before the contract is entered into. So typically, it would in theory be possible to conduct a procurement exercise from OJEU to award in a 3 month period using this procedure.<sup>19</sup>
- 1.27 However, the restricted procedure prohibits negotiations on the fundamental aspects of the contract and therefore is a rather inflexible procedure when a complex contract needs to be awarded. In those circumstances a **competitive dialogue procedure** is often used which allows for the gradual reduction of the number of bidders/solutions during the process and negotiations to be conducted on the contract and technical solution during those stages prior to the submission of a final tender. This is a practical approach so that usually only the final two bidders incur bid costs to produce comprehensive tenders. Similarly, this involves a 30 day OJEU advertising period, but the duration of the other competitive dialogue stages are not regulated so the process can be adapted as to the complexity of the requirement and available time.
- 1.28 Another efficient means of awarding a contract would be to use a framework agreement which has already been procured through an OJEU advertisement for the use by contracting authorities named on the OJEU Notice. The company would have to follow the procedures set in the framework agreement to award call-off contracts (which may allow for a direct award or through a further mini-competition). It would not need to commence and conduct fresh OJEU Notice competition which would represent a considerable resource and time saving. However, the call-off agreement from a framework cannot be substantially amended and therefore there are limitations in terms of their suitability. Where contracts fall within the light regime, there are considerable procedural flexibilities as to the manner in which those procurement competitions are conducted so long as certain general principles specified

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<sup>16</sup> There are various types of contracts which are exempt from the procurement rules and also situations where contracting authorities are permitted to select providers to negotiate with directly without competition. However, they go beyond the scope of this general summary.

<sup>17</sup> This note does not cover the full range of procedures and flexibilities enabled by the procurement rules.

<sup>18</sup> This can be 25 days where tenders are submitted electronically. Also the company (if it was a "sub-central" authority) is also able to agree shorter time-limits through mutual agreement with the bidders and can impose a return time of a minimum of 10 days in default of agreement.

<sup>19</sup> However, the council would also have to budget time in preparation of the procurement documents (including the contract and evaluation methodologies) which normally would have to be available when the OJEU notice is published.

in the Regulations are followed. However, the formal procedures (e.g. restricted procedures, competitive dialogue etc.) are often followed as a basis of competition familiar to the market.

### **Risk of challenge**

- 1.29 It is important to be aware of the risks created should the Council determine that a given company is not a contracting authority and therefore not subject to the Regulations. These are explained briefly in the next few paragraphs. In broad terms, there are two types of legal challenge - those under the Regulations and judicial review. Both legal options require swift action to be taken, and a level of commitment and costs from a challenger. Non-time limited and free of charge complaints (for example, to auditors or internal compliance officers) also exist as a risk.
- 1.30 Before the award of a contract, a challenger can seek to suspend the process of contract award through commencing proceedings. Such proceedings have the effect of automatically suspending contract award. The council would need to apply to the court to have the suspension lifted as otherwise this would stay in place until the first instance court hearing and there are further sanctions for signing the contract while a suspension is in place. Practically, challenges can be time-consuming and expensive, and could leave the company unable to enter into the contract in question. Other remedies which the court can order before the award of a contract include damages for loss of opportunity, the setting aside of a decision or action by the contracting authority, and/or an order that the contracting authority should amend a document.
- 1.31 After award of a contract, a claim would generally be for damages. However, there is also the possibility under the Regulations of a claim to cancel the ongoing performance of the contract after it has been awarded; this is known as ineffectiveness. One of the grounds for ineffectiveness is the failure to advertise the contract by placing an OJEU contract notice (when required to by the Regulations), (i.e. an illegal direct award).
- 1.32 If the court makes a declaration of ineffectiveness, it must also order that the contracting authority pay a civil financial penalty (which can be unlimited). If the court decides not to render the contract ineffective - for example due to public interest grounds - it must order at least one, or may order both of, (i) a contract shortening order or (ii) a civil financial penalty. In deciding on the remedies to apply, the court's overriding consideration is that the penalties must be effective, proportionate and dissuasive.
- 1.33 There are strict time limits for bringing a challenge. These are generally 30 days from the date the claimant knew or ought to have known of the breach of the Regulations for all claims except ineffectiveness. Ineffectiveness claims can be brought up to six months from the day after the date the contract was entered into. It is possible to take steps to reduce these timescales.
- 1.34 Practically, there is a risk that the 30-day period does not start running until a claimant is aware or ought to have been aware of the breach. The exact date on which a claimant knew or ought to have known of the breach can be difficult to establish and therefore it is difficult to predict whether this risk period has lapsed. This means that it is possible for the risk of challenge to be present for a long time.
- 1.35 Judicial review is a wider risk which has a broader reach as any affected party can bring such a challenge. It is a remedy of last resort as the starting point for most claimants is to use the Regulations as the basis of a claim. Judicial review claims must be brought as quickly as possible, and in any event within 30 days of the date of the decision being challenged where a claim relates to the Regulations.

### **Summary conclusions**

- 1.36 Contracting authorities must comply with the Regulations and therefore the Council would be subject to these obligations. Companies not explicitly caught by the Regulations can be subject to them if they fall within the definition of "*bodies governed by public law*". Therefore, establishing a separate company to deliver, will not automatically avoid the application of the Regulations. The company itself may need to observe procurement law obligations in sourcing works, goods and services in carrying out objectives.

- 1.37 A trading company may fall inside or outside the definition of a body governed by public law depending on the facts, and the council may wish for a trading company to fall outside the definition. Determining whether a company is a contracting authority will need to be assessed on the facts pertinent to that company.
- 1.38 The test for whether a company is a contracting authority is an ongoing one rather than a one-off classification. This means that the Council would need to monitor how a given company operates and the commercial arrangements for providing support to it. As well as helping the Council and that company to be clear whether the latter is subject to the Regulations, this would also provide a good audit trail should a third party challenge ever be brought.
- 1.39 It would be possible to avoid contracting authority status by operating a trading company on a genuinely commercial basis. Operating on this basis will ensure that purchasing decisions are driven by a desire to obtain the best value possible rather than in accordance with the directions of the Council. If a company is structured in this way, it would be free to award contracts which might otherwise be caught by the Regulations as it sees fit (subject to compliance with its articles of association and any other contractual limits imposed by the councils). However, the strength of this argument (that a company is not a contracting authority) would be reduced if a company is not sufficiently financially independent, for example, because the Council provides financial support to protect it from commercial losses, such as by way of a guarantee.
- 1.40 We would be happy to provide further detail on how direct contract awards can be made by a company which is a contracting authority, if requested.

## 2 TECKAL CONSIDERATIONS

### Requirements for Teckal compliance

- 2.1 As noted in the previous section, contracting authorities are public bodies which are subject to the EU procurement rules for the award of public contracts. The Council is a contracting authority for the purposes of these rules. However, public contracts awarded to a legal body controlled by a contracting authority that satisfy certain conditions (referred to in this Paper as **Teckal Cos**) fall outside the application of the EU procurement rules.
- 2.2 The Teckal test is set out in Regulation 12 of the Regulations. The basic test provides that a public contract awarded by a contracting authority to a legal person which is owned by it falls outside of the procurement rules where all of the following conditions are fulfilled:<sup>20</sup>
- 2.2.1 Control - the contracting authority exercises over the legal person concerned a control which is similar to that which it exercises over its own departments.
- "Control" will be established where all of the following conditions are fulfilled:
- (a) it exercises a decisive influence over both strategic objectives and significant decisions of the controlled legal person, or
  - (b) the control is exercised by another legal person which is itself controlled in the same way by the contracting authority.
- 2.2.2 Essential activities - more than 80% of the activities of the controlled legal person are carried out in the performance of tasks entrusted to it by the controlling contracting authority or by other legal persons controlled by that contracting authority.

The commercial or market orientation of a Teckal Co can erode the control test being satisfied, and significant third party trading may threaten the essential activities test being satisfied. In this context, "activities" refers to the average total turnover or an appropriate alternative activity-based measure such as costs incurred by the relevant legal person or contracting authority with respect to services, supplies and works for the 3 years preceding

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<sup>20</sup> Regulations 12(1) to 12(3)

the contract award. If the legal person's turnover or alternative activity-based measure such as costs are either not available for the preceding 3 years or are no longer relevant, it is sufficient to show that the measurement of activity is credible, particularly by means of business projections.

- 2.2.3 No private capital - there is no private capital participation in the controlled legal person. The Regulations do permit non-controlling and non-blocking forms of private capital participation required by national legislation (providing it is compatible with the European Treaties) which do not exert a decisive influence on the legal person being awarded the contract. At present, there are no forms of investments in Teckal Cos authorised in UK legislation.

### **Governance and control**

The company's governance framework will need to be designed and implemented to ensure compliance with the "control" limb of the Teckal test set out in Regulation 12(3).

- 2.3 At a "strategic" level, the Council would need to:
- 2.3.1 sign off a periodic business plan – this may be an annual plan or a multi-year plan updated on a rolling basis; and
  - 2.3.2 exercise control over key decisions through the requirement for unanimous approval of certain "reserved matters".
- 2.4 Within each Teckal Co, at a board level (for extra assurance):
- 2.4.1 the Council (as owning contracting authority) should have the right to appoint, remove and replace up to a specified number of board representatives. The representatives present at board meetings should also be able to exercise the vote(s) of the representatives who are not present, where the present and absent representatives have been nominated to that role by the Council;
  - 2.4.2 the quorum at any board meeting should require at least one representative appointed by the Council to be present;
  - 2.4.3 if there are more executive board members appointed than non-executive board members, then if the non-executive board members vote the same way, the matter becomes a reserved matter which can only proceed if the Council approves it; and
  - 2.4.4 if the non-executive board members appointed by the Council notify the Board that a particular matter (which is not otherwise a reserved matter) is sufficiently important to the Council, then the matter becomes a reserved matter which can only proceed if the Council approves it.
- 2.5 Further key governance issues are considered in Schedule 5.

### **"Reverse" Teckal**

- 2.6 Under Regulation 12(2):
- "A public contract also falls outside the scope of this Part where a controlled legal person which is a contracting authority awards the contract to—*
- (a) its controlling contracting authority, or*
  - (b) another legal person controlled by the same contracting authority,*

*provided that there is no direct private capital participation in the legal person being awarded the contract with the exception of non-controlling and non-blocking forms of private capital participation required by national legislative provisions, in conformity with the Treaties, which do not exert a decisive influence on the legal person being awarded the contract."*

- 2.7 Under this provision of the Regulations, the Teckal Co (itself being a contracting authority) would be permitted to award contracts to the Council (as its controlling contracting authority) or another body controlled by the Council. This is often referred to as the "reverse" Teckal principle in that it exempts certain contracts from EU procurement law principles. The rationale for this principle appears to be that since the two organisations enjoy an "in-house" relationship, the controlled body's ability to award contracts to its controlling authority has little scope for distorting competition in the market.<sup>21</sup> The practical advantage of this is the ability for the controlling authority to provide services to support the operation of the Teckal Co (e.g. resourcing and support services).

#### **Trading with other authorities which do not want to become partners and/or the private sector**

- 2.8 Under the "essential activities" limb of the Teckal test, more than 80% of the activities of the controlled legal person are carried out in the performance of tasks entrusted to it by the controlling contracting authority or by other legal persons controlled by that contracting authority. Accordingly, if the Council wishes to utilise a Teckal Co for the purposes of "external" trading – by which we mean trading with other public and private sector entities – then this will need to equate to less than 20% of the overall tasks entrusted to the Teckal Co, which would be measured in the manner summarised in paragraph 2.2.2 above.
- 2.9 Care would need to be taken to ensure that this "trading allowance" was not inadvertently breached, for example by the volume of activities undertaken for the Council falling to 80% or less of the overall volume of the Teckal Co's activities. For this reason, if the level of trading may cause the Teckal Co to fail the "essential activities" test, the Council should consider establishing a separate Trade Co, through which the external trading can be operated. This would then protect the Teckal Co's services back to the Council.
- 2.10 We would recommend that a detailed calculation is made of the activities proposed to be transferred into each Teckal Co on day one and then in future tranches, to work out the headroom each will have to undertake external work.

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<sup>21</sup> The provision also allows the Teckal Co to award contracts to other bodies controlled in the same way by its exclusive controlling authority (i.e. a "sister" Teckal Co sharing the same parent company)

## SCHEDULE 4 – COMMON CORPORATE VEHICLES

### 1 INTRODUCTION

1.1 In this Paper we have concentrated on the most common forms of corporate vehicle considered or established by local authorities, namely:

- 1.1.1 a private company limited by shares (**CLS**);
- 1.1.2 a private company limited by guarantee (**CLG**);
- 1.1.3 a community interest company limited by shares (**Share CIC**);
- 1.1.4 a community interest company limited by guarantee (**Guarantee CIC**);
- 1.1.5 a limited liability partnership (**LLP**); and
- 1.1.6 a community benefit society (**Society**).

1.2 We have not included less common corporate vehicles (such as charitable companies) or unincorporated arrangements (such as a contractual joint venture, limited partnership or traditional partnership), but can include these if requested.

### 2 SUMMARY TABLES CORPORATE VEHICLES

<b>Private company limited by shares (CLS)</b>	
Incorporation	<p>An application for incorporation may be undertaken on paper or electronically, either in person by the subscribers (i.e. those wishing to incorporate a company and become the initial shareholders) or by a formation agent on their behalf.</p> <p>Incorporation requires submission of a completed application form IN01 to the Registrar of Companies setting out the name, registered office, list of directors, company secretary (if any), shareholders and class, value and rights attaching to shares) together with a £40 fee (or £100 for the "same-day" service for applications received by 3pm Monday to Friday).</p> <p>A memorandum and articles of association must also be submitted to Companies House with form IN01 (if no articles are submitted, the company will be incorporated with "model articles").</p> <p>The shareholders often enter into a shareholder agreement setting out the ways in which they will regulate the business of the company. This document is intended to be a private document and, if drafted correctly, does not need to be filed at Companies House. This enables the shareholders to keep more "commercial" terms of their relationship confidential.</p>
Constitution	<p>Articles of association and, if required, a shareholder agreement.</p> <p>Shareholders can choose to restrict the company's capacity to transact certain types of business by inserting restrictions into the articles of association (traditionally referred to as a company's "objects"). However, the modern approach is not to restrict a company's capacity through the company's articles, unless there is a very good reason for doing so. A shareholder agreement often defines the company's "Business" and may provide for an agreed business plan to which the shareholders and company are expected to adhere.</p>
Ongoing corporate regulatory requirements	<p>A company is subject to the regulation of the Registrar of Companies and must file with the Registrar:</p> <ul style="list-style-type: none"> <li>• its memorandum and articles of association;</li> </ul>

	<ul style="list-style-type: none"> <li>• its registered office address;</li> <li>• details of the directors and company secretary (if any);</li> <li>• the audited accounts (certain exemptions apply to this rule for smaller companies) details of any charges registered against the company;</li> <li>• its annual return;</li> <li>• certain shareholder resolutions and other company forms.</li> </ul> <p>This disclosure of information will entail a level of public disclosure of the company's internal governance and performance.</p>
<p>Ownership and changes in ownership</p>	<p>A company is owned by its shareholders and can exist with only one shareholder. The shareholders can exercise all rights attached to their shares as detailed in the Companies Act 2006, articles of association and any shareholder agreement.</p> <p>Subject to the Act and the terms of the articles / any shareholder agreement, new shares can be issued, either to existing shareholders or new investors, and existing shares can be transferred. Issuing or transferring shares is generally a straightforward process, although the shareholders may agree more restrictive processes.</p> <p>A share in a company represents an investment, so it is a common vehicle for shareholders establishing a vehicle with the ultimate aim of realising the value of the company through a sale and/or dividend income. A transfer of shares in the company would be subject to 0.5% stamp duty unless certain exemptions apply.</p> <p>The liability of a shareholder – in that capacity – is limited to amount unpaid on any shares issued to them.</p> <p>Note – a shareholder may have liability towards the company or third parties if, for example, it is a contract counterparty with the company, guarantor of the company's debts and obligations or funder.</p>
<p>Governance</p>	<p>Most decisions are delegated to the board of directors. The default rule is that each director has one vote, although there may be circumstances where a director cannot vote (e.g. in relation to a conflict of interest). Directors may delegate some of their functions to other persons or committees if it is reasonable for them to do so.</p> <p>Directors owe duties to the company including under the Companies Act 2006 and at common law (e.g. in relation to confidentiality). They may also incur personal liability for the company's debts if they have been guilty of wrongdoing, such as wrongful or fraudulent trading.</p> <p>Some decisions are reserved to shareholders through the Act (e.g. adopting new articles), requiring either a special resolution (75% approval) or an ordinary resolution (simple majority approval). The articles and any shareholder agreement may impose higher thresholds than the Act requires – for example, the shareholders may agree certain matters require their unanimous consent, rather than merely majority consent.</p> <p>In addition, the shareholders will require additional control through the company's governance processes if the company is to be established as a "Teckal" company.</p>
<p>Funding</p>	<p>Subscription monies received by company from new or existing shareholders can be used as working capital, but company money cannot be returned to shareholders while the company is a going concern unless complex maintenance of capital rules in the Act are complied with.</p> <p>The company can also borrow, either from the shareholders or third parties and may need to grant security for repayment of the debt.</p> <p>Any equity or debt funding provided by the shareholders will need to comply with State aid rules.</p>

Treatment of profit/ surplus	<p>Profits can be retained within the company or distributed to shareholders if they are available for the purposes of distribution under the Companies Act 2006.</p> <p>Profits are normally divided between shareholders pro rata to their shareholdings, although the rights attaching to the shares and any commercial agreement between the shareholders may apportion differently, or otherwise restrict, the amount each shareholder can receive.</p>
Insolvency	<p>Provisions of Insolvency Act 1986 apply and a company can enter into a voluntary arrangement, administration or liquidation.</p> <p>If a company becomes insolvent or goes into liquidation, a shareholder who has not fully paid for its shares will be liable to pay the outstanding amount to the liquidator. Directors may have to contribute to assets of the company if liable for misfeasance, fraudulent trading or wrongful trading (a director found guilty of fraudulent trading may also be imprisoned). Transactions which are classed as "preferences" and transactions at undervalue may be set aside.</p> <p>Directors have a duty to co-operate with the insolvency office holders and to prepare and file a statement of affairs and may be disqualified under the Company Directors Disqualification Act 1986 if:</p> <ul style="list-style-type: none"> <li>• they are convicted of an indictable offence in connection with the promotion, formation or management of a company (e.g. fraudulent trading);</li> <li>• they persistently breach companies legislation;</li> <li>• they are found guilty of fraudulent trading in the course of the winding up of a company; or</li> <li>• they are found to be "unfit" to be concerned in the management of a company.</li> </ul>

<b>Private company limited by guarantee (CLG)</b>	
Incorporation	<p>The process is the same as for a CLS, except that the details regarding the shareholders and shares will be replaced with details of the members of the company (sometimes referred to as guarantors) and the amount each of them is guaranteeing. The guarantee is usually a nominal amount (e.g. £1). It is possible for members to enter into different levels of guarantee.</p> <p>The members often enter into a members' agreement setting out the ways in which they will regulate the business of the company. This document is intended to be a private document and, if drafted correctly, does not need to be filed at Companies House. This enables the members to keep more "commercial" terms of their relationship confidential.</p> <p>The word "limited" can be removed from the corporate name of the company in certain circumstances.</p>
Constitution	Articles of association and, if required, a members' agreement. It is more common to find a CLG with an "objects" clause, thereby restricting its capacity.
Ongoing corporate regulatory requirements	Broadly the same as for CLS, although details of the members (and any changes to the membership) do not need to be notified to Companies House on an annual basis.
Ownership and changes in ownership	<p>The company is owned by members and can exist with only one member. The members can exercise all rights detailed in the Companies Act 2006, articles of association and any members' agreement.</p> <p>Subject to the Act and the terms of the articles / any members' agreement, new members can be admitted to membership of the company and existing members can cease to be</p>

	<p>members. However, membership is not "transferred" (as there is nothing to transfer; new members merely agree to provide the guarantee.</p> <p>The liability of a member – in that capacity – is limited to the value of its guarantee. Each member guarantees a nominal sum, to be paid to the company in the event of the company being wound up whilst the member is a member, or within one year of ceasing to be a member. As with a CLS, a member of a CLG may have liability towards the company or third parties in other capacities.</p> <p>A member's guarantee in a CLG does not represent an investment as the guarantee represents a future liability; whilst the members of a CLG could in theory agree to "transfer the company" for value to a third party, a CLG is not a suitable vehicle if members ultimately want to exit and realise the value of the company.</p>
Governance	Same as for a CLS, although decisions reserved to the members under the Companies Act 2006 are passed by reference to the voting rights held by each member rather than by the number of shares held by each shareholder.
Funding	<p>As there is no shareholder, there is no ability to raise "equity" funding but equally no liability on members to contribute to the company's capital or rules surrounding the return of capital to members (as would be the case with a CLS).</p> <p>The company can borrow, either from the members or third parties and may need to grant security for repayment of the debt.</p> <p>Any equity or debt funding provided by the members will need to comply with State aid rules.</p>
Treatment of profit/ surplus	A CLG can make distributions of profit to members in accordance with members' rights under articles of association. If the articles do contain a provision prohibiting distributions or profit (which is common with CLGs), then profits/surpluses must only be utilised for the company's purposes.
Insolvency	Same as for a CLS. However, on liquidation members (or former members who have resigned within 12 months of liquidation) will have to contribute up to the value of their guarantee to the company for payment of debts and liabilities, costs and expenses of winding up and adjustment of the rights of contributories among themselves.

### Community interest company limited by shares (Share CIC)

Incorporation	Broadly the same as for a CLS except that the proposed CIC must deliver a "community interest statement" which sets out how the company will pass the community interest test (i.e. the company must show that a reasonable person would consider that its activities are being carried on for the benefit of the community or a section of the community. A section of the community is any group of individuals who share a common characteristic which distinguishes them from other members of the community and a reasonable person might consider that they constitute a section of the community).
Constitution	<p>Articles of association and, if required, a shareholder agreement. CICs are required to incorporate into their memoranda and articles of association certain requirements about the CIC's form, the "asset lock" (see below) and its governance. Model articles for CICs have been published – whilst no CIC is obliged to use these models, any provisions in a CIC's memorandum and articles which are inconsistent with the requirements will be of no effect.</p> <p>A CIC's remit is limited to its community purposes and its assets are subject to the asset lock (see below)</p>
Ongoing corporate	CICs governed by shares are subject to the same ongoing regulatory requirements as CLSs. They are also subject to the CIC Regulator.

regulatory requirements	<p>The CIC Regulator is a light touch regulator who principally relies on the CIC's shareholders and other interested parties to draw matters of concern to its attention.</p> <p>The CIC Regulator has significant enforcement powers, but these are only intended to be used in serious circumstances. Those powers include the power to appoint and remove directors, appoint a manager of the CIC and, in extreme situations, order the transfer of shares or present a petition to the court for the winding up of a CIC. The consent of the CIC Regulator must also be obtained in relation to matters such as proposed changes in a CIC's objects.</p> <p>CICs have to produce an annual CIC report, which will be delivered with their accounts to Companies House and placed on the public record. The report must record what the CIC has done to pursue the community interest and involve its stakeholders during the year. Stakeholders would be people or groups that are affected by the activities that the CIC pursues. The annual report must also contain additional financial information such as any payments to directors or declarations of dividends in the preceding year.</p>
Ownership and changes in ownership	<p>Same as for a CLS. Directors may refuse to register the transfer of a share to a person of whom they do not approve.</p> <p>The Regulator has powers of intervention which include transferring the shares and taking action in the name of the CIC (see "Ongoing corporate regulatory requirements" above).</p>
Governance	<p>Same as for a CLS, but directors of a CIC will also have the responsibility (along with shareholders when they take collective decisions about the CIC) for ensuring that the CIC continues to satisfy the community interest test.</p>
Funding	<p>Same as for a CLS, except that payment of dividends on shares and performance related interest on debt is subject to certain caps (see below under "Treatment of profit/ surplus").</p>
Treatment of profit/ surplus	<p>Profits / surpluses are subject to the "asset lock", the principle elements of which are:</p> <ul style="list-style-type: none"> <li>• a CIC may only transfer assets out of the CIC if the transfer is: (a) at market value (that is for full consideration); (b) if less than market value then the transfer is to another CIC or other asset locked body (either specified in the CIC's articles or with the consent of the Regulator); or (c) otherwise made for the benefit of the community; and</li> <li>• a CIC adopting the asset lock requirements set out in regulations may only pay dividends to asset-locked bodies either specified or consented to by the Regulator. A CIC adopting the alternative asset lock requirements may pay dividends to shareholders who are not asset-locked bodies, including private investors (in the latter case, subject to a maximum aggregate dividend equal to 35% of distributable profits).</li> </ul> <p>Where interest is payable on debts or debentures and the interest is linked to the performance of the CIC, the maximum recoverable interest rate is 20%.</p> <p>On dissolution of a CIC any surplus assets must be transferred in the manner set out below under "Insolvency".</p> <p>There is no statutory definition of "assets" within the legislation governing CICs. However, the CIC Regulator has stated that "assets" must be given a wide interpretation and would include land, cash and revenue streams. This means, for example, that payments to staff and directors must not be disproportionately high.</p> <p>Payment of dividends is subject to compliance with rules on distributions contained in the Companies Act 2006.</p>
Insolvency	<p>Insolvency position same as for a CLS, except that surplus assets remaining after satisfaction of the CIC's liabilities can be paid to shareholders only up to the price paid for their shares and any remaining residual assets thereafter must be distributed to an asset locked body named in the articles, or if no asset locked body is named or the CIC Regulator believes that</p>

	body not to be an appropriate body (e.g. because it is about to be wound up) as the Regulator directs.
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<b>Community interest company limited by guarantee (Guarantee CIC)</b>	
Incorporation	Broadly the same as for a Share CIC.
Constitution	Broadly the same as for a Share CIC, except that the articles of association will not contain any rights attaching to shares and distribution of profits is prohibited.
Ongoing corporate regulatory requirements	Same as for a Share CIC.
Ownership and changes in ownership	Same as for a CLG, so no shareholders. Membership is not transferable and distribution of profits is prohibited.
Governance	Same as for a Share CIC.
Funding	Same as for a Share CIC, except no funds can be raised by means of issuing shares.
Treatment of profit/ surplus	Same as for a Share CIC, but distribution of profits to members prohibited.
Insolvency	Same as for a Share CIC, except no surplus assets will be paid to members for their shares (because there are none).

<b>Limited liability partnership (LLP)</b>	
Incorporation	LLPs are incorporated by submitting a completed form LLIN01 to Companies House (setting out the name, registered office, list of members and designated members) together with a £40 fee. An LLP requires at least two designated members. Where the LLP is essentially wholly-owned, one member owns a nominee company which in turn holds the second member interest in the LLP.
Constitution	The Limited Liability Partnerships Act 2000 imposes certain "default" rights as between the members (e.g. equal capital contributions and equal shares in profits), but these are normally displaced by specific provisions in a members' agreement. The members' agreement is not filed with the Registrar of Companies and it is not publicly available. Unless otherwise restricted in the members' agreement, an LLP will have unlimited capacity to carry out all lawful activities.
Ongoing corporate regulatory requirements	Regulated by Companies House. An annual return and accounts of the LLP must be submitted to Companies House each year in much the same manner as a limited company. Other event-driven filings may also need to be made (e.g. on a change of members details, registered office, accounting reference date, etc.).
Ownership and changes in ownership	An LLP is owned by its members who can exercise the rights given to them under the LLP Act and any members' agreement. A member's liability is normally limited to the amount of capital it has agreed to contribute to the LLP, which can be minimal.

	<p>Note – a member may have liability towards the LLP or third parties if, for example, it is a contract counterparty with the LLP, guarantor of the LLP's debts and obligations or funder.</p> <p>Where an LLP is wound up, both past and present members of the LLP are liable to contribute to the assets of the LLP to the extent that they have agreed to do so with the other members, in the members' agreement. It is therefore common to see a provision in a members' agreement stating that the members are not liable to contribute in this way.</p> <p>An LLP can have an unlimited number of members (two of which must be designated members) who can be added with unanimous consent of members or smaller number of members if agreed otherwise.</p> <p>The members' agreement will set out how new members' interests (i.e. interests in the LLP) may be issued and existing members' interests may be transferred. A transfer of a member's interest will be by way of an assignment of the interest. This is slightly more complex than transferring shares for a company.</p>
Governance	<p>The default position is that all members are entitled to be involved in the day-to-day management of the LLP and that decisions connected with the business of the LLP require the approval of a majority of the members, but if there is a change in the nature of the business, unanimous approval would be required. The members' agreement will normally amend this default position and can specify that certain decisions may be taken by a manager or managers (or a Partnership Board (see below), and that other matters can be "reserved" for the members. In this respect, an LLP is a flexible vehicle.</p> <p>It is common in JV arrangements between corporate members for the members to establish some form of "Partnership Board" which operates in much the same way as a company's board of directors. Members' powers can be delegated to that Partnership Board to enable the day to day management of the LLP's business to be controlled by the Board. If the members' agreement gives the Board the requisite power, then persons other than members of the LLP (or representatives of the members) could be co-opted onto the Board.</p> <p>An LLP requires at least two formally-appointed "designated members" who are required to deal with the statutory obligations of the LLP, such as appointing an auditor or signing the accounts on behalf of the members.</p>
Funding	<p>The injection of capital into the LLP will be governed by a members' agreement.</p> <p>The LLP is not bound by any rules relating to the maintenance of its capital although the members' agreement may set out how and when capital can be transferred out of the LLP.</p> <p>Banks, in providing finance to the LLP, may require restrictions to be imposed on the LLP to ensure that capital is not transferred out of the LLP in a manner which affects the LLP's ability to repay such finance.</p>
Treatment of profit/ surplus	<p>The default position under the LLP Act is that all members will share in the profits of the LLP equally. This can be modified in the members' agreement if required.</p> <p>LLPs are not bound by the rules imposed on companies in relation to availability of profits. The members' agreement may restrict the circumstances in which profits can be shared between members.</p> <p>An LLP is also permitted to retain profits in the business if it so wishes or if is so required, in the same manner as a company.</p>
Insolvency	<p>The insolvency regime for LLPs is largely the same as for companies. The Insolvency Act 1986 allows LLPs to enter into voluntary arrangements, administration or go into liquidation.</p> <p>Members of an LLP may be liable to contribute to the assets on the LLP on a winding up if they are guilty of fraudulent or wrongful trading under section 213 or 214 of the Insolvency Act 1986.</p> <p>Certain transactions, known as preferences, may be set aside if they are made within the six months ending with the onset of the insolvency. In the case of preferences with connected</p>

	<p>parties or transactions at an undervalue, within a period of two years ending with the onset of insolvency.</p> <p>In addition to the regime in relation to preferences, if the LLP became insolvent, or if there was no real prospect of avoiding an insolvent liquidation, there is scope in legislation for any distributions (i.e. extraction of profits or assets) to members to be "clawed back". This means that any amounts or assets withdrawn in the two years before the commencement of winding up, whether as capital, repayment of loan or distribution of profit, can be clawed back from the member receiving the withdrawal, if that member knew or ought to have concluded that, after the withdrawal, there was no reasonable prospect that the LLP would avoid an insolvent liquidation.</p> <p>Members can also be disqualified from acting as company directors through the application of the Company Directors Disqualification Act 1986 to the insolvency of LLPs.</p>
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Community benefit society (Society)	
Incorporation	<p>Registering a Society is subject to a number of conditions:</p> <ul style="list-style-type: none"> <li>• that the Financial Conduct Authority (<b>FCA</b>) is satisfied that the business of the Society is being, or is intended to be, conducted for the benefit of the community;</li> <li>• that the Society has at least three members (or two members both of which are themselves Societies);</li> <li>• that the Society's rules contain the required provisions;</li> <li>• that the place under those rules to be the Society's registered office is in Great Britain or the Channel Islands.</li> </ul> <p>An application to register a Society (on the form issued by the FCA) must be sent to the FCA, together with two copies of the Society's rules (or one copy if the application is made electronically) and the requisite application fee.</p> <p>The FCA does not publish any model rules for a Society. However, there are a number of Societies with rules which have been approved by the FCA as model rule books. If a new Society adopts an existing set of approved model rules, it will benefit from significantly lower registration fees. The registration fees increase incrementally according to the number of amendments being made to a model set of rules. If no amendments are made, the registration fee is £40. If more than 11 amendments are made to a model set of rules, or if model rules are not being used at all, the registration fee is £950.</p>
Constitution	<p>A Society must have rules that bind all members and contain provisions on the following matters:</p> <ul style="list-style-type: none"> <li>• its name;</li> <li>• its objects, which will restrict the Society's "remit";</li> <li>• its registered office;</li> <li>• the terms of admission of the members;</li> <li>• the method for holding meetings, voting and how to make changes to the rules;</li> <li>• the way in which committees, managers and officers may be appointed and removed, and their respective powers and remuneration;</li> <li>• the maximum shareholding that may be held by each member;</li> <li>• whether or not the Society may borrow money from members or other, and if so, under what conditions, under what security and to what limits of amount;</li> <li>• whether and how shares are transferable or withdrawable;</li> </ul>

	<ul style="list-style-type: none"> <li>• how the accounts are to be audited;</li> <li>• how members may withdraw from the Society ;</li> <li>• how profits are to be applied;</li> <li>• if the Society is to have a common seal, provision for its use;</li> <li>• whether any part of the Society's funds may be invested, and if so, by what authority and in what way.</li> </ul> <p>Members have the right, within certain legal limits, to enforce the terms of the contract and hold the officers of the Society to account through the courts. However, no member is bound by a rule amendment that increases his liability to contribute to the Society's share or loan capital unless he has consented to that amendment.</p> <p>Any amendment to the rules is not valid until the amendment has been registered with the FCA.</p>
<p>Ongoing corporate regulatory requirements</p>	<p>A registered society is similar in a number of ways to a CLS, but it is not regulated via the Registrar of Companies and the Companies Act 2006 does not apply. The FCA is the registering authority for societies registered under the Co-operative and Community Benefit Societies Act 2014. The FCA has powers to investigate and inspect Societies, as well as to suspend or cancel their registration.</p> <p>Once a Society is registered, it must operate in compliance with its governing rules and the Act. In particular, it must:</p> <ul style="list-style-type: none"> <li>• keep books of account;</li> <li>• keep a copy of the balance sheet on display at the registered office;</li> <li>• submit an annual return to the FCA every year, accompanied by the annual accounts and auditor's report;</li> <li>• pay an annual fee to the FCA based on total assets as reported in the latest annual return;</li> <li>• give notice to the FCA of any change of registered office;</li> <li>• keep a register of members and officers;</li> <li>• apply to the FCA in relation to any change to the rules or Society name (no change is effective until registered by the FCA);</li> <li>• ensure its registered name is displayed on the outside of its registered office and every other place it carries on business, and appears in legible characters on all required documents and communication;</li> <li>• inform the FCA if it no longer wishes to be registered.</li> </ul> <p>However the FCA does not hold a public register of all Societies, and the Act does not require the same extent of filings as the Companies Act 2006. Accordingly, a Society may be a more appropriate vehicle if privacy is a key consideration for members.</p>
<p>Ownership and changes in ownership</p>	<p>A Society is owned by its members, who hold shares in its capital. The liability of members is limited to the share capital they hold in the Society and the amount of any unpaid share capital. However, the nature of a shareholding in a Society is fundamentally different from a shareholding in a limited company because the shares are not equity shares that constitute a proportion of the underlying value in the Society and there is either no right or a limited right for members to receive any return on their shares. In addition, the power of the members within a Society is equal, on the principle of one member, one vote, and is not determined by the number of shares held.</p> <p>A registered society must have at least three members, or two members both of which are themselves Societies.</p>

	<p>Shares (whether withdrawable or non-withdrawable) are usually transferable; the Society's rules will include provisions regarding transferability and will set out details regarding the form of transfer and registration of transfer.</p>
Governance	<p>A Society is managed by its officers. They have a range of duties based on the same underlying principles as those of company directors although the codified duties under the Companies Act 2006 do not apply to officers of Societies. Officers will commit an offence by failing to comply with the provisions of the Act.</p> <p>While there is no specific section in the Act requiring a Society to appoint a secretary, there are a number of mentions of the Society's secretary throughout the legislation and on the FCA forms, which means it will be necessary to appoint one.</p>
Funding	<p>The share capital of a Society should not exceed what is required to support the Society's activities. If the Society is able to meet its working capital requirements from reserves, there can be no proper reason to seek more share capital because a share offer in these circumstances is not for the purposes of the Society.</p> <p>Societies may issue withdrawable share capital (sometimes referred to as community shares) up to a limit of £100,000 per member. Shareholders holding withdrawable shares may withdraw their investment at any time. It is sometimes used as a quick way to raise additional capital from investors, but it is a riskier form of capital because investors could request to withdraw their investment at any time. However, there is no absolute right to withdraw capital; the Society's rules will often have provisions that control or limit the withdrawal of shares and withdrawal will always be subject to the Society having the cash available. The rules will also provide for the method for withdrawing shares and how the payment for the balance due on them is to be made.</p> <p>A Society with withdrawable share capital is not permitted to operate the business of banking.</p> <p>Societies may also issue non-withdrawable share capital. There is no maximum limit on the non-withdrawable shares held by each member.</p> <p>There are restrictions in relation to the terms on which a Society can borrow.</p>
Treatment of profit / surplus	<p>A Society may not distribute its profits or assets to members; profits must be used to further the objects of the Society by being ploughed back into the business.</p> <p>Where the Society's rules allow assets to be sold, the proceeds of the sale should be used to further the Society's business activities only.</p> <p>The rules must not allow its assets to be distributed to its members on dissolution. The rules should state that on dissolution the assets should be transferred, for example, to some other body with similar objects. If no such body exists, the rules should state that the assets must then be used for similar charitable or philanthropic purposes.</p>
Insolvency	<p>A Society may be the subject of a winding up petition and a consequent court order putting it into compulsory liquidation. Alternatively, the Society may pass a resolution for its voluntary winding up. In either case, the process is identical to that for a company, save that any documents are filed with the FCA not Companies House. In broad terms, Societies (other than Societies providing social housing) are also able to enter into administration, a company voluntary arrangement or a scheme of arrangement.</p> <p>A Society may be dissolved by an instrument of dissolution to which at least three quarters of the members have signed to indicate their consent or if the Society is dormant.</p> <p>If a Society is insolvent, it is liable to be wound up under the Insolvency Act 1986 and its members may be liable to contribute towards the payment of the Society's debts and the expenses of winding up, during the winding up process. Their contribution will be no more than any amount not paid up on their shares. The liability of members as contributories continues for one year after their membership ends.</p> <p>In the event of the dissolution of a solvent Society by any procedure, the rules must not allow its assets to be distributed to its members on dissolution. The rules should state that on dissolution the assets should be transferred, for example, to some other body with similar</p>

	objects. If no such body exists, the rules should state that the assets must then be used for similar charitable or philanthropic purposes.
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## SCHEDULE 5 – GOVERNANCE ISSUES

### 1 INTRODUCTION

1.1 This section addresses a number of key governance issues for any Council proposal to establish a wholly-owned corporate vehicle, namely:

1.1.1 governance responsibilities of the shareholders; and

1.1.2 directors and board composition.

### 2 GOVERNANCE RESPONSIBILITIES OF THE SHAREHOLDERS

2.1 Each corporate vehicle shares one feature in common in that each vehicle as a separate legal personality independent of its "owner". In a company limited by shares, the owners are its shareholders. Shareholders ultimately control the company through the ability to appoint and remove directors on the company's board and certain statutory rights to make decisions in the form of special and ordinary resolutions. In addition, shareholders may exercise control in accordance with the rights given to them either in the articles of association or a shareholder agreement.

2.2 The approach to a shareholder agreement and the appropriate level of control exercisable by the Council is likely to vary depending on the structure of the company. For example:

2.2.1 Is it a Teckal company (where control over the company's decision-making is more important) or a trading company (where the Council is more comfortable to delegate most matters to the company's board)?

2.2.2 Is it a contracting authority or otherwise the procurement rules?

2.3 For local authority wholly owned companies, it would be normal for a shareholder agreement to be put in place to provide the Council with strategic control over the operation of the company through the right to approve a business plan and certain "reserved matters". They reflect the decisions which are often important enough to the owners of a separate vehicle to warrant the owners' specific approval. The type of decisions usually included in lists of reserved matters include:

2.3.1 entering transactions of a significant scale;

2.3.2 changing the type of business undertaken;

2.3.3 admitting new shareholders to the company;

2.3.4 changing the constitution of the company; and

2.3.5 winding up the company.

However, they would need to be modified to suit the particular governance requirements of individual vehicles and may require negotiation where third parties are involved in the vehicle.

2.4 Irrespective of the nature of the vehicle, there is often considerable debate and discussion on exactly which decisions should be reserved matters as this is a key control mechanism which the council can exercise over the vehicle. Where the vehicle is to be structured for Teckal compliance, then the level of control must be commensurate with the Teckal test. However, councils often wish to take the opportunity to require a range of issues to be referred back to them for decision even if these are beyond those required to show compliance for Teckal purposes.

2.5 A balance needs to be struck between maintaining appropriate control (both for Teckal purposes (where appropriate) but also to recognise that the vehicle is owned by the Council and operating largely with public money) and giving the vehicle sufficient freedom and flexibility to operate commercially.

- 2.6 In addition to the reserved matters, the Council may also wish to consider an additional layer of protection which in effect extends the matters requiring Council approval. This can be particularly effective where the Council has limited day to day involvement in the vehicle and can be outvoted at the vehicle's board level, due to an imbalance in favour of executive and/or independent non-executive directors. Such a mechanism could operate as follows:
- 2.6.1 if there are more executive directors appointed than non-executive directors, then if the non-executive directors vote the same way, the matter becomes a reserved matter which can only proceed if the Council approves it; and
  - 2.6.2 if the non-executive directors appointed by the Council notify the vehicle's board that a particular matter (which is not otherwise a reserved matter) is sufficiently important to the Council, then the matter becomes a reserved matter which can only proceed if the Council approves it.
- 2.7 The Council will need to decide it wishes to exercise its shareholder function. Given the function is about the strategic control over the company's activities, it would be usual for this function to be exercised by the Council's members. Depending on the level of control retained under the shareholder agreement, this could be:
- 2.7.1 through all shareholder decisions going to Cabinet;
  - 2.7.2 a committee of the Cabinet being established to undertake some or all decisions;
  - 2.7.3 certain decisions being delegated to certain members (e.g. a portfolio holder) and/or senior officers.
- 2.8 If a matter is not by law or through the vehicles' governing documents reserved to its owners, then it is effectively delegated to those persons charged with management responsibility within the vehicle. In a company, this group is the board of directors.

### **3 DIRECTORS AND BOARD COMPOSITION**

- 3.1 Directors owe a number of duties under the Companies Act 2006 and law generally and a summary of the principal duties and liabilities of directors can be found in Schedule 6. Additionally, it is commonplace, though not essential, for a private company to appoint a secretary. Given this is often a role which falls to Council officers, we have also included a summary of the principal duties and liabilities of company secretaries in the same Schedule.
- 3.2 Directors will be in control of the operation and management of the company, subject to the control which the owner(s) have under the articles of association and any shareholder agreement.
- 3.3 There is no set template for the size or composition of the board of a local authority-owned company, whether this is a trading or a Teckal company model. There are however a number of issues to be considered when deciding on the make-up of the board:
- 3.3.1 the appropriate size for a board;
  - 3.3.2 the appropriate mix of skills and experience needed to lead a successful enterprise;
  - 3.3.3 the need to demonstrate sufficient control (when this is required for Teckal compliance) and
  - 3.3.4 the potential for conflicts which could hinder the effective operation of the board (or indeed the Councils).
- 3.4 Although the company will be a body which is owned in whole or in part by the Council, it must be allowed to operate as a separate commercial enterprise. The company's board therefore needs to be of a sufficient size to ensure an appropriate spread of skills and experience (see below) but not so

large so as to inhibit fast and flexible decision making, sometimes to tight commercial timescales. We would usually consider that a board of between 4 to 7 individuals (with the ability of directors who cannot attend any meeting to send agreed alternates/substitutes) to be a workable size.

- 3.5 The Council will need to consider ideally what skills and experience are needed from individual directors to drive the company forward and make it successful. This will depend on the type of business the company will be undertaking and also on the commercial nature of the enterprise.
- 3.6 If the company is largely intending to focus on providing services back to the owning shareholders, the company board may look different from one driving forward a commercial operation which is intended to grow significantly in the market. The latter type of enterprise will need to ensure it has directors with appropriate financial and business experience. The executive leadership of the company will also need to be factored in. If the lead managers are largely former Council officers who may not have a commercial background, they will need to be supported by a commercially astute company board.
- 3.7 In terms of the different "types" of people who may be considered for board membership, these can be identified as follows:
- 3.7.1 elected councillors of the Council (non-executive directors);
  - 3.7.2 officers of the Council (also called non-executive directors), i.e. officers who are not transferring to the company but are staying in their Council roles;
  - 3.7.3 senior managers/employees of the company itself (executive directors), i.e. officers who have either transferred/been seconded from the Council to the company or been directly recruited by the company. It would be usually only be the Chief Executive and possibly the Director of Finance who would be considered for director roles as well as their employee roles. It is not mandatory to have any executive directors on a board and an alternative approach is to have senior managers sitting as a separate "operational" board beneath the company board (which would comprise non-executive directors only) and be accountable to the company board; or
  - 3.7.4 independent people selected (ideally through open recruitment to adhere to good governance principles) because they bring specific skills and experience (often referred to as independent non-executive directors).
- 3.8 The question of whether elected members should be on the company board is considered further below from a conflicts perspective. If a view is taken that elected members should be on the company board, it is still a relevant to consider what personal skills and experience they are required to bring.

## **4 CONFLICTS OF INTEREST**

- 4.1 In relation to conflicts, there are a number of issues to consider which can impact on the composition of the board and in particular, what role should elected councillors and/or council officers play in relation to the board.

### ***Council officers as directors***

- 4.2 Our advice to councils contemplating appointing officers and/or members to a board of a corporate entity which it owns, is generally to avoid councillor directorships. This is because it is easier to manage the conflicts for an "officer director" than for an elected member - the Council can agree to the officer continuing to act as an officer despite potential conflicts; agree not to take action against him/her where s/he is required to act contrary to the interests of the Council due to his/her role as a director; and agree to his/her remuneration as a director.
- 4.3 There are three caveats to the recommendation of appointing officer directors which may affect who is identified to undertake this role:

- 4.3.1 We would advise against statutory officers (Monitoring Officer, s.151 officer and the Head of Paid Service) being appointed as company directors as they may be required to undertake their statutory roles in relation to the company at some point which would raise difficult conflicts.
- 4.3.2 There needs to be consideration of the "retained client" role i.e. if all officers who know anything about the services being delivered are either transferred to the company to run them and/or on the company board as a director, who is left to provide the expert, impartial advice to the Council to make decisions about service performance by the company and about decisions in relation to the company in their capacity as owners.
- 4.3.3 If officers, who are also company directors, are making decisions (at Council level) about the company, those decisions will potentially be open to challenge, that their decision is influenced by bias (because of their role at the company) and/or by pre-determination (that they have made their minds up because of the company role and are not making the decision objectively and fairly).
- 4.4 It is a criminal offence for officers, under the cover of their office, to accept anything other than their proper remuneration. Accordingly, where officers are appointed as directors by reason of their post within the Council, they may not accept any payment from the company for their services as a director, unless the Council agrees that the additional payment shall form part of the proper remuneration. It is therefore recommended that the officer director in question should formally notify the Council of their interest, and their declaration should be kept on the officer declaration file. Where there is a desire the director role to be remunerated, an alternative approach which is sometimes taken is for the officer to have a separate contract with the company (i.e. not as part of the officer's contract of employment with the authority) and to receive remuneration through this. In these cases, the employing authority will need to provide approval for the individual to take on the separate role.

#### ***Elected members***

- 4.5 Although it is completely lawful for elected members to be directors of Council companies, there are some intrinsic conflicts which need carefully to be addressed. These relate both to the Code of Conduct for members but also to the risk of decisions made by a councillor where s/he is also a director of the company being challenged on the basis of bias or predetermination. Whilst the Council could grant a dispensation which covers a disclosable pecuniary interest under the Localism Act 2011, it is not possible for the Council to avoid accusations of bias or predetermination, especially if the member is senior. Directorships can therefore constrain elected members' "Council side" activities and inhibit members carrying out their elected strategic and scrutinising roles.
- 4.6 In the light of this, local authorities often decide to involve only officers in director roles, ensuring that elected members are free to decide key issues about the organisation (i.e. the reserved matters) on behalf of the Council in its strategic role as sole or part owner.
- 4.7 Where the Council is seeking to establish a company as a non-contracting authority, the position would typically be stronger without elected members on the board. This is because it would help create greater distance between the company and the Council and reduce the perception or risk that the vehicle has a policy purpose rather than being purely an investment/financial purpose.
- 4.8 Directors' remuneration (if any) with the company will be governed by the provisions of the Local Authorities (Companies) Order 1995. Remuneration and expenses for councillor directors must not exceed levels that the local authority could pay as comparative members' allowances. Any remuneration they receive will be deducted from the special responsibility allowance that they receive within the Council and they may only claim mileage and subsistence at the rates that apply to members.

#### ***Practical points***

- 4.9 If members or officers are appointed as directors of the company, there will be a number of arrangements/processes to be put in place to ensure that conflicts are properly addressed and managed as follows:

- 4.9.1 the constitution of the company should address "inherent situational conflicts" of the Council-appointed directors on the board given that these conflicts can be foreseen because of the links between the Council and the company – this helps to ensure openness of decisions making and probity at the company end of activities;
- 4.9.2 appropriate conflicts and interests should be declared and recorded at all relevant company meetings;
- 4.9.3 at the Council end, any officer serving as a director on a company must declare interests (and be given the necessary consents to act);
- (a) under section 117 of the Local Government Act 1972;
  - (b) under his/her contract of employment; and
  - (c) under any relevant code of conduct for officers;
- 4.9.4 any elected member serving as a director of a company must declare an interest under the Councillors' Code of Conduct) and comply with other rules about members on companies (including a restriction on any remuneration); and
- 4.9.5 there must be arrangements at the Council end of activities to ensure that decisions can be made in relation to the company which are robust. Although all the necessary conflicts and interests can be declared, if decisions are made at the Council by members or officers who have an interest in that decision from a company perspective, there will always be a risk of an allegation of bias or pre-determination being made to challenge that decision.

## SCHEDULE 6 – DUTIES AND LIABILITIES OF DIRECTORS AND COMPANY SECRETARIES

### 1 INTRODUCTION

- 1.1 A company's board is its decision-making body, responsible for the company's activities, its prosperity and future. Direction, decision-making and leadership must come from the board of directors first if they are to be embedded anywhere else in the company. For that reason, directors owe a number of duties.
- 1.2 Directors' duties arise in different ways:
- 1.2.1 General and specific duties arising under the Companies Act 2006
  - 1.2.2 Duties arising under general law
  - 1.2.3 Duties imposed by the company itself
- 1.3 Company secretaries do not owe general duties in the same way as directors (unless they themselves are classed as shadow directors), but they may owe other duties in a manner similar to directors.
- 1.4 This is a vast and complex area of law, so the following high level summary is not a definitive statement of all duties and liabilities which a director and/or a company secretary may face. We would be happy to provide further detail separately on any of the points raised in this note if required.
- 1.5 It should be noted that our client is the Council, not any particular person who may be appointed to the role of director and/or company secretary. The Council may provide this note to such an individual provided that such person does not rely on this note and seeks his/her own independent advice if required.

### 2 DIRECTORS' GENERAL DUTIES UNDER THE COMPANIES ACT 2006

- 2.1 Sections 171-177 of the Companies Act 2006 set out the following general directors' duties:
- 2.1.1 ***to act within powers*** – a director must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred
  - 2.1.2 ***to promote the success of the company*** – a director must act in a way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so, he must have regard to (amongst other things) the following factors:
    - (a) the likely consequences of any decision in the long-term;
    - (b) the interests of the company's employees;
    - (c) the need to foster the company's business relationships with suppliers, customers and others;
    - (d) the impact of the company's operations on the community and the environment;
    - (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
    - (f) the need to act fairly as between members of the company
  - 2.1.3 ***to exercise independent judgment*** – this duty is not infringed by his acting (i) in accordance with an agreement duly entered into by the company that restricts the future

exercise of discretion by the directors or (ii) in a way authorised by the company's constitution

2.1.4 **to exercise reasonable care, skill and diligence** – this means the care, skill and diligence that would be exercised by a reasonably diligent person with (i) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and (ii) the general knowledge, skill and experience that the director has

2.1.5 **to avoid conflicts of interest** - a director must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

2.1.6 **to not accept benefits from third parties** - a director must not accept a benefit from a third party conferred by reason of (i) his being a director, or (ii) his doing (or not doing) anything as director

2.1.7 **to declare interests** - if a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors

2.2 Where more than one duty applies in a given case, the directors must comply with each applicable duty. The general duties also do not require or authorise a director to breach any other law.

2.3 The general duties apply to all the directors of a company. "Director" is defined in the Act to include any person occupying the position of director, by whatever name called.<sup>22</sup> The Act makes no distinction between executive and non-executive directors.

2.4 The general duties are owed to the company. Two broad implications follow from this:

2.4.1 Directors must act in the interests of the company, even where they are appointed to the board by a third party, such as the Council. The nominated directors will need not only to avoid conflicts of interest but to avoid the perception of any conflict.

2.4.2 Only the company will be able to enforce the general duties, although in certain circumstances individual members may be able to bring an action on the company's behalf (often referred to as a derivative action) and creditors may be able to do so where the company is (or may become) insolvent

2.5 It is important to note that the Companies Act 2006 did not codify all common duties and law rules or equitable principles which directors need to consider when exercising their functions as directors. Directors will continue to owe certain equitable and common law duties to the company, such as:

2.5.1 the duty of confidentiality (this can be particularly problematic where directors are appointed by a third party with potentially overlapping interests, such as the Council); and

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<sup>22</sup> It is also worth noting that the general duties apply to shadow directors where, and to the extent that, the corresponding common law rules and equitable principles so apply. A shadow director is a person in accordance with whose directions or instructions the directors of the company are accustomed to act, but a person is not a shadow director only because the directors act: (i) on advice given by them in a professional capacity, (ii) in accordance with instructions, a direction, guidance or advice given by that person in the exercise of a function conferred by or under an enactment, or (iii) in accordance with guidance or advice given by that person in that person's capacity as a Minister of the Crown. For the purpose of the general duties, a body corporate (as defined) is not to be regarded as a shadow director of any of its subsidiary companies only because the directors of that subsidiary are accustomed to act in accordance with its directions or instructions.

2.5.2 the duty to consider or act in the interests of creditors when the company is insolvent, with a view to minimising losses to them.

2.6 Liability for breach or threatened breach of the general duties is personal to the directors concerned and unlimited in scale. Accordingly, it is not possible to quantify the potential exposure of a director. Under section 178 of the Companies Act 2006, the consequences of a breach or threatened breach of the duties are the same as for breach of the corresponding common law or equitable principles. The remedy for a breach of section 174 (*duty to exercise reasonable care, skill and diligence*) will usually be damages. Remedies for breaches of other general duties may include:

2.6.1 an injunction

2.6.2 setting aside of the transaction, restitution and account of profits

2.6.3 restoration of company property held by the director

2.6.4 damages

2.6.5 termination of the director's service contract

### 3 SPECIFIC DUTIES OF DIRECTORS UNDER THE COMPANIES ACT 2006

3.1 The Companies Act 2006 lays down a regulatory framework for the management and conduct of companies. Many sections of the Act require companies to send information to Companies House, hold certain meetings, or to do or refrain from certain actions in particular circumstances.

3.2 The Act imposes potential liabilities for non-compliance on the company and, usually, "on every officer in default". Directors, along with the company secretary (if appointed), are the officers who are potentially liable for any defaults of this nature. Prosecution for regulatory offences (not filing information at Companies House, etc.) is rare, though not unknown.

### 4 DUTIES IMPOSED ON DIRECTORS BY GENERAL LAW

4.1 Directors are responsible for seeing that the company is run lawfully, i.e. in accordance with the general law. As a result, the duties under the Companies Act 2006 cannot be regarded in isolation, because a director is also subject to a wide range of other legislation (the scope of which is too wide for this note) including:

4.1.1 ***Company Directors Disqualification Act 1986*** - the circumstances in which an application may be made for the disqualification of a director are as follows:

- (a) the director has been guilty of three or more defaults in complying with companies legislation regarding the filing of documents with the Registrar of Companies during the preceding five years
- (b) he or she is, or was, a director of a company that has at any time become insolvent and that his/her conduct as a director of that company makes him or her unfit to be concerned in the management of a company
- (c) the director is found to be guilty of wrongful or fraudulent trading as defined in the Insolvency Act 1986 (see below)

4.1.2 ***Insolvency Act 1986*** –

- (a) ***Fraudulent trading*** - fraudulent trading occurs where, if in the course of the winding up of the company, it appears that business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose (note that the corresponding provision in the Companies Act 2006 does not require the company to be undergoing a winding up, so a charge of fraudulent trading can arise at any

time). This includes where debts have been incurred by a company knowing that they cannot be paid. Fraudulent intent must be shown. Any person knowingly a party to the fraud may be made liable to contribute to the company's assets, may be convicted and (under the equivalent provision in the Companies Act 2006) imprisoned for up to 10 years and/or fined. A director may be disqualified from acting as a director for up to 15 years.

- (b) **Wrongful trading** - this is where a company has gone into insolvent liquidation and it appears to the court that any person who has been a director of the company knew or ought to have known that this would occur and failed to take all reasonable steps to minimise the loss to the creditors. Keeping a company in a situation where it is trading at a loss, so increasing the deficit to creditors, rather than ceasing to trade or putting the company into liquidation, is clear failure to take such steps. No fraudulent intention is required – "honest but incompetent" is no defence, and the onus is on the director to prove that he took every reasonable step to minimise the potential losses to creditors. If wrongful trading is established, the court may order a director liable to contribute to the assets of the company and the disqualification of that person from acting as a director. The court may make a director disqualification order against any person who has been a director of a company which has gone into insolvent liquidation and who appears not to be a "fit person" to be concerned in the management of a company.
- (c) **Misfeasance** - a director of a company is guilty of misfeasance if he has misapplied or retained, or become accountable for, any money or other property of the company. This section does not create any new offences or impose any novel duties, but provides a summary means of pursuing directors. The courts have confirmed that the misfeasance procedure is appropriate for cases of negligence as well as alleged breaches of fiduciary duty. Any director found guilty of misfeasance may be held liable to repay or account for money or property to the company (together with any interest which the court may impose thereon) or contribute such sum to the company's assets by way of compensation as the court thinks just.

#### 4.1.3 **Health and Safety at Work etc Act 1974 –**

- (a) Health and safety law places duties on organisations and employers, and directors can be personally liable when these duties are breached: members of the board have both collective and individual responsibility for health and safety.
- (b) The range of legal obligations placed on employers with respect to health and safety is extensive. The particular obligations which apply in any given case will depend on the activities carried out by the company, the extent of the risks posed by these activities and other factors such as the number of employees.
- (c) The Health and Safety at Work etc Act 1974 sets out the basic health and safety duties of a company, its directors, managers and employees. It also acts as the framework for other health and safety regulations, including the Management of Health and Safety at Work Regulations 1999.
- (d) The main obligations imposed by the Act and Regulations include the following:
  - (i) Employers are responsible for ensuring the health and safety of their employees and those that are affected by their activities so far as reasonably practicable.
  - (ii) An employer must assess and review the work-related risks faced by its employees and by others affected by the company's activities. This risk assessment must be "sufficient and suitable".

- (iii) An employer must make and give effect to appropriate arrangements for the effective planning, organisation, control, monitoring and review of the preventive and protective measures.
  - (iv) An employer must audit the adequacy of these procedures.
  - (v) One or more competent persons must be appointed to implement the measures needed to comply with health and safety law.
  - (vi) An employer must provide its employees with understandable and relevant information and training on the risks they face and the preventive and protective measures to control those risks.
- (e) Employers with five or more employees must also:
- (i) produce a written health and safety policy;
  - (ii) describe the arrangements for putting the policy into practice;
  - (iii) bring the policy and any revision of it to the attention of employees;
  - (iv) revise the policy whenever appropriate;
  - (v) record appropriate arrangements for the effective planning, organisation, control, monitoring and review of the preventive and protective measures; and
  - (vi) record the significant findings of risk assessments and any group of employees identified by it as especially at risk.
- (f) A breach of any of these statutory obligations will constitute a criminal offence by the company, leaving it open to a range of sanctions.
- (g) If a health and safety offence is committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the organisation, then that person (as well as the organisation) can be prosecuted under section 37 of the Health and Safety at Work etc Act 1974. "*Consent*" means knowledge and awareness of the circumstances and the risks which caused the health and safety failure. "*Connivance*" means knowing and not doing anything about the risks. "*Neglect*" means unreasonable breaching of a duty of care.
- (h) Those found guilty are liable for fines and, in some cases, imprisonment. In addition, section 2(1) of the Company Directors Disqualification Act 1986 empowers the court to disqualify an individual convicted of an offence in connection with the management of a company. This includes health and safety offences. This power is exercised at the discretion of the court; it requires no additional investigation or evidence.

#### 4.1.4 **Common law manslaughter -**

- (a) Individual directors are also potentially liable for other health and safety related offences, such as the common law offence of gross negligence manslaughter.
- (b) Under the common law, gross negligence manslaughter is proved when individual officers of a company (directors or business owners) by their own grossly negligent behaviour cause death. This offence is punishable by a maximum of life imprisonment.

- (c) A person need not be aware of the risks created by their conduct for that person to be convicted of manslaughter. However, a defendant who is reckless might be more likely to be found grossly negligent.
- (d) Although prosecutions of company directors for manslaughter are hard to secure, there have been some convictions. For example:
  - (i) in July 2004 Nationwide Heating Systems Limited and the company's managing director were convicted of the manslaughter of a young apprentice killed in an explosion at Princess Yachts International yard in February 2003. The managing director was sentenced to twelve months imprisonment;
  - (ii) in 15 September 2005, a company director of MW White Ltd, was sentenced to twelve months imprisonment for the manslaughter of an employee at his paper recycling business; and
  - (iii) in January 2005, Lee Harper, the managing director of Harper Building Contractors, was sentenced to fifteen months imprisonment after an employee fell through a skylight.
- (e) Since 1990 it has been possible in theory to indict a company for manslaughter.<sup>23</sup> However, successful prosecution of large corporations has proven difficult, as it is often almost impossible to identify the "controlling mind" of the company (see for example, the failure to obtain a conviction in cases relating to the *Herald of Free Enterprise*, the Hatfield rail crash and the Ladbroke Grove rail crash).

#### 4.1.5 **Corporate Manslaughter and Corporate Homicide Act 2007 -**

- (a) Under this Act, an offence will be committed where failings by an organisation's senior management are a substantial element in any gross breach of the duty of care owed to the organisation's employees or members of the public, which results in death.
- (b) The maximum penalty is an unlimited fine and the court can additionally make a publicity order requiring the organisation to publish details of its conviction and fine.

## 5 DUTIES IMPOSED ON DIRECTORS BY THE COMPANY ITSELF

- 5.1 The company may impose duties on its directors by its articles and by delegation by the board of functions to particular directors.
- 5.2 Directors are bound by the terms of the company's articles (which may impose specific duties on them) and by any lawful decisions of the company, whether made by the members collectively or by resolutions of the board.

## 6 DUTIES OF A COMPANY SECRETARY

- 6.1 Neither the Companies Act 2006 nor the common law explicitly states what the company secretary should do once appointed. There is published guidance relating to the role and importance of company secretaries, but most is provided in the context of listed and large private companies and no agreed definition of the role exists. Accepting that the scope of the secretary's role will depend on the particular business and administrative arrangements of the company, probably the best starting point is the general description developed by the Institute of Chartered Secretaries and Administrators (ICSA). ICSA summarised the role of the company secretary as someone who:
  - 6.1.1 wins the confidence of and acts as a confidential sounding board to the chairman and other directors on issues of concern;

<sup>23</sup> *P&O European Ferries (Dover) Limited* [1991] 93 App R 72

- 6.1.2 provides, where appropriate, a discreet but challenging voice in relation to board deliberations and decision making, drawing in particular on his or her professional experience and historical knowledge of the company; and
  - 6.1.3 keeps under review legislative, regulatory and governance developments that may impact the company and ensures that the board is appropriately briefed on them.
- 6.2 Within this broad description, the company secretary is responsible for:
- 6.2.1 effective administration and good corporate governance at board level, including organising board meetings, taking clear minutes of proceedings and supplying directors with records of decisions taken;
  - 6.2.2 updating the company's internal corporate registers and public filings, and otherwise safeguarding the company's interests by ensuring legislative and regulatory compliance; and
  - 6.2.3 communicating with members and other stakeholders, particularly in relation to matters of corporate governance.
- 6.3 No pre-existing skill or qualification is required of a private company secretary (unlike for the secretary of a public company) and local authorities should always consider the skills and experience of the proposed company secretary before nominating him or her to act in this capacity.
- 6.4 In addition, to fulfil this role the company secretary must act impartially and not be subject to the undue influence of one or more of the directors. Again, real or perceived tensions can arise where the local authority nominating the secretary also nominates a number of directors to sit on the company board.

## **7 LIABILITIES OF A COMPANY SECRETARY**

- 7.1 Firstly, a company secretary may incur liabilities under statute.
- 7.2 The limited number of specific references in the Companies Act 2006 to the company secretary might lead a person newly appointed to that post to underestimate the extent of the responsibilities of the role. However, under the Act a company's directors, managers and the company secretary are classed as "*officers*". If a company is in breach of a requirement in the Act which gives rise to an offence, then any officer who authorises or permits or participates in the breach, or fails to take reasonable steps to prevent it, may be prosecuted for the offence. Over 150 provisions in the Act provide that where the company fails to comply with its obligations, then "*an offence is committed by every officer of the company who is in default*", with the most commonly stated penalty being a fine. If the secretary is the person with prime responsibility for the task, then he or she will be the person in default and liable to a fine. As a practical matter, prosecutions of company secretaries for defaults of this nature are rare. However, even if not fined personally, it is potentially very embarrassing for a secretary if, due to his or her personal default, the directors and/or company are fined.
- 7.3 There are also potential offences in other statutes including in relation to tax matters, health and safety, publication of materially misleading, false or deceptive written statements, environmental pollution and insolvency. In relation to insolvency, if the secretary becomes aware that the company has become insolvent or is likely to become insolvent if continuing in business, the general view is that the secretary has a duty to draw the attention of the directors to this fact and the consequences of allowing the company to continue in business. Failure to give that advice may amount to negligence for which, in appropriate circumstances, the secretary may be liable to the company. If the secretary was a "*party to*" carrying on the business of the company for a fraudulent purpose, then this may attract liability under the Insolvency Act 1986 and/or the Companies Act 2006, with penalties under the latter statute including a fine and/or imprisonment.
- 7.4 Finally, a secretary needs to be aware of the fact that his or her conduct may constitute that of a shadow director. A shadow director is "*a person in accordance with whose directions or instructions the directors of the company are accustomed to act*" (see earlier footnote).

- 7.5 If a person is found to be a shadow director, then that person will be subject to a number of duties and obligations as though he or she were a "fully-intended" director of the company (for example, potential liability for fraudulent or wrongful trading under the Insolvency Act 1986 and breach of directors' duties under the Companies Act 2006). A shadow director may also be disqualified from acting as a director in the grounds of unfitness under the Company Directors Disqualification Act 1986.
- 7.6 A company secretary is an agent of the company under common law. A person acting as a company secretary owes the following fiduciary duties to the company:
- 7.6.1 to act in good faith in the interests of the company;
  - 7.6.2 to avoid conflicts of interest;
  - 7.6.3 not to act for any collateral purpose; and
  - 7.6.4 not to make secret profits from dealings for or on behalf of the company.
- 7.7 Breach of these duties may result in the secretary becoming liable to the company for damages. However, the company's constitution – being a contract between the members themselves and the company - can acknowledge and modify those duties to ensure that the company secretary's pre-existing loyalty to the local authority is recognised.
- 7.8 A common response to being appointed as a company secretary is to find a junior team member to undertake the role. However, a company secretary may not be able to abrogate responsibility by delegating a particular function to another person, if that other person then fails to perform the function. So, where a function which would otherwise fall within the scope of the secretary's duties is delegated, the secretary should ensure that the delegate is competent and trustworthy and should keep him or herself informed as to the activities the delegate is carrying out.

## **8 PRACTICAL TIPS AND PROTECTIONS**

- 8.1 The most effective way for a director to avoid liability arising from his position is to act in accordance with his duties. In light of those duties, the following may be of assistance to directors in connection with their decision-making, to help minimise the potential liabilities they may face:
- 8.1.1 Maintain up-to-date financial and operational information
  - 8.1.2 Circulate meaningful information (i.e. information designed to promote debate and reasonable decision-making)
  - 8.1.3 Meet as often as necessary - more regularly if issues are raised
  - 8.1.4 Don't ignore problems – always heed the warning signs and don't "put things off until tomorrow"
  - 8.1.5 Be clear what the Board is being required to consider and decide – ensure discussions are focused and culminate in unambiguous decisions
  - 8.1.6 Seek professional advice where appropriate
  - 8.1.7 Keep detailed records of decisions
  - 8.1.8 Always aim for collective decision-making
- 8.2 Whilst company secretaries, in the normal course of business, are not taking decisions in the same way as directors, the tips above are also of general use for people appointed to that office in relation to both their duties and their role in promoting good decision-making by the directors.

- 8.3 The Council should also consider other common means of protecting directors on the boards of companies with its corporate group, such as:
- 8.3.1 Directors' and officers' (D&O) insurance (subject to the rules around insurance in the Companies Act 2006)
  - 8.3.2 An indemnity from the company (again, subject to the rules in the Act)
  - 8.3.3 An indemnity from the Council (subject to the Council's ability to grant one)
- 8.4 Finally, it is worth remembering that a director's conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company can be ratified under section 232 of the Companies Act 2006, by the company's members, subject to certain procedural hurdles. Section 1157 of the Act also provides that where proceedings for negligence, default, breach of duty or breach of trust are brought against a director, the court may relieve him from liability if it considers both that (i) he has acted honestly and reasonably and (ii) considering all the circumstances of the case, he ought fairly to be excused. A director may also apply to the court for relief where he has reason to expect that a claim may be made against him.

## SCHEDULE 7 – CONTROLLED AND INFLUENCED COMPANIES

### 1 INTRODUCTION

- 1.1 Companies under the control of local authorities or subject to their influence are required to comply with the provisions of Part V of the Local Government and Housing Act 1989 (the **1989 Act**) and the Local Authorities (Companies) Order 1995 (the **1995 Order**). This legislation is designed to prevent local authorities setting up or becoming involved in companies through which they could then carry out functions outside the scope of the strict controls on local government expenditure and operations.
- 1.2 The 1995 Order imposed restrictions on all "*controlled*" companies and certain "*influenced*" companies: for the purposes of the 1995 Order these companies are "*regulated*" companies. Regulated companies are effectively treated as part of the local authority for capital finance purposes.

### 2 DEFINED TERMS

#### "Controlled" company

- 2.1 Section 68 of the 1989 Act defines "controlled" companies. If **any one** of the following conditions is met, the company will be controlled:
- 2.1.1 The company is a "subsidiary" of the local authority by virtue of section 1159 of the Companies Act 2006.
- 2.1.2 The company is not a subsidiary, but the local authority has the power to control a majority of the votes at a general meeting of the company.
- 2.1.3 The company is not a subsidiary, but the local authority has the power to appoint or remove a majority of the directors of the company.
- 2.1.4 The company is under the control of another controlled company.

#### "Subsidiary"

- 2.2 The company will be a "subsidiary" of the local authority if **any one** of the following conditions is true:
- 2.2.1 The local authority holds a majority of the voting rights in the company on all or substantially all matters. The local authority must be named as holder of those rights, and in this context "*voting rights*" means shareholders' rights (if limited by shares) or the rights of members to vote at a general meeting of the company on all or substantially all matters (if limited by guarantee).
- 2.2.2 The local authority is a member of the company and has the right to appoint or remove a majority of its board of directors.
- 2.2.3 The local authority is a member of the company and controls a majority of the voting rights in it (for example, by an agreement with the other members).
- 2.2.4 The company is subject to the control of a company that is itself controlled by the local authority.

#### "Influenced" companies

- 2.3 A company is subject to the "influence" of a local authority if **all** of the following conditions are met:
- 2.3.1 It is not a controlled company.
- 2.3.2 There is a "business relationship" between the company and the local authority.

- 2.3.3 There is a "personnel association" between the company and the local authority. A personnel association exists when:
- (a) at least 20% of the total voting rights at a general meeting are held by persons associated with the local authority; or
  - (b) at least 20% of the directors are persons associated with the local authority; or
  - (c) at least 20% of the total voting rights at a directors' meeting are held by persons so associated.
- 2.3.4 A person is at any time "associated" with a local authority if they are at that time a member or officer of the local authority, or both an employee and a director, manager, secretary or similar officer of the company under the local authority's control, or if they have been a member of the local authority within the preceding four years.

**What constitutes a "business relationship" with a local authority?**

- 2.4 A company has a "business relationship" with a local authority if one or more of the following apply:
- 2.4.1 Within 12 months up to and including the day on which the question arises, more than half of the company's turnover is made up of payments from the local authority or from a company under the control of the local authority.
  - 2.4.2 More than 50% of the company's turnover is derived from exploiting assets in which the local authority or company under the control of the local authority has an interest.
  - 2.4.3 The total of the following exceeds 50% of the net assets of the company:
    - (a) grants made either by the local authority (being expenditure for capital purposes) or by a company under the control of the local authority; and
    - (b) the nominal value of shares in the company which are owned by the local authority or by a company under its control.
  - 2.4.4 The total of grants, shares and loans or other advances made or guaranteed by the local authority or by a company under its control exceeds 50% of the fixed and current assets of the company.
  - 2.4.5 The company at that time occupies land by virtue of an interest obtained from the local authority or a company under its control at less than best consideration reasonably obtainable.
  - 2.4.6 The company intends at that time to enter into or complete a transaction and when that is done there will be a business relationship under any of the above.

**3 EFFECT OF BEING A CONTROLLED OR INFLUCENED COMPANY**

- 3.1 If the company in question is a regulated company, then the following consequences would arise:
- 3.1.1 Any financial support for the company, or possible liability for the Council associated with the company, will have to be included in any assessment of the Council's finances under the prudential framework for capital investment by local government.
  - 3.1.2 All "relevant documents" must state that the company is controlled by the Council and name the Council.
  - 3.1.3 Remuneration and expenses for councillor directors must not exceed levels that the local authority could pay as comparative members' allowances.

- 3.1.4 The company would be bound by the restrictions on publication of information imposed by section 2 of the Local Government Act 1986. This means that it would be prohibited from publishing party political material.
- 3.1.5 Directors of the company must be removed if they become disqualified for membership of a local authority.
- 3.1.6 The company must obtain the Audit's Commission's consent (we assume now the NAO) to the appointment of its auditor.
- 3.1.7 Requirements are imposed relating to the provision of information to the local authority's auditor and members and of financial information to the local authority.
- 3.1.8 If the company is not an arm's length company, then it must allow for public inspection of the minutes of any general meeting for four years after the meeting, unless disclosure would be in breach of any statutory requirement or obligation owed to any individual.

## SCHEDULE 8 - STATE AID

### 1 STATE AID REGIME

#### What is State aid?

- 1.1 State aid is a concept which derives from European law. Under the Treaty of the Functioning of the European Union (the **Treaty**), State aid is *"any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods ..., in so far as it affects trade between member states"*.<sup>24</sup> The Treaty prohibits the grant of State aid unless the aid is expressly permitted under the Treaty or by the European Commission (the **Commission**).
- 1.2 Both the Commission and the European Court of Justice have interpreted the term *"State aid"* very widely to include many different forms of state financial assistance or economic advantage. As a result, any benefit to an organisation (including a Teckal company owned and controlled by a contracting authority) is potentially caught as an aid.<sup>25</sup> Examples of State aid include:
- 1.2.1 working capital or other loans;
  - 1.2.2 provision of premises or use of equipment on a free or discounted basis;
  - 1.2.3 sales of goods or services to the organisation at an undervalue;
  - 1.2.4 purchase of goods or services from the organisation at an overvalue;
  - 1.2.5 provision of grant funding e.g. for the acquisition of assets; and/or
  - 1.2.6 equity investment.
- (Please note that this is not an exhaustive list)
- 1.3 The concept also extends to more complex situations, such as the construction of infrastructure by a local authority which may benefit specific third parties in addition to the local authority itself.
- 1.4 The following four elements need to be present in order for aid to constitute State aid:
- 1.4.1 the aid is granted by the member state or through state resources;
  - 1.4.2 the aid favours a certain undertaking/group of undertakings (i.e. an entity/entities engaged in economic activity) or the production of certain goods;
  - 1.4.3 the aid distorts or threatens to distort competition; and
  - 1.4.4 the aid affects trade between member states or is capable of having an effect on cross-border trade.
- 1.5 In assessing whether aid from the state to a recipient is permissible, it should first be considered whether the aid can be brought outside of the scope of the four conditions above (i.e. it can be argued that the aid does not amount to State aid). If each of the above conditions is satisfied, it should then be considered whether the aid is "permitted" aid (i.e. the aid has been approved by the Treaty or Commission (see paragraph 1.7 for further details)).

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<sup>24</sup> Article 107(1) of the Treaty

<sup>25</sup> *Van Landewyck* (Joined Cases C-180/98 and C-184/98).

## What are the key arguments for contending that the proposed aid does not constitute State aid?

- 1.6 A number of arguments that can be deployed to contend that a proposal is not in fact a State aid. The key arguments which can be made in this respect are as follows:
- 1.6.1 ***The market economy investor principle applies*** - this means that there is no State aid because the benefit flows from a transaction on market-facing terms (for example, a loan is being offered to an organisation by a local authority on the same commercial terms as a private sector investor would offer to that same organisation, whether in terms of anticipated return on capital, charges for use of land or property or otherwise). This is often the easiest way of side-stepping the State aid rules. However, while this may be relatively easy to demonstrate - for example, by market testing or benchmarking the aid with aid available from a private provider - the provision of aid on this basis may mean that the recipient struggles in the early stages of its life. We have summarised some further considerations in relation to the market economy investor principle in section 2 below.
  - 1.6.2 ***There is no impact on competition as the benefit has itself been competed for*** - in order to run this argument, an aid giver would need to ensure that a robust procurement programme had been adhered to in respect of the aid.
  - 1.6.3 ***There is no impact on trade between member states*** - this argument can be difficult to run and is only likely to be applicable to a very local enterprise providing a service which is not provided elsewhere in the EU. These circumstances are rare and generally confined to cultural activities. In general the EU has taken quite a wide view of the scope for potential impact on trade between member states and has not required evidence of actual impact.
  - 1.6.4 ***The recipient is not operating as an undertaking*** (i.e. not engaged in economic activity) for the purpose of the proposed scheme. It is possible for the same entity to be classified as an undertaking in one scenario but to fall outside of the definition of an undertaking in different circumstances.

## What forms of permitted State aid are there?

- 1.7 Although the Treaty prohibits in principle the grant of State aid, the aid will be deemed acceptable if it falls within any of the following categories:
- 1.7.1 any of the exemption provisions, such as the general block exemption regulation (**GBER**)<sup>26</sup> or the de minimis regulations<sup>27</sup> (see paragraphs 1.9 and 1.10 for a summary of these principles);
  - 1.7.2 Services of General Economic Interest (**SGEI**)<sup>28</sup> in accordance with the SGEI package of measures (see paragraphs 1.14 to 1.18);
  - 1.7.3 the aid has been notified to, and approved by, the Commission under Article 107(3) of the Treaty; or
  - 1.7.4 the Treaty has declared the proposed aid to be compatible with it under Article 107(2) of the Treaty or elsewhere.
- 1.8 It is important to note that exemptions are analysed separately, but the amounts may be aggregated to avoid member states evading the limits on the proportion of eligible costs they can fund (known as the "*intensity of aid*").

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<sup>26</sup> Commission Regulation 651/2014/EU of 17 June 2014

<sup>27</sup> Commission Regulation 1407/2013/EU of 18 December 2013

<sup>28</sup> Commission Decision 2012/21/EU; Commission Regulation 360/2012/EU and the 2012 Communication from the Commission C2012/C8/02

## **General Block Exemption Regulation (GBER)**

- 1.9 The Commission recognises that there are certain circumstances where the granting of aid may be beneficial and would not unduly distort competition. Consequently, the Commission has established a regulatory framework, which includes the GBER, to permit the granting of aid in certain limited circumstances. Under the GBER, aid may be granted provided that it:
- 1.9.1 falls within one of the listed categories of aid;
  - 1.9.2 meets the requirements set out within the relevant category/article; and
  - 1.9.3 falls beneath any threshold applicable to the granting of the aid.
- 1.10 Any aid which is granted under the GBER must be notified to the Commission within 20 days of implementation.

## **De minimis Regulations**

- 1.11 If the amount of the proposed aid falls below €200,000 over a rolling period of three fiscal years, then the impact is regarded as being sufficiently small to be disregarded for State aid purposes. The de minimis regulations set out procedural requirements attaching to the grant of aid using this mechanism, including the formal notification to the recipient that the aid is being made available under the de minimis regulations. A higher threshold of €500,000 may be used where funding is restricted for use in developing and providing affordable housing, but a formal SGEI act of entrustment would be required (see below in relation to SGEI).<sup>29</sup>
- 1.12 The relevant authority and recipient should maintain records of all de minimis aid granted or received. The fiscal year point is usually helpful in that the period is the current fiscal year and the two previous years (1 April to 31 March), so it may mean that the relevant period is shorter than three years at any given time.
- 1.13 So, for example, as loan or equity finance is not in the form of a cash grant, each would need to be converted into the gross grant equivalent so that the total amount can be calculated to ensure that it does not exceed the permitted amount. For example, aid in the form of a loan on less than the market interest rate would require comparison against the market rate and the potential aid would be the difference between the two. If the Council offered a loan at 3.5% but the market would have charged 6.5%, then the cash equivalent of the 3% difference would need to be calculated. For the same reason, where aid is payable in instalments it must be discounted to its value at the moment it is granted (an EU discount rate is published for this purpose). A local authority which is minded to rely on the de minimis rules to ensure compliance for the lending to a company will therefore need to calculate whether the aid will fall below the threshold.

## **Services of General Economic Interest (SGEI)**

- 1.14 SGEI are services which can be identified as being of particular importance to the public, and which are generally delivered pursuant to public service obligations e.g. certain social services. Member states have discretion as to which services they classify as being "services of general economic interest". However, the Commission has established specific conditions which must be fulfilled for aid to fall within the scope of an SGEI; in general it will not be appropriate to designate services where the services are or can be provided under market conditions.<sup>30</sup>
- 1.15 Initially, the conditions which had to be satisfied in order for an activity to constitute an SGEI were set out by the European Court of Justice in the *Altmark* case,<sup>31</sup> where it was held that compliance with those conditions meant that aid was not State aid. These requirements have subsequently been

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<sup>29</sup> Commission Regulation (EU) No 360/2012 of 25 April 2012.

<sup>30</sup> Commission Communication on the application of European State aid rules to compensation granted for the provision of SGEI 2012/C8/02, paragraph 48

<sup>31</sup> Case C280/00

developed in the "SGEI package" published by the Commission so that in some circumstances (where the strict *Altmark* criteria are not met) the aid will still constitute permitted aid.<sup>32</sup>

- 1.16 According to *Altmark*, aid will be an SGEI and will not constitute State aid where:
- 1.16.1 there is an entrustment act i.e. the provider of the aid must have been entrusted with a special task by the state and have a public service obligation to discharge it. This can be (and often is) incorporated within funding or even shareholder agreement documents;
  - 1.16.2 the parameters for establishing compensation must be established in advance, and in an objective and transparent manner - only the costs directly associated with the SGEI can be taken into account and these costs must be clearly established at the outset;
  - 1.16.3 the amount of compensation must not exceed what is necessary to cover the costs incurred in discharging the public service obligation and a reasonable profit (**avoid overcompensation**); and
  - 1.16.4 the compensation offered must either be the result of a public procurement procedure or the result of a bench-marking exercise to analyse the costs of an average "well-run" undertaking within the relevant sector (**selection of provider**).
- 1.17 The SGEI package clarifies key concepts established by *Altmark* and aims to provide a simpler, more flexible mechanism for supporting the delivery of high-quality public services. In terms of the *Altmark* limb to avoid overcompensation, the SGEI package requires that compensation is limited to what is necessary for covering the costs incurred in discharging the public service obligation and reasonable profit is deemed to be the rate of return on capital. Selection of provider should be at the least cost to the community. This removes the requirement for costs to be assessed on a well-run provider basis which is difficult to assess.
- 1.18 The SGEI package therefore gives the council a degree of flexibility in connection with aid, including the lack of a defined limit on the aid and an absence of any need to notify, although some authorities do notify if they feel there are doubts or scope for challenge and they wish to seek a ruling in their favour.
- 1.19 Affordable housing (i.e. housing provided on below-market terms for those selected by means testing) has been recognised as meeting the requirements of SGEI. However, the SGEI Decision requires the housing to be made available to "*disadvantaged citizens or less socially advantaged groups*," which means it cannot be used in relation to properties for market sale or rent. Although the courts and the European Commission have accepted that affordable housing can be an SGEI, this is an area that has nevertheless been the subject of challenge. There is therefore a tension between a local authority seeking to maximise the financial return of its investment in a housing company and charging rents that are affordable. In our view, the higher the margin that is charged above the local housing allowance rate, the greater the risk of a State aid challenge on the basis that the activity should not be treated as an SGEI. It is also the case that the higher the margin, the greater the possibility that those renting the accommodation might have otherwise rented from a market provider who could as a result be motivated to bring a challenge.

#### **What happens if the aid is State aid?**

- 1.20 Broadly speaking, if the transaction amounts to State aid and cannot be brought within one of the permitted aid categories referred to in paragraph 1.7, a member state is prohibited from providing such aid unless it has previously been notified to and approved by the Commission.
- 1.21 The broad categories where the Commission must or may approve State aid are set out in Articles 107(2) and 107(3) of the Treaty. The Commission will normally make a preliminary decision within two months as to whether there may be a problem. If there is a potential problem, a full investigation

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<sup>32</sup> Commission Decision 2012/21/EU.

may take 18 months to complete. Where an application for pre-clearance is made it is unlawful to preempt the decision by giving the aid in advance of a decision.

- 1.22 Failure to comply with the State aid regime could result in the following:
- 1.22.1 the State aid payment being halted;
  - 1.22.2 the recipient being required to repay the State aid plus interest;
  - 1.22.3 aggrieved competitors seeking legal action for damages; and
  - 1.22.4 the Commission commencing infringement procedures against the member state, possibly resulting in a fine.
- 1.23 A claim for damages can be brought in the UK courts, for example by a competitor who believes that it has suffered loss as a result of not being the same level of support.<sup>33</sup> The limitation period for lodging a complaint with the Commission is 10 years and, as there is no charge for doing so, it is relatively easy to bring a challenge this way.

## **2 MARKET ECONOMY INVESTOR PRINCIPLE – FURTHER CONSIDERATIONS**

- 2.1 The exemption (to the general prohibition against the granting of State aid by the Council) is most likely to be the market economy investor principle. We have set out some further considerations below.

### **Lending**

- 2.2 Any loans from the Council should be offered on market terms. If the parties are able to demonstrate that a private investor would be willing to invest on the same terms (for example, the loans will provide viable financial returns for that private investor) the market economy investor principle will apply. As discussed above, where the benefit of the aid flows on market-facing terms, the aid will not amount to State aid.
- 2.3 In order for the parties to rely on the market economy investor principle, the loan agreements will need to reflect genuine commercial terms, including in respect of any interest which will be payable in the event of late payment/default by the company. The Commission has set out a methodology for calculating a loan rate which is applicable for State aid cases although as an exception one might also use comparator actual data as to what is available in the market at the time.
- 2.4 The EC methodology is to calculate a reference rate for each member state, currently 0.94% for the UK, and provides for a loan margin dependant on the level of collateralisation and the strength of covenant of the relevant company in terms of its rating category.<sup>34</sup>
- 2.5 The rating category for a new business is unlikely to be better than "satisfactory" and may be "weak" depending on the business plan and the robustness of the income streams. In this context, where the income streams will be from third parties, we would suggest that the relevant rating category should be no better than "weak".
- 2.6 However, depending on the nature and structure of the loans it may also be possible to argue that if security over the assets acquired is being granted, then the level of collateralisation may be classified as "high". This is calculated by reference to the loss given default and a high collateralisation would indicate a loss given default of less than 30% - in other words, if the Council lent £100 to a joint venture company and the security given meant it was comfortable that if the company became insolvent the Council would nonetheless recoup £70 or more, then that would be a high level of collateralisation.
- 2.7 The current EU table for the mark-up in basis points is set out below:

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<sup>33</sup> For example, *Betws Anthracite v Anthrazit Ibbenburen* [2004] 1 CMLR 12.

<sup>34</sup> [https://ec.europa.eu/competition/state\\_aid/legislation/base\\_rates2020\\_05\\_en.pdf](https://ec.europa.eu/competition/state_aid/legislation/base_rates2020_05_en.pdf)

Rating category	High collateralisation	Normal collateralisation	Low collateralisation
Strong (AAA-A)	67	75	100
Good (BBB)	75	100	220
Satisfactory (BB)	100	220	400
Weak (B)	220	400	650
Bad / financial difficulties (CCC and below)	400	650	1000

- 2.8 Commission guidance suggests a minimum of 4% mark-up for new companies, which would suggest a minimum of 4.94% for loans, but independent advice on what is available in the market may justify a minimum lower rate.
- 2.9 It is important to consider what security a "lending" council would receive in exchange for the loans. The debt investment arrangements should ensure that the level of protection afforded to that council is the same as a private investor would demand. It is envisaged that the level of collateralisation for a working capital type loan is likely to be low unless supported by the assets acquired. This collateralisation may be covered through a form of charges over particular assets or a debenture over all assets to support all monies due.
- 2.10 We anticipate that the Council will want to set the rate or return on any loans at or above the cost of borrowing any money which the Council (as lender) seeks to obtain from third parties itself. It is also important to take into account other market factors including loan to value ratios and fees which may be levied by financial institutions if they were making the loan, for example facility fees. These criteria will need to be reflected in the loan documentation in order to replicate what an external lender would require and thereby ensure compliance with the market economy investor principle.

#### **Equity investment in a company**

- 2.11 In light of the relevant interest rates which would apply to any loans, the Council could explore the possibility of investing in the company on an equity basis. From a State aid perspective, it is possible for a council to make an equity investment in the company provided that it considers the market economy investor principle. We would recommend that the Council arranges for an independent financial evaluation to be carried out to assist in proposing the terms on which the equity investment would be made.
- 2.12 Common "investor" considerations would be:
- 2.12.1 Is the company intended to be an income generation investment for the Council?
- 2.12.2 Is the Council hoping to make a large return on the sum invested when it transfers its equity interests in the company to an appropriate purchaser?
- 2.13 Where the Council, as investor, is considering the return on its equity investment, the return need not be immediate but the approach should be a commercial one rather than being driven by wider social concerns. Independent advice would demonstrate that the council had considered these issues.
- 2.14 The Council must also take care to ensure that any investment return reflects the degree of risk to the Council to evidence that the proposed aid is genuinely an investment and not a form of financial support.

- 2.15 The Council should also have regard to the duties around investment and the need to consider security, liquidity and yield in that order. It may not be possible to exit from any equity investment quickly.

### **Non-financial support**

- 2.16 We assume that the Council will enter into some form of resourcing agreement with each company. If the Council relies on the market economy investor principle and charges a market rate for doing so, then it will not breach the State aid rules.
- 2.17 However, it is more common for authorities to obtain the reimbursement required under the *Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009* when a company is established for a commercial purpose only requires recovery of cost.
- 2.18 There is therefore a tension - between complying with the market economy investor principle and the Trading Order – if a company is established for a commercial purpose, because the latter (as noted above) requires reimbursement only. However, we are not aware of a challenge being brought on this point and this is the approach commonly taken by local authorities establishing companies.
- 2.19 If the Council anticipates that it may in future be required to provide a guarantee to a third party in respect of the company's performance, we would highlight that there is a specific set of requirements which must be observed in order for the guarantee to fall outside of the remit of State aid. These requirements are:
- 2.19.1 the borrower cannot be in financial difficulty;
  - 2.19.2 the guarantee is for a fixed period and amount, and linked to a specific transaction or obligation;
  - 2.19.3 the guarantee does not exceed 80% of the loan or obligation, so as to avoid aid to the lender (from our experience elsewhere, this requirement can cause difficulties for a start-up company, unless it has other assets); and
  - 2.19.4 a market oriented price is paid for the guarantee. In other words, the Council would need to charge an annual premium to the company guaranteed that is the same as or higher than the market rate for a company with the same credit rating.

## SCHEDULE 9 – SAMPLE RESERVED MATTERS LIST

Number	Reserved Matter
	<b>Constitution of the company</b>
1	Varying in any respect the articles or the rights attaching to any of the shares or memberships (as applicable) in the company.
	<b>Officers and Shareholders of the company</b>
2	The appointment and the appointment terms (including any remuneration terms) of any Council Directors.
3	The appointment and the appointment terms (including any remuneration terms) of the chief executive officer.
4	The removal of any Council Directors (including any terms on which such Directors are removed from their office as Directors).
5	The admission of further shareholders or members to the company or agreeing any rights or restrictions attaching to any shares or memberships allocated to such new shareholders or members as applicable).
	<b>Future direction and development of the company</b>
6	Forming any subsidiary or acquiring shares in any other company or participating in any partnership or incorporated joint venture vehicle
7	Amalgamating or merging with any other company or business undertaking.
8	Selling or disposing of any part of the business of the company.
9	Adopting or amending the Business Plan of each respective company and any in-year changes.
10	Undertaking any business or action which is inconsistent with the Business Plan then in force or omitting to undertake any action which is required by that Business Plan except with the prior written consent of the Council
11	Passing any resolution for its winding up or presenting any petition for its administration (unless it has become insolvent).
12	Agreeing or approving any other material services the total value of which exceeds £● per annum to be provided by the company to a third party not approved under the Business Plan.
13	Appoint any agent (not being a subcontractor) to conduct the whole or any part of the business of the company, other than the appointment of an agent to conduct an area of the business of a company.
14	Apply for the listing or trading of any shares in its issued capital or debt securities on any stock exchange or market (where applicable).
	<b>Management of the business of the company</b>
15	Changing the company's registered office.

Number	Reserved Matter
16	Changing the company s name.
17	Creating or agreeing to create a charge, security or encumbrance over the company's assets, shares or income.
18	Approving any matter that is reasonably likely to have an adverse effect on the reputation of the Council.
19	Changing the nature of the business or commencing any new business which is not ancillary or incidental to the business of the company.
20	Agreeing to enter into or entering into any acquisition or disposal of any material assets by the company the total value of which exceeds £● per annum.
21	Giving notice of termination of any arrangements, contracts or transactions the total value of which exceeds £● per annum or materially varying any such arrangements, contracts or transactions and such termination or variation is likely to have an adverse impact on the financial status of a company.
22	Granting rights (by licence or otherwise) in or over any intellectual property owned or used by the company.
23	Changing the company's auditors.
24	Agree to make or making any loan (otherwise than by way of a deposit with a bank or other institution, the normal business of which includes the acceptance of deposits or in the ordinary course of business) or granting any credit (other than in the normal course of trading or the granting of trade credit to a company which has been approved under the Business Plan) or giving any guarantee or indemnity (other than in the normal course of trading).
25	Changing the Financial Year of the company.
26	Increase or reduce the amount of its issued share capital, grant any option over or in its share capital, redeem or purchase any of its own shares or otherwise alter, or effect any reorganisation of, its share capital (where applicable).
27	Declare or pay any end of year dividend of the company (where applicable).



## Finance Advisory Service Request

This proposal relates to the Council's plans to establish a group structure of trading entities primarily for the purposes of regeneration and housing development but this includes services on behalf of the Council.

Among the objectives and the reasons for considering a company structure are:

- Optimising financial risks of the Council, and limiting capital debt exposure
- Operating private sector rented and/or for sale housing

We are looking for professional services advice regarding legal and financial structure options, to inform the preferred approach to delivering the objectives.

This includes:

1. Accountancy advice in regards to setting up a SPV with advice needed in following areas
  - a. Advice re IFRS 10 and other relevant standards, and their implications of consolidation of a wholly owned SPV (a) within a company group structure and (b) on Council accounts. As particularly in relation to accounting for debt liability and repayment on consolidation and whether SPV debt provides an MRP requirement in consolidated accounts.
  - b. Consideration of scenarios and providing advice regarding optimum structures for land and property assets and transactions – acquisitions and disposals – for example where land is currently in Council ownership. Accounting and tax implications for freehold, leasehold alternative structures. Include consideration of the Council's VAT partial exemption requirements.
  - c. Advice regarding accounting and tax implications and considerations for provision of working capital and capital financing by the Council to the entity(ies) – minimising risk to the Council, and considering provisions of securities within a group structure.
  - d. Tax advice in relation to SPV's and a series of wholly owned subsidiaries including tax implications and most tax efficient approach for such arrangements.
  - e. Advice re standard financial governance matters and considerations for SPV structures, including insurance provisions you would expect to be in place as standard.
  - f. Other issues to be aware of in setting up a wholly owned SPV that will mainly deliver property projects but may add services in time
  - g. Issues in Articles and Mems to pick up the above and keep maximum flexibility
  - h. Issues to consider in relation to what may need to be covered in a shareholder agreement
  - i. Review and advice in regards to compliance issues in the draft SPV report and recommendations
  - j. Attend Executive, Scrutiny and Council Meetings
  - k. Provide advice in a written report



Visions & Master Plans  
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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A  
of the Local Government Act 1972.

Agenda Item 12

Document is Restricted

