

SEVENOAKS DISTRICT COUNCIL TRADING COMPANY NAMED QUERCUS 7 LIMITED

Legal and Democratic Services - 26 January 2016

Report of Chief Officer Communities and Business, Chief Officer Legal and Governance and the Chief Finance Officer

Status: For Consideration

Also considered by: Cabinet - 4 February 2016

Key Decision: No

Executive Summary: This report provides information on how the new Trading Company Quercus 7 Limited will work operationally and requests Cabinet to approve the current working arrangements and the further proposed arrangements.

Portfolio Holder Cllr. Firth

Contact Officers Christine Nuttall Ext. 7245, Adrian Rowbotham Ext. 7153, Lesley Bowles Ext. 7430

Recommendation to the Legal and Democratic Services Advisory Committee:

Advise Cabinet on how the new Trading Company Quercus 7 Limited will work operationally in order for Cabinet to approve the working arrangements, that is:

- a) the appointment of Chief Officers initially put forward as Directors on incorporation;
 - b) the composition of The Trading Board, established to oversee the trading activities of the Company, to comprise the Cabinet with a quorum of three Members to be chaired by the Leader of the Council;
 - c) the job description and specification required to recruit the 2 Non-Executive Directors as set out at Appendix B and such recruitment to be either using internal resources or through a firm of specialist Management & Recruitment Consultants with an approved budget of up to £6,000 in this respect;
 - d) remuneration to be paid to the Non-Executive Directors up to £5,000 each;
 - e) the Chief Officer Legal and Governance in conjunction with the Chief Finance Officer be authorised to finalise a Shareholder Agreement and Loan Arrangements for the Company in conjunction with relevant Portfolio Holders.
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Recommendation to Cabinet:

Subject to comments from the Legal & Democratic Services Advisory Committee, Cabinet approve how the new Trading Company Quercus 7 Limited will work operationally, and the working arrangements, that is:

- a) the appointment of Chief Officers initially put forward as Directors on incorporation;
- b) the composition of The Trading Board, established to oversee the trading activities of the Company, to comprise the Cabinet with a quorum of three Members to be chaired by the Leader of the Council;
- c) the job description and specification required to recruit the 2 Non-Executive Directors as set out at Appendix B and such recruitment to be either using internal resources or through a firm of specialist Management & Recruitment Consultants with an approved budget of up to £6,000 in this respect;
- d) remuneration to be paid to the Non-Executive Directors up to £5,000 each;
- e) the Chief Officer Legal and Governance in conjunction with the Chief Finance Officer be authorised to finalise a Shareholder Agreement and Loan Arrangements for the Company in conjunction with relevant Portfolio Holders.

Reason for recommendation: It is important that Members are fully informed on the need for SDC to have a Trading Company and how the new Trading Company Quercus 7 Limited will work operationally as they will form the Company Shareholders, and that the views of the Advisory Committee are taken into account by Cabinet when approving the current working arrangements and further proposed arrangements for the future success of the Company.

Introduction and Background

- 1 Council on 31st March 2015 authorised the Chief Officer Legal and Governance to incorporate a company (the Company) wholly owned by the Council in consultation with the Chief Executive, Chief Finance Officer and Portfolio Holder for Finance so as to allow the Council to exercise the power to trade contained in the Local Government Act 2003 and the Localism Act 2011 and to settle the detailed arrangements for the establishment of the Company together with the Governance structure recommended by EC Harris Built Asset Consultancy (EC Harris).
- 2 The establishment of the Company builds on the direction set out in the Corporate Plan for the Council to move towards a more financially self sufficient position. The Company will enable the Council to operate property development on a commercial basis as well as allowing the Council

to invest in residential property to be leased which it is not otherwise allowed to do.

- 3 On the 31st December 2015 the Company, Quercus 7 Limited (the Company) was incorporated and the Certificate of Incorporation along with the Articles of Association are Annexed at Appendix A to this report. The Articles of Association are very much in standard format but can be changed if the need arises.

Company Structure - Governance

- 4 EC Harris advised on the setting up of a generic trading company which could be concentrated, at this stage, on property development as its main activity and it was proposed that the initial Board of Directors comprise three Officers, plus 2 Non-Executive Directors who would be approved by Cabinet and such Non-Executive Directors could receive a small remuneration.
- 5 For the initial set up the following Chief Officers have been appointed as Directors. This being The Chief Finance Officer, Chief Officer Communities & Business and the Chief Officer Environmental & Operational Services. Cabinet is asked to approve such appointments.

The Trading Board

- 6 It is proposed that The Trading Board is established on behalf of Sevenoaks District Council to oversee the trading activities of the Company. The Trading Board will comprise the Cabinet and for meetings a quorum of three Members will be required with the Leader of the Council being the Chairman of The Trading Board. Cabinet is asked to approve the composition of such Board. Within the Shareholder Agreement the Shareholder (the Members of SDC) will delegate to Cabinet the responsibility to oversee the trading activities of the Company via The Trading Board.

Recruitment of the 2 Non-Executive Directors

- 7 The 2 Non-Executive Directors now have to be chosen by Cabinet via The Trading Board. Recruitment of the Non-Executive Directors can take place utilising the job description and specification set out at Appendix B to this report, either using internal resources or through a firm of specialist Management & Recruitment Consultants. Cabinet is asked to approve such arrangements with an approved budget of up to £6,000 if using a firm of specialist Management & Recruitment Consultants. The job description and specification has been produced by Trowers & Hamlin LLP based on what is ordinarily required by such a Trading Company taking into account the advice received from EC Harris which was that the Non-Executive Directors be selected on the basis of relevant professional experience in property investment and corporate governance, and with careful consideration given

to any potential conflicts of interest. In addition, the Council would also be desirous in having Non-Executive Directors with professional experience in property construction and risk assessment.

- 8 Members should be aware that the remuneration of the Non-Executive Directors in relation to a local authority owned company is governed by legislation which does not allow for the Non-Executive Directors to be paid more than an ordinary Member of the Council for sitting on a Council Committee. As a result it is suggested that the Non-Executive Directors be offered no more than the approximate basic allowance for all Members, this being no more than £5,000 and Cabinet approval is sought in this respect.
- 9 However, 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. Therefore if the Non-Executive Directors are paid a salary and such salary is provided via Sevenoaks District Council's payroll, the Council would need to charge the Company at the market rate for providing such a service to the Company.

Articles of Association

- 10 The Articles of Association govern the way in which a company's internal affairs are regulated. This may be likened to an agreement between all the Shareholders being the Members of Sevenoaks District Council (Members of SDC) and the Company itself. The Articles do follow the relevant model articles. The Articles can be changed if the need arises although the Articles cannot over rule the provisions of the Companies Act and so care needs to be taken if changes are made to the basic model Articles.
- 11 The Articles of Association are exhibited at Appendix A to this report along with the Certificate of Incorporation and, comprise the following:
 - The Articles are for a company limited by shares.
 - The Articles state that there can only be one shareholder and this is defined as all of the Members of SDC.
 - The liability of the Council is limited to the nominal value of its share.
 - The Shareholder (the Members of SDC) will agree the general investment targets for the period and the associated budget, enabling the Board to set an annual and 5 year business plan. Half-yearly reports from the Company will go to Cabinet.
 - The Cabinet appoint the Directors and can remove them.
 - The Directors shall be officers of the Council, together with up to two outside Non-Executive Directors.

- If a Director ceases to be employed by the Council (except the outside Directors) then they will automatically cease to be a Director.
- There must be a minimum of 3 Directors and the number of External Directors shall be two but the Shareholder may choose to increase the number of External Directors.
- Three Directors must be present in order to have a valid Directors meeting.
- The Directors can appoint their own Chair, although this is something that the shareholder (Members of SDC) could decide.
- The Council can pass a resolution that either prevents or directs the Directors to do something.
- The Company can pay dividends, which will accrue to the Council as a whole for the benefit of the District and will not benefit individual Members.
- The Company does not have to have a seal to execute documents. Deeds and documents can be signed by two Directors.
- The Company shall have a Company Secretary.
- The Company is obliged to comply with all requirements that flow from the fact that it is a wholly owned subsidiary of a local authority.
- The Articles cannot be amended or the name of the Company changed unless the Council approves a resolution to amend them.
- The Company cannot engage in anything that represents a substantial change in the business of the Company without a resolution being passed by the Council.
- The Company can purchase indemnity insurance for the Directors

Shareholder Agreement

- 12 The Shareholder Agreement is separate to the Articles of Association and does not have to be registered at Companies House. The Shareholder Agreement regulates the relationship between the Shareholder and the Company and gives rights and obligations that would not normally be put into the Articles, or would not be appropriate for inclusion in the Articles. The Shareholder Agreement can provide that the Annual General Meeting of the Company takes place in the Council Chamber on an evening when Full Council takes place with the shareholder (Members of SDC) being invited to attend. The Company will be a controlled Company, being entirely owned by Sevenoaks District Council who will approve:

- The setting of the general investment targets each year and the associated budget;
- Appoint or remove Auditors;
- Any borrowing arrangement and giving security in respect of such borrowing;
- Making any application for planning permission or lodging an appeal against a planning authority;
- And any matter that the Council shall advise the Company of in writing.

In this way the Company shareholder (Members of SDC) has ultimate control over the activities of the Company and the Company's operational matters.

Cabinet is requested to authorise the Chief Officer for Legal and Governance in conjunction with the Chief Finance Officer and the relevant Portfolio Holders to finalise the details of the Shareholder Agreement.

Members' Ability to Further Control the Company

- 13 As can be seen by the suggested provisions within the Articles of Association the Company shareholder (Members of SDC) has ultimate control over who will be the Directors of the Company and the shareholder (Members of SDC) can change the make up of the board with immediate effect if so desired. In addition the Company Secretary can be asked to stand down in the same way.
- 14 The Articles of Association can make provision for the shareholder (the Members of SDC) to appoint Director(s) by serving notice in writing to the Company. Such notice shall state such particulars of the Director(s) as are required to be included in the Company's Register of Directors.
- 15 In addition the Articles of Association can make provision for the shareholder (Members of SDC) to remove any Director(s) by serving notice in writing to the Company and to appoint any other person to be a Director in place of a Director who leaves office by whatever means.
- 16 The notice of appointment or removal of a Director(s) pursuant to the Articles can take place with immediate effect on delivery to the Secretary of the Company.
- 17 The Trading Company will fall within the category of a "controlled company" as defined by the Local Government and Housing Act 1989 and as a result will be subject to The Local Authorities (Companies) Order 1995. The Order sets out regulations that are specific to controlled companies and start from the basis that the public should be aware that the company they are dealing with is controlled by the local authority.

- 18 For example, the company must provide information about the affairs of the company to any Member of the local authority as they shall reasonably require for the proper discharge of duty as a Member. They must also provide information that the local authority's auditors require in relation to the accounts and affairs of the company.

The Loan Agreement

- 19 On the 31st March 2015 Full Council gave authority for a budget of £10,000 for set up costs of the Company. This to be funded from the Property Investment Reserve.
- 20 Now that the Company has been incorporated the Council will need to make loans to the Company to fund the Business Cases(s).
- 21 The financial objective of the Property Investment Strategy is to achieve a 6% income return. Different types of investment will provide different levels of return, income and capital.
- 22 The loans will be sourced from the Property Investment Reserve. Amounts in this reserve are agreed by Members as part of the budget setting process.
- 23 There is the potential to increase the amount set aside for the Property Investment Reserve through additional reserves, further capital receipts, although all this would be subject to Council approval.
- 24 Specialist financial advice may need to be sought when the Company makes acquisitions or receives loans from the Council in order to ensure that State Aid regulations are complied with.
- 25 Cabinet is requested to authorise the Chief Officer Legal and Governance in conjunction with the Chief Finance Officer to finalise the Borrowing arrangements and necessary Agreements in conjunction with the relevant Portfolio Holders.

Staffing Implications

- 26 There should be no direct implications for staff currently employed by the Council in relation to the Company as it is not proposed that any staff transfer to the Company. Staff may in time be working on specific work relating to the Company but all time and resources will be specifically accounted for and charged to the Company. If the Company does decide to employ staff directly, with Council staff transferring to the Company under TUPE, the Company will be required to offer any such staff comparable terms and conditions of employment including pension rights. No such plans are currently envisaged.

State Aid

- 27 State Aid is defined as "a Member State's financial aid which favours selected businesses and has the potential to distort competition and affect

trade between EU Member States”. Article 87(1) European Convention sets out the criteria, all of which must be met for state aid to be present:

The aid favours certain undertakings or the production of certain goods,

The aid is provided through State resources,

The aid distorts or threatens to distort competition,

The aid affects trade between Member States.

- 28 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. As a result it will be necessary to demonstrate independence of the Company from the authority.
- 29 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.

Legal Implications and Risk Assessment Statement

- 30 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. In addition, the Localism Act 2011 gives a local authority the power to trade. 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. It is under such legislation, that the Company was incorporated.
- 31 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.
- 32 The Company is a “controlled company” as defined in the Local Government and Housing Act 1989 as it is a subsidiary company of a local authority and as

such the shareholder (Members of SDC) can have ultimate control over the activities and operational matters of the Company.

33 The key strategic risks are identified as follows:

Risk	Likelihood 1(low)- 5(high)	Impact 1(low)- 5(high)	Total	Controls
Failure to set up trading arrangement in strict compliance with legislation	1	3	3 Low	Extensive consultation with other authorities and, appropriate, external advice on governance arrangements and financial requirements
Using trading powers where there is a statutory obligation to provide them	1	3	3 Low	Consideration to be given on a case by case basis as to the ownership of assets
Possibility of trading ultra vires	1	2	2 Low	Every new trading activity via the company to consider statutory obligations
Possibility of challenge to state aid	1	2	2 Low	Obtain full cost recovery and any loan given to the Company to be set at commercial lending rates - financial advice sought
Possibility of conflicts of interest arising for members or officers as Directors	1	3	3 Low	Recommendation not to have Members on the Board to remove the possibility of conflicts of interest. Officers to abide by the Code of Conduct for Employees and are subject to the Officer Employment Procedure Rules. Strengthened requirements on conflicts of interest set out in the Articles of Association
Failure to arrange adequate insurance cover for the Company's liabilities/assets	2	4	8 Medium	Ensure Insurer for the Company is kept up to date with any new areas of trading activity
Failure to comply with taxation laws -	2	3	6 Medium	Advice given by EC Harris in relation to taxation generally with further

corporation tax & vat				advice sought if necessary
Consideration of potential TUPE implications	1	1	1 Low	Review regularly
Trading Company failure	1	3	3 Low	Market testing and valuations to be obtained and the implementation of tight budgetary controls
Conflict of interest over workload priorities of Council projects and Company projects	2	2	4 Low	Effective resource planning and compliance with Corporate Plan. Non-Executive Director(s) on the Board
Company credit rating	1	2	2 Low	Council could act as guarantor and insurance to mitigate
Challenge from Council's Auditors	1	2	2 Low	Follow CIPFA Code of Practice on LA Accounting. All transactions applicable to the Company can be identified using unique transaction records and coding structures. Council's Auditors to be kept fully informed in relation to any new trading activities
Lack of capacity to manage additional work	2	2	4 Low	Careful programming of staff resources
Contractual disputes	2	3	6 Medium	SDC's in house legal section to be employed to check all contracts before they are entered into and expert advice sought when necessary
Poor investment acquisitions if purchased through the Company	2	2	4 Low	Each investment acquisition will be of good quality with the potential of high income return as set out in the EC Harris Report and Business Case
Poor rate of return on investment property	2	2	4 Low	Annual valuation which sets a target rate of return and allows for financing costs and the generation of an annual surplus

Business Case

- 34 The establishment of the Company builds on the direction set out in the Corporate Plan for the Council to move towards a more financially self-sufficient position. The agreed plan articulates an approach of investing in assets that will generate revenue income to allow less reliance on diminishing Government Support.
- 35 In December 2013 the Council was subject to a Peer Challenge process which endorsed the Corporate Plan and the Council's approach recommending that the opportunity to generate greater income from investing in property assets would significantly contribute towards the aim of financial self-sufficiency.
- 36 The Company will enable the Council to operate property development on a commercial basis as well as allowing the Council to invest in residential property to be leased which it is not otherwise allowed to do. In order to operate and manage a balanced portfolio the ability to trade commercially and to invest in residential property is, key.
- 37 Now that the Company has been established the Company's Board will develop and approve an annual and 5 year Business Plan. This will set out in detail the expected financial results of the business. Cabinet via The Trading Board will receive half yearly reports.
- 38 Business opportunities other than trading in property can also be developed within the Business Plan to enhance the profitability of the Company.
- 39 Risks associated with the operation of the Company are set out in detail above.

Equality Assessment

- 40 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Conclusions

- 41 The Company was set up as it was 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 that this Council may enhance the economic wellbeing of the District as well as providing an income stream which will help the Council be self-sufficient and not dependent upon Government funding.

- 42 This reports sets out the current arrangements that have been put in place for the Company and asks Cabinet to endorse such arrangements and the further proposed arrangements including authorisation to finalise a Shareholder Agreement and Loan Arrangements in conjunction with the relevant Portfolio Holders.

Appendices

Appendix A - Articles of Association and Certificate of Incorporation

Appendix B - Job Advert and Personal Specification for the recruitment of the 2 Non-Executive Directors

Background Papers:

[EC Harris Built Asset Consultancy](#)

[Report to Council dated 31st March 2015 entitled "Authority to Establish a Local Authority Trading Company"](#)

Christine Nuttall, Chief Officer Legal and Governance

Adrian Rowbotham, Chief Finance Officer

Lesley Bowles, Chief Officer Communities and Business