

Executive

30 June 2016

Report of the Chief Executive

Portfolio of the Executive Member for Finance and Performance

Council Owned Companies: Future operating models and proposals for the City of York Trading Company Board

Summary

1. The Executive has agreed to review the governance of the Council owned companies in light of the Public Interest Report recommendations. The Council is the sole owner of two companies and the joint owner of five others. This report describes their existing governance arrangements. The report also makes reference to other bodies which provide significant services to the Council but which are not Council owned.
2. As the Council develops proposals to deliver its budget over the coming years, it is considering the income generating opportunities presented by trading some of its activities through external trading companies. This report therefore also sets out proposals to create a common governance structure to oversee Council current and future trading activity.
3. The City of York Trading Shareholder Group have made recommendations for Executive approval in respect of appointment of a Managing Director and changes to Board structure which are attached at Annex A and B.

Recommendations

4. Executive is asked to agree:
 - a. To establish a single member decision making committee to act as shareholder and oversee the business of all Council trading companies (The Shareholder Committee) composed of a minimum of 2 Executive Members.

Reason:-To ensure effective governance of trading company activity.

- b. To agree the terms of reference and the roles and responsibilities of The Shareholder Committee as set out in the report.

Reason:-To ensure effective governance of trading company activities.

- c. That the Chief Executive in consultation with the Leader and Deputy Leader determine and publish within the framework approved by the Executive, initial delegations on a company by company basis to The Shareholder Committee if separate from the Executive and subsequent officer delegations. These delegations to be reviewed from time to time with the Council's broader scheme of delegations.

Reason: - To give effect to the Governance principles agreed by Executive.

- d. Subject to approval of the above recommendations, the existing shareholder arrangements cease upon creation of The Shareholder Committee.

Reason: - To remove existing shareholder arrangements.

- e. To note the conflicts of interest that Directors can be subject to as identified in paragraph 9 of the report and that these will continue to be considered in the approach to the selection of Directors.

Reason: - To ensure the principals of good governance principals are reflected in the Council appointments process.

- f. That the practice to provide briefings to newly appointed Directors on their role and, in particular, on managing conflicts of interest is made a formal requirement for all future appointees to attend.

Reason: - To ensure that Directors are conversant with their multiple statutory responsibilities.

- g. To consider and give effect to the recommendations of the existing City of York Trading Shareholder Group in relation to the recruitment proposals for a Managing Director for City of York Trading Ltd and approve the proposed role description and salary, together with the revised structure of the City of York Trading Ltd Board itself.

Reason: - In order to comply with decision making arrangements relating to the business of the shareholder group.

Background

5. Local authorities have established companies over a number of years. Their use may be set to increase as authorities look to deal with the challenging budget situation faced across local government, since a company structure is usually required to enable trading for profit with organisations or individuals outside the public sector.
6. As a shareholder, the Council's role is not to manage the business. That is a matter for the Board and the company's senior staff. As commentators such as Grant Thornton have noted¹ the overriding determinant of a company's success is the drive and ambition of the people running the business. Company Boards must therefore be allowed sufficient freedom to deliver the strategic and operational priorities of the Company. The Board must also have Directors with the right skills to be able to manage the business of the company.
7. However, proper governance arrangements should include safeguards and arrangements for oversight which protect the Council from poor performance and excessive risk taking.
8. Where former local authority in house services are being provided through companies, steps are commonly taken to ensure that, at least at the outset, the Council can take advantage of the Teckal exemption. This is the EU principle which allows public bodies to enter contracts with their own companies without following normal procurement processes. To benefit from the exemption the company must rely on the public authority for at least 80% of its business and the authority must exercise over the company a similar level of control to that which it exercises over its own departments. The governance arrangements must therefore ensure that this level of control can be exercised.
9. Company Directors have a duty to act in the interest of the company. However, where those Directors are Councillors they are still bound by the Members code of conduct and where there are Officers, conditions of their contracts of employment will still apply. The conflicts which may arise have to be managed within the governance and operational arrangements. It is inevitable that there will be some "Potential" conflicts, but through appropriate controls, monitoring and review, such conflicts can be managed.
10. In considering the governance arrangement currently in place the following sections of this report consider the following key issues:

¹ Spreading their wings: Building a successful local authority trading company

Ownership and activities
Board make up
Arrangements for oversight
Arrangements for Managing conflicts

11. The current Shareholder advisory body has considered proposals brought forward by the City of York Trading Ltd and have made recommendations to the Executive for consideration of the appointment and terms for a new Managing Director.

Existing Trading Activities

City of York Trading Limited

12. The Council is the sole shareholder of this company, the main business of which currently is the supply of temporary teaching, care and administrative staff, although other services can be and are traded through the company. The company was established in 2011 with a number of reports on its governance having been taken through the former Cabinet. The governance arrangements were established with the advice of expert external lawyers.
13. The Council is responsible for appointing the Company's Board and selecting the Chair. From its inception the Board has been chaired by a Councillor. Officers currently fill two other positions. There is no payment for these roles. There is provision for external Directors, one of whom is currently in position.
14. A shareholder's agreement sets out decisions which the Directors can only make with the approval of the Council. In particular, the Council is able to control the strategic direction of the Company through having the right to approve substantial changes in its business plan. The Executive reviewed this agreement at its meeting in September 2015.
15. A cross party shareholder's committee (now known as the CYT Shareholder Group) has had oversight of the company from inception and receives a quarterly report. The Group has no decision making powers but, in accordance with the 2015 agreement may advise the Executive on the exercise of its powers as shareholder and may make recommendations to the Board in respect of the appointment of Directors.

16. Decisions required by the Council are executive decisions which may be made in accordance with the scheme of delegations by the Executive, Executive Members or the Officers as appropriate.
17. Separating the monitoring and decision making roles between the City of York Trading Shareholder Group and the Executive are an accepted way of working. Norfolk County Council, although operating a non executive structure, has a similar split between the decision making committee and the shareholder committee which oversees the Norse group. Norse is perhaps the largest local authority trading company in existence.
18. The governance arrangements for City of York Trading Ltd recognise and authorise for company law purposes the potential conflicts which could arise between Council and company roles. Operating practices are in place to control conflicts which may favour the company. In particular these could relate to decisions making around the appointment of agency staff. Accordingly Directors do not authorise the engagement of company workers on Council business. The proposed move to the Company employing its own Managing Director will further reduce the potential for conflict although could reduce the level of direct Council influence over the company.

Make it York Limited

19. The Council is the sole shareholder of this company which was established to deliver marketing, culture, tourism and business development in the City. The company was established in 2015 and the former Cabinet received several reports in respect of its proposed governance. This was also considered by the relevant scrutiny committee. External expert legal advisers were instructed on behalf of both the Council and the new company in agreeing these governance arrangements.
20. The Council has appointed a Board of twelve including two Council representatives. There are no payments for these roles. The Board is independently Chaired and employs a full time Managing Director. At least one Council appointed Director must be present for a Board meeting to be quorate.
21. The Company's Articles set out a range of decisions which can only be made with the approval of the Council. These would require Executive approval. As with City of York Trading Ltd, the Council is able to exercise strategic control though having the power to agree certain reserved matters including the approval of the company's business plan.

22. A cross party shareholders' group meets quarterly. Similar group to the City of York Trading Shareholder Group and monitors the company's performance but has no decision making powers.
23. A potential conflict of interest exists in that the Company is a provider of services to the Council. In recognition of this risk a separation of duties between the client Officer and the Council appointed Directors has recently been put in place. A further risk could arise if the Council were called upon to make decisions affecting the company's business. That risk is managed by following normal protocols relating to the declaration of interest.

Yorwaste Limited and SJB Recycling

24. Yorwaste was established in 1993 by North Yorkshire County Council, as an arms length waste disposal company to meet legislative requirements then in place. Following Local Government Reorganisation a 22.27% shareholding transferred to the City Council. Yorwaste has recently established itself as being Teckal compliant with the support of the former Cabinet through a decision of March 2015. Expert external legal advice was obtained in refreshing the governance arrangements at this time. SJB is a Recycling and waste company purchased by Yorwaste and through the Teckal process this company has now come under the same direct ownership and governance arrangements as Yorwaste.
25. NYCC are entitled to appoint three Directors and CYC two. These may be Officers or Members.
26. Member Directors on Yorwaste are entitled to an allowance established in accordance with NYCC's remuneration arrangements which are paid for by the Company. The Company also employs a full time Managing Director and Non Executive Directors have also been appointed. The distribution of voting rights ensures that together the Council Directors have control.
27. There is an obvious potential for conflicts of interest with Yorwaste. The Council is a purchaser of Yorwaste services. It is also potentially a competitor in that CYC operates a commercial waste collection service as does Yorwaste. So far as the company is concerned this potential conflict is recognised and authorised by the Company's Articles. Until recently issues relating to the purchase of services were controlled through the fact that contracts were won in open competition. As the Company is now Teckal compliant competition is no longer required. Instead a system of open book accounts has been introduced.

28. In relation to the potential conflict arising from Yorwaste being a competitor of the CYC's commercial waste service, this is mitigated by ensuring that the Council Directors do not participate in the pricing of any CYC contracts and would not participate in pricing decisions at Yorwaste.
29. In order to demonstrate the level of control required for Teckal compliance a shareholder's agreement provides for a shareholder's representative to approve reserved matters. These are the approval of the annual business plan and certain transactions which are not contained within the plan. In order to ensure independence the Shareholder representative is the Director of Customer and Business Support Services for York and his equivalent for North Yorkshire.

Yorkshire Purchasing Organisation (YPO)

30. The City of York Council was a founder member of the Yorkshire Purchasing Organisation. This is a local authority joint committee which supplies products and services to the public sector. In 2014 the then Cabinet approved York along with the thirteen other founder members establishing and taking a share in YPO Procurement Holdings Limited. This decision allowed YPO to offer services to organisations with which it would not be permitted to trade as a local authority joint committee.
31. Each shareholder is entitled to appoint one Director to the company who must be either a member or employee of the Council. The Council has appointed a Member to the Board. A strategic officer's advisory group made up of officers of each Council advises the board. This mitigates the risk which may arise if the appointed Directors are themselves inexperienced in the management of the business undertaken by the Company. YPO also employs its own staff including a full time Managing Director who works on company business.
32. A shareholder's agreement sets out a number of matters which require the unanimous agreement of the shareholders.
33. Given that the business of this Company relates to the provision of services outside the public sector the potential for conflicts of interest to arise is relatively limited.

Veritau

34. Veritau is a shared services company established in 2009 providing internal audit services to York and North Yorkshire who own the

company in equal shares. A number of reports were considered by the Executive in 2008 and 2009 approving the company's governance. Those reports demonstrate appropriate legal advice to have been taken.

35. A sister company provides services to the North Yorkshire district councils. That Company is owned by Veritau Limited and the five district councils. Those arrangements were approved by the then Cabinet in 2012.
36. Veritau's Board is made up of the two Section 151 Officers in an unpaid capacity, the Councillor from each Authority with the finance portfolio (also unpaid), the Company's two most senior officers including its full time Managing Director and independent Directors.
37. A shareholder's agreement includes a number of matters which are reserved for shareholder approval including establishing the business plan and undertaking or ceasing to undertake any aspect of the business.
38. It could be argued that there is a potential for a conflict of interest between a Section 151 Officer and the finance portfolio holders being directors and their role as a customer of internal audit. This is partially, mitigated by the fact that the Council has entered a ten year agreement with Veritau for its core services (albeit with the normal change provisions expected in a long term contract).
39. Furthermore, in the context of the services provided by Veritau it is considered to be a strength that the Section 151 Officer performs this role. It is a legal requirement to undertake an efficient internal audit and the internal audit function is integral to the performance of the Section 151 duties in relation to the proper administration of the Council's affairs. Having the Section 151 Officers as Directors helps to ensure that Veritau retains a focus on its core business as the Council's internal audit function.

York Science Park Limited

40. The City Council holds a small minority shareholding in York Science Park Limited with the University of York being the majority shareholder. The company manages York Science Park.
41. The Council has the right to appoint one Director. Currently that is an Officer appointment in an unpaid capacity.

42. The Council has its own commercial property portfolio which could create a conflict of interest. This risk is mitigated by the fact that the Council's Director is not involved in the management of the property portfolio.

Science City York Ltd

43. Science City York is a company limited by Guarantee of £1 and was established on a shared ownership basis with the University of York. The University withdrew from the company in July 2014 and the company is now dormant, undertaking no trading activity. It should be noted that the Science City York brand is currently used by Make It York to deliver its services but there is no relationship with the company. Going forward the Council will need to determine if it wishes to keep this company.

Other Models

44. Local authority trading companies are, of course, only one of a number of alternative service delivery models which exist. In York there are also three examples of services which were formerly provided directly by the Council but which are now provided by charities/social enterprises to which staff transferred from the Council. These are the Library Service provided by Explore, the York Museums Trust (YMT) and the Aids and Adaptations Service provided by Be Independent. These entities are not controlled by the Council and the Council does not appoint to their Boards, although the Council does nominate two trustees to YMT and like Company Directors they are required to act in the interest of the Trust and not the Council. These entities were all established by reports on proposed governance with the Museums Trust recently being the subject of a detailed review by the Executive. In each case the entities and the Council received legal advice in respect of the establishment of the company.
45. While the Council cannot dictate how these entities are run (and would create legal difficulties for itself if it attempted to do so) the Council clearly has significant influence as the major customer of both services.

Future Trading activity

46. There are future opportunities for trading and the Executive has already instructed officers to explore options for the establishment of companies for commercial property partnerships in the Southern Gateway and Off Street Parking. Many other opportunities will arise over time other Councils have examples in areas such as :-

- Commercial Property Development
- Schools Support services
- Consultancy
- Fleet maintenance
- Commercial Waste Collection
- Recycling

Proposals for a common Governance Framework of current and future trading companies

47. In light of the recent increase in trading companies and the exploration of opportunities to create trading companies in the future, there is increasing complexity in the Council's governance arrangements and this in turn brings risks that the Council will not be able to demonstrate that it is clearly managing its differing responsibilities, as both an owner (shareholder) of a number of companies and a client of the businesses. Greater consistency of the governance of these bodies will provide reassurance that :-
- The Council is seen to be acting in an open and transparent manner in respect of its trading activities;
 - the objectives of the companies are being delivered;
 - that performance and risk are being managed;
 - that the extent of any delegation of responsibilities to Shareholders and Directors is clear;
 - that there is transparency around key Council decisions;
 - that commercial confidentiality can be effectively maintained where appropriate.
48. Given the likelihood that there will be significant structural change to the organisation in the coming years and it is envisaged there could be an increase in the number of arms length trading companies even beyond those currently being explored it is recommended that the Council take a proactive approach to governance in response to current complexity and in advance of future change.
49. If the Council were to expand upon trading operations without consolidating governance arrangements, this could lead to a preponderance of stakeholder committees which will be increasingly difficult to resource and manage. It is therefore desirable to establish a consistent approach with The Shareholder Committee overseeing all

shareholder responsibilities to these companies, recognising The Shareholder Committee responsibilities will vary from company to company depending on the specific company constitution. There would be for example, variations in The Shareholder Committee responsibilities between wholly owned companies and jointly owned companies.

50. This complexity of current arrangements is self evident in the current processes that the City of York Trading Ltd has undertaken in respect of the proposed appointment of the new Managing Director. The process is now drawing to a close and the existing shareholder group have recommended the proposed details and terms of appointment which are attached at annexe A and B. The Executive is asked as part of this report's recommendations to confirm those recommendations.

Governance Principles

51. In establishing a governance framework around the operation of trading companies, new arrangements will need to abide by the following principles :-
- Defined role for Executive, Shareholders, and Council appointed Company Directors, Scrutiny Committees, and Client Officers establishing clear lines of responsibility and accountability.
 - Clear specification of outcomes from the Council as Client.
 - Clearly identified reserved matters that cannot be considered by the Board of Directors and clear schemes of delegation including delegations to The Shareholder Committee if formed, covering the exercise of shareholder powers.
 - The Governance structures should actively safeguard the council's interests through effective risk management and oversight of delivery against strategic objectives.
 - All companies should develop Strategic Business Plans to which they are held accountable to by The Shareholder Committee and are regularly reviewed and kept up to date.
 - Company structures should be streamlined by function and where necessary should use group structures to manage variations of delivery models or where individual company risk profiles necessitate placing limits on liability.
 - Deliver the appropriate level of commercial agility around decision making to exploit trading opportunities.

- Comply with legislative requirements as appropriate to their corporate structure and form.
- Engage as necessary external private sector expertise through appropriate engagement of Non Executive Directors.
- Where council staff transfer into a company there must be a clear migration plan to ensure TUPE compliance.
- All Council appointed Directors to Company Boards and The Shareholder Committee Members will be provided with appropriate training in order to effectively discharge their responsibilities.

Governance Structure

52. Consideration has been given to how a potential Governance structure options and the following proposal are intended to provide a clear and focussed option for ensuring clarity and effectiveness of function. The diagram at Annex C illustrates the proposed governance structure.

Roles and Responsibilities

53. The core roles and responsibilities of each level of the proposed governance model are set out below:-

Option A

An Executive Committee would be formed to fulfil the role of (The Shareholder Committee).

54. The Executive would be responsible for :-
- I. Establishing new companies/decommissioning existing companies;
 - II. Determining the Articles of Association;
 - III. Establishing the % share of ownership;
 - IV. Agreeing any investment of funds or assets;
 - V. Agreeing any lending to the company;
 - VI. Establishing the scheme of delegation and identifying reserved matters;
 - VII. Appointing/Dismissing Directors (this may be delegated to Staffing Matters and Urgency Committee or the Shareholder Committee).

55. It is proposed that in order to provide flexibility of roles that The Shareholder Committee be an Executive Committee supplemented at Members' discretion by advisors, partners or cross party representation who will not have voting rights. They will be responsible for :-
- I. Acting as owners/joint owners of the company;
 - II. Sign off Strategic business plans;
 - III. Monitoring performance and financial delivery against strategic business plans;
 - IV. Operating within powers delegated by the Executive and exercise decision making over reserved matters;
 - V. Determining the remuneration of Directors and any senior managers as identified in the specific scheme of delegation and agreeing any performance related bonus payments to staff;
 - VI. Making recommendations to Executive for any investment in/asset transfers to or lending to companies;
 - VII. The Shareholder Committee would determine on an individual company basis whether they wish to delegate functions to Officers of the Council to increase commercial flexibility.
56. Council appointed Company Directors could be constituted from a mix of Elected Members, Officers of the Council or external Non Executive Directors. Where this is a partnership company there will also likely to be Board Members appointed by the partner organisations. Company Boards would typically be responsible for :-
- I. Undertaking the legally defined role of Company Director;
 - II. Strategic operational control of the company;
 - III. Developing and delivering a Strategic Business Plan;
 - IV. Regular reporting on progress and performance against the Strategic Business Plan;
 - V. Agreeing the pay structure and terms and conditions of employment for company staff including any performance related pay schemes (but excluding any generic bonus payments).
57. The Client Officers would be the Council Senior Managers as identified by the Chief Executive who will be responsible for :-

- I. Commissioning outcomes from Companies to fulfil corporate objective through SLA/Contracts as appropriate;
- II. Seeking to ensure that the council requirements are addressed into the Strategic Business Plan;
- III. Monitoring delivery against the agreed outcomes/SLAs;
- IV. Support the activity of scrutiny committees in reviewing performance of companies.

58. Corporate & Scrutiny Management Policy & Scrutiny Committee would :-

- Scrutinise the decision making of The Shareholder Committee and the statutory officers that support it.

59. Other Scrutiny Committees would as appropriate to their remit :-

- Scrutinise the performance of individual companies in delivering the specified outcomes of service level agreements or contracts with the council supported by Client Officers.

Option B

60. Under Option B, it is proposed that no Shareholder Committee of the Executive would be created with the Executive taking full responsibility for the roles and functions identified above of both The Shareholder Committee and the Executive.

61. This option benefits from including more Members of the administration in the shareholder decision making process. However, this option will give rise to the potential for a greater number of conflicts of interest to arise should Executive Members wish to be on the Boards of some of the Companies.

62. The additional disadvantage of Option B is that it has the potential to reduce the speed of decision making for the Companies whose commercial flexibility is an anticipated outcome of their creation. Therefore this in order to deliver additional flexibility this option could lead to greater officer delegation when practically implemented.

63. Option A however reduces these risks as it provides the Council with a three tier approach to decision making. Flexibility increasing and financial significance reducing as the decisions are delegated further down the structure. As only a sub set of the Executive is envisaged on The

Shareholder Committee this should allow greater flexibility in the appointment of Directors.

Conclusion

64. The report demonstrates that each existing company which is controlled by the Council or in which it has a significant stake was established following consideration by then Executive or Cabinet. In each case appropriate legal advice was taken on the company's governance structures. They are all therefore fundamentally sound.
65. For those companies which require the benefit of Teckal compliance the governance arrangements in place require certain matters to have shareholder approval. For Yorwaste the governance arrangements themselves dictate how that approval should be given – through the appointed shareholder representative. For other companies currently normal Council decisions making protocols apply.
66. Historically differing approaches have been taken to the appointment of Directors and the role of shareholder. In some cases the governance arrangements dictate who should be appointed. In others there is flexibility.
67. As we create more trading companies this has the potential to increase the governance complexity and this in turn brings risks that the Council will not be able to demonstrate that it is clearly managing its differing responsibilities as both an owner (shareholder) of a number of companies and a client of the businesses.
68. This report brings forward proposals to place the governance of all current and future companies where the Council has a shareholding within a common framework. As local authority owned companies it is clearly appropriate that elected Member oversight is provided. However, commercial enterprises do need to be able to operate quickly in a commercial environment and ensure that the right skills are available to their Boards to enable them to operate effectively.
69. The Council has issued guidance in the past to its appointed Directors. The Council should ensure that it is standard practice to issue such guidance whenever new appointments are made and not rely simply on the companies providing appropriate training.

Council Plan

70. The establishment of a new Governance framework for all traded activity will contribute to the objective to:-

- i. We are entrepreneurial, by making the most of commercial activities.

Implications

71.

- **Financial** - There are no direct financial implications to the council regarding the proposed governance arrangements. However the companies owned by the council provide the opportunity to deliver future financial savings.
- **Human Resources (HR)** – There are no HR implications associated with this report
- **Equalities** – The proposals within this report are related to internal governance arrangements and exploration of options and therefore have no community impact other than increasing transparency of decision making.
- **Legal** – The review of existing Governance arrangements has been undertaken by the Monitoring Officer and found to be sound.
- **Information Technology (IT)** - There are no IT implications.
- **Crime and Disorder** – N/a
- **Property** – There are no property implications associated with this report. However the governance arrangements in respect of company structures will assist in preparing the Council to be in a position to maximise the potential of its assets in the future.

Risk Management

72. The review of existing governance structures for the Council's arms length companies concludes that the arrangements where individually fit for purpose upon creation and received appropriate legal advice at the time.
73. However no structure will remain fit for purpose for ever and there is a degree of confusion and a lack of transparency with the multiple models currently in use.
74. In light of the Public Interest Report and the increasing number of companies now in existence this report proposes that the above risks are mitigated by rationalising the governance arrangements of existing companies into a single governance framework. This approach is intended to make the structure fit for purpose now and in the future should the Council choose to establish additional companies.

75. To guard against obsolescence of these proposals it is proposed that these arrangements are reviewed alongside the scheme of delegation.

Contact Details

Author:

Neil Ferris
Director City &
Environment Services
Tel.No. 01904 551448

Andy Docherty
Assistant Director
Tel No. 01904 551004

Tracey Carter
Assistant Director for
Finance, Property and
Procurement Tel No.
553419

Chief Officer Responsible for the report:

Steve Stewart – Interim Chief Executive

**Report
Approved**

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Date 20 June 2016

Specialist Implications Officer(s)

Financial – Patrick Looker
Finance Manager
ICT
Tel No. 551207

Legal – Andy Docherty
Assistant Director of Governance &
Tel No. 551004

HR – Mark Bennett – Head of HR
Tel 554418

Wards Affected: List wards or tick box to indicate all

All

Background Papers: None.

Annexes

Annex A – CYT Shareholder Group Recommendations

Annex B – CYT Job Description

Annex C – Illustrative Company Governance Arrangement

Glossary of abbreviations used in the report:

CYT – City of York Trading Ltd

CEO – Chief Executive Officer

EU – European Union

MD – Managing Director

MIY – Make it York

NYCC – North Yorkshire County Council

PRP – Performance Related Pay

SLA – Service Level Agreement

TUPE – Transfer of Undertakings (Protection of Employment) Regulations 2006

YMT - York Museums Trust YPO- Yorkshire Purchasing Organisation