

HEADING: LOCAL AUTHORITY OWNED TRADING COMPANY

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Portfolio: Communications, Policy and Partnerships

Ward(s) affected: All

Purpose of the Report

To seek Cabinet approval to formally establish a wholly owned trading company for communications services.

Recommendations

- a) **Cabinet approves establishing a local authority trading company which would be limited by shares and owned wholly by the council.**
- b) **Cabinet approves the governance and board membership proposals outlined in the business case.**

Reasons

The formation of the company should allow the council to explore trading in a way that maximises the potential of its resources as well as contributing to the medium term financial planning and wider efficiency agenda.

1. Background

- 1.1 At its meeting on 15 January 2014, Cabinet agreed in principle to the establishment of a local authority trading company for communications services which would be limited by shares and owned wholly by the council. It also noted at that meeting that a further report would be brought forward at the earliest opportunity outlining governance and board membership arrangements as well as the “business case” for the company before any trading activities commenced.
- 1.2 The purpose of this report is to enable Cabinet to consider the business proposals for the new venture. Full details are attached to this report as Appendix A. In addition, there is a much smaller commercially confidential Appendix B which includes financial data which it would be better for the council not to disclose as it could put the trading company at a financial disadvantage and which meets Part II requirements.
- 1.3 This report also outlines proposed governance and board membership arrangements.
- 1.4 If Cabinet supports the various proposals then it is being recommended to approve establishing the Wholly Owned Trading Company for Communications Services.

- 1.5 Specialist legal advice has been taken since the last Cabinet meeting to give an independent assessment on proposals which had been previously outlined.
- 1.6 The company involved is one of the largest dedicated public sector and project groups outside London and its reputation for excellent project work is reflected in its appointment as an approved adviser to central and local government as well as public sector frameworks throughout the United Kingdom.
- 1.7 The advice received makes it clear that various pieces of legislation are in place which ensures the proposals being considered by the borough council to trade communications services are permissible.

2. Issues

2.1 Governance

- a) It is essential, with the reputation of the council involved, that the authority has an appropriate level of control over the trading company and that this level of control is consistent with the ability of the company to run itself as a separate but accountable business.
- b) This will be achieved by:-
 - (i) The council being the sole Corporate Member/Shareholder of the company at the initial stage. As such, the council will be able to instruct the Board of Directors and therefore have the final say on things like the appointment and removal of Directors, remuneration, winding up and funding.
 - (ii) Completing a Shareholder Agreement between the company and the council whereby the company agrees to only do certain things with the consent of the council such as borrowing money, recruitment of staff.
 - (iii) Auditing requirements – the company will have its own auditing arrangements in place.
 - (iv) Private companies are no longer required to have a Company Secretary. This requirement was abolished pursuant to the Companies Act 2006, as from 6 April 2008. However, for governance reasons it is being recommended that the council does have a Company Secretary. Discussions will take place internally to identify an appropriate resource.
 - (v) The Directors will be subject to the provisions of the Companies Act 2006 regarding the duties and obligations of Directors. Guidance will be sought from the council's legal services and then shared with the Directors when they are formally appointed.
 - (vi) Cabinet will be involved in any decisions over the appointment of directors.
 - (vii) Directors, who are also elected members of the council, will be subject to the code of conduct which the council has in place and the statutory requirements relating to disclosable pecuniary interests when acting in the capacity of councillor.
 - (viii) The company will not be subject to local authority rules regarding meetings. Meetings will themselves be of board members only although the company should be expected to make available for inspection by any member of the public a copy of the minutes of any of its general meetings.
 - (ix) The company will have its own financial regulations and these will be based on those currently in place for Newcastle-under-Lyme Borough Council.

- c) It is proposed the Company Board will consist of three directors – a serving Newcastle-under-Lyme borough councillor; the Head of Communications; a non-Executive Director with commercial expertise in public relations to be approved by Cabinet.
- d) A job description and person specification has been drafted for the directorship which will be occupied by a borough councillor to ensure the most appropriate person available can be appointed.
- e) At the outset it is recommended that the council should be the sole shareholder but it is suggested that an option could be considered as trading progresses for staff within the Communications Service to be given the opportunity to become shareholders – although the council would retain a majority interest in the company. This would help incentivise performance and potentially increase income opportunities for the council.

2.2 Service Level Agreement

- a) The company will initially operate by using existing staff resources from the Communications Service at the borough council. Some services will be subject to trading and offered to the private sector, other public sector partners or the third sector. These services will be contracted out on an hourly rate or commission basis between the council and the trading company. This removes the complications around the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) and directly employed staffing (HR. payroll, pensions etc) as the staff remain in the employment of Newcastle-under-Lyme Borough Council.
- b) A Service Level Agreement (SLA) will be agreed each year between the borough council and the Communications Service. This will be reviewed and negotiated annually with a corporate group chaired by the Chief Executive acting on behalf of the council.
- c) The SLA will identify very clearly the key corporate objectives and outcomes which the borough council will require delivering with regard to communications activities on a daily, weekly, monthly and annual basis. This agreement will then allow the service to consider what resources are available in terms of taking on work which will generate an income for the council's wholly owned trading company.

2.3 A Controlled Company

Part V of the Local Government and Housing Act 1989 imposes various requirements on companies which are under the control of a council. The proposal to form a wholly owned company is therefore likely to bring it within the scope of Part V. A controlled company will be required to:-

- a) Mention on all business letters, notices and other documents of the company and its website the fact that it is a company controlled, or influenced, by the borough council.

- b) Not publish any material which the relevant authority would be prohibited from publishing by section two of the Local Government Act 1986.
- c) Remove any director who becomes disqualified for membership of a local authority otherwise than by being employed by a local authority or a controlled company.
- d) Provide and authorise or instruct its auditors to provide information to the council's auditors.
- e) Provide to an elected member of the council reasonable information about the affairs of the company.

2.4 Business case for trading

- (i) Powers conferred by Regulation Two of the Local Government (Best Value Authorities) (Power to Trade) (England Order 2009) and the Local Government Act 2003 allows the council to do for a commercial purpose anything it is authorised to do for the purposes of carrying on any of its ordinary functions. Since the council undertakes communication service activities for the purpose of the council's own activities, this gives further power to trade those services in the market.
- (ii) The Order, however, requires the council to approve a business case and recover all of the costs for any accommodation, goods, services, staff or any other thing that it supplies to the company.
- (iii) The specialist advice received by the council argues that while the Localism Act power does not require a business plan or the recovery of costs, it is arguable that the Order and the Local Government Act 2003 - under which it is made – amount to restrictions to which the general power is subject. And the advice received by the council therefore suggests it would be prudent to prepare and approve a business plan and ensure relevant costs are recovered. This is set out in Appendix A.
- (iv) Normally, when a company is being prepared for launch, a business plan is produced which outlines its objectives, its strategies, the market it is in and its financial forecasts. This document has many functions from securing external funding to measuring success within the business as well as planning for the future.
- (v) The circumstances surrounding the establishment of the borough council's wholly owned trading company for communications are such that this level of detailed business case is not necessary at this stage but will be prepared before the company starts trading activity.
- (vi) Delivery of the Service Level Agreement with the council is the first priority for the Communications Service and as such, much will depend in the first year of trading around how much spare capacity is available after delivery of the SLA.
- (vii) Also, it should be remembered that the company is not trying to secure external funding – one of the reasons for producing a business plan.

- (viii) The first two years of the company should be viewed as a low risk, “proof of concept” exercise to grow confidence within the service, develop commercial expertise and skills and take the first steps in trading.
- (ix) At the end of the first two years and during the third year of trading activities, the board of directors will be asked to consider the appropriate future direction of the company. As part of this discussion they will be asked to make appropriate recommendations to Newcastle-under-Lyme Borough Council on this matter for its consideration and allow for full consultation for all those directly affected by any proposals.
- (x) The business case for trading is outlined in detail in Appendix A. The appendix also includes detailed information on legal considerations, a broad timeline, exit strategy and so on.

2.5 Tax

- a) Officers from the council's Finance Service have given initial consideration to the tax issues which a trading company and the council could face and they have also been in touch with the council's advisers on such matters.
- b) Further detailed discussions and advice will be sought in the lead up to the commencement of trading but at this stage guidance on VAT and Corporation Tax has been made available and is outlined below.
- c) VAT
 - (i) If the income of the company exceeds £79,000 p.a., it will have to register for VAT, which would mean:-
 - The company would have to charge VAT to its customers where appropriate.
 - The company would have to know when, and when not, to charge VAT - VAT would be applicable to PR work and some types of printing e.g. calendars, business cards and diaries are standard rated; books, magazines and advertising leaflets are zero-rated.
 - VAT invoices would have to be issued by the company where appropriate.
 - The company would be able to reclaim VAT on expenditure relating to its publicity and printing services, assuming it has VAT invoices from its suppliers for those services.
 - The company would have to account for VAT to HMRC and send it a quarterly VAT return.
- (d) Corporation Tax
 - (i) This is a tax on the taxable profits of limited companies and some organisations including clubs, societies, associations, co-operatives, charities and other unincorporated bodies.
 - (ii) There are currently two rates of Corporation Tax, depending on the company or organisation's taxable profits:-

- the lower rate - known as the “small profits” rate.
 - The upper rate - known as the “full” rate or “main” rate.
- (iii) The "small profits" rate is for profits not exceeding £300,000. Tax would be charged at 20 per cent. This is the rate for the current year and previous years. The "main rate" of Corporation Tax has been reduced from 23 per cent to 21 per cent for 01/04/14, but this is for profits exceeding £1,500,000. If profits fell between £300,000 and £1,500,000 a rate is calculated somewhere between the "small profits" rate and "main rate".

3. Options Considered

- 3.1 A number of options were considered as part of the original report to Cabinet in January 2014.
- 3.2 The preference at this stage is that the council continues to pursue establishing a local government trading company as this most clearly provides an opportunity for the council to venture into commercial activities which could aid and support the council during difficult financial times for the public sector.
- 3.3 It will also be an opportunity for staff to develop greater business and associated technical skills which will benefit the council, their careers and promote the professional “can do” attitude which is already widespread within the authority.

4. Proposal

- 4.1 Establishing a trading company for communications services using the model outlined previously to Cabinet is a significant step forward for the borough council.
- 4.2 The model has significant benefits as the company will be a trading shell with no full-time staff or assets in the initial stages. This means there are no TUPE issues or liability risks to the council as the sole shareholder.
- 4.3 It also means that the primary focus can remain on providing core communications services to the council through the Service Level Agreement while using any spare capacity to trade services in a way which allows staff to learn how to run a business, take commercial decisions and find their feet in a completely new environment.
- 4.4 Over time as business confidence grows, opportunities should arise for developing income streams and if this is successful considering longer-term aims – say over the next five years or so – which could see a new model develop such as an employee-led mutual, arm’s length trading company or a staff buy-out.

5. Reasons for Preferred Solution

- 5.1 The formation of a wholly owned company for communication services will allow the authority to explore trading in a way that optimises expertise, skills and resources within the council’s current staff.

- 5.2 The preferred solution of establishing a company will also be an opportunity for staff to develop greater business and associated technical skills which will benefit the council, their careers and promote the professional “can do” attitude which is already widespread within the authority.
- 5.3 A wholly owned company will initially operate by using existing staff resources from the Communications Service at the borough council. Their services will be contracted on an hourly rate or commission basis between the council and the trading company. This removes the complications around the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) and directly employed staffing (HR, payroll, pensions etc) as the staff will remain in the employment of Newcastle-under-Lyme Borough Council.

6. Outcomes Linked to Sustainable Community Strategy and Corporate Priorities

- 6.1 This project is likely to help the council to deliver on two of its corporate priorities. With regards to “a borough of opportunity”, if the wholly owned company is a success then it should increase competitiveness in the local market place thus ensuring a wider range of pricing and opportunity for businesses interested in communications services.
- 6.2 There may also be an opportunity for a holistic service to be provided to businesses who take on council land or property for development. As part of any purchase or leasing arrangement, businesses could be offered the council company’s services to help them establish and grow their ventures.
- 6.3 And if successful, the company may also consider recruitment which could lead to employment opportunities for local people.
- 6.4 In addition, the proposal is likely to support the council’s corporate priority of “becoming a co-operative council delivering high quality, community-driven services.” The Service Level Agreement between the borough council and the Communications Service – which is an integral part of this proposal - will ensure a real focus on the key outcomes which are important to the council in terms of communications. This will ensure the council’s communications continue to be high quality and community focused so residents are involved and informed about council policies, services, events and activities.

7. Legal and Statutory Implications

- 7.1 There are a number of legal and statutory implications which the council needs to be aware of in regards to establishing a wholly owned company for trading purposes. These are all dealt with in the body of this report and also in Appendix A which is the business case that supports the proposals in this report.

8. Equality Impact Assessment

- 8.1 No differential impacts have been identified in relation to this proposal.

9. Financial and Resource Implications

- 9.1 There are no additional resource requirements to deliver this programme of work. All activity within the company will fully recover the council's costs.
- 9.2 The council must recover the full cost of any accommodation, goods, services, employees or anything else it supplies to the company in pursuance of any agreement or arrangement to facilitate the power to trade. The majority of this will be accommodated within the hourly rate charged between the council and its clients. The detailed proposals for these charges are commercially sensitive information and for that reason have been separated from the main report. They are the only part of this report to be treated as confidential and are contained in Appendix B.
- 9.3 There will be some initial costs incurred by the council in setting up its company as well as complying with the regulatory framework for limited companies. As this is a company being set up for the borough council it is felt appropriate that these small costs can be met from within existing Communications Service budgets.
- 9.4 The creation of the company is intended to provide a mechanism for the council to reduce its demand and the associated costs of its communications service as the council's budget reduces. As has been set out in Section 2.2, the borough council will have an annual service level agreement for communications services which it anticipates will need to reduce as the council's budget reduces. Through the vehicle of the company, the capacity which is released will be traded. Over time it is accepted that the borough council's demands upon the Communications Team will reduce and that this will be balanced by growth in the traded element of the service through the company.
- 9.5 An early task for the Board of the company will be to produce a business plan which will show how the company will grow its business to offset the reduction in the level of communications services which will be demanded by the council through the service level agreement. Similarly through its medium term financial planning and budget making process the council will determine how much resource it will allocate to Communications and what level of resources it will call upon under the service level agreement. Through this mechanism it is anticipated that a comprehensive Communications Service can be sustained but in the expectation that as the borough council's requirements are reduced, the level of external traded business through the company will grow.
- 9.6 If Cabinet agrees to the company being set up then the next few weeks will be spent focusing on making the necessary arrangements for all statutory and governance issues to be settled. As a result, only around half of the current financial year will be available for trading purposes.
- 9.7 The Service Level Agreement between the Communications Service and the council gives indicative periods for when surplus capacity may be used for trading purposes. These periods have been used as a basis for calculating the potential income which may be achieved.

- 9.8 However, it should be stressed that the income targets will only be achieved if:-
- a) The Service Level Agreement is adhered to. Additional requirements which are added would impact on periods allocated for trading purposes.
 - b) Corporate support for securing external work with partners is delivered.
 - c) A minor restructure in the Communications Service is implemented without further delay. This does not involve any staff reductions or negative impacts on terms and conditions.
 - d) Officers in the Communications Service successfully make the transition to securing and delivering work for clients.
 - e) Marketing and promotion activities support efforts to generate business.

10. Major Risks

10.1 These were outlined in detail in the previous Cabinet report and can be summarised as:-

- a) Reputational risk associated with trading within and outside of the borough and the wider perception on the success of the venture.
- b) The operational risks are more around the financial returns and the ability of the business to deliver the expected benefits.

10.2 An appropriate exit strategy has been developed and is included in the detailed business case attached as Appendix A. This shows how the trading activities could cease and the impact that would have upon the future.

10.3 Other mitigating factors which help to reduce the risks involved are:-

- a) Specialist legal advice has been procured to ensure the trading company and the proposals associated with it are legal.
- b) A Service Level Agreement has been drafted which outlines core communications activities which the council requires to be delivered during the trading company's first year of operation. This will be reviewed annually.
- d) It is proposed that trading activities will be around the margins of surplus capacity.

10.4 Overall it is considered that the risk associated with the actual formation of the company is low and that the trading activities and resultant impact on the council will be beneficial.