

**THIS LAND BOARD REPRESENTATION**

**To:** Commercial and Investments Committee

**Meeting Date:** 22nd June 2018

**From:** Deputy Chief Executive & Chief Finance Officer

**Electoral division(s):** All

**Forward Plan ref:** N/a                      **Key Decision:** No

**Purpose:** The Committee is asked to consider the shareholder's representatives on the Board of This Land in light of the contents of this report.

**Recommendation:** It is recommended that the Committee:

- a) Consider the contents of this report;
- b) Note the removal of Mr Quentin Baker as a Director of This Land;
- c) In light of the issues highlighted in this report consider which of the following options should be adopted:
  - a. Request that the Deputy Chief Executive identify a short list of Council officers that might be appropriate for filling the current vacant role of shareholder's representative on the Board of This Land.
  - b. The Committee nominate a political representative to fill this role.
  - c. A short list of potential independent representatives be identified for the Committee to consider for the filling of this role.

<b><i>Officer contact:</i></b>	<b><i>Member Contact:</i></b>
Name: Chris Malyon	Name: Councillor Josh Schumann
Post: Deputy Chief Executive & CFO	Post: Committee Chairman
Email: <a href="mailto:Chris.malyon@cambridgeshire.gov.uk">Chris.malyon@cambridgeshire.gov.uk</a>	Email: <a href="mailto:Joshua.Schumann@cambridgeshire.gov.uk">Joshua.Schumann@cambridgeshire.gov.uk</a>
Tel: 01223 699796	Tel: 01223 706398

## **1. Background**

- 1.1 The County Council established This Land as a wholly owned development and investment company in 2016. The Commercial and Investments Committee is responsible for discharging the functions on behalf of the shareholder, the County Council. The County Council is a single shareholder as a body corporate rather than 61 individual shareholders as individual Members of the Council.

## **2. Current Shareholder Representation**

- 2.1 At the recent Annual General Meeting of This Land the Non-Executive Directors of the Company for the forthcoming year were confirmed as Chris Malyon and Quentin Baker. The meeting was informed by the Managing Director that an independent Chairperson was being sought and once a shortlist had been compiled the Shareholder would be invited to interview and make the decision, as they would with all future appointments.
- 2.2 At the Commercial and Investments Committee immediately preceding the recent AGM of the Company a discussion took place on the motions that the Shareholder wished to put to the AGM. As part of that discussion Councillor Nethsingha raised a point regarding the appointment of Non-Executive Directors where their appointment to the Board was as a direct consequence of their employment with the Council, be that as an officer or as a Member. It was agreed that where the employment of any individual with the Council was brought to a close then their role, as a Director of the Company, should automatically be terminated as of their last day of employment with the Council.
- 2.3 At that point the Committee were unaware that Quentin Baker, one of the Non-Executive Directors of the Company, was about to resign from his role with LGSS Law and as Monitoring Officer of Cambridgeshire County Council. As a consequence of his resignation Quentin has been removed as a Director of the Company and his name has been removed from the register at Companies House. This resignation leaves the Company Board currently with one Executive and one Non-Executive Director. This is not a long term sustainable position.

## **3. Future Board Representation**

- 3.1 The Articles of Association of This Land were agreed by the Shareholder before they were registered at Companies House. Under the Articles the Shareholder can appoint an official observer to attend Board meetings and report back to the Committee either monthly or quarterly albeit this role carries with it no voting responsibilities on the Board of the Committee.
- 3.2 At the recent Annual General Meeting of This Land a request was made that the dates of the Board meeting should be made available to the Shareholder in order to facilitate the attendance of an observer attending on behalf of the Shareholder. All Members of the Committee, at that point, were provided with the dates and Councillor Ian Bates has requested to attend two of the dates set out in that schedule. Without wishing to stifle any Member attending in this capacity the process will need to be managed. If other Members of the Committee also express a desire

to attend there will be practical accommodation issues as the meeting room at This Land offices cannot support significant additional attendees.

- 3.3 There has however been significant debate over whether there should be some political representation on the Board of the Company. When establishing the governance of the Company independent legal advice was sought from Bevan Brittan LLP. The full report was considered by the Committee when they considered and approved the Articles of the Company. The following is however an extract of the key elements appertaining to this issue from that advice.

#### *Members*

*14.14 The conflicts issues for members relate both to the code of conduct, and also to the risk of decisions made by members who are also directors being challenged on the basis of bias or predetermination or bias.*

*14.15 Directors who are members must disclose any potential conflicts of interests and observe the requirements of the code of conduct of the Council required under the Localism Act 2011. Such directors must also be careful (when undertaking their Council role) to behave in ways which avoids suggestions of bias or predetermination. This can be difficult and more so for more senior members, for example, the Cabinet members. Despite the potential for the Council to approve dispensations to effectively authorise the conflict from a councillor standards perspective, it could remain difficult in practical terms for the member to deal with a matter in a satisfactory way and it could lay both the member and the Council open to allegations of bias and potential challenge.*

*14.16 For example, take a scenario where the Council has invested say £25m in a housing vehicle for development. A councillor on the board of the company is aware that the development is not going well and the company risks insolvency so a board meeting is held where they agree they will approach the Council to restructure the financing and obtain further funding in order to further the company's activities. In this situation a councillor or officer who made the decision to approach the Council with this proposal in light of the company's best interests would then be in a difficult position if the individual was then responsible for considering the proposal and making a decision either as a senior officer or member within and in the best interests of the Council. In such situations questions of bias, predetermination and general probity around public decision making would be difficult to satisfactorily manage.*

*14.17 As mentioned in section 10.11.4, where the Council is seeking to establish a company that is not caught by the procurement rules, the position would typically be stronger without members on the board. This is because it would help create greater distance between the company and the Council and reduce the perception or risk that the vehicle has a policy purpose rather than being purely an investment/financial purpose.*

*14.18 Directors' remuneration (if any) for members is restricted in law. This means that they cannot receive any additional remuneration from the company for acting as a director which is beyond the special responsibility allowance they would have received had the activities of the company been discharged by the Council. Any remuneration they receive will be*

*deducted from the special responsibility allowance that they receive within the Council and they may only claim mileage and subsistence at the rates that apply to members.*

#### *Non-executive directors*

*14.19 Officers and/or independent directors could be appointed and engaged either on an executive (i.e. employed or engaged by the vehicle as a worker) or a non-executive capacity. A non-executive director is a director who is not employed by the company and would usually be an independent. Whilst it is considered good governance for a company to have one or more non-executives on its board this will not always be practical or necessary. A non-executive director is intended to increase probity and to bring additional experience to the company in order that it is operated to the best advantage of its shareholders and in accordance with relevant legislation/ rules. A company will usually be of reasonable size before appointing a non-executive and they can be reasonably expensive (to reflect their relevant experience).*

*14.20 The board will need to agree the terms of delegation from the board to the individuals engaged to delivery CHIC's business plan. This could be to individuals employed by the vehicle, to staff seconded in (whether or a full or part time) from the Council and/or individuals contracted in on a temporary basis.*

- 3.4 The advice, whilst quite clear, doesn't rule the option out completely. It simply highlights that there are risks of the Company being challenged by others as being a 'contracting organisation' and therefore subject to local government procurement rules. The risks and issues appertaining to whether a local authority trading company is deemed to be a contracting organisation are set out in detail in the Appendix to this report.
- 3.5 Members of the Committee have referenced other local authorities that do have political representation on the Boards of local authority wholly owned companies that they operate. Whether these organisations have the same level of procurement activity, and therefore risk, that This Land will be undertaking is another matter. Members of the Committee may however feel that even with these risks the benefit of political input to the Board of This Land makes the risk worth taking.
- 3.6 If the Committee do decide to appoint a Member to the Board there is probably a benefit in that Member not being a Member of C&I Committee. This would therefore provide a degree of separation from the interests of the Shareholder as discharged by the Committee and the interests of the Company as discharged by the Board of Directors.

#### **4. Recruitment of Independent Non-Executive Directors**

- 4.1 The Managing Director of the This Land provided a verbal update to the Annual General Meeting regarding the desire to appoint an independent chair of the Board. He highlighted that the process to attract potential applicants had been delayed in order that the product that the Company was offering to the market had been better defined, that a business plan had been published, and that company actually owned

some assets to be able to demonstrate that it was a serious business proposition. Now that all those items are in place the recruitment process has begun in earnest.

- 4.2 As was agreed at the Annual General Meeting that all appointments to the Board would be made by C&I Committee. However the Managing Director has agreed to assess who might be a suitable candidate, with relevant experience to add value to the Board and the Company, and who might be willing to join the Company at this point. The Managing Director has approached an individual with suitable credentials but at the point of drafting this report they had neither accepted nor declined the offer to engage on whether the opportunity was of interest to them.

## 5. ROLE OF THE NON EXECUTIVE DIRECTOR

- 5.1 A non-executive director is a member of the board of directors but they do not form part of the executive management team. They are not employees of the company or affiliated with it in any other way and are differentiated from executive directors who are members of the board who also serve as executive managers of the company. However they do have the same legal duties, responsibilities, and potential liabilities as their executive counterparts.
- 5.2 Non-executive directors provide independent oversight and serve on committees concerned with sensitive issues such as the pay of the executive directors and other senior managers; they are usually paid a fee for their services but are not regarded as employees.
- 5.3 All directors should be capable of seeing company and business issues in a broad perspective. Nonetheless, non-executive directors are usually chosen because of their independence and initiatives, and are of an appropriate caliber and have particular personal qualities.
- 5.4 It is important for the successful operation of the company that the non-executive directors add value to the operations of the company by ensuring that the executive deliver the outcomes set out in the Articles of the Company and in accordance with the wishes and aspirations of the shareholder(s).
- 5.5 As This Land evolves the skills and attributes that the Company will benefit from most from its non-executive board members will also change. At this point however the Company can benefit from a broad range of skills/experiences. The following is a set of skills/experiences that the shareholder should therefore be looking for any non-executive appointment to bring to the Board:

<ul style="list-style-type: none"><li>• Quantity Surveyor</li><li>• Legal</li><li>• Finance</li><li>• Workforce Development</li><li>• Customer Services</li><li>• IT/Digital</li><li>• Design</li></ul>	<ul style="list-style-type: none"><li>• Marketing</li><li>• Sales</li><li>• Land Assembly</li><li>• Planning</li><li>• Supply Chain Management</li><li>• Governance</li><li>• Tax</li></ul>
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## **6. ALIGNMENT WITH CORPORATE PRIORITIES**

### **6.1 Developing the local economy for the benefit of all**

There are no significant implications for this priority arising directly from the proposals contained in this report.

### **6.2 Helping people live healthy and independent lives**

There are no significant implications for this priority arising directly from the proposals contained in this report.

### **6.3 Supporting and protecting vulnerable people**

There are no significant implications for this priority arising directly from the proposals contained in this report.

## **7. SIGNIFICANT IMPLICATIONS**

<b>Implications</b>	<b>Team</b>	<b>Name of Officer Consulted</b>
Resource	Finance	Tom Kelly
Statutory, Legal and Risk	Legal	Mickaela McMurtry
Equality and Diversity	Author	Chris Malyon
Engagement and Consultation	Communications	Christine Birchall
Localism and Local Member Involvement	Author	Chris Malyon
Public Health	Public Health	Val Thomas

### **7.1 Resource Implications**

The appointment of an independent Chair, and independent Non Executive Directors, will have resource implications for This Land and these will be funded by the Company as part of their operating expenditure.

### **7.2 Statutory, Risk and Legal Implications**

The potential legal risks appertaining to the Shareholder appointing a political representative to the Board of This Land are set out in this report.

### **7.3 Equality and Diversity Implications**

There are no significant implications within this category.

### **7.4 Engagement and Consultation Implications**

There are no significant implications within this category.

## **7.5 Localism and Local Member Involvement**

There are no significant implications within this category.

## **7.6 Public Health Implications**

There are no significant implications within this category.

## **8. Source Documents**

<b>Source Documents</b>	<b>Location</b>
Bevan Brittan report	Section151/CHIC//Legal advice
This Land Articles of Association	Section151/CHIC/Articles

## 10 CHIC AS A CONTRACTING AUTHORITY

- 10.1 An important requirement of the Council is that CHIC is able to operate within the market as a commercial entity and not be subject to regulations that affect public bodies, in particular the procurement Regulations. The effect of this, as an example, is that CHIC could purchase building contractors, back office or property management services from the Council or a third party without tendering the opportunity. It would be possible for CHIC to be structured this way, and we set out below the legal issues to be considered in order to do so.

*Legal test*

- 10.2 To decide if a body is a contracting authority, it is necessary to work through the definition of "bodies governed by public law" in the Regulations. These are:

*"bodies that have all of the following characteristics:*

*(a) they are established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;*

*(b) they have legal personality; and*

*(c) they have any of the following characteristics:*

*(i) they are financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law;*

*(ii) they are subject to management supervision by those authorities or bodies; or*

*(iii) they have an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law."*

- 10.3 The court has emphasised as a general principle that the definition must be interpreted broadly. This means that the specific facts of a case are important, and in these circumstances they will therefore have to demonstrate clearly that CHIC does not fall within it.

*Will CHIC have a separate legal personality?*

- 10.4 Yes, and so this limb will be met.

*Will CHIC meet one or more of the control tests in section 10.2(c)?*

- 10.5 Yes. Under the proposed structure, the Council will fund CHIC on a commercial basis. As a result, the first part of the control test would not be met. The second part of the test is more difficult to apply, but could well be met if the Council is seen as having the

ability to scrutinise CHIC to an extent that constituted management supervision. The threshold for this test is low. However, as the Council's briefing paper to us indicates that it will be the sole shareholder and so the only body with the right to appoint CHIC's directors, CHIC will definitely meet the third part of the test i.e. more than half of the board is appointed by the State or another body governed by public law.

*Is CHIC established for the specific purpose of needs in the general interest?*

- 10.6 Yes, as the court has construed this limb so broadly it is prudent to assume a body has been established for meeting needs in the general interest.

*Do those needs have an industrial or commercial character?*

- 10.7 This limb provides the most scope for falling outside the definition of a body governed by public law, and the court has decided that both the characteristics of the marketplace and the nature of the body must be considered.

- 10.8 The key principles are set out below:

*"51. If the body operates in normal market conditions, aims to make a profit, and bears the losses associated with the exercise of its activity, it is unlikely that the needs it aims to meet are not of an industrial or commercial nature. In such a case, the application of the Community directives relating to the coordination of procedures for the award of public contracts would not be necessary, moreover, because a body acting for profit and itself bearing the risks associated with its activity will not normally become involved in an award procedure on conditions which are not economically justified."*

*Advice*

- 10.9 CHIC is more likely to reflect these principles, reducing the possibility of CHIC being classified as a contracting authority, if CHIC's structure is such that it:

10.9.1 operates in normal market conditions;

10.9.2 aims to make a profit; and

10.9.3 bears its losses.

- 10.10 It is clear that the Council intends CHIC to operate for a profit as this is its overriding objective. If the other two factors are also present then there would be good grounds for a court to conclude that CHIC is unlikely to purchase goods, works or services for anything other than economic reasons.

- 10.11 In order to embody all three commercial principles, and strengthen the grounds for arguing that CHIC is not a contracting authority, we suggest that the following actions should be taken. It is difficult to establish a structure that removes entirely the risk of CHIC being classified this way, but these suggestions would create a good argument that it is not:

- 10.11.1 making it clear in the Council's decision-making process that it is setting up CHIC to generate profit, rather than to pursue policy objectives, by relying on its investment power,<sup>4</sup> the general power of competence<sup>5</sup> or a combination of the two, and for this reason is using the company limited by shares model, with unrestricted articles of agreement and the ability to distribute profits by way of dividends. This suggestion has to a large extent been met in the Report;
- 10.11.2 providing all financial and other support from the Council on market terms, documented by suitably commercial terms and conditions. It is likely that this suggestion will be met, for example, because funding will be provided on market terms. It will be important to take the same approach for any other services that may be provided by the Council;
- 10.11.3 having a clear audit trail acknowledging that the Council does not intend to step in and provide support on non-commercial terms in the event of insolvency or similar financial difficulty. We have not seen anything to this effect;
- 10.11.4 appointing directors who are not Council officers or members and who have relevant commercial experience. Two senior Council officers have already been appointed (the Chief Finance Officer and the Director of Law), and the Report indicates that the Council intends to add three other directors with relevant experience. We do not know at this stage if these will be officers, members or external appointments, and for the purpose of structuring CHIC to sit outside the Regulations, would recommend that the key criteria for selection should be commercial experience;
- 10.11.5 sourcing the management capability needed from the market, whether employing someone, or contracting-in resources from the market (rather than seconding someone from the Council), with the clear criteria of suitable commercial experience. Both this and the previous suggestion lend more of a "commercial feel" to the structure;
- 10.11.6 not establishing CHIC as a Teckal company (considered in section 17.2). Although the tests for a contracting authority and Teckal status are different, they are closely related, and it would be more difficult to claim non-contracting authority status whilst being subject to the control of the Council and limited to providing 80% of activities to it. This suggestion will be met as the Council does not intend to establish CHIC with Teckal status.

10.12 If these suggestions are adopted, there are good grounds for deciding that CHIC will not be a body governed by public law caught by the Regulations. The case would be even stronger if the Council did not have the right to appoint the majority of the board of directors, because there would be no relationship of close dependency (please

see the control tests in section 10.2(c) above). The Council should therefore consider if this would be an acceptable position.

- 10.13 There will remain a residual risk that CHIC could be classified as a body governed by public law because of the broad way the court has interpreted the term in the past. The risks of challenge cannot be removed entirely, and we would be happy to provide more detailed advice about the implications of challenge if that would be helpful. As the test of whether a body is a contracting authority is an ongoing one, we recommend that CHIC's status is monitored regularly to see if any of the facts, and so its status, have changed. If it becomes clear that a change might have occurred then this can be addressed. Regular monitoring would also provide an audit trail that the issue has been considered properly should a challenge be brought.

## 11 STRUCTURE

- 11.1 The Report considered two models: a company limited by shares and a company limited by guarantee. The Council decided that the former was more suitable for a project designed to generate long term revenue generated by rental income and capital receipts received by CHIC. In our view, this is the most appropriate model to achieve the Council's objective, in particular because of the ability to distribute profits, its ability to form groups for certain tax purposes, and being the most flexible form for future alternative investment and exit options.
- 11.2 The Report provides authority to establish one or more companies. For the reasons set out in the tax analysis above, the Council should consider establishing a group structure comprising a holding company and three subsidiaries as follows:
- 11.2.1 a holding company to provide a corporation tax group for the different companies to allow carrying across of trading losses;
  - 11.2.2 two separate companies for development and rental activity, rather than both activities being through CHIC. This would maximize the possibility of VAT recovery;
  - 11.2.3 a company for trading in selling units. This would provide greater clarity and a stronger position for discussions with HMRC over treatment of trading and investment assets.
- 11.3 In addition to this headline structure, the Council and CHIC should consider establishing multiple versions of vehicles, for example development companies, to ring-fence risk associated with different developments or phases of developments. This should allow the Council to more effectively manage risk as well as facilitating alternative investment or exit routes in respect of different sites or phases. There is no set rule as to when a separate vehicle would be warranted. The Council would need to balance the additional cost and administration of having a separate vehicle against the size of the site or phase and the desire to ring-fence associated liability. In similar circumstances we know that some councils prefer to create a separate company for each individual development, but (to mitigate against administrative cost and complication) not separate companies for each **phase** of development.

- 11.4 The above structure is focused on housing delivery. The position with commercial property is different with there not being the same benefits of a company letting out commercial tenancies as apply to residential, in particular the ability of a company to provide non-secure tenancies of residential property. Given the preferential tax position of the Council it is common for commercial investment property to be held by a local authority. However, there may be wider reasons for it being held by CHIC, or a vehicle within the CHIC group, including isolation of risk and/or the ability to operate and make decisions on a more commercial basis than the Council might be able to do.
- 11.5 A holding company could also undertake a governance function in managing the subsidiaries with just one relationship between the group and the Council rather than multiple relationships. There is flexibility in exactly how this is set up. At one end of the spectrum, it could pass all decisions relating to the subsidiaries straight to the Council so that it took no material decisions itself, and the Council in effect managed their activities. At the other end, it could act as a filter between the strategic control of the Council and delivery of operational matters by the subsidiaries. The latter approach is recommended in light of the desire to structure CHIC as a non-contracting authority.
- 11.6 The holding company and its subsidiaries will be classed as regulated companies subject to the restrictions in Part V, Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995. Classification as a regulated company has a number of legal and practical implications, which are explained in Schedule 1.

## **12 GOVERNANCE**

- 12.1 CHIC's governance will be based on the two roles of shareholder and director, which are considered below.

## **13 SHAREHOLDERS**

- 13.1 The Council will be the sole shareholder of CHIC, and unless this element of the proposed structure changes will control CHIC through the appointment and removal of directors and certain other statutory rights. We understand from the Report that the Council would like to keep the governance structure simple and avoid the potential for conflicts of interest (considered below in section 14). As a result, it decided that the Assets and Investment Committee should exercise the Council's rights as shareholder which should also include the rights the Council has under the shareholders' agreement.
- 13.2 In a local authority-owned company it is common for a shareholders' agreement to give the Council strategic control over the operation of CHIC through the right to approve a business plan and the requirement that certain listed decisions, referred to as "reserved matters", be referred back to the Council as shareholder rather than being within the discretion of the board of directors. As the intention is for CHIC to not be a Teckal company and sit outside the Regulations, the Council should limit the control exercised in this way. The Council's rights under the shareholder agreement should be focused on control/monitoring of the commercial performance

of CHIC in light of the equity investment made by the Council. We have prepared a draft of the articles of association and shareholders' agreement that reflect this.