

## **THE GOVERNANCE OF COUNCIL INTERESTS IN COMPANIES**

### **- CODE OF PRACTICE (cabinet and scrutiny example)**

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## **The Governance of Council Interests in Companies - Code of Practice**

### **1. Introduction**

- 1.1 The purpose of this Code of Practice is to provide a reference point to the Council [local authority] and interested parties (councillors, officers, company representatives and contractors) in understanding the requirements of the Council in setting up a local authority company, and in particular a local authority trading company (LATC), and how the governance arrangements for that company will work once set up.
- 1.2 The OECD/G20 helps define corporate governance by saying that it:
- *“involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders; and*
  - *“provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”.*<sup>1</sup>
- 1.3 This Code of Practice therefore sets out how the Council will normally go about managing those relationships and ensuring that a company will go on to deliver the objectives established for it by the Council. It also briefly explains and makes reference to the law and basic requirements placed upon a local authority in establishing or owning companies.
- 1.4 The Code of Practice is set out as:
- an explanatory background;
  - a set of guiding principles; and then
  - a set of working expectations.
- 1.5 Attached, as appendices, are also key documents used in this process.

### **2. Background**

#### **(a) Local authority trading and the local authority trading company <sup>2</sup>**

- 2.1 There are long-established powers for councils to trade. Among the most important is the Local Authorities (Goods and Services) Act 1970, which authorises councils to enter into agreements with other local authorities and other designated public bodies, for the provision of goods, materials and administrative, professional and technical services, for the use of vehicles, plant and apparatus and associated staff, and for the carrying out of maintenance. Payment terms are set out in an agreement. These are not limited to cost

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<sup>1</sup> “G20/OECD Principles of Corporate Governance - OECD Report to G20 Finance Ministers and Central Bank Governors” - September 2015

<sup>2</sup> Source: Local Government Association Briefing

recovery. The 1970 Act is the bedrock of trading within the public sector and there is substantial experience of its operation. But the Act is limited in scope. For example, it does not allow trading with the private sector or the public at large. Other established trading powers are specific in nature, such as the Local Government (Miscellaneous Provisions) Act 1976, which enables councils to enter into agreements with anyone for the use of spare computer capacity.

- 2.2 The Local Government Act 2003 added new possibilities to charge for services, to both provide extra services at cost and to trade with the private sector. Under the 2003 Act, the Government authorizes trading by means of a trading order. The Trading Order currently in force was made in 2009<sup>3</sup>, which permits all councils in England to trade or "to do for a commercial purpose", anything which they are authorised to do for the purpose of carrying on their ordinary functions, which includes use of the granted general power of competence.
- 2.3 Under that 2003 Act and Trading Order, as augmented by the Localism Act 2011, for a local authority to exercise the power to do things for a commercial purpose (which the authority couldn't otherwise do), then it must be done through a company. Councils are thus enabled to establish a company by which they can trade with the private sector for a profit - that is to enter into commercial contracts. The profits may then go back to the council through dividends or service charges.
- 2.4 The reason given for this legislative requirement was that:  
*"local authorities and their trading arms have to be on a level playing field with the private and commercial sector in both a positive and negative way. They should not be at a disadvantage, but they should not have an outstanding advantage. Taxation is a particular issue. It is right to carry forward the requirement that such bodies should be companies and trading as such."*
- 2.5 To exercise the power to establish a company and trade, a local authority must first approve a business case ('a comprehensive statement') covering:
- 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 other relevant outcomes that the business is expected to achieve.
- 2.6 That business case is then implemented and refreshed by way of a business plan, which should be updated and submitted for approval each year, to guide the company in carrying out its continuing activities.
- 2.7 The local authority must also recover the costs of any accommodation, goods, services, staff and anything else they supply to the company under any agreement or arrangement. This is an absolute requirement and distinct from

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<sup>3</sup> *The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009*

the various rules on procurement or providing state aid.

- 2.8 Other important legal, commercial and financial considerations for councils or fire and rescue authorities setting up a trading company include company law issues, the cost of bidding for contracts, tax liability (corporation tax and VAT), EU procurement law and state aid rules and employment law (TUPE and pensions).

### **(b) The Local Authority Company**

- 2.9 The kind of company that must be utilized to enable the Council to trade in this way is defined in Part V of the Local Government and Housing Act 1989 ('LGHA 89'). That lists:
- a company limited by shares;
  - a company limited by guarantee and not having a share capital;
  - a company limited by guarantee and having a share capital;
  - an unlimited company;
  - a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965.
- 2.10 The LGHA 89, and the current Order<sup>4</sup> made under it, places local authority companies into one of three categories, being controlled or influenced by the local authority (a regulated company) or a company in which the local authority has a minority interest. It then goes on to set out a number of additional restrictions and requirements to which the local authority and the regulated company (or society) and any subsidiaries must adhere.
- 2.11 The reasons for these extra requirements were described by the Government of the day, when setting out the reasons for the LGHA 89, as being that:
- "when a company is effectively under the control of a local authority... the most significant controls that Parliament has laid down for the conduct of local authorities should apply to that company."*
- 2.12 These requirements cover issues of audit, payments, delivery of information to the authority's members and identification. For example, a regulated company is required to mention that it is a company controlled, or as the case may be influenced, by a local authority, naming the relevant authority or authorities, on all relevant documents, which are defined by reference to the companies legislation and are the same documents on which a company is required to disclose its registered name<sup>5</sup>, such as business letters, its order forms and its websites.

### **(c) Other Local Authority Entities**

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<sup>4</sup> *The Local Authorities (Companies) Order 1995*

<sup>5</sup> "...being of any kind mentioned in paragraphs (a) to (d) of section 349(1) of the 1985 Act" - now Regulation 24 of the Company, Limited Liability Partnership and Business (Names and Trading Disclosures) Regulations 2015 made under the replacement section 82 of the 2006 Act.

- 2.13 If it isn't needed as a means by which it can trade, a local authority is free to involve itself in any one of a number of different forms of sole and joint ventures to best assist it in achieving its goals and aims, which may or may not involve establishing an entity that has a separate legal personality. These may also be as above, companies as defined by the Companies Act and which can include an industrial or provident society or a community interest company. They may alternatively be established as a distinct trust, with the council or appointees as trustee. They may be embodied as limited liability partnerships. They may also exist simply as unincorporated partnerships, with other public bodies or private persons (that can often act as if they were a distinct entity), such as the Local Economic Partnership.
- 2.14 There are certain rules yet to be brought into force, and the Secretary of State holds reserve powers, that may require, prohibit or regulate the taking of specified actions by entities connected with a local authority and those appointed to or representing the local authority at them<sup>6</sup>. In this respect:
- "entity" means any entity, whether or not a legal person, and
  - an entity is stated to be "connected with" a local authority if financial information about that entity must be included in the local authority's statement of accounts.
- 2.15 Whilst this Code of Practice will apply to all companies in which the Council has an interest, it may not be as appropriate for the governance of the Council's relationship with other entities which it is connected to, is a member of or has an interest in. In these instances, regard will be had to this Code but its application will be determined on a case by case basis.

#### Limited Liability Partnerships

- 2.16 Particular amongst these is the limited liability partnership (LLP), which are an increasingly common entity of which local authorities are a member. A limited liability partnership is a body corporate (with legal personality separate from that of its members) and is formed of 'two or more persons associated for carrying on a lawful business with a view to profit'<sup>7</sup>. An LLP will also file annual accounts and be registered with Companies House.
- 2.17 LLP's have a number of advantages for local authorities, including significant tax advantages and that it lies outside of the regulation applicable to local authority trading companies. Unlike a company, however, an LLP is not a vehicle by which the Council can undertake commercial activities via the general power of competence under the Localism Act 2011 or the charging and trading powers under the Local Government Act 2003, so a key disadvantage is that it must rely on specific local government powers and the vires of the functions included must be carefully considered. An LLP is also not suitable for later conversion to a company or to be formed as a charitable body. An LLP is, therefore, very well suited to forming joint ventures to deliver local government

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<sup>6</sup> Section 212 Local Government and Public Involvement in Health Act 2007

<sup>7</sup> Limited Liability Partnership Act 2000

functions such as land and property development<sup>8</sup>.

- 2.18 The cross-application of this Code will therefore particularly apply to limited liability partnerships (LLP), where the management agreement will reflect many of the elements of the articles or shareholder agreement referred to below. This will include, for example, the same reserved decision making in respect of appointment of representatives to the partnership management board, receipt of financial and other information by the Council and that the venture is limited to only undertaking its business in accordance with the approved business plan.

### **3. Guidance**

- 3.1 In exercising the power to establish a local authority trading company (LATC), local authorities were obliged under the 2003 Act to have regard to Statutory Guidance. The “*General Power for Local Authorities to Trade in Function Related Activities Through a Company*”<sup>9</sup> was issued and it is to this document that this and other councils in establishing the companies have had regard to.
- 3.2 That Statutory Guidance is now out of date, however, and was withdrawn as of 17<sup>th</sup> June 2014. Whilst new guidance is awaited, the withdrawn guidance nevertheless remains useful and largely very relevant. Where it is still relevant, this Code has had regard to it and, where associated with the principles of this Code, accompanying direct quotes from the Government Guidance are included throughout.
- 3.3 All listed companies are subject to the *UK Corporate Governance Code*<sup>10</sup>. The Council will expect all of its companies and their subsidiaries, and indeed any company with which it is associated, to adopt the “comply or explain” approach of the UK Corporate Governance Code as a demonstration of best practice in corporate governance.
- 3.4 The *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*<sup>11</sup> and also the *Corporate Governance Handbook*<sup>12</sup> have additionally been utilised in the compiling of this Code of Practice.
- 3.5 The Council itself has adopted a NNN Council Code of Corporate Governance and the approach of this Code of Practice will fall to be associated with the provisions of that Code.

### **4. Principles of Governance of Council Companies**

- 4.1 In setting out the governance relationship between the Council and its

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<sup>8</sup> “*Structures for Collaboration and Shared Services: Technical Notes*” (DCLG)

<sup>9</sup> First published: 29 July 2004: UK Govt Archive

<sup>10</sup> September 2014: Financial Reporting Council

<sup>11</sup> First edition: November 2010: Institute of Directors (IoD) and European Confederation of Directors’ Associations (ecoDa)

<sup>12</sup> Third edition 2013: Institute of Chartered Secretaries and Administrators (ICSA)

companies, group of companies and organisations it has invested in, this Code has three key underpinning principles. These are as follows, preceded by a relevant quote on the subject from the Government Guidance.

## **I. Controls and Freedoms**

### The Guidance:

- 4.2 *“A successful company will be one that works alongside the authority in delivering joint objectives. The authority will have to consider how to balance the need to assist the company to achieve its trading objectives with the principles of transparency, accountability and probity.”*

### The Principles

- 4.3 It is recognised that, whilst appreciating this should not be unfettered, a trading company needs to be given commercial freedoms to enable it to succeed.
- 4.4 Accordingly, governance arrangements will seek to ensure that:
- the company will be provided with sufficient freedoms to achieve its objectives; and
  - the Council will retain sufficient controls to ensure that its investment is protected, that appropriate social and financial returns on investment can be obtained and that the trading activities of the companies are conducted in accordance with the values of the Council.

## **II. Relationship, Integrity and Accountability**

### The Guidance:

- 4.5 *“It is important that trading companies can operate on an equal footing with their competitors, but it is equally important that they are not used as a device for inhibiting legitimate public access to information about local government and local government services.”*

### The Principles

- 4.6 It is recognised that, whilst appreciating its procedures operate in a way that protects the company’s commercial interests, those procedures should ensure that the Council can carry out its functions as an investor, as a trustee of public funds and a local authority committed to both due responsibility for the exercise of its functions and for providing a vision for the City.
- 4.7 Accordingly, governance arrangements will seek to ensure that:
- the executive can make investment decisions based upon complete and accurate consideration of business cases and business plans;



- the executive can evaluate social and financial benefits and returns on investment; and
- the Council's overview and scrutiny committees are able to exercise their powers in relation to the executive's decision making

in a manner that ensures the companies can provide full and frank financial and business reporting against their business plans and be open to an appropriate level of scrutiny without fear of commercial confidentiality being breached.

### **III. Understanding of role**

#### **The Guidance:**

- 4.8 *“A trading company will be a separate legal entity from a local authority. It will derive its legal authority from its Memorandum of Association and the Companies Acts. Its directors and officers will derive their authority from the articles of association and the law relating to companies.*

...

*“Those “who are appointed directors will participate directly in the activities of the company, and are answerable to the company and have the powers and duties of company directors whilst they do so.*

...

*“Local authority members and officers should be aware of potential conflicts of interest when carrying out their roles for their authorities, or when acting as directors of trading companies.”*

#### **The Principles**

- 4.9 It is recognised that, as company ventures have a separate legal personality to the local authority, the success and good governance of the company venture depends upon those involved understanding their role and responsibilities collectively and individually.
- 4.10 Accordingly, governance arrangements will seek to ensure that there is sufficient induction, training and other materials in place so that:
- their legal duties;
  - stewardship of assets;
  - the provisions of the governing documents;
  - the external environment; and
  - the total structure of the organizations and the venture
- are appropriately understood by Members of the Council in their role as part of the executive or of overview and scrutiny, by officers of the Council associated with these duties and by the directors of the companies.



## **5. Ownership and control of the company**

- 5.1 NNN Council, the local authority as a corporate body, will be a member of the company. The membership will be as guarantor if a company limited by guarantee or, as will be the norm if a LATC, the holder of shares (perhaps the only share) in a company limited by shares.
- 5.2 The rights and duties as a member of the company will, however, almost always fall to be exercised as an executive responsibility. This means that decisions to be taken by the Council as a member of the company (as shareholder) fall to be decided on by the elected Mayor/Leader. In the normal way, therefore, these functions may be delegated by the Mayor/Leader to the cabinet or an officer and will be subject to key decision and access to information rules, call-in and review by overview and scrutiny committee.
- 5.3 For ease of use, where decisions are to be taken by the local authority as a member of a company, those decisions are referred to in this Code as being taken by 'the executive'.
- 5.4 The authority of the shareholder is exercised where decisions of the company are reserved for approval of the executive before they can be implemented, but also directly in the form of a shareholder's written resolution or at the company's general meetings.
- 5.5 At the company general meetings the executive will be present and voting as a member of the company, where this presence and voting will be in the form of a single person known as the 'shareholder representative'.
- 5.6 Decisions to be made by the executive, rather than left to the company itself, are known as 'reserved matters'. Reserved matters cover such things as the approval of the company's annual business plan or mid-year amendments to it, the appointment of directors, certain key financing decisions and so forth. These are established either through agreement with the company, known as a shareholders agreement, or as set out in the company's governing articles of association.
- 5.7 The relationship between the local authority (and the companies it is a member of) is governed by these and other key documents that are required to establish a local authority company, and a trading company in particular. In establishing the local authority's company and then in governing the relationship with what is now a separate legal personality, the executive will need to put in place the following documents:
- The **business case** which assesses the risk involved in the proposed trading enterprise and decides whether or not it should be established and proceed to trade; the 'comprehensive statement' referred to in 2009 Order. It starts the process of business planning.
  - The **articles of association**, or the memorandum and articles of association as it used to be called, which is the constitution of the company. This is the legal documents required to set up a limited company and give details of its

name, aims and authorised share capital, conduct of meetings, appointment of directors and registered office.

- The **shareholders agreement**, or management agreement, which sets out the rights of the Council as the sole or co-shareholder and how it can exercise those rights. It details the powers of the board of the company and how and when the shareholder might influence those powers. It is important to note that the shareholder agreement is capable of being developed and added to as the company develops.
- The **financial agreements** which are the commercial agreements that set out what assistance is to be provided and on what terms. This may be purely financial, such as a direct loan or a facility such as a parental guarantee, and made on commercial terms. It may also be in the form of goods, services or staff to be provided and set out in a resourcing agreement or a service level agreement, which is likely to be on a service charge or cost recovery basis. The agreements may require regular and detailed access to information and financial reporting to the Council and/or holding company.
- The **business plan** which sets out the objectives of the business, how they are to be achieved and standards met adjusted in the light of experience and changing circumstances. It is a comprehensive analysis of the business situation at a particular point in time. It is often referred to as the annual business plan because it is expected to be submitted for shareholder approval annually.

5.8 A model shareholder agreement for use with the holding company, setting out the principal decisions reserved for the executive's approval, including subsidiaries of the company as a group, is outlined at Appendix 2.

## **6. Shareholder Group or Board**

6.1 The structure described above creates a governance process whereby, so far as appropriate under this Code's Principles, the company is left to get on with its business. Following the UK Corporate Governance Code, the companies will utilise a unified board, with appropriate non-executive directors providing outside expert help and with board committees (such as an audit committee) to provide oversight and ensure delivery.

6.2 The Mayor/Leader, in turn, will seek to inform the executive decisions and to hold the company to account by utilising a reflection of the company board structure in the form of a Shareholder Group, including external expertise and sub-groups. The role of this group is to provide the necessary oversight from a shareholder's perspective that the parameters, policies and boundaries that the executive as the shareholder has established for the company are being adhered to. In it, the Mayor/Leader (or his or her appointee) remains the decision maker but the Group act as advisors in the making of those executive decisions.

6.3 Such a Shareholder Group is considered to be an effective means of

governance of the companies. This is because it allows for decision making and discussion in an informed atmosphere, which also provides the executive with:

- a mechanism to communicate the shareholders' views to the company; and
- a means to evaluate the effectiveness of the company board and the delivery of the company performance against strategic objectives.

6.4 It is intended that the Mayor/Leader (or his/her appointee) will make most decisions concerning the executive's role in respect of company interests at meetings of the Shareholder Group (in a similar manner to the Mayor/Leader's executive decisions made at various partnership boards and the health and well-being board). It is envisaged that key decisions concerning the companies will, however, still normally be made at meetings of the Cabinet.

6.5 The Terms of Reference for the Shareholder Group are set out at Appendix 1.

## **7. Scrutiny**

7.1 The overview and scrutiny committees have a significant role to play to ensure that the company is able, and the executive has properly required the company, to make sufficient returns for the investment to be worthwhile and, indeed, ensure that the social objects set for it are not lost in the drive towards the overriding and essential requirement for the company to be economically successful.

7.2 It is the executive, the Mayor/Leader and Cabinet, who is responsible for approving the business case to establish a company, of setting the right balance between the economic, social and environmental objects of a company when it is established and of subsequently exercising the Council's powers as shareholder.

7.3 Once established, the company must then get on with the business of delivering the objectives with which it has been tasked, within the parameters set for it. It must be otherwise free, however, to operate in its own best interests and to compete on an even basis with its competitors in the marketplace.

7.4 Again, it is the executive, either generally or when considering reserved matters, to whom the company must answer and by whom it is held to account for its success, or failure, in achieving the objectives set for it.

7.5 The key role of overview and scrutiny is then to advise the executive and hold it to account on behalf of the wider public interest and its role within the Council.

7.6 This creates a flow of information and accountability, in which

- the company needs to get on with the business of delivery;
- the executive needs to make the company decisions reserved to it and to hold the company to account for performing against them; and

- Members as part of overview and scrutiny need to advise on or scrutinise the decisions of the executive.

This needs to be done in a trading environment that requires them all to make speedy and reactive commercial decisions and to handle often highly valuable and commercially sensitive information.

- 7.7 Overview and Scrutiny, to fulfil its role, requires a means of access to the sensitive information and debate that inform the Shareholder Group and the Mayor/Leader's decision making, without either oppressing that process or endangering its own strictly non-executive role.
- 7.8 To this end it is considered that the Chair of Overview and Scrutiny Management Board (OSM) is best placed to be involved, use his/her knowledge of this committee and its remit to sift the information and be alert to those matters that need to be brought to the overview and scrutiny committees' attention and be investigated further. Accordingly, the Chair will be invited to the forum created to handle this crucial information flow, the Shareholder Group. To retain the independence required of the OSM Chair, this is not membership as direct advisor as part of the decision making, but as an informed observer.
- 7.9 Overview and Scrutiny committees may then review any matter concerning the Council's companies and make proper use of its full powers and function, having had these matters drawn to its attention by, and with the benefit of, a fully informed Chair.
- 7.10 In carrying out any such review, the Government Guidance states that:  
*"The local authority should ensure that its overview and scrutiny committees are able to exercise their powers in relation to the discharge of local authority functions under the relevant legislation.*
- 7.11 To this end, the legal framework for local authority companies includes an express requirement concerning the provision of information to Members of the Council, which reflects the similar provision in relation to local authorities generally. This states that a local authority regulated company "*shall provide to a Member of the Council such information about the affairs of the company as the member reasonably requires for the proper discharge of his duties.*"<sup>13</sup>
- 7.12 The exception here is that the company cannot be required to provide information in breach of any enactment, or of an obligation owed to any person.
- 7.13 It is also worth noting that, where a Member or an officer has become a member or director of a local authority company, the local authority must make arrangements for them to be open to questioning about the company's activities by Members of the Council at a meeting of the authority, or a committee or sub-committee, or by cabinet members in the course of proceedings of the cabinet or a committee of the cabinet. Importantly, the Member or officer is not required

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<sup>13</sup> Article 7, Local Authorities (Companies) Order 1995

to disclose confidential information about the company.

## **8. Investment and Finance**

- 8.1 The balance of how each company venture may be financed will be assessed and set out in the business case, required at the very beginning of the venture and the incorporation of the company as described above, and in business plans as made or amended and agreed by the executive. Each decision will take into account state aid implications and such matters as where legislative and regulatory requirements demand full cost recovery or standard commercial terms to be applied.
- 8.2 Where the purpose of a company is to better utilise assets owned by the Council, for example, the principal investment in the company is likely to be those assets. The assets may then be made use of by the company through their being transferred in their entirety from the Council to the company or by being provided to the company by the Council under a lease, loan or use agreement.
- 8.3 Investment at the initial stage of a trading company will normally be by way of purchase of share capital, either directly in the company or, more likely, via NNN Holding Limited, often together with a loan or loan facility on commercial terms. This is to fund those costs which arise at the start of the company or company joint venture, including the holding company and its subsidiaries, to cover initial set up costs, working capital costs and collateral costs. For purchased company interests, share value should reflect the fair value of the going concern.
- 8.4 Direct investment may well also be by various other forms of agreement. This may be for the supply of monies, directly as a loan or under a parental guarantee, credit agreement, facility and so forth, which should be on standard commercial terms. It may also be for the supply of goods, property or staff, as described above and at section 12 below.

## **9. Companies Structure**

- 9.1 The principal means by which the local authority will normally own and hold interests in its trading and other forms of company will be through a single company (the Company), acting as a holding company. Wherever practically feasible and advantageous to the authority, each of the individual company ventures will then be a subsidiary of the single company and they will operate together as part of the a group of companies.
- 9.2 The primary objective of a group structure is that the Company, as a holding company, is able to provide a single point of focus for leadership of the authority's commercial activity, communication with the authority, utilisation of shared resources and as a forum for strategic decision-making across the group. Its board of directors will set the overall strategy in relation to the

activities of its subsidiaries.

- 9.3 In doing so, the board of the Company will also sign off all business plans and hold its subsidiaries to account. The executive, supported by the Shareholder Group, will approve any decisions that would have an effect on the shareholder's rights and hold the group of companies to account as a whole.
- 9.4 The subsidiary companies will, therefore, be expected to adopt a common 'group' approach, with the managing director and the Company's board holding a clear leadership role on behalf of the authority. This will, for example, involve the group of companies:
- (a) using existing Council policies and strategies where appropriate and the company and its subsidiaries, wherever practicable;
  - (b) adopting a common approach across the group on branding and its finance, ethics and procurement policies and practices;
  - (c) being required by the authority to have the holding company approve the procurement and authorisation of spend levels set by each company for its directors and staff; and
  - (d) also having more detailed matters to be set as a common approach by the company for itself and its subsidiaries by the holding company, where it considers that that will increase effectiveness, efficiency and engender common understanding, which is likely to include such things as group financial procedure rules, fraud and whistle-blowing policies, decision making levels and procedures, capability and disciplinary procedures, health and safety practices and so forth.
- 9.5 The Company will similarly provide a natural home and conduit for support and control roles that will be common across the group, such as company secretarial services, procurement, finance and human resources. These fall into two groups. The first is those services that would be better employed directly by the holding company, such as financial and payroll systems for example. The other are those provided as managed services to the companies by the Council, under a resourcing agreement (or service level agreement), because this is more cost effective, appropriate or is a demand of the shareholder, such as HR or company secretarial and legal services. (This is described further at section 12 below).
- 9.6 The secondary purpose is financial, in that group companies can share VAT registration where appropriate and can be treated as holding group accounts. The latter means that reporting is as one set of accounts and that profit and loss can be distributed across the group, setting one off against another, as might be desired to meet the aims and values set for the group.
- 9.7 The executive will approve the appointment of auditors for the group and its accounts will appear as part of the Council's financial statements.

## **10. The Company's Board**

- 10.1 The Government Guidance advised that a local authority company will be run



by its board of directors answerable to the shareholders, in accordance with the articles of association, and goes on to suggest that a board of between 3 and 8 directors is most likely to be practical (although this will be dependent on the circumstances of each company). The participating Local Authority should be represented on the board of its company.

10.2 The representatives who are appointed directors by the executive will participate directly in the activities of the company and are answerable to the company and have the powers and duties of company directors whilst they do so. Accordingly, the Government Guidance goes on to suggest that this requirement in a trading company and the accompanying conflict of interests that may arise means that officers are better placed to fulfil this role.

10.3 Whilst it will therefore be the norm that officers, not members, will be appointed as directors, this should not prevent the Council from appointing Members as directors where that is considered to be in the best interests of the company and the Council. If Members of the Council are appointed as directors of a company, the following paragraphs should be borne in mind and, in particular, that the member notes that:

- Conflicts of interest may be waived by a company but, as a matter of public law, never in the decision making of the Council: the Council Member / company director will always have a conflict of interest when it comes to their role as a councillor that must be resolved and resolved in the favour of the company. A Member as director, therefore, must not be a party to making a decision of the Council affecting the company, but may proffer evidence or advice to the Council on the company's behalf when invited to do so.
- Liaison should be through the key Member and/or officer concerning the company and the Council's activities
- The Member's Code of Conduct applies to a Member's activity as a director, except only where it directly conflicts with the interests of the company and, where that may be the case, the potential conflict notified to the company secretary and to the Council's monitoring officer.
- The only monies or other remuneration to be received by the Member in connection with the directorship will be as a special responsibility allowance (SRA) given by the Council to the amount of the corresponding SRA in the Members' Allowances Scheme.

10.4 As the holding company for the group, the Company board of directors will be formed of:

- Executive directors, being:
  - the managing director;
  - with the option of the managing directors of the authority's principal trading companies where appropriate
- Non-executive directors, being:
  - a chief officer of the Council (Chair of the Board);



- independent person(s) appointed to bring oversight, experience and skills that would be advantageous and appropriate for the companies;
  - other senior officers of the Council as appropriate; and
  - Members of the Council if considered advantageous and appropriate.
- 10.5 The chair of the board of directors, as Council appointee, will have a deciding say to be exercised through means of a 'golden vote' procedure on the board. This approach is to ensure that the Council's officers will always be able to out-vote the directly appointed directors on the holding company. Such matters as the quorum requirement for board meetings of the company and the like will be expected to reflect that objective.
- 10.6 The Company will have two standing committees, which will be as follows:
- The Remuneration Committee, which will conduct appointments and remuneration decisions and recommendations to the Council (where an appointment is not wholly reserved to the Council).
  - The Audit Committee, which will fulfil the same role and function as the Council's Audit Committee, the outputs of which will feed into the holding company board, the company business plans and the Council's own statement of accounts and Annual Governance Statement.
- 10.7 In respect of the individual wholly owned trading companies, non-trading (Teckal) companies and joint ventures, the appointment of directors of the company will be as are considered best to meet the requirements of the subsidiary or venture concerned.
- 10.8 Where an officer or Member is placed on a company board, he or she will be provided with an indemnity for their actions in that role. This is provided for under the Local Authorities (Indemnities for Members and Officers) Order 2004. It should be noted, however, that any such indemnity only covers actions taken honestly and in good faith.
- 10.9 Appointments of an officer as a company director will be of the relevant post or office of the Council, not as an individual. This will be reflected within each of the companies' articles in that if any one of the Council appointed directors ceases to be an employee, office holder or Member of the Council, as applicable, then they automatically also cease to be a director of the company.
- 10.10 The remuneration of officers of the Council appointed directors to a company controlled or influenced by the Council, other than permitted expenses, will be met by the Council and not the company. This is because, whilst that director's overriding duty is to the company, that person's role as director on the company board is only because of, and in fulfilment of, their employment as an officer of the Council, for which they are remunerated by the Council under that contract of employment. The position on the company is an inherent part of their job, for which payment is not to be made twice, directly or by different persons, for the same work.

- 10.11 That is not to say that the Council would fail to recognise that the position of an officer appointed as a company director or company officer will include distinct and potentially onerous additional responsibilities. Rather, it is that it is the Council that needs to recognise the value of those responsibilities, through a job evaluation process or other means by which the Council sets salaries, in considering any review of an officer's remuneration. To do otherwise risks a future action against the officer or the Council and, if a payment were made to a Council officer by the company that was considered to be a fee or reward accepted under the colour of his or her office or employment other than his proper remuneration, that officer may also have committed a criminal offence<sup>14</sup>.
- 10.12 The law requires that, where a Member of the Council is a director of a regulated company, the Member may only receive payment for that directorship up to the amount payable for that role under the authority's Special Responsibility Allowance (SRA)<sup>15</sup>, set as a result of the recommendation of the Independent Remuneration Panel<sup>16</sup>. These payments may be made by the company directly or, more normally and as would be the case here, by the Council for reasons of simplicity, accounting and accountability.
- 10.13 The view behind this is that the regulated company is, in fact, simply a part of the Council. In the same way that there is a bar on Members of the Council being employees, the philosophy runs akin to that for officers in that the Council may not pay a councillor for any other activities they may carry out as a Member of the Council other than through their SRA.

## **11. Conflicts of interest**

- 11.1 The Government Guidance states that "*Local authority members and officers should be aware of potential conflicts of interest when carrying out their roles for their authorities, or when acting as directors of trading companies.*"
- 11.2 There will always arise a point where, in matters of reporting, contractual discussion, investment requests or resourcing agreements, there is potential for the same person to be a decision maker or advisor both for the Council and the company.
- 11.3 This is a reflection of the position of each company as a separate legal entity and that the directors of each company are subject to. As the Corporate Governance Guidance and Principles puts it:

*'An important principle of Company Law is that directors have a duty to promote the success of the company as a whole. They are specifically prohibited from directing the activities of the company in favour of themselves or particular shareholders and/ or stakeholders'.*

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<sup>14</sup> s117(2) of the Local Government Act 1972

<sup>15</sup> Article 5 of the Local Authorities (Companies) Order 1995

<sup>16</sup> Reg 21 of the Local Authorities (Members' Allowances) (England) Regulations 2003.

- 11.4 Appendix 3 sets out a briefing for directors' duties.
- 11.5 An essential element of this in terms of this Code is that, whilst changes to the Companies Act and current articles of association allow for appropriate provisions dealing with conflicts of interest and the ability of company directors to authorise them, an officer of the Council or a Member can never waive their duty to act in the public interest in exercising their responsibility for functions of the Authority. This will, on occasion therefore, create an inescapable conflict of interest between someone's role as a Member or, more likely, as an officer of the Council and as a director of a company, of which those involved need to be aware.
- 11.6 There are also natural points where it is expected that the Council and one of its trading companies will take a different approach. In this respect, the Government Guidance states that:
- “The local authority should consider appointing a ‘contract officer’ and/or ‘contract member’ with primary responsibility for liaison between the company and the authority, and for access to information about it. It might wish to place limitations on these individuals to ensure that they are fully accountable to the authority as a whole and to ensure that the Section 151 Officer/Monitoring Officer countersigns major decisions about the company’s operations.”*
- 11.7 This is the role of the Shareholder Group. In support of that function, the Council will appoint a lead authority and client-side officer to lead on managing contractual arrangements with the companies and in holding of the companies to account.
- 11.8 A certain form of wholly owned local authority also exist to provide services directly to or for the Council (known as a ‘Teckal’ company). The relationship between the authority and the company are set out in a contract for services. In this scenario, clear separation is required between commissioner and provider and there will be a requirement for further support to be provided, beyond the position of lead authority and client officer.
- 11.9 Officers placed into any of these roles are, at some point, likely to find themselves in a position where they are, or are negatively seen to be, acting against the interest of their own authority and also challenging the Council as their employers or senior managers to whom they might normally answer to. As a result of such activities, their performance in the company or actions they feel are required of them by the company, some of those officers may even find themselves in a position where it is no longer felt tenable that they can be appointed by the authority as a director of a company. The Council as an employer, from the viewpoint of both the executive and overview and scrutiny, wholly recognises these unusual positions that such officers may find themselves. The Council therefore undertakes that no officer will suffer any ill affect to his or her employment or career with the authority for fulfilling these activities to the best of their ability or in undertaking these actions asked of them.

## **12. Managed Services, Support Arrangements and Employees**

- 12.1 The authority is required under the 2009 regulations to recover the costs of any accommodation, goods, services, staff or any other thing it supplies to a company in pursuance of any agreement, or arrangement in place. It cannot subsidise the operation of the company in this way.
- 12.2 The Government Guidance in addition clarifies that
- “Because the power to trade is subject to a restriction requiring it to be exercised through a company, it follows that the authority has the requisite power to enter into arrangements with a company in order for the trading power ... to be exercised. It is not necessary therefore, for the company to be expressly designated as a public body under the Local Authorities (Goods and Services) Act 1970, in order for the authority to be able to provide it with staff, goods etc, for the purpose of exercising the power to trade.”*
- 12.3 This means that the authority may enter into an agreement with the companies to provide services at cost or as a surplus service charge and that staff time and resources utilized for company purposes should be carefully accounted for. Where this is done at cost, which shall be the norm, it is helpfully stated in the Guidance that the approach should be in accordance with the CIPFA definition of ‘whole cost’.
- 12.4 Referred to above as the ‘managed services’, those areas of the authority’s resources so utilized might include project management, initial set-up staff, human resources, audit, business continuity, communications, procurement, legal or finance and so on. Equally, it may be that the main source of staffing for the company’s trading activities comes from Council staff seconded for that purpose, be that whole time or on a client by client, job by job basis. It is for the company and the executive to agree what level of authority led resource is appropriate, should or could be delivered to the company in each case. The parameters of those services can be agreed through a Resourcing Agreement or what is known as a Service Level Agreement (SLA).
- 12.5 The authority as shareholder, however, does need to be assured that there are effective and robust support services in place in certain areas. This is to satisfy itself that sufficient standards of operational governance, legal and company secretarial compliance and effective financial management within the company are adhered to. The authority will reserve to itself the ability under the Shareholder Agreement to insist on supplying these services to a controlled company, at cost, if it feels that these standards are not otherwise being met or are not in its opinion likely to be met.
- 12.6 In particular, the Company Secretary role should have a consistent approach across all of the companies or group of companies. This is to ensure consistent interpretation of the compliance standards across the companies and of the governance relationship between the companies and between the companies

and the Council. In addition, it ensures that appropriate and proper intelligence is shared across the companies and the authority. In relation to all authority controlled companies and their subsidiaries, therefore, the position of company secretary as an officer (not a director) of each company in the group is to be fulfilled by the Council's Monitoring Officer, being the equivalent corporate governance, assurance and general counsel position for the Council. All company secretarial and general counsel duties for the companies will then be carried out through that office, either directly or through the position of an assistant company secretary, with the exception of where a conflict of interest is identified and is acknowledged by that officer.

- 12.7 With the exception of those staff supplied by or seconded from the authority for trading purposes or for managed services as described above, it is expected that staff of the companies will be directly recruited and employed by the companies themselves. Where the business case includes that staff are transferred this will be subject to full reporting and then consultation and requirements under TUPE legislation and guidance.

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*Adopted in accordance with the Cabinet decision of DDD*

*[To be] Presented to the NNN Council Audit Committee of DDD.*

**NNN COUNCIL**  
**SHAREHOLDER GROUP - TERMS OF REFERENCE**

**Overview**

The purpose of the Shareholder Group is to advise the Mayor/Leader in the exercise of his/her responsibility for the Council's functions as corporate shareholder of a company or group of companies and in their role to represent the interests of the Council as Shareholder Representative at meetings of a company.

**Decision making**

The Mayor/Leader (or other Cabinet member appointed by the Mayor/Leader for this purpose) may make decisions concerning companies in which the Council is or is proposed to become a shareholder, either:

- (a) in Cabinet; or
- (b) in the presence of the Shareholder Group.

**Membership and Arrangements**

The Shareholder Group shall consist of the Mayor/Leader (or other Cabinet member appointed by the Mayor/Leader for this purpose) in the presence of:

- (a) Such Members of the Cabinet as are appointed by the Mayor/Leader (which shall be at least two);
- (b) Two co-opted members, who will be independent persons providing relevant expertise and appointed on merit (but which process may be carried out in association with the Audit Committee's arrangements for co-opted appointments); and
- (c) Relevant senior officers of the Council as are appointed by the head of paid service (or their deputies); together with
- (d) The Chair of Overview and Scrutiny Management Board, as a Member of the Council from outside of the Cabinet, to act in the capacity of Observer.

The Service Director for Finance (s151 officer) and the Service Director for Legal and Democratic Services (monitoring officer), or their deputies, will be advisors to the Group to provide open and strong advice.

Other members of the Cabinet (who are not directors of any of the companies concerned) may attend and vote as substitutes in the event that an appointed member of the Shareholder Group is unable to attend

## **Restrictions on Membership**

As the Shareholder Group is to advise and discharge executive functions in relation to company matters and the role of the Shareholder Representative, only Cabinet members can be members of the Shareholder Group with voting rights, although other Cabinet members and non-Cabinet members can be invited to attend, without voting rights.

## **Meetings**

The Shareholder Group shall meet on a basis agreed by itself and normally in private.

The quorum shall be the Mayor/Leader (or other Cabinet member appointed by the Mayor/Leader for this purpose) in the presence of a minimum of:

- (a) one other Cabinet Member;
- (b) one independent co-optee; and
- (c) one senior officer appointed to the Group (or their appointed deputy).

An invitation to attend must have been provided to the Chair of Overview and Scrutiny Management Board/Committee (or their nominated deputy) at least three clear days in advance of the meeting taking place. This notice period may be waived if the Chair of Overview and Scrutiny Management Board/Committee (or their nominated deputy) so agrees.

An invitation to attend must also have been provided to the section 151 officer and the monitoring officer (or their nominated deputies), which will normally be at least three clear days in advance of the meeting taking place.

The Mayor/Leader (or appointee) will chair the Shareholder Group and a Vice Chair will be selected from the elected members of the Shareholder Group.

## **Sub Groups**

To assist it in its functions the Shareholder Group:

1. may establish and consult standing sub-groups, such as might be required in respect of:
  - (a) Audit and Risk;
  - (b) Ethical practices; or
  - (c) Nominations and Remuneration
2. may establish and consult ad-hoc or task and finish sub-groups in respect of any matter; and
3. may establish and consult stakeholder groups on any particular aspect or the generality of the objects of the trading companies



A sub-group or stakeholder group may contain such co-opted members, advisors or observers as the Shareholder Group sees fit.

## Functions

1. Monitor the performance of a company in relation to its Business Plan and, in particular, the company's performance:
  - (a) in financial matters
  - (b) against the social goals of the company as set out in the company's Objects, Business Case or Business Plan; and
  - (c) against the values of the Council.
2. Evaluate and monitor:
  - (a) the financial and social returns on investment (be that shareholding, loans or direct investment); and
  - (b) risks and opportunities  
including those arising from joint ventures or new opportunities.
3. Consider matters reserved to the Council for shareholder approval, such as:
  - (a) Varying Articles of Association
  - (b) Varying ownership and structure
  - (c) Variations to shares (number of, rights, etc.
  - (d) Entering contracts that:
    - (i) have a material effect on NNN Council business (including other companies within the group)
    - (ii) are outside of the business plan or do not relate to the business
    - (iii) significant in relation to the size of the business, the business plan, etc.
  - (e) Material legal proceedings outside of ordinary business
  - (f) Adopting and amending business plans each year and strategic plans (3 years)
  - (g) Appointment, removal and the remuneration of directors (members of the company board)
  - (h) Selection of the chair of the board
  - (i) Appointment of auditors
  - (j) Issue of dividendsas more particularly set out in a company's Articles of Association or Shareholder Agreement.

## Relationship

The Shareholder Group as it considers appropriate in accordance with its functions described above, may:

1. report and make formal recommendations to the Mayor/Leader, directly or to

- the wider Cabinet;
2. make reports to and consult Overview and Scrutiny (including full Council) or
  3. make reports to and consult the Audit Committee, in relation to that Committee's particular functions.

OUTLINE OF THE  
**SHAREHOLDER AND COMPANY AGREEMENT**

1. DEFINITIONS AND INTERPRETATION
2. FINANCING THE COMPANY
3. DIVIDEND POLICY
4. SUBSIDIARIES
5. MANAGEMENT OF THE COMPANY
6. SHAREHOLDER GROUP
7. THE BUSINESS PLAN AND COMPLIANCE WITH THE BUSINESS PLAN
8. REPORTING AND ACCOUNTING MATTERS
9. BANKING ARRANGEMENTS
10. TERMINATION
11. UNLAWFUL FETTER ON THE COMPANY'S POWERS
12. ASSIGNMENT AND SUB-CONTRACTING
13. FURTHER ASSURANCE
14. REMEDIES AND WAIVERS
15. ENTIRE AGREEMENT
16. VARIATION
17. CONFLICT WITH THE ARTICLES
18. SEVERANCE
19. CONFIDENTIALITY
20. NOTICES
21. NO PARTNERSHIP OR AGENCY
21. COUNTERPARTS
22. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999
23. GOVERNING LAW AND JURISDICTION

Guidance Note to NNN Council Members and Officers when acting as  
Directors of Council Companies