

Report of the Cabinet Member for Finance, Performance and Customer Service

## **FORMATION OF A YORKSHIRE PURCHASING ORGANISATION LIMITED COMPANY**

### **Summary**

1. To seek approval for the formation of a trading company for Yorkshire Purchasing Organisation (YPO). A limited company will protect the current level of activity relating to schools/academies and also allow YPO to explore opportunities not available to a Joint Committee. The holding company will be set up as a company limited by shares for purpose of private sector trading for profit essentially with schools /academies in relation to energy procurement, and will run alongside the existing YPO management committee structure. Any change to that arrangement will be subject of further reports for member approval as appropriate.

### **Background**

2. YPO was established in 1974 to maintain effective, efficient and economical arrangements for the supply of goods, materials and services. As the YPO business develops there are number of restrictions placed on that development by the current joint committee structure. These include both risk based restrictions and legal trading power restrictions.
3. YPO is responsible for over £220m worth of energy procurement on behalf of public bodies (typically local authorities and schools). As schools become academies and break away from local authority control, the YPO energy buying consortium is in danger of breaking up. Since schools currently represent in the region of 35% (£77m) of all energy bought via the consortium, any loss of this volume would have an adverse effect on YPO's buying power in the market and would also have an impact on the level of revenue enjoyed by

YPO from providing this service. Local Authorities are increasingly unwilling to sign up academies onto the authority's energy arrangements and are leaving academies to organise their own energy procurement (often resulting in greatly increased costs). YPO has been successful in agreeing arrangements with the energy providers to allow the academies to stay in the consortium in their own right. However this is seen as an interim arrangement and as the number of academies increases, the energy suppliers may not wish to carry the risk of dealing with them directly. YPO wish to establish a limited company trading entity which would become part of the consortium in its own right and could sign up academies and other bodies directly, thus allowing YPO to continue to provide the service and aggregate demand. This would not be wise under the current joint committee structure as the credit risk would be borne by all member authorities. Using a limited company will limit this risk and also allow for YPO to apply a risk premium to its charges to this segment of the consortium.

4. A limited company would also allow YPO to offer the energy buying service to non-public sector organisations. This is something that a key YPO competitor is already doing.
5. Similarly, as services are outsourced within local authorities and schools YPO is restricted in its ability to trade with the outsourced partners. This occurs with energy when services are outsourced to large construction and FM companies but also in areas such as food (schools catering), cleaning materials (cleaning services) and temporary labour (care homes). A limited company structure would allow YPO to retain business when it moved to the private sector and would also allow YPO to actively target private sector organisations already in place.
6. Finally, there is a risk that legislative changes (particularly in state aid legislation) will make it more difficult to trade via a joint committee structure in the future. The establishment of a limited company will future proof the organisation against this potential risk. Given the complexity and timescales in setting up a limited company owned by thirteen member authorities, it is better to be prepared for this risk than trying to react after the event.
7. Alternative proposals for achieving the objective of protecting existing YPO activity have been considered but this proposal is the only option that is available to Local Authorities for trading on a

commercial basis with non-public bodies. In addition, we have considered the option to do nothing and believe that this would end in diminished returns for Founder Members and see YPO business reduce significantly over the next five years.

## **8. Points to Note:**

- 8.1. The Directors of the Holding Company will be the elected member nominated by each Founder Member Local Authority.
- 8.2. The Directors on subsidiary boards are expected to be YPO officers through a service agreement with the holding company.
- 8.3. The Articles of Association will be drawn widely however the Contracting and Financial Procedure rules will provide appropriate levels of delegation and authority for managing the business of the company.
- 8.4. Risk Management will be handled by YPO through the service agreement.
- 8.5. Whilst the Local Authorities will be the shareholders, the nominated Member will be a Director of the company and must make decisions in the best interests of the Company. Where a shareholder decision is required then specific delegation to vote as the shareholder will be required from the relevant Local Authority.
- 8.6. The development of a Service Agreement between the Holding Company and YPO Joint Committee will be part of the Shareholder agreement.
- 8.7. The shareholding will be one share to each shareholder and disposal of shares will either be to other shareholders or the company at nominal value.

## **Consultation**

9. There has been extensive consultation with member authorities throughout 2013, as well as detailed discussions between Strategic Officers, Legal Officers and elected Members over several months,

and the consensus has been reached that there is the need to establish a Limited Company at this time. Each member authority will be required to follow their own democratic process in order to obtain formal agreement to become a shareholder of the company and it is expected that, in most cases, this will require a resolution of each council.

## **Options**

10. There are two options:

Option 1:- To form YPO Procurement Holdings Limited.

Option 2:- Not to form a company.

## **Analysis**

11. Option 1 is recommended by YPO officers as a commercial imperative in order to protect current revenue and future growth. To continue to trade solely as a joint committee, only with public bodies would not enable future growth and may not protect current revenue.

## **Council Plan**

12. The formation and operation of the proposed company will lead to a creation of jobs and growth in the economy.

## **Implications**

### **Financial**

13. The financial implications of establishing a Limited Company fall into 3 clear categories. These are the initial set-up costs, the initial capitalisation of the company and the on-going annual cost of service provision under the Service Agreement.

14. The initial set-up and capitalisation costs are estimated at £85,000. This can be funded by retaining £6,500 per Founder Member authority from the 2013 dividend distribution. YPO surpluses for 2013 are likely to be greater than had originally been estimated so this should be easily achieved without impact on individual Councils.

15. The on-going service charges, which will be incurred by the new company are estimated at £15,000 annually. These will be paid by the new company from profits generated.
16. Any profits generated by the new company will be subject to Corporation Tax. Any post tax profit will then be distributed to the 13 shareholders in equal proportions.

### **Human Resources (HR)**

17. There are no staffing or other implications as the company will obtain services and staff from YPO through the Service Agreement.

### **Equalities**

18. Although the company formation has no direct equality implications, the company will enable those not currently able to trade with the joint committee to trade with it.

### **Legal**

19. Legal Powers

Founder member authorities comprising YPO joint committee wish to provide goods and services to the public and private sector bodies which are for example not covered by the Local Authorities (Goods and Services) Act 1970. There are arguably two “overlapping” statutory provisions :-

- (a) Section 95 of the Local Government Act 2003 (“2003 Act”) and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 SI 2393 (“2009 Order”). This provides the power to trade in “function related activities”
- (b) Section 1 - 4 of the Localism Act 2011 (“2011 Act”) (General Power of competence) for non functional related trade.

Both the 2003 Act and the 2011 Act require the formation of a company. Such a company will arguably be regulated by part 5 of the Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995 (“LACO 1995”) if the courts decide the 2003 Act and LACO 1995 amount to a pre commencement limitation or restriction under section 2 (1) of the 2011 Act. The legal framework governing Local Authority

companies is in the process of being amended by the introduction of Part 12 of the Local Government Public Involvement in Health Act 2007 (which is not yet in force).

20. Local Government Act 2003

Under Section 95 of the 2003 Act and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009, the Founder Members have power to trade with public or private sector bodies (or to do for a “commercial purpose”) anything which they are authorised to do for the purpose of carrying on any of their ordinary functions. This relates to function related activities.

“Ordinary functions” are defined in section 97(11) of the 2003 Act, as well as those functions of the relevant authority that are not contained in section 95, (those outside the specific trading function). Therefore before deciding to trade commercially Founder Members must be satisfied that they have the power to engage in the activity.

21. In terms of YPO activities, the discretionary procurement activities in the sale of goods to public sector bodies are things that they have power to do for their ordinary functions. Accordingly they can do this for a commercial purpose (e.g. Selling in the market for profit and losses). Section 95 is subject to the following main restrictions :-

21.1. The power is only exercisable through a company (Section 95(4) of the 2003 Act) within the meaning of part 5 of the Local Government and Housing Act 1989.

22. Before exercising the power the authority must :-

- Have regard to guidance issued by the Secretary of State (S96(2)). Statutory guidance has been issued by ODPM “General power for Local Authorities to trade in function related activities through a company” (July 2004) (As amended by DCLG in April 2007)
- Prepare and approve a “Business Case” in support of the proposed exercise of the power that is defined in article 2 of (4) of the 2009 trading order. This is to ensure the risk is effectively managed by the authority

- Must recover the cost of accommodation, goods, services, staff, or anything that applies to a trading company under any agreement or arrangement to facilitate the exercise of the section 95 power to trade (article 2(3) of the 2009 Trading Order). This is to ensure compliance with state aid rules.

23. Under the 2009 Trading Order, the Business Case for these purposes is a comprehensive statement as to :-

- (a) The objective of the business;
- (b) The investment under the resources required to achieve those objectives;
- (c) Any risks the business might face and how significant those risks are and
- (d) The expected financial results of the business together with any other relevant outcomes that business is expected to achieve. This is line with the Councils fiduciary duty and that public money is properly and reasonably used in public law terms. For the purpose of the Trading Order 2009 and statutory guidance it appears that the business case at annex 1 meets the statutory requirements.

24. Localism Act 2011 (General Power of Competence)

The general power of competence provides that “A Local Authority has power to do anything that individuals generally may do” (section 1(1)). On the face of it, this would permit Founder Members to trade in the market and sell goods and services to private and public sector bodies. However, the 2011 Act makes this clear that this can be done for a “Commercial purpose”. This is not defined in the 2011 Act but is likely to mean trading for profit and to do it anywhere in the United Kingdom.

The 2011 Act provides that if a parallel power (e.g. Local Government Act 2003) imposes any restrictions, the 2011 Act power is subject to those restrictions. Accordingly use of the 2011 Act would be still be subject to the requirement that :-

- Before exercising the power they must prepare a Business Case in support of the proposed exercise of that power, and approve that Business Case; and
  - Recover the cost of any accommodation, goods, services, staff or any other thing that they supply to the company.
25. Local Authorities cannot fetter their discretion. The exercise of powers under Section 95 of the 2003 Act and or the 2011 Act is subject to Public Law considerations of rationality, acting reasonably, and having regard to relevant matters and ignoring irrelevant considerations. In addition there are other statutory constraints such as Section 149 of Equality Act 2010 and the Competition Act 1989 need to be considered. It is not considered that the formation of the trading company would distort or restrict competition or abuse a dominant position.
26. The Founder Members have the power to subscribe for shares (and receive dividends) in the company under Section 1 of the Localism Act 2011, and must determine that the investment is reasonable in terms of the Council's fiduciary duty to tax payers and its duty of duty of best value [given the anticipated return on investment mentioned in the Business Case].
27. Founder Members have the power to provide support services including staff to the company to the company under Section 1 of the Localism Act 2011 and to make a charge (Cost recovery only) under section 93 of the 2003 Act and accordance with statutory guidance.
28. It would be within the powers of the Founder Members, and a proper exercise of their powers to enter into the shareholder agreement. The Founder Members have the necessary powers by virtue of Section 95, Section 111 of the Local Government Act 1972 and by virtue of Section 1 of the Localism Act 2011. Section 111 gives the Founder Members the power to do anything (whether or not involving expenditure, borrowing or lending money or the acquisition on disposal of any property or right) which is calculated to facilitate, or is conducive or incidental to the discharge of any of its functions. In addition the Founder Members have investment powers under Section 12 of the 2003 Act.



29. In order for the company to be registered using the name Holdings, it must be a parent company, or become a parent company within three months of incorporation.
30. YPO Procurement Holdings Limited would need to:
- hold a majority of voting rights in another company, or
  - be a member of that other company and have the right to appoint or remove the majority of its board of directors, or
  - be a member of that company and control alone the majority of voting rights.
31. Given the intentions behind the company structure approval is now sought to also incorporate a subsidiary which will be wholly owned by YPO Procurement Holdings Limited and the first directors of which shall be Simon Hill (Managing Director of YPO) and Paul Smith (Procurement and Supply Chain Director). This will ensure that all three of the criteria set out above have been met.

## **Other Implications**

### **Information Governance**

32. The information governance of the arrangements made between the company and YPO will be governed by a service agreement which will include data sharing agreements, whereby information is conveyed to ensure that information is processed properly and safeguarded appropriately.

### **Strategic**

33. The proposal to establish a limited company has two strategic implications:
- 33.1. It will allow founder members of YPO to protect existing activity as they will be able to continue trading through the limited company with private companies to which Local Authorities may outsource service delivery;
- 33.2. In the light of the expected reduction in Local Authority expenditure, it will allow YPO Founder members to explore

opportunities to increase and expand the current customer base beyond the public sector.

### **Corporate Implications**

34. The corporate implication for the Council is that it will become a shareholder in and a member of the company.
35. The Council will clearly wish to ensure that the company is acting in the interests of the Joint Committee at all times, and this will be achieved by a schedule of matters requiring unanimous consent of all the shareholder Councils : the most important of these is approval of the Annual Business Plan of YPO Procurement Holdings Limited.

### **Risk Management**

36. This is set out in the Report.

### **Recommendations**

37. It is recommended that Cabinet:
  - i) Note the preparation of the Business Case by YPO Officers in support of the proposed exercise of the power to trade and approve the final Business Case set out at annex 1 (exempt) to this report
  - ii) Agree to the formation of the trading company limited by shares wholly owned by the Founder Members of YPO (to be known as YPO Procurement Holdings Limited) to act as a holding company for a range of special purpose vehicles in order to protect the business of the YPO joint committee.
  - iii) Agree that the Council becomes a shareholder of the company limited by shares under the name of YPO Procurement Holdings Limited which may trade in accordance with section 95 of the Local Government Act 2003 and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 and or Section 4 of the Localism Act 2011.

- iv) Recommends Council to make appointments as its director and alternate director on the Company Board.
- v) Notes that the Chairman of the Board of the company will be as set out in the Shareholder agreement
- vi) Authorises the Director of Customer and Business Support Services to exercise the Council's powers of shareholder at general meetings in the company
- vii) Approve the governance and funding arrangements for the company as set out in this report.
- viii) Delegates authority to the Director of Customer and Business Support Services in consultation with the Assistant Director of Governance and ICT to finalise the detailed arrangements for the formation of the company including relevant financial matters and, governance issues, such as matters to be reserved to the Council as shareholder and to delegate authority to the Assistant Director of Governance and ICT or authorised representatives to enter into all necessary legal agreements or documentation and ancillary to the implementation of the above recommendations in accordance with the following documents substantially in the form set out in the;
  - The Memorandum and Articles of Association of the company – See annex 2 (exempt)
  - The Shareholder Agreement - See annex 3 (exempt)
  - The Management Services Agreement – See annex 4 (exempt)

**Reason:**

38. The business case (as set out at Annex 1) (exempt) is based upon protecting the current business which could be lost if outsourced to private bodies, access to new business to enable continued growth and protection against financial risk, resulting from structural changes in the customer base.

## Contact Details

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Report  
Approved

Date 20 March 2014

### Specialist Implications Officer(s) *List information for all*

*Implication ie Financial*

*Implication ie Legal*

*Name*

*Name*

*Title*

*Title*

*Tel No.*

*Tel No.*

**Wards Affected:** *List wards or tick box to indicate all*

**All**

**For further information please contact the author of the report**

### Background Papers:

Papers issued to the YPO Joint Committee for the 31<sup>st</sup> January 2014 meeting (exempt)

**Annexes (exempt as described in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972, as amended : Information relating to the financial or business affairs of any particular person (including the authority holding that information)**

**Annex 1** The Business Case

**Annex 2** The Memorandum and Articles of Association of the company

**Annex 3** The Shareholder Agreement

**Annex 4** The Management Services Agreement