

NAME OF COMMITTEE	Council
DATE	24th June 2014
REPORT TITLE	Creating a Local Authority Trading Company
Report of	Head of Environmental Health & Housing
WARDS AFFECTED	All

Summary of report:

The purpose of this report is to request Council to approve the formation of a Local Authority Trading Company with the sole shareholders being West Devon Borough Council and South Hams District Council. The Company will be a Company Limited by Shares. The trading company will provide opportunities for the Councils to generate new income streams over and above current and proposed income generated through reviewing core service delivery, as well as capital and revenue from changing the way we use land and buildings. The company will be 100% owned by the two authorities and will have no private shareholders. All profits generated by the company will be reinvested back to the Councils based on relative trading activities.

Financial implications:

The direct financial costs associated with this report relate to the cost of registering a trading company and will be in the region of £100 plus officer time in preparing the necessary documentation and governance arrangements. It is not possible at the present time to ascertain the likely income relating to the establishment of this trading company. This will depend on the success of subsequent trading activities.

RECOMMENDATIONS:

It is recommended that Council agrees to:

- (i) create a wholly-owned Local Authority Trading Company with West Devon Borough Council and South Hams District Council having an equal shareholding, with profits being redistributed between the Councils based on relative trading activities;
- (ii) authorise the Head of Paid Service in consultation with the Leader and Deputy Leader of the two Councils to decide on the final company name and the date and details of incorporation of the trading company;
- (iii) authorise the Head of Paid Service in consultation with the Leader and Deputy Leader of the two Councils to determine the number and appointment of Directors to the trading company; and,

- (iv) pursue those priority areas identified by the Income Generation Working Group for income generation as outlined in Appendix 1 of this report and for officers to work up more detailed business cases where appropriate.

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1. BACKGROUND

- 1.1 The financial landscape for local authorities has changed significantly in recent years with continuing reductions to many of the Council's funding sources. The Council has responded over the years with a range of initiatives, particularly the shared services arrangements, and more recently with the implementation of the T18 programme. It is recognised that the times of austerity have not yet passed. Many local authorities are now looking to significantly increase the current range of income sources as a way of assisting service delivery. This approach is reflected in 'Our Purpose' document which clearly sets out that in order to achieve a secure financial future for the Council, we have to not only reduce our costs, but also secure additional income streams.
- 1.2 There are numerous legislative powers available for local authorities to 'trade'. Until relatively recently, the powers were generally restrictive in nature, only allowing local authorities to trade in certain functions. With the introduction of the Localism Act 2011, however, freedom was given to local authorities to trade in any business area they wished. Where that trading is to be undertaken for a 'commercial purpose' however, then that trading can only be done through a company type that is detailed in the Companies Act. Other types of trading, such as between public bodies, can be achieved without the need to go through a trading company.
- 1.3 Over the past few months the Council has explored ways to generate new income for both Councils. The Income Generation Task and Finish Group in South Hams and the Income Generation Working Group in West Devon has met on a number of occasions to look at ways of generating additional income for the Councils. It should be recognised that the Council already generates significant income from a number of sources and this will continue in the same manner in the future. In order to pursue some additional potential income opportunities, however, it would be necessary to create a 'trading company'. The Council on the 19 February 2014 approved an 'in principle' decision to create a Local Authority Trading Company. This report seeks Council approval to establish such a wholly-owned company with West Devon Borough Council and South Hams District Council as the sole shareholders.
- 1.4 It is important for the Council to progress with the trading element of its income generation work in order to:
 - Maintain front line services over the long term through reinvestment of any trading profits;

- Develop commercial acumen in tandem with transformation programme efficiencies. It will enable staff to develop new skills and abilities and enable them to apply a more commercial approach to their areas of work;
- Ensure a culture of self-reliance is promoted which sends a positive message around the potential for growth of Council services;
- Ensure that the Council is best placed to identify and pursue potential market opportunities by being able to bid for and secure contracts.

1.5 A number of local authorities are now actively pursuing income generation as a way of protecting front-line services and there are a number of notable success stories.

2. GOVERNANCE ARRANGEMENTS

2.1 It is proposed that the Trading Company will be a 'Company Limited by shares' and as such meets the requirements of the Localism Act 2011. The share issue will be two £1 ordinary shares with an equal shareholding between the two Councils. The Company will have its own legal identity and also have the benefit of limited liability. Consequently the debts of the Company stay within the company and any creditors would not have recourse to the Council or any of the Company Directors except in exceptional circumstances.

2.2 The Company will have a Board of Directors appointed. It is proposed that delegated authority is given to the Head of Paid Service in consultation with the Leader and Deputy Leader of both Councils to determine the most suitable number and type of Directors in due course. The Directors will not receive any remuneration.

2.3 The Directors of the company will have responsibility for managing the affairs of the company and ensuring a profitable trading environment. They would be responsible for the day to day management and for making recommendations to the shareholders as to the direction of company travel. They will be bound by the Shareholder's Agreement limiting their freedom to undertake certain actions.

2.4 All Directors will need to comply with their statutory duties under the Companies Act 2006 including a duty to act in the best interests of the Company and to avoid conflicts of interest. Council members and/or employees appointed as Directors will need to be aware that potential conflicts of interest may arise when carrying out their roles for the Councils and when acting as Directors for the Company. Member Directors will still also be bound by the Members' Code of Conduct, in so far as this Code does not conflict with their legal obligations as Directors. An outline of these duties, responsibilities and liabilities will be provided to the Directors as part of their letters of appointment.

2.5 As sole shareholders of the company, the Councils will have overall control of the company. It is often necessary in business to make rapid business decisions. Where those business decisions fall outside of the powers available to the Directors of the company, then those decisions will need to be referred to the appropriate decision-making body of the Council in an expedited fashion.

- 2.6 A scheme of delegations will be developed to clarify decisions that can be taken by staff and Directors.
- 2.7 The Company shall be bound by a Shareholder Agreement. This agreement will ensure that the Company cannot do certain things without the approval of the relevant Member body. It details the powers of the Board of the company and how and when the shareholders might influence the company. It will relate to issues such as production of business plans, regular reports to Council, consents for acquisition and disposal of assets, loans and distribution of profits. The shareholders agreement can be amended and developed as necessary to ensure that a proper balance of powers between the company and the Councils remain as the company grows.
- 2.8 Service Level Agreements will be completed with the Council regarding use of Council staff and resources.
- 2.9 It is proposed that the Company will initially use Council accommodation and resources in its operations and will reimburse the Council for doing so. The proposals should not have any direct implications for staff as it is not proposed that any staff will transfer to the Company. Staff may at times be working on Company business, but that time and resource will be charged to the company. In the longer term, the company may employ its own staff subject to the demands and prospects of its trading functions.
- 2.10 In order to protect commercial confidentiality, it is recommended that the final company name and trading styles are determined by the Head of Paid Service in consultation with the Leader and Deputy Leader of the Council. The Company will be purchased 'off the shelf' in order to facilitate the administrative process. The Company will have to abide by UK Company and taxation legislation including the filing of annual returns and accounts. The general administrative demands of the company can be met within existing expertise within the Councils.

3. TRADING AREAS

- 3.1 Members at both authorities have through their respective Income Generation Groups identified a number of areas where they wish to see an initial push on income generation. These areas are detailed in Appendix 1. It should be noted that not all of these initiatives may need to be undertaken through a trading company. In some instances it will be advantageous to use the company for trading, in other instances it may not. The exact route of trading will be taken on a case-by-case basis. The trading company will supplement the organisational design principles within the T18 model in that it will allow the Council to directly commission through the company if the business case determines that it is the most appropriate delivery arm. Having the trading company established, will enable the Councils to explore and rapidly exploit any opportunities that may arise.
- 3.2 No detailed business plans have yet been worked up in respect of those initial trading activities highlighted in the Appendix although these will be worked up in

the coming months. Once those Business Plans have been produced, then trading in those areas can only take place with the agreement of both Councils. If no agreement can be reached on the implementation of a Business Plan, then an individual Council will not be able to pursue that trading opportunity in isolation. This will avoid the situation where demand on officers from one authority to undertake trading could adversely impact on the operational activities of the other.

- 3.3 Other potential trading areas may well come to light in future months. Where opportunities arise, then subject to a suitable business case being in place and both Councils being in agreement, the Council will be in a position to exploit potential opportunities and new trading areas where they arise. It is not proposed at this stage that any Council Services be transferred to the company. It will be essential that any business proposed to be undertaken through the trading company has clarity about the cost of generating the income expected, so that the focus is on profit, including taxation, VAT and procurement costs which will be incurred.
- 3.4 It may be necessary to redistribute profits between the Councils based on relative trading activities. Protocols will be established to allow this to happen in a fair, consistent and transparent fashion.
- 3.5 It is likely that trading will be modest at the outset, especially in the first year of trading. Experience from other local authority trading companies reflects the need to allow the company time to expand and establish its presence in the market. There will be sufficient trading within the first trading year to cover any company administration and operating costs. As business plans are developed and business opportunities and trading expands and develops, it may be necessary to establish separate and/or subsidiary trading companies. Again the decision to take such a course of action will be supported by an appropriate Business Case.
- 3.6 Subject to approval by both Councils, the Trading Company will be established at a date agreed by the Head of Paid Service in consultation with the Leaders and Deputy Leaders at both Councils, in accordance with the administrative and governance arrangements as set out in this report.

4. LEGAL IMPLICATIONS

- 4.1 In order to 'trade for a commercial purpose' the Council must establish a trading vehicle such as a limited company. Operating a trading arm through a company vehicle such as a Limited Company will require that the Directors of the company operate in accordance with UK Company law. Although the company has limited liability, the Directors of that company may individually face claims for wrongful operation of the company. It is therefore recommended that the Council indemnify the Directors through appropriate Directors Liability Insurance both whilst acting as a director and for a period of six years following cessation as a company director.

- 4.2 Whilst some elements of commercial trading would require greater input from officers than others, this will be considered in detail as part of each individual business case. This will include the potential impact on day-to-day service provision and also impact on other previously agreed corporate priorities such as T18.

5. FINANCIAL IMPLICATIONS

- 5.1 This report looks to improve the financial position of the council for future budget years. Income generation will be dependent on specific decisions made on individual service and trading elements. It is not possible to determine the likely income and profits that will be generated, and will be dependent on the business cases that are agreed.
- 5.2 To ensure a level playing field with the rest of the private sector and to avoid breaching state aid rules, the Company will not be subsidised by this authority. The full costs of any borrowing, accommodation and services provided will be recovered by the Council. Suitable administrative and governance arrangements will be established to ensure this is the case.
- 5.3 The cost of creating a registered trading company in the first instance is approximately £100 and can be met from existing revenue funds. The ongoing costs will be dependent upon the amount of resources called upon to generate that income.
- 5.4 Officers have had informal preliminary discussions with the Councils external auditors about the principle of setting up a trading company. Grant Thornton were supportive in principle with the proposed approach and welcomed the innovation that the two Councils continue to promote to respond to the financial challenges. However the auditors also emphasised the importance of ensuring that the detailed arrangements are carefully considered to ensure that they are tax efficient. Prior to finalising the incorporation of the trading company there will be further discussion with Grant Thornton to ensure that the detailed arrangements are in the two Councils best interests in terms of both allowing us to exploit early income generation streams which cannot be developed without utilising a trading company, as well as enabling the Councils to maximise longer term opportunities potentially emerging from the T18 Programme.

6. RISK MANAGEMENT

- 6.1 The Risk Management implications are shown at the end of this report in the Strategic Risks Template.

7. CONCLUSION

- 7.1 It is recommended that the two Councils approve the creation of a wholly owned trading company as a further step to changing the culture of the organisations. The detailed arrangements of the company will be determined by the Head of Paid Service in consultation with the Leaders and Deputy Leaders of the two Councils. Any trading proposed to take place through the company will require an approved business plan. This initiative will not adversely affect income generation which can more appropriately take place through core service

activity, or through effective use of assets. Setting up the trading company however adds to the options available to improve the financial position. Establishing and subsequently modifying the trading company arrangement is relatively simple and it therefore enables us to learn from some initial low key, low risk opportunities, amending the approach based on the learning and development which will arise.

8. RISK MANAGEMENT

Corporate priorities engaged:	Community well-being; Access to services; Customer first
Statutory powers:	<i>Localism Act 2011</i>
Considerations of equality and human rights:	There are no equality or human rights issues associated with this report. Any specific issues that arise from future company trading will need to be dealt with on a case-by-case basis. This will include the need to consult on any significant policy changes.
Biodiversity considerations:	N/a
Sustainability considerations:	N/a
Crime and disorder implications:	None
Background papers:	None
Appendices attached:	Appendix 1: Income Generation Ideas arising from South Hams Task and Finish Groups and West Devon Income Generation Working Group