

## **CREATING A LOCAL AUTHORITY OWNED TRADING COMPANY**

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**Portfolio:** Communications, Policy and Partnerships

**Ward(s) affected:** All

### **Purpose of the Report**

To ask Cabinet to agree in principle to the creation of a local authority company to allow commercial trading in communications activities.

### **Recommendations**

- a) **Cabinet agrees in principle to the establishment of a company which would be limited by shares and owned wholly by the council.**
- b) **Cabinet notes that a further report will be brought forward at the earliest opportunity outlining governance and board membership arrangements as well as a business case for the company before any trading activity commences.**

### **Reasons**

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

## **1. Background**

- 1.1 Under the Local Authorities (Goods and Services) Act 1970, councils have the power to provide any administrative, professional or technical services, goods or materials, or certain maintenance works, including on a commercial basis, to any “public body” as defined under the Act (for example, local authorities, Government departments).
- 1.2 In addition, councils have the power to do anything which is incidental to the discharge of their functions, and this can include trading spare capacity.
- 1.3 The Local Government Act 2003 allowed local authorities to do for a commercial purpose anything they are authorised to do for the purpose of any of their ordinary functions. The Localism Act 2011 includes a new general power which allows local authorities to do anything that individuals generally do.
- 1.4 This is extended to include doing things for a commercial purpose through a company. Before exercising the powers in the 2003 Act, a business case must be prepared and approved and where the 2003 Act powers are used, the council must recover the costs of any accommodation, goods, services, staff or any other thing that it supplies to the company as part of any agreement or arrangement to facilitate the exercise of the trading power.
- 1.5 It is also important to demonstrate that all costs are recovered and that there is no actual or hidden subsidy so as to avoid any potential challenge by a competitor on the basis that the council is providing State Aid to the company.

- 1.6 A number of local authorities are taking advantage of the opportunities legislation has created. At Ashford for instance there are two companies operating – one is based on a property company and the other is a building consultancy company. Birmingham City Council’s building control services have now been rebranded as Acivico (Building Consultancy) Ltd.
- 1.7 North Yorkshire County Council and its wholly owned company NYNET is responsible for delivering the rural broadband programme for North Yorkshire and rural area around York.
- 1.8 Wokingham Enterprises Ltd is a company wholly owned and set up by Wokingham Borough Council for the purpose of enabling the regeneration of the town centre of Wokingham. The company was set up in 2009 but actually began trading on 24 June 2010. The main trading activity is that of property investment. The income is derived from the assets acquired in June 2010 which comprised a number of retail units collectively known as Peach Place.
- 1.9 Two London councils – Westminster City Council and Lambeth Council – are leading the way in trading activities centred on communications. Westminster for instance provides communications services for a number of other councils across the country on a commercial basis including some in this area.
- 1.10 To ensure a level playing field with the private sector and to avoid breaching State aid rules, any company established by the borough council must not be subsidised by it. This means the local authority is expected to recover the full costs of such things as accommodation, supplies and support services that the company may use. It should also be noted that the company should not be a threat to the local economy.
- 1.11 Where the council wishes to undertake commercial activity, which is not ancillary to its core public service activity, and which does not involve a defined public body, that activity needs to be undertaken through a trading company.
- 1.12 It is proposed that the council establishes a company limited by shares with the council as the only shareholder at this stage. The company will not therefore require an “asset lock” and this will enable any profits to be distributed to the council.
- 1.13 Trading of skills and expertise will be focused around the margins of service delivery at the outset and concentrate on seizing opportunities presented by any instances of spare capacity. Over time, as the borough council changes shape in an effort to meet issues presented by its financial circumstances, this is likely to see demand from the council for core services reduce. This will in turn be reflected in the budgets which are made available to services as the council continues to deliver savings and efficiencies. In areas where trading companies are established, the wholly owned company could step in and take advantage of any additional surplus capacity by generating revenue for the council.

## **2. Issues**

- 2.1 The borough council’s recently published Medium Term Financial Strategy clearly highlights the financial challenges which the council is facing over the coming years. Reductions in Government support for the public sector to help tackle the national debt; pressure on income streams and no increases in Council Tax are all contributory factors which mean many councils are looking to explore new ways of providing services.

2.2 The formation of a wholly owned company will allow the council to explore trading in a way that optimises expertise, skills and resources within the council's current staff. It can also allow services an opportunity to shape their own future in a more proactive way by tapping into new market places to generate revenue. Longer-term, if successful, this could eventually lead to services exploring other development opportunities such as employee led mutuals.

2.3 Moving forward, a number of key factors would have to be resolved to successfully lay the foundations for a wholly owned trading company to survive and then flourish. These are outlined below.

#### 2.4 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).
- b) It is essential that a robust Service Level Agreement is in place between the Communications Service and the council itself. This 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 wholly owned trading company.
- c) Initially, as outlined earlier in this report, trading will focus on any spare capacity. As the borough council evolves to meet financial, legislative and customer demands, there is likely to be changes in demand levels on services. This will in turn be reflected in the budgets which are made available to services as the council continues to deliver savings and efficiencies. In areas where trading companies are established, the wholly owned company could step in and take advantage of any additional surplus capacity. This would not only generate revenue for the council but could also have a positive impact on employment. To this end, it is important that detailed and achievable Service Level Agreements are in place and are reviewed on an annual basis.

#### 2.5 Governance arrangements

- a) Detailed governance arrangements will be brought back to Cabinet before a company is established.
- b) The risks to the council of creating a company are the risk to the council's reputation and financial consequences. It is therefore essential from the council's point of view, to minimise those risks by ensuring that the council retains sufficient control of the company and that the company is subject to strict governance.
- c) It is likely that the company will be a separate legal entity from the council and will enjoy limited liability. Consequently, any debts accrued by the company will stay with the company and creditors would not have recourse to the council or any of the company directors, save in certain defined cases, for example, fraudulent or wrongful trading.

## 2.6 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 rate applicable to 01/04/14 has not yet been set.
    - (iv) 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".

## 2.7 Teckal

- a) This is a trading restriction which is contained in the Public Contracts Regulations 2006 and the underlying European law. The broad objectives of this legislation are to ensure that public bodies award contracts that are above the specified value thresholds only after fair competition and only on the basis of the lowest price or the most economically advantageous offer.

- b) For obvious reasons this can present a difficulty when the contract being let is to a joint company for public sector shared services or to a staff mutual, where the intention is to continue to provide the services from within the public realm rather than outsource it to the private sector.
- c) The Teckal case established that under certain circumstances, a contract let to a third party will not count as a public service contract if the “local authority exercises over the person (i.e. the company) concerned a control which is similar to that which it exercises over its own departments and at the same time, that person carries out the essential part of its activities with the controlling local authority or authorities. These two elements have been called the control and function tests.
- d) These are obviously issues which need to be considered if the eventual path for any wholly owned trading company is to move towards mutualisation and the council would be the main contract for a mutual company. But at this stage the company being considered for Communications Services will be trading around the margins of surplus capacity independently of the council and therefore at this stage Teckal is not a major consideration but needs to be borne in mind in relation to future developments.

### **3. Options Considered**

3.1 There are a number of options which have been considered as part of this report and they are outlined below.

#### *3.2 Option One – take no action*

a) Taking no action and leaving the Communications Service at the council to carry on functioning as it does at present should not be seen as the lesser of any options. The Communications Service at the borough council currently works well with surveys showing residents, and also staff, indicating they feel they are kept informed by the borough council on key events, activities, decisions and services.

b) However, the pressures on the public purse highlighted earlier in this report suggest a more proactive course of action may be preferable for Communications as it bids to shape a future which is not fully reliant on council finance.

#### *3.3 Option Two – Wholly Owned Company*

a) This is the most favoured option. Establishing a local government trading company provides an opportunity for the council to venture into commercial activities which, if successful, could aid and support the council during difficult financial times for the public sector.

b) 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.

c) That isn't to say there aren't risks associated with this venture. For instance, the local economy is still fairly sluggish and business may be difficult to generate for a fledgling company plus there is only limited “private sector” experience within the department. Despite that, the Communications Service at the borough council has a good reputation and this should stand the team in good stead as it bids for work.

d) One of the benefits of establishing a Wholly Owned Company is that there are significantly reduced risks both for the council and the staff involved. As no staff would be directly employed by the company there will be no TUPE issues. Also, if the company fails to be a success then the council would have the option of ceasing to trade without any staffing or asset disposal issues. Staff would continue

to deliver the Service Level Agreement with the council and use any capacity which had been targeted for trading to enhance and develop services within the SLA.

### 3.4 *Option three* – Mutual models

- a) Although this may become a longer-term goal, it is not felt the most appropriate vehicle for Communications at this moment in time.
- b) The term “mutual” is used in a variety of different ways and contexts. For this report it is used as an umbrella term to describe an organisation whose primary purpose is to generate benefits for members. Members of a mutual may consist of employees, service users, communities, the private sector or even a combination of the above.
- c) If the council decided at the outset that mutualisation was the preferred option then the Teckal guidance outlined above does become an issue. And the Cabinet Office, which is currently a champion of mutualisation within the public sector, expects mutual to have a programmed “separation” point. At that point of separation the council would not be able to simply award work in-house and all of its requirements would be met through open procurement.
- d) In the current economic climate and with the limited private sector experience in the department, this is not seem as the most appropriate route at this moment in time. But as experience grows – and council finances continue to diminish – it is worth further consideration at some point in the future.
- e) One of the key plus points for a mutual at some point in future is that it gives staff a greater personal stake in the success and development of any venture as they can benefit directly from growing the business.

3.5 So, the preference at this stage is that the council opts for 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. 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 The Local Government Act 2003 requires a full business case to be approved before trading commences. At this stage, this report is simply intended to establish the principles of trading and the company itself with potential governance structures, board membership details and business case information provided in a further report to Cabinet.

4.2 Full business plans setting out detailed proposals for trading activities will be reported back to Cabinet before any trading commences.

4.3 The council has already secured advice from the Cabinet Office and also Local Partnerships, an enterprise jointly owned by HM Treasury and the Local Government Association which provides commercial expertise to the public sector in trading services, about its proposals. This advice has been extremely beneficial and at this stage the emphasis of that advice has been around getting all the building blocks securely in place before progressing further.

- 4.4 In particular, it has been recommended that a significant amount of time be devoted to business case planning, governance and legal issues. Advice in these areas is to be made available but it will have to be assessed and implemented in a way which supports the borough council's plans. Discussions have also taken place about the possibility of a mentor being provided from another public sector organisation who have already progressed down the trading route.
- 4.5 At this stage it is likely that some trading activity will commence in the next financial year. A significant amount of work has already been done in preparing for Cabinet to consider this matter including staff discussions, soft market testing, reviewing potential business opportunities and research on the various models available to the council on service delivery.

## **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 During the last few years, as the outlook for local government finance has worsened, councils across the country are exploring new and innovative ways to enable them to continue to deliver services to residents. Establishing a wholly owned company to potentially generate income for the council is the option which at this moment in time is deemed most appropriate for communications.
- 5.4 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).
- 5.5 As mentioned previously, the council already has the ability to trade without needing to start a Wholly Owned Company. However, there is a potential for this area of work to grow and it is for that reason that this option is being recommended.
- 5.6 Although there is every confidence that the skills and expertise within the Communications Service will enable the company to be a success, if it does not manage to establish itself then it could be wound up with no subsequent losses incurred by the council. If that situation were to arise then there would also be no staffing issues and the Communications Service will simply continue to meet the terms of the Service Level Agreement for the council which is discussed earlier in this report.

## **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 newest 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.
- 7.2 The Local Government Act 2003 requires a full business case to be approved before trading commences. As mentioned earlier in the report, if Cabinet agrees in principle to the formation of the trading company for communications, work will then proceed to develop an appropriate business case and this will be reported back to Cabinet in due course.
- 7.3 Directors of the company will be subject to the provisions of the Companies Act 2006 Regarding the duties and obligations of Directors. All 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.

## **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 costs. The proposal itself has the potential to develop new income streams for the council. There will be a small cost in setting up the company and in complying with the regulatory framework for limited companies.
- 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 the companies.
- 9.3 One of the reasons behind the formation of the trading company, although not the sole reason, is to help secure additional income which will help support the core



function of the council in the longer term. Any commercial activity comes with a degree of financial risk and needs to be managed and understood.

- 9.2 At this stage it is only the principles around the company formation that need to be agreed, the approval process of the detailed business plans will identify the financial risks and potential returns in more detail.
- 9.3 The company will operate using existing borough council staff and where appropriate other external resources rather than having directly employed members of staff. This negates any transfer of undertaking issues, such as TUPE etc. It is not proposed within the initial business plan period to employ staff directly within the company but this may change if it enjoys a measure of success.
- 9.4 The recharging of staff time from the company to the council provides an easy mechanism to ensure that the full costs are applied to the company and that there are no issues around "state aid" or uncompetitive practises being used.
- 9.5 Staff will be involved in developing the business case and assessing trading opportunities. They have also been involved and informed in the discussions leading up to this proposal and there is a recognition at all levels that establishing a trading company is not only an excellent option to secure future work but also to develop not only the service but themselves as well.
- 9.6 The formation of the trading company provides an opportunity for the council to utilise the talents and the good will of its staff to be more creative in the business environment leading to better job satisfaction and career development.

## **10. Major Risks**

- 10.1 The risks associated with the formation of a local authority trading company can be classified into two main areas:-
  - 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. The reputational risk could and should be seen as a positive risk as the borough council will be demonstrating its desire to operate in an entrepreneurial way for the benefit of local Council Taxpayers as well as the wider community.
- 10.2 The detailed business case for the company will contain a risk assessment with details of the risks that have been identified and what mitigation action has been or will be taken to minimise that risk. The financial risk is considered to be limited given the scale and nature of the business during the initial business plan period.
- 10.3 An appropriate exit strategy will need to be developed within the detailed business case showing how the trading activities could cease and the impact that would have upon the future.
- 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.