

SUSTAINABLE GROWTH AND ENVIRONMENT CAPITAL SCRUTINY COMMITTEE	APPENDIX 1 Agenda Item No.
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Report of the Executive Director Resources BLUE SKY PETERBOROUGH	

Wholly owned Council Company

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1. **PURPOSE**

- 1.1 Members requested that the report to the Committee contains information on:
- the extent of the control or influence which the Committee can exercise over a wholly owned Council Company; and
 - the sanctions and controls which the Council has available to it.
- 1.2 To that it is worth adding, and beginning with, information on:
- why a Council would set up a company at all; and
 - how is a local authority company different from other kinds of company
- 1.3 That information was considered best presented in the form of the following Briefing Note.

2. **WHY WOULD THE COUNCIL ESTABLISH A LOCAL AUTHORITY COMPANY?**

- 2.1 Local authorities may wish or are required to form or become a member of a company for a variety of reasons. There is, however, a predominant reason for establishing a wholly owned company and that is to trade commercially with a view to making a profit.
- 2.2 Local authorities are established and governed by statute, and can only act where they have a relevant statutory power. Those powers must be exercised reasonably and in accordance with the purpose of the legislation to avoid the actions being declared unlawful, and therefore void, on the grounds that an action is “ultra vires”. This includes the exercise of the general power of competence.
- 2.3 A local authority has a limited number of statutory powers which permit a local authority to act in a way that produces a surplus or profit over costs. Beyond

those specific statutory provisions, a local authorities' powers to trade are primarily set out in the Local Authorities (Goods and Services) Act 1970 (LA(GS)A 1970) and the Local Government Act 2003 (LGA 2003) augmented by section 4 of the Localism Act 2011 in respect of the general power of competence.

- 2.4 The LA(GS)A 1970 deals with local authorities trading with other public bodies only, which is not dealt with here.
- 2.5 The latter deals with local authorities trading more widely, provided that there is no statutory duty to provide the services and no other statutory power to trade, and includes trading with individuals and the private sector. The key to the Council wishing to exercise these general powers to undertake a commercial activity or to make a profit for the authority is that, where
- “a local authority does things for a commercial purpose, the authority must do them through a company”¹***
- 2.6 The reasons for this are fairly straightforward. On the one hand, it is about protecting the public purse and other services by not exposing the Council to a high risk from a possibly bankrupt venture. On the other, it is about providing for a healthy and competitive marketplace and preventing a local authority from using its public sector base to act in an anti-competitive manner. This includes ensuring that the commercial venture of the authority is subject to normal liabilities for corporation tax, VAT, regulatory costs and so forth.
- 2.7 This was subject to a Parliamentary comment at the time, which stated 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.”*
- 2.8 The principal power to trade, and the one relied upon by the Council to date, is under the Local Government Act 2003 and an Order made under that Act. This power is synonymous with the provision in the Localism Act stated above and creates a framework within which local authorities can operate their trading activities with the public and other commercial businesses. That framework requires the Council, amongst other things, to
- operate through a local authority company;
 - have regard to the guidance issued by the secretary of state in exercising the power; and
 - prepare and approve a business case before exercising the power.
- 2.9 The business case to be approved by the Authority is defined as a comprehensive statement as to:
- the objectives of the business;
 - the investment and other resources required to achieve those objectives;

¹ Section 4, Localism Act 2011

- 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.

- 2.10 It is good practice to refresh this business case, in the form of a business plan considered each year, to guide the company in carrying out its continuing activities.
- 2.11 An authority can provide goods, services and staff to the trading company. The authority is required to recover from the company any costs incurred in making such provision.

3. A LOCAL AUTHORITY COMPANY

- 3.1 Local authority interests in companies are governed by Part 5 of the Local Government and Housing Act 1989.
- 3.2 At the time of its introduction, the Government stated that the purpose of this piece of legislation was 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."***
- 3.3 This remains the case and the Council's companies are subject to the controls in this Act and the regulations made under it, currently the Local Authorities (Companies) Order 1995. This means that a 'regulated company' for these purposes:
- must mention on all relevant documents that it is controlled or influenced by a local authority, and name the relevant authority or authorities;
 - have limits are placed on the allowances payable to directors of such companies;
 - are bound by the restrictions on the publication of information imposed on local authorities; and
 - must remove directors if they are councillors become disqualified for membership of a local authority.
- 3.4 Requirements are also imposed as to the provision of information to the local authority's auditor and to Members, and of financial information to the authority.
- 3.5 In particular, a trading company over which a local authority has influence or control, especially where the Council is the only shareholder, must comply with local authority finance regulations.
- 3.6 It is worth adding that the local authority also needs to consider the financial implications of having a trading company on the balance sheet and must have regard to any other financial commitment or obligation they may have to such companies.

4 SANCTIONS AND CONTROLS WHICH THE COUNCIL HAS AVAILABLE TO IT

- 4.1 A wholly owned company means exactly what is implied by the term. More specifically, a local authority owned or controlled company is a subsidiary of the authority for the purposes of s.1159 of the Companies Act 2006. This means that it is a company in respect of which the Council
- holds a majority of the voting rights in it;
 - has the right to appoint or remove a majority of its board of directors;
 - controls alone a majority of the voting rights in it; or, as is most often this case,
 - all three of the above.
- 4.2 For all intents and purposes under the Companies Acts, the Council is the holding company of this company, its subsidiary.
- 4.3 Those ownership rights will be expressed through the actions of the Cabinet, because the functions being carried out by the company will almost certainly be executive functions of the Council. This control will be directly, through the adoption of the business plan or service agreement with the company, or through delegated authority to the cabinet members or the officers of the Council appointed to the company board by the Leader or Cabinet.
- 4.4 The Cabinet should view the company's audited accounts and reports on the activity and trading position of the company. The authority should also approve the business plan and see the accounts at least annually but are likely to require more frequent reports².
- 4.5 A company wholly owned or controlled by the Council therefore has near ultimate and complete control of the subsidiary company.
- 4.6 No conflict of interest can therefore arise between the Council and the wholly owned or subsidiary company.
- 4.7 The only exception to this is that the Directors of the Company owe an overriding duty in company law to the act in the best interests of the company. If the highly unusual occasion arose that caused the Council to act against the interests of its own company, therefore, the directors' duties are first to the company and if necessary to the exclusion of the interests of the Council.

5. THE EXTENT OF THE CONTROL OR INFLUENCE WHICH THE OVERVIEW & SCRUTINY COMMITTEE CAN EXERCISE OVER A WHOLLY OWNED COUNCIL COMPANY

- 5.1. The short answer is pretty much the same as for any executive function of the Council.

² Guidance issued by the Sec of State: Para 75, "General Power for Local Authorities to Trade in Function Related Activities Through a Company - Guidance on the Power in the Local Government Act 2003" July 2004

- 5.2. Where a Member or an officer has become a member or director of a local authority company, the Council 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. The member or officer is not, however, required to disclose confidential information about the company.
- 5.3. The legal framework for local authority companies includes an express requirement concerning the provision of information to Members of that 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.”³

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.

- 5.4. This is expressed most directly in the *“General Power for Local Authorities to Trade in Function Related Activities Through a Company - Guidance on the Power in the Local Government Act 2003”*. This is the guidance issued by the Secretary of State that the Council must have regard to in exercising its trading powers through a company. This states that:

“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 local authority should ensure that its own internal auditors have access to information held by the company and its subsidiaries.

“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. When a local authority (or a committee or executive) meets to consider the affairs of the trading company, such matters may be exempt from disclosure to the public if they fall within Schedule 12A of the Local Government Act 1972 (as provided in section 100A(4) of the 1972 Act). Matters listed in Part I of the Schedule are exempt from disclosure if the local authority so provides by resolution, although Part II of the Schedule qualifies a number of the exemptions. However, in the interests of openness, transparency and accountability a local authority will want to consider whether it would be in the public interest for discussions to take place in public”

6. SUMMARY

- 6.1 The company is wholly owned by the Council. The Leader or Cabinet will have determined the business case and will review it, will appoint the directors and will exercise the single vote that goes with owning all of the shares.

³ Art 7, Local Authorities (Companies) Order 1995

- 6.2 Regular formal reports should be made to the Leader or Cabinet by the company, including an annual refresh of the business plan.
- 6.3 An Overview & Scrutiny Committee may scrutinise a local authority controlled company, be that wholly owned or by majority shareholding, in the way that it would scrutinise any other part of the Council.
- 6.4 The Committee may call a director of the company who is a Member or an officer of the Council before it to give evidence. The Committee should expect open and full disclosure of the activities and finances of the company, but should be aware of the commercial sensitivity in how it receives and deals with this information.