

ESTABLISHMENT OF LOCAL AUTHORITY TRADING COMPANY STRUCTURE

Cabinet – 10 April 2014

Report of Chief Officer Legal and Governance

Status: For Decision

Also considered by: Finance and Resources Advisory Committee – 26 March 2014

Key Decision: Yes

Executive Summary: To authorise in principle the creation of a local authority trading company structure to facilitate opportunities for income generation in order to reduce the reliance on Government grants.

This report supports the Key Aim of effective management of Council resources

Portfolio Holder Cllr. Ramsay

Contact Officer(s) Mrs. Christine Nuttall – Ext. 7245

Recommendation to Cabinet:

- (a) That the Chief Officer Legal and Governance be authorised to incorporate a company wholly owned by the Council so as to allow the Council to exercise the power to trade contained in the Local Government Act 2003 and the Localism Act 2011.
 - (b) That the broad governance and funding arrangements for the trading company, as set out in this report, be approved and the Chief Officer Legal and Governance in consultation with the Chief Executive, Chief Finance Officer and Portfolio Holder for Finance and Resources be given delegated authority to settle the detailed arrangements for the establishment of the company.
 - (c) That consideration be given by the Cabinet as appropriate to any individual business cases in respect of the use of the Council's trading powers as part of the development of the future strategy for income generation.
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Reason for recommendation: To allow the Council to undertake trading activities in order to generate additional income in order to be less reliant on Government funding.

Introduction and Background

- 1 Following the recent Peer Challenge the Peer Review Team suggested that in order to enable the Council to become more self reliant as set out in its Corporate Plan,

it would need to generate more income. The legal framework to enable that to be achieved would require the Council to set up a trading company.

- 2 This report proposes that Sevenoaks District Council (“SDC”) establishes a generic trading company, wholly owned by the Council, to enable the Council to take advantage of the powers to trade for profit introduced under the Local Government Act 2003 and the Localism Act 2011, where opportunities to do so arise and it is appropriate to use the company as a vehicle for the trading activity proposed.
- 3 The legal framework to allow local authorities to undertake trading activities has become relaxed in recent years. There are specific powers contained in the Local Government Act 2003 which allow a local authority to undertake trading activities. In addition, under the “general power of competence” introduced by Section 1 of the Localism Act 2011 local authorities now have a general power that enables them to do anything that a private individual is entitled to do, subject to certain statutory limitations. However, it should be noted that things done for a commercial purpose even under the Localism Act 2011 must be done through a company.
- 4 It is now timely for the SDC to take the necessary preparatory steps to be in a position to utilise its trading powers where individual business cases may be identified. It is therefore proposed that a trading company structure be established.

Company Structure

- 5 There are a number of different types of corporate vehicle available. These break down as follows:
 - Company limited by share;
 - Company limited by guarantee;
 - Industrial and provident society.

There are some other vehicles, such as a community interest company, a limited liability partnership or a joint venture company. However, for the purposes of general trading it is unlikely that such vehicles would be considered to be appropriate.

In practice a Company Limited by Shares tends to be used for those operations which have a commercial character and a Company Limited by Guarantee or Industrial & Provident Society for those which are set up to deliver community purposes or are set up for charitable purposes.

- 6 Given that it is essential that there is a proper examination of a business case before a local authority uses the power to trade in any particular circumstance this will align with the approach SDC is taking to explore appropriate options which would include the development of business cases. Individual business cases relating to trading activity would then be implemented through the trading company structure. However given there is the potential over a period of time for

a range of different business cases to be developed, it may prove advantageous to establish over time a group company structure with a number of subsidiary companies being undertaken to deliver the individual business cases.

Company Requirements

- 7 In setting up the trading company, the following issues need consideration and definition.

Company Name

Purpose of the Company

Aims of the Company

Set up Requirements and Costs

There will be a number of other detailed matters to be resolved and it is suggested that an appropriate delegation be granted to enable these to be settled as set out in the recommendation.

Company Name

- 8 It is proposed that the Members' Communications Working Group be tasked with choosing the name of the Company. Any subsidiary companies that may be developed over time may have a different trading name.

Governance Arrangements

9. The Company must legally appoint Directors. The Directors of the company must ensure that the company does everything it is obliged to do by law and that any decisions they make are in the best interests of the company.

It is proposed that initially the small Board of Directors as set out below be appointed from the senior officers of the Council.

Roles in Company

Roles at Sevenoaks District Council

Finance Director –

Chief Finance Officer

Commercial Director –

Chief Officer Environmental & Operational Services

Managing Director –

Chief Executive

Company Secretary –

Chief Officer Legal and Governance

It is envisaged that there will be 3 non executive Directors who will be Members of SDC to be nominated by the Leader of the Council.

Chief Officers in the above roles may need to draw upon the support from an outside firm of accountants or lawyers if necessary.

Further Directors, including independent Directors who are neither members nor officers may be appointed in the future if it is believed they may benefit the business of the company.

10. The Memorandum of Association will need to be completed. This will set out the company's objects which are proposed to be 'to carry on business as a general commercial company'. It also shows details of the company's share capital.
11. The Articles of Association will also need to be completed. These set out the regulations governing the running of the company's affairs.
12. It is envisaged that an off the shelf company will be purchased which will have wide trading powers including property investment.
13. A major Governance issue is the relationship with SDC (the Shareholder) and the Company's internal processes. It is important that the Company is able to act quickly in order to generate and sustain business but on the other hand the Council needs to manage risks and to be able to determine whether it is appropriate for the Company to enter into a particular contract(s). Therefore, it is proposed that a provision be included in the Articles of Association whereby the Council's consent via its Shareholders be granted before a particular property acquisition or business contract is entered into by the Company. The Council being the Shareholders would be represented by Cabinet especially as property acquisition and disposal is a Cabinet function. Cabinet will be able to approve any proposed acquisition or disposal by the Company up to a value of 5 million pounds and an emergency meeting of Cabinet may be called if there is a need for an urgent decision.
14. It is likely that some of the Governance structure of the Company or group of Companies will evolve over a period of time. However, it is envisaged that the Cabinet will be responsible for overseeing the Company's overall trading activities. It is suggested that the Directors of the Company or any of its subsidiaries should not be the members of the Cabinet. The Executive Directors will be officers of the Senior Management Team ("SMT") who will be accountable to the Cabinet, with Cabinet acting on behalf of Council who will be the Shareholders.
15. It is also proposed that there is a monthly shareholder meeting at which the Council (the Shareholders) are represented by the Cabinet to which the Executive Directors of the Company i.e. the relevant Officers of the SMT would report.

Accounting and Banking Arrangements

16. The Company will have to comply with all the regulatory requirements of the Companies Acts and additionally with the regulatory regime for local authority companies under the Local Government and Housing Act 1989.
17. The company may need to charge VAT and will be liable for corporation tax on its profits. However, given that SDC must ensure that it fully recovers the cost of all staffing resources and other goods and services provided, it is anticipated that the company's tax liability could be minimised.

18. It is envisaged that the Company will not have a separate bank account from the outset, but all transactions will be posted through the Council's bank account. This model will prevent cash flow implications and avoid the requirement for a working capital balance when the company begins trading.
19. The Company will use the Council's financial facilities. The accounting structure will ensure that all income, expenditure and VAT can be allocated to the Company by use of appropriate budget codes. The Company will use its own stationery for purchase orders and invoices and will facilitate the submission of the Company's VAT returns.
20. Balances held by the Company will be calculated on an annual basis. The Company will be responsible for providing its accounts and tax returns in the appropriate format within set deadlines.
21. The Company will be responsible for the engagement of an external auditor.
22. As the company will be controlled by the local authority a number of requirements may undoubtedly need to be met such as:
 - The company must state on company stationery that the company is controlled by a local authority, giving the name of the relevant authority.
 - The company must limit the remuneration and allowances paid to directors who are officers or members of the local authority to the amounts payable for comparable local authority duties, or as travelling and subsistence allowances.
 - The company must not publish party political material.
 - The company must provide information to the local authority's auditors.
 - The company must provide information to members of the local authority.

Business Case

- 23 By setting up a generic trading company, the authority has the flexibility to operate it in a variety of ways.
- 24 The potential opportunities for trading are wide ranging and it is difficult to explore new services and routes to market without the company set up. Initially the main thrust of the generic trading company will be to invest in land and buildings that can increase SDC's income as set out in the Corporate Plan. The Corporate Plan sets out what the Council will do to make progress in delivering its promises over the next two years. "To help us get there we want to go further, to be truly ambitious and seek to become financially self sufficient. We want to break new ground and make the Council less reliant on Government funding".
- 25 The trading company will enable the Council to operate property investment on a commercial basis. The Report of the Chief Finance Officer entitled "Investment Strategy – Assets For Income" sets out an Investment Strategy for acquiring physical Assets and Cabinet will be asked to approve the proposed Investment

Strategy. The Business Case in relation to the Investment Strategy will be developed for consideration at a future Cabinet meeting and will cover the following aspects:

- The objectives of the property trading activities
- The investment and other resources required to achieve those objectives
- Any risks the business might face and how significant those risks are and
- The expected financial results of the business, together with any relevant outcomes the business is expected to achieve.

The precise funding mechanism for the property side of the Company will be considered as part of the development of the full business case. However, such a mechanism could include a loan or series of loans by the Council to the Company to allow it to invest in accordance with the Strategy and Business Case.

Under such circumstances, borrowing costs would be met by the Company. Loans would be made available to the Company on a basis which is compliant with the terms of funding which are similar to those which would be achievable by a private funder given the importance of Competition law and State Aid rules. Specialist advice may be sought as part of the development of the business case.

26 Examples of other areas of potential trading activities are as follows:

- Other local authorities and the private sector may use the expertise of Sevenoaks in order to improve their own services.
- Communications could be an area for possible trading activity.
- There may be possibilities for expanding our trade waste service. This can be done under the Goods and Services Act if the work is undertaken for other local authorities or public bodies.
- Events organisation is also another trading possibility leading on from the Council's successful involvement in delivering the Para Olympics

27 If the above outline company structure framework is established then this will expedite implementation of business cases which involve the use of trading as and when they may be approved in due course.

Staffing Implications

28 The company will initially be operated on the basis of part-time secondments from the Council and as a result TUPE will not apply to transfer staff on SDC's terms and conditions to the company.

29 However, if new contracts are secured, or existing contracts are novated such that staff are required to be whole time employed on external contracts traded through the company, then either

- a) Staff could continue to be seconded to the company in the short term; or
- b) Staff will need to be employed directly by the company.

Long term, or for any significant number of employees, option a) above is less attractive because

- c) SDC will be liable for redeployment or for bearing the cost risk of potential redundancy of the employees if the company loses a relevant contract;
- d) Depending on the number of staff who may need to be seconded to the external company this may have an effect on the capacity for our present HR/payroll services which could result in additional costs.
- e) The District Auditor may query the inclusion of staff on SDC's payroll who are not employed at all in the provision of SDC services.

- 30 If the trading company employ staff directly, and former SDC staff are transferred to the Company under TUPE, the company will be required to offer any new staff comparable terms and conditions including pension rights. Staff who are TUPE transferred to an external contractor have the legal right to pension rights that are the same as, or broadly comparable to, or better than those s/he had as an employee of the authority.

State Aid

- 31 In order to ensure transparency and competitiveness with the private sector and not to breach the rules in relation to State Aid the company must not be subsidised by the authority. This means that the authority must recover the costs of any accommodation, goods, services, employees or any other support it supplies to the company. It will be necessary to set up suitable systems and financial controls to ensure this is the case and to demonstrate independence of the company from the authority.
- 32 The Trading Company should be mindful of its trading impact on the local economy. In recognition of this concern it may be decided that new lines of business would only be taken on after a Market Impact Assessment had been carried out.
- 33 However, the trading company could fill gaps in the local market and could benefit local businesses by procuring goods and services to support the trading activity.

Key Implications

Financial

- 34 The set up costs will come from existing approved budgets.
- 35 There may be a need to set up separate financial systems and accounting arrangements (including VAT). Future running costs may be offset to a degree against future income streams.

- 36 It is anticipated that the trading company will use part time seconded staff, use council accommodation, equipment and services on the basis of recovering the full cost, and as a result start up costs should be minimised but would include matters such as insurance and auditors fees.
- 37 Financial advice will be required in relation to Prudential borrowing requirements especially in relation to the ability to borrow to invest in property.
- 38 It is envisaged that some legal advice will also be required in relation to the package put together by the Council's in house legal department prior to the Company launch taking place.
- 39 There are financial risks arising from the use of the Councils' trading powers. These would need to be analysed in detail as part of any individual business case put forward for the use of the trading powers. Although a trading company would be a separate legal entity with the benefit of limited liability it would be of doubtful propriety for the local authority as a public body and the single shareholder in the company not to honour any liabilities of the company to creditors in the event of significant trading losses occurring.
- 40 However as the Council will have effective control of the company, oversight of its on going operations would allow for early detection of any developing financial problems and the opportunity to take preventative action.

Legal Implications and Risk Assessment Statement.

- 41 A local authority is able to establish a Local Authority Trading Company ("LATC") through powers in section 95 of the Local Government Act 2003. A local authority is permitted to trade in anything that it is authorised to do under its ordinary functions. The company can with good business planning generate a surplus which can be re-invested into services, or the council, being the single shareholder.
- 42 The Local Authorities (Goods and Services) Act 1970 (the 1970 Act) continues in force and it enables councils to provide services to other councils and to other public bodies but not to the private sector or the public in general. Successful trading has been undertaken by this authority under this legislation since 1970 enabling the saving of money and the achievement of efficiencies through economies of scale. The trading company will enable the authority to take advantage of trading opportunities that cannot be undertaken using the powers within the 1970 Act. However, it is anticipated that existing trading will continue to happen as it currently does under the 1970 Act as this is the most cost effective way to trade with other local authorities and public bodies.
- 43 Under section 1 of the Localism Act 2011 Local Authorities now have a general power that enables them to do anything that a private individual is entitled to do, as long as it is not expressly prohibited by other legislation.
- 44 The key strategic risks are as follows:
- L = Low M = Medium H = High

Risk	Likelihood/Impact		Risk Management
Failure to set up trading arrangement in strict compliance with legislation	L	M	Extensive consultation with other authorities and, appropriate, external legal advice on governance arrangements
Using trading powers where there is a statutory obligation to provide them	L	M	Every new service to trade via the company to list services in their Business Case and to consider statutory obligations.
Possibility of trading ultra vires	L	L	Every new service to trade via the company to consider statutory obligations
Possibility of challenge to state aid	L	L	Obtain full cost recovery
Possibility of conflicts of interest arising for members or officers as Directors	L	M	Abide by Codes of Conduct
Failure to arrange adequate insurance cover for the Company's liabilities/assets	L	H	Ensure Insurer for the company is kept up to date with any new areas of trading activity.
Failure to comply with taxation laws – corporation tax & vat	L	M	Advice to be sought on taxation planning
Consideration of potential TUPE implications	L	L	Review regularly
Trading Company failure	L	M	Benchmark fees and costs. Employ tight budgetary controls
Conflict of interest over workload priorities of Council projects and Company projects	L	L	Effective resource planning and compliance with Corporate Plan

Company credit rating	L	L	Council could act as guarantor and insurance to mitigate
Challenge from Council's Auditors	L	L	Follow CIPFA Code of Practice on LA Accounting. All transactions applicable to the company can be identified using unique transaction records and coding structures
Lack of capacity to manage additional work	L	L	Careful programming of staff resources and review of balance of staffing needs.
Contractual disputes	L	M	SDC's in house legal section to be employed to check all contracts before they are entered into
Poor investment acquisitions	L	L	Each investment acquisition will be of good quality with the potential of high income return set out in a business case
Poor rate of return on investment property	L	L	Annual valuation which sets a target rate of return and allows for financing costs and the generation of an annual surplus

Equality Impacts

Consideration of impacts under the Public Sector Equality Duty:		
Question	Answer	Explanation / Evidence
a. Does the decision being made or recommended through this paper have potential to disadvantage or discriminate against different groups in the community?	No	There are no Equalities implications arising from this report.
b. Does the decision being made or recommended through this paper have the potential to promote equality of opportunity?	No	

Consideration of impacts under the Public Sector Equality Duty:		
Question	Answer	Explanation / Evidence
c. What steps can be taken to mitigate, reduce, avoid or minimise the impacts identified above?		N/A

Conclusions

It is considered appropriate to make use of the increased power given by the Localism Act 2011 to enable trading to take place for profit through a limited liability company wholly owned by the Council in order for this authority to be less dependent upon Government funding.

Background Papers:

Templates for Business Plans:

- [Template developed by Mutual Ventures](#)
- [Barclays – Your Business Plan](#)

[Grant Thornton – Responding to the Challenge](#)

[Unison – Branch guide to local authority trading companies](#)

[General Power for Local Authorities to Trade](#)

[Information received from Surrey County Council](#)

[PropertyWeek.Com “Surrey council pioneers prop-co”](#)

[Sevenoaks District Council Corporate Plan](#)

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