

Classification: Public

Key Decision: No

Gravesham Borough Council

Report to: Full Council

Date: 17 December 2019

Reporting officer: Director (Corporate Services)

Subject: Formation of a Local Authority Trading company

Purpose and summary of report:

To present Members with a proposal for the establishment of a Local Authority Trading Company (the Holding company), which has previously been discussed at Cabinet and recommended for Full Council consideration. Specifically to:

- Seek approval for the establishment of a Local Authority Trading company (with Subsidiaries to follow).
- Seek approval of the draft Business Case template, which will be used to seek approval for creation of future trading subsidiaries of the Holding company, and to outline the activities of those subsidiary companies.
- Seek approval to amend the Council's Constitution and Contract Procedure rules to ensure that the Council continues to have robust contract management arrangements in place.

Recommendations:

Following discussion and subsequent recommendation from Cabinet on 2 December, Full Council are asked to approve:

1. The formation of the Local Authority Trading company (LATCo) Holding company as detailed in the report.
2. That the Council reserves the right to be a shareholder of any LATCo subsidiary and this shall be included in any governance agreement between the Council and LATCo (through the Memorandum of Association (MOA)).
3. That delegated authority is given to the Chief Executive, in consultation with the Leader of the Executive, the Monitoring Officer and the Section 151 Officer to confirm and register the name of the company and take all necessary practical, legal and financial actions necessary in relation to the creation of the LATCo and development of the relevant governance framework in order to enable the effective operation of that company and associated subsidiaries and subject to any necessary amendments to the Council's Constitution being brought back to Full Council for approval.

1. Introduction

- 1.1 The Council's draft Corporate Plan for 2019-23 sets out the commitment of "Delivering a Gravesham to be proud of" which will be achieved through the delivery of three overarching corporate objectives for the Council:

#1 People	protected environment quality living	<i>A proud community; where residents can call a safe, clean and attractive borough their home.</i>
#2 Place	vibrant economy connected community	<i>A dynamic borough; defined by a vibrant and productive local economy taking advantage of growth in the area, supported by its strong and active community.</i>
#3 Progress	entrepreneurial authority strong leadership	<i>An entrepreneurial authority; commercial in outlook and committed to continuous service improvement, underpinned by a skilled workforce and strong governance environment.</i>

- 1.2 The Council has a clear ambition to become an entrepreneurial local authority; putting in place a package of new ways of working in order to implement a commercial culture to maintain and improve the Council's frontline offer and deliver a social return on investment. To achieve this ambition, this includes the formation of a local authority trading company.

2. Financial Background to the establishment of the LATCo

- 2.1 When drafted in early 2016, the Medium Term Financial Strategy 2016-17 to 2019-20 identified that whilst the Council was able to draw on its Working Balances to support its annual revenue budget initially, a residual funding gap of £2.5m would emerge in 2019-20 were the Council to take no action. The Strategy also set out the action to be taken by the Council to bridge the funding gap.
- 2.2 The funding gap, and therefore action required by the Council, increased by £0.4m to £2.9m when setting the budget for 2017-18, primarily driven by the changes to the design of the New Homes Bonus Scheme. The funding gap was widened by at least a further £1m at budget setting 2018-19 due to the financial impact of low housebuilding rates in the borough, the higher than anticipated staff pay award and lower than expected interest rates.

	£
Bridging the Gap Activity	
- Property Acquisition Strategy	(400,000)
- Fees and charges activity	(270,000)
- Service Review Process option implementation	(1,430,000)
- Shared Service Progression	(240,000)
- Budgetary Challenge Measures	(200,000)
- Property Acquisition Strategy (Phase 2)	(397,000)
- Balancing the Budget Initiatives	(1,274,000)
TOTAL VALUE OF ACTIVITY	(4,211,000)

- 2.3 Given the financial pressures that have arisen for Councils in recent years, there has been a need for local authorities to consider the way in which they operate and provide their services. This has resulted in Councils exploring other options for income generation such as purchasing commercial properties, but most noticeably there has been an increase in the number of Councils looking to form trading entities to deliver Council objectives and produce income streams.
- 2.4 Gravesham Borough Council is no different and the Council recognised this when exploring additional budgetary initiatives to either save money or generate income. Specifically, Members approved the following option:
- “Progress the introduction of a Local Authority Trading company (LATC) to enable commercialisation of Council activities”*

3. The Council’s key objectives and long-term ambitions for the LATCo

- 3.1 The Council has already implemented a number of innovative initiatives to drive further income generation, largely in the area of property acquisitions. However, as a way of generating income from operating within a commercial environment, where it is appropriate to do so and in order to comply with legal requirements laid down in the Localism Act 2011, an opportunity exists for the Council to sell services to the general public through a company structure. A key driver for this is a use of current resources within Council services, where it is suitable to do so, in order to deliver a profit for any such company and, therefore, the Council as the sole shareholder for a company.
- 3.2 Councils have long established powers to trade, first introduced in the Local Authorities (Goods and Services) Act 1970, however, this act only allowed for the trading of services between local authorities and other designated public bodies. These powers were expanded within the Local Government Act 2003 to allow Councils to trade with the private sector, where authorised to do so (in the form of a Trading Order from central government) for the purposes of carrying out ordinary functions. The introduction of the Localism Act in 2011 broadened these powers to allow Local Authorities to operate commercially in any function (not just the ordinary functions of a Council), but explicitly stated that such activities must be delivered through a company. Councils are therefore able to establish a company structure by which they can trade with the private sector for a profit – any such profits can be returned to the Council in the form of dividends or service charges.
- 3.3 The intention therefore is for the Council to set up a holding company which will be wholly-owned by the Council with subsidiary companies being formed (subject to detailed business cases as outlined below) for specific services that are to be delivered. At this stage, the long-term intention is to have four specific subsidiary companies as follows:
- Vehicle Workshop Services
 - Housing Management (non Council-owned dwellings)
 - Repairs and Maintenance Services
 - Property Development

- 3.4 Detailed business cases and business plans will be developed for each of the subsidiaries and will be presented to the Cabinet for consideration and approval following creation of the holding company. A draft business case template is appended to this report at appendix three, which will form part of the overall framework for establishing a subsidiary as part of the overall LATCo structure.
- 3.5 At this stage, authority is being sought to establish the holding company only, with the Council being the sole shareholder of that company. The report was discussed with the Cabinet at its meeting on 02 December 2019, and Cabinet support the recommendations set out on page one of the report.
- 3.6 In order to provide clarity, the relevant terminology used in the remainder of this report is as follows;
 - 3.6.1 The Parent Company – the holding company of the local authority trading company structure.
 - 3.6.2 Subsidiary/ies – specific trading operational companies that sit under the parent holding company.
 - 3.6.3 Company (or LATCo) – a reference to the overall structure of the company, including both the parent holding company, together with any subsidiaries as formed.

4. Governance Arrangements and Operating Model

- 4.1 It is important that the correct governance arrangements are established when setting up the LATCo. In framing these proposals officers have heeded the advice and guidance provided by the Lawyers in Local Government (LLG) guidance note – *The governance of Council interests in companies* – which sets out the best practice arrangements for local authorities establishing trading companies. A copy of the guidance note is appended to the report at appendix two for Members perusal.
- 4.2 In establishing a trading operation, which would in practice be executed through the establishment of subsidiaries sitting under the holding, the Council as sole shareholder of the LATCo, must first approve a business case. In line with legal guidance which is based upon the UK Corporate Governance Code, whilst Full Council is responsible for the creation of the holding company, it is a function of the Executive to consider recommendations in relation to the creation of trading subsidiaries.
- 4.3 As the Council has adopted the Leader and Cabinet arrangement under the Local Government Act 2000, Executive functions are reserved to the Leader of the Council to consider such recommendations and therefore the majority of decisions needing to be taken by the Council as shareholder will be taken by the Leader, informed by a Shareholder Group. There is however an expectation within the Corporate Governance codes of practice that key decisions relating to the shareholder's oversight of the LATCo would normally be made at meetings of the Cabinet – one such decision being the creation of trading subsidiaries.

4.4 Accordingly, the business case document that the Cabinet would be required to consider in order to exercise this function as the shareholder should detail the following

- The objectives of the business;
- The investment and other resources that are required to achieve these objectives;
- The risks that the business may face and how significant these risks are; and
- The expected financial results of the business along with details of any outcome that the business is aiming to achieve.

In line with this requirement, Officers have developed a business case template, which has been progressed with assistance and input from the Members of the Commercial Services Committee, a copy of which is appended to the report at appendix three.

4.5 In line with good governance principles, once established, each year the LATCo will produce a business plan, which will need to be approved on an annual basis by the Cabinet; this will update the Council, as the shareholder, on the planned activities for the LATCo for the forthcoming year. It will be for the parent company, to approve the detailed annual Business Plans for each subsidiary – thereby providing the flexibilities and freedoms for those subsidiaries to trade effectively – except where any proposals in those Business Plans may require funding from the Council as Shareholder.

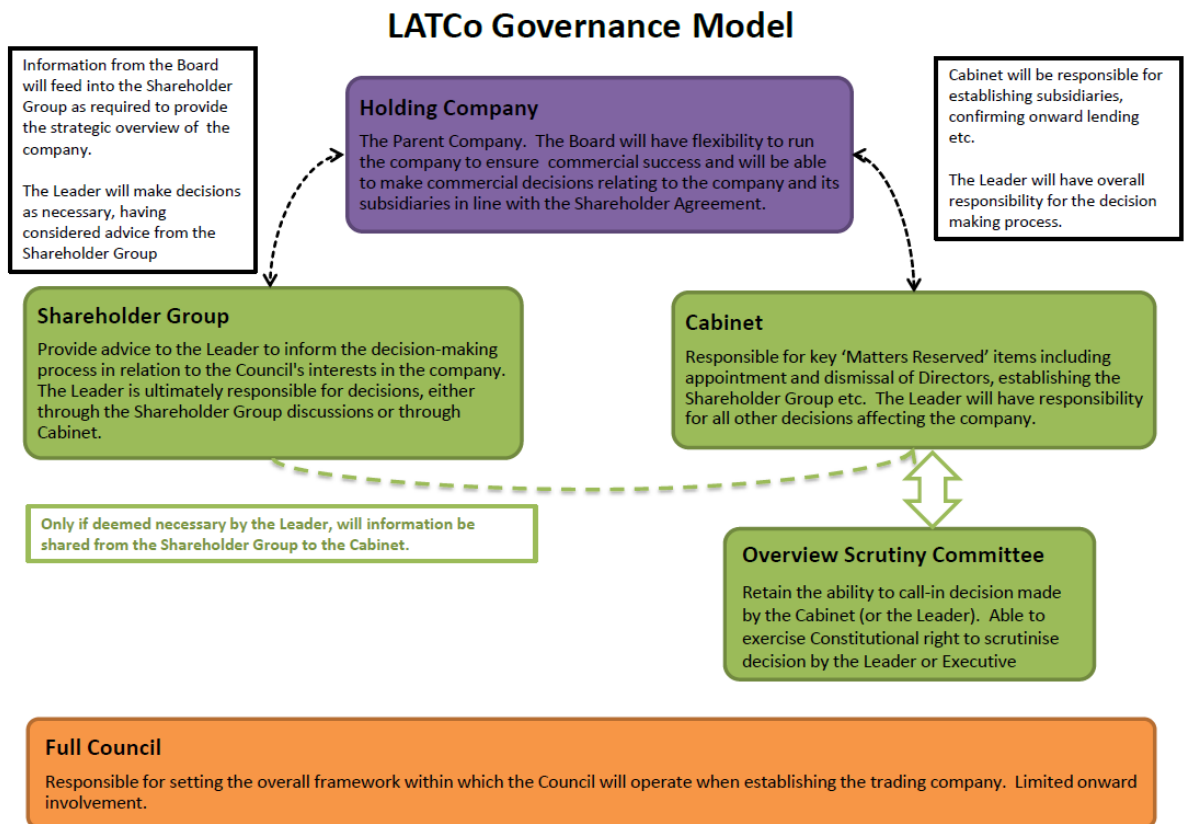
4.6 In order to maximise the opportunity for success of the LATCo itself, there is a need for the LATCo to have a high degree of commercial freedoms, whilst ensuring that there is the appropriate level of control for the Council. As such, the governance arrangements will clearly set out how:

- the Council will retain sufficient controls to ensure that the investments it makes in the LATCo are protected and that there are the appropriate social and financial returns for the Council. In addition the arrangements will set out how the activities of the LATCo are undertaken in line with the Council's values.
- the LATCo will be provided with sufficient freedoms to achieve it's objectives.

The balance of these freedoms, whilst maintaining sufficient control, will be encapsulated within the Articles of Association for the holding company and the Shareholders Agreement, both of which will be presented to the Cabinet for consideration and approval should Full Council approve creation of the parent company structure.

5. Governance Operating Model.

5.1 The model below illustrates how the operations of the LATCo, and interactions with the Council, as sole shareholder are intended to operate;



- The Holding Company**
The Parent Company, will provide the overall leadership for the commercial activity of the Council and will be responsible for overall communication with the Council, direction of the company resources and strategic decision-making across the group i.e. including any subsidiaries that are set up. The Parent Company Board will set the overall strategy for the company and its subsidiaries.

The Board will be responsible for signing off the annual business plans of the subsidiary companies as well as managing and monitoring the spending and resources of each subsidiary. Only decisions that affect the Shareholder's rights of the group of companies as a whole will be reserved for the Shareholder. These are detailed later in the report under the reference to 'Cabinet' roles and responsibilities on page seven.

The Board will be responsible for ensuring that the required support services are provided across the group, which will include establishing Service Level Agreements (SLAs) with the Council for such services as required. There will be a requirement for the company, as a Local Authority Trading company, to adhere to existing Council policies and strategies as appropriate, such as recognition of trade unions and adoption of the green book terms and conditions for employment.

- **Shareholder Group**

The purpose of the Shareholder Group is to advise the Leader, who has the role as the key decision maker with regards to the Council's role as shareholder, to enable the Leader to best represent the interest of the Council. The Group provides the necessary oversight, from a shareholders' perspective, that the parameters, policies and boundaries that have been set for the company are being met.

The potential membership of the Shareholder Group could be made up of the Leader plus:

- Members of the Cabinet or wider body of Members, as appointed by the Leader (a minimum of two additional Members, and a maximum of five to allow for independent co-opted members of the group to be appointed);
- Co-opted members who are independent and are able to provide additional expertise and advice as necessary (up to a maximum of three in line with the above). Such positions could, for example, be offered to trade union representatives;
- Relevant Senior officers of the Council. The Section 151 Officer and Monitoring Officer (or officers nominated to act in their place), will act as advisors to the Group.

In addition, it is suggested that the Chair of the Overview Scrutiny Committee could be given the right as a non-voting member to attend meetings of the Shareholder Group, to enable the Chair of Overview Scrutiny to fulfil the Constitutional Scrutiny role and have access to information that has informed the Leader's decisions.

A specific set of terms of reference for the Shareholder Group will need to be established. An example Terms of Reference is shown in the LLG Guidance document at appendix two. Additionally, a Shareholders Agreement will be developed to set out in detail the governance and approved decision making process, in line with the Terms of Reference as appended at appendix five. Both documents will be brought back to Cabinet in due course for approval in line with the functions of Cabinet outlined below.

It should be noted that only if deemed necessary by the Leader, will information from the Shareholder Group be shared with the Cabinet.

- **Cabinet**

In line with the guidance provided within the LLG document, it is recommended that the Cabinet will be responsible for decisions relating to the following areas;

- Approval of the Parent Company's annual Business Plan (or mid-year amendments), which will include key aspects from the Business Plans of the subsidiary operations
- Appointment and dismissal of Directors for the Board of the Parent company as well as establishing the membership for the Shareholder Group.
- Investment decisions (in so much as the Council's investment in the company is protected).

- The financial agreements which set out the financial assistance that will be provided by the Council. Any decisions relating to funding and onward lending to the holding company and/or subsidiaries (where budgetary provision has been made by Full Council) will rest with the Cabinet.
- Delivery of appropriate social and financial returns on investment.
- Ensuring that trading activities are conducted in accordance with the values of the Council.
- The business case for the establishment of each subsidiary. This must assess risk and is the start of the full business planning process for the trading company (as per appendix three). The initial business plan for the subsidiary will be included as part of the initial business case document to Cabinet but once established, the responsibility for approving annual business plans of the subsidiaries will rest with the holding company Board.
- The Articles of Association (AoA), which establishes the constitution for the company structure.
- The Shareholders Agreement which sets out the rights of the Council as the sole shareholders and details the powers of the Board of the company and at what point the shareholder can influence this.

All other decisions relating to the company will rest with the Leader who can execute these either as a direct result of discussions with the Shareholder Group or, if felt appropriate, through discussions with the Cabinet directly.

- **Overview Scrutiny Committee**

The Overview Scrutiny Committee will be able to exercise all of its rights as set out within the Council's Constitution in relation to decisions taken by the Executive.

- **Full Council**

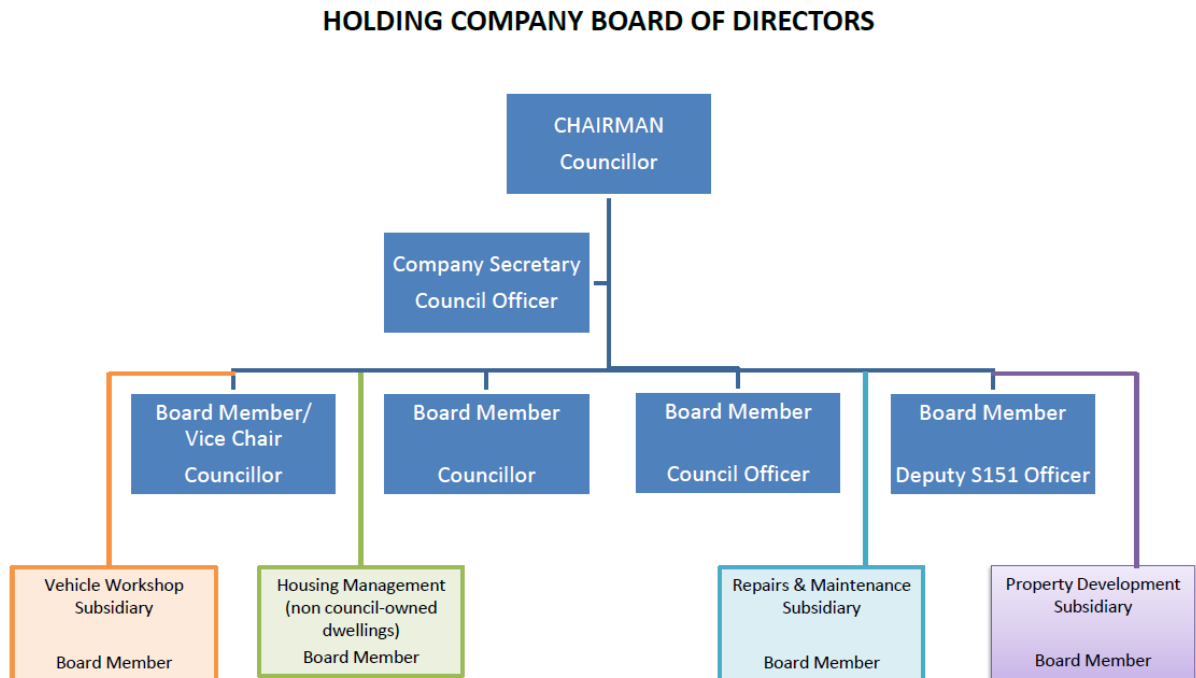
Full Council is responsible for establishing and approving the Council's Policy Framework and Budget which, in relation to the recommendations, would entail the formation of the Parent company. Therefore Full Council will be responsible for establishing the framework within which the Council will operate when considering the establishment of subsidiary companies to the LATCo. They will also set some of the appropriate delegations to enable Gravesham to effectively manage and develop subsidiaries of the Parent company.

5.2 It should be noted that whilst the Commercial Services Cabinet Committee has been instrumental in assisting in the development of the Framework for establishing the LATCo, moving forward the role of this committee will focus on the property acquisition element of the Council's commercial activity. This is to ensure there are no conflicts of interest as it is suggested that the Chair of the Committee will potentially be the Chairman of the LATCo Parent company Board, as well as any other Members of the Committee who may be involved in the Parent company Board.

5.3 The role of Lead Member for Commercial Services was specifically established to ensure the Lead Member had no other direct responsibilities for Council services and therefore, will be able to undertake a potential role within the LATCo without any conflicts of interest.

6. Proposed Company Structure

6.1 The proposed structure of the Local Authority Trading company is as follows:



6.2 The structure of the LATCo board will include both officers and Members of the Council, with three Councillors and two officers with decision-making/voting rights; the company Secretary would have no voting right. It is anticipated that the Councillors selected will be representative of the political balance of the Council. Both officers and Members selected for the Board member roles will be chosen based upon the skills required for the given roles on the Board.

6.3 It will also be necessary to ensure that there is no inherent conflict of interest between the directors of LATCo and their roles within the Council. For example a member of the proposed Shareholder Group would have a conflict if he/she was also a LATCo board director, as the Shareholder Group will hold the LATCo board to account. The Council has already been mindful of this and will ensure that officers on the Shareholder Group will not have a role on the LATCo Parent company board. In addition, specific training is to be arranged to ensure both officers and Members are clear on what constitutes a conflict of interest so that this can be managed moving forward.

6.4 Subject to the approval of this framework by Full Council, which includes delegations to the Chief Executive in consultation with the Leader and Statutory Officers, the specific make-up of the Shareholder Group will be determined and proposals will be developed for the make-up of the Holding Company Board for Cabinet consideration. The appointments will be made in relation to the relevant post or office of the Council, and not the individual.

6.5 Should an officer cease to be an employee of the Council or a Member cease to be a Member of the Council, they will automatically cease to be a Director of the company.

- 6.6 It should be noted that where an officer or Member is appointed to the company board, he or she will be provided with an indemnity for their actions in that role under the Local Authorities (Indemnities for Members and Officers) Order 2004. This will however, only cover actions taken honestly and in good faith.
- 6.7 It is suggested that the LATCo parent company Board voting rights will be limited to the LATCo Board Chairman and four Board Members. The subsidiary company Board Members will have no voting rights at this stage, although this may be something to be reviewed in the future. As such, it has been suggested that the Articles of Association for the company will be drafted with sufficient flexibility to enable the company to respond to changes in Board membership, whilst not jeopardising the legal standing of the company itself.
- 6.8 At this stage, it is not considered necessary to have Non-Executive Directors as part of the LATCo or future subsidiary company Boards. However, this is something that will be kept under consideration as the company expands into the provision of other services and or development. To protect the Council and LATCo, both of these will enter into a shareholders' agreement which will reserve to the Council the right to approve strategic, financial and ownership decisions. Such an agreement would recognise that LATCo and its subsidiaries form part of the Council's group (and need to be accounted for as such).
- 6.9 As LATCo subsidiaries are formed the Council may acquire shares in each of them so that it can enter into a Shareholder Agreement with the LATCo and the relevant subsidiary. These subsidiary shareholder agreements would operate in a similar manner – reserving important subsidiary board strategic decisions to consent from LATCo's board and/or the Council.
- 6.10 Training will be provided to appropriate officers and Members who have a role in the governance arrangements of the holding company or any subsidiary companies, in order to ensure statutory responsibilities and requirements of the roles are clear. Training will be provided by the Council's external legal advisors Trowers & Hamlins and an outline of the training provision is appended to this report at appendix four.

7. An overview of the company's Articles of Association

- 7.1 The articles of association of the company will be a document which, along with the other agreements, form the company's constitution, defines the responsibilities of the directors, the kind of business to be undertaken, and the means by which the shareholders exert control over the board of directors.
- 7.2 The recommendation is that the LATCo has bespoke articles which are likely to be based on those detailed Schedule 1 of the model Articles Companies (Model Articles) Regulation 2008 with the necessary modifications to reflect accountability to the Council, the Council's requirements and matters reserved for Shareholder Approval.
- 7.3 Appendix five to the report provides a set of Heads of Terms for the key issues that will be established through the Shareholders Agreement for Member consideration. These will form part of the overall Articles for the company and the Shareholders Agreement that will be subject of a future report to Cabinet for consideration and approval.

8. Next Steps

8.1 In line with the recommendations made within this report, Full Council are requested to approve the creation of the parent holding company, and provide delegated authority to the Chief Executive (in consultation with the Leader, Monitoring Officer and Section 151 Officer), formal registration of the holding company will commence. In addition, the following will form the next steps in order to create a functional company structure to deliver the Council's ambitions;

8.1.1 The Cabinet will receive the following proposals for consideration and approval;

- Proposals in relation to the make-up of the holding company Board
- The Articles of Association (AoA) for the holding company, which establishes the constitution for the company structure.
- The Shareholders Agreement which sets out the rights of the Council as the sole shareholders and details the powers of the Board of the company and at what point the shareholder can influence this.
- The financial agreements which set out the financial assistance that will be provided by the Council to the company (subject to this being within existing budgetary provision – any additions to the Council's budget will require the approval of Full Council)
- Detailed Business Case documents in relation to formation of operational trading company subsidiaries (in line with the anticipated activities set out at paragraph 3.2 above)

8.1.2 Full Council will receive the following proposals for consideration and approval;

- Proposed amendments to the Council's Constitution which are considered necessary in order to support the governance arrangements outlined within this report.

9. Financial implications

9.1 Extensive legal advice has been sought from both the Council's internal Shared Legal Service and from the Council's external legal advisors. The costs associated with the external legal advice has been incorporated into the costs already associated with the Council's involvement in the Heritage Quarter project, as this has been deemed necessary in determining the appropriate procurement route for this project.

9.2 In addition, expenditure will be incurred in relation to the purchase of generic web domains in order to protect the holding company websites for future use by the company.

9.3 There will also be some initial costs in respect of the registration of the company with Companies House and in officer time spent in establishing the LATCo. These costs will be accommodated within existing budgets.

- 9.4 Detailed financial analysis will be undertaken for each of the subsidiary companies, and will be presented in the business case which will be submitted to Cabinet for approval. This will include financial modelling over a five-year period and will identify any set-up costs as well as potential income/expenditure.
- 9.5 There will need to be future consideration regarding VAT registration. Once the company (or its subsidiaries) reach the VAT registration threshold (currently £85,000 for the 2019/20 tax year), the company will need to be registered for VAT.
- 9.6 The Council will provide support services, such as financial advice, IT support, legal support etc. to the company through various service level agreements (SLA). The charge made to the company will be at full cost i.e. the Council will charge the company full cost recovery rates for the services that are provided through the SLA.

10. Background Papers

- 10.1 Background papers pertaining to this report are held by the Corporate Change Team. Anyone wishing to inspect background papers should, in the first place, be directed to Committee & Electoral Services who will make the necessary arrangements.

IMPLICATIONS	APPENDIX 1
<p>Legal</p>	<p>There are two key pieces of legislation which allow a local authority to trade in the services it provides:</p> <ul style="list-style-type: none"> - The Local Government Act 2003 which allows local authorities to trade in the ordinary day to day functions of the Council. - The Localism Act 2011 which allows local authorities to trade in any area (unless expressly prohibited or limited by statute). <p>Should the Council wish to trade in Council services such as private repairs and maintenance, private housing development and vehicle repairs then a local authority trading company would have to be set up to enable this.</p>
<p>Finance and Value for Money</p>	<p>As set out in section two, the Council's Medium-term Financial Strategy 2016-17 to 2019-20, originally set out a funding gap of £2.9m. Whilst considerable action has been taken to 'bridge the gap' in term of identifying savings and new income streams, Cabinet approved the delivery of a further £1m of savings in November 2018 as a result of additional funding pressures and commercialisation is a key step to closing this additional funding gap.</p>
<p>Risk Assessment</p>	<p>Establishing a wholly-owned trading company on behalf of the Council does present some risks, although the establishment of the parent company alone has very low risk. Specific risks associated with the individual subsidiaries will be fully considered as part of the business case/business plan which will be developed at the appropriate time.</p>
<p>Data Protection Impact Assessment</p>	<p><i>A data protection impact assessment (DPIA) should be carried out at the start of any major project involving the use of personal data or if you are making a significant change to an existing process.</i></p> <p>a. Does the project/change being recommended through this paper involve the processing of personal data or special category data or criminal offence data? No – at this stage, the formation of the parent company will have limited data accessibility. A specific DPIA associated with the individual subsidiaries will be completed as part of the business case/business plan which will be developed at the appropriate time, in order to ensure all GDPR requirements have been considered.</p> <p>b. If yes to question a, have you completed and attached a DPIA including Data Protection Officer advice? N/A</p> <p>c. If no to question b, please seek advice from your nominated DPIA assessor or the Information Governance Team at gdpr@medway.gov.uk. N/A</p>

IMPLICATIONS	APPENDIX 1
Equality Impact Assessment	<p>a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer.</p> <p>No - at this stage, the formation of the parent company will have limited equality implications. A specific equality impact assessment associated with the individual subsidiaries will be completed as part of the business case/business plan which will be developed at the appropriate time, in order to ensure all equalities requirements have been considered.</p>
	<p>b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer.</p> <p>N/A</p>
	<p><i>In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above</i></p>
Corporate Plan	<p>Objective 3 - Progress:</p> <p>An entrepreneurial authority; commercial in outlook and committed to continuous service improvement, underpinned by a skilled workforce and strong governance environment.</p>
Crime and Disorder	<p>There are no specific crime and disorder implications resulting from this report.</p>
Digital and website implications	<p>At this stage, there are no specific digital or website implications. There will however, be a need to consider digital and website implications as the company expands and the subsidiaries progress.</p>
Safeguarding children and vulnerable adults	<p>There are no specific safeguarding children and vulnerable adult's implications resulting from this report.</p>