

**CABINET MEETING: 16 JUNE 2016**

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**COMMISSIONING AND PROCUREMENT LOCAL AUTHORITY  
TRADING COMPANY (LATC)**

**REPORT OF THE CORPORATE DIRECTOR OF RESOURCES**

**AGENDA ITEM: 5**

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**PORTFOLIO: CORPORATE SERVICES & PERFORMANCE (COUNCILLOR  
GRAHAM HINCHEY)**

*Appendix 1A to this report is exempt from publication by virtue of paragraph 14 of Part 4 and paragraph 21 of Part 5 of Schedule 12A of the Local Government Act 1972*

**Reason for this Report**

1. To enable Cabinet to consider and approve proposals to establish a Local Authority Trading Company (Company) to deliver procurement and commercial services to public and private sector organisations.

**Background**

2. The Commissioning & Procurement Local Authority Trading Company Business Case (Appendix 1) was developed utilising the Office of Government Commerce "Five Case Model" which is seen as best practice for the public sector:
  - Strategic Case
  - Economic Case
  - Financial Case
  - Commercial Case
  - Management Case
3. The Business Case includes a detailed assessment of the three shortlisted delivery model options, the services that could be offered, the planned outcomes/benefits to the Council, cost benefit analysis, risk assessment and describes the legal structure and governance arrangements.
4. This Cabinet report provides an overview of the main issues addressed in the Business Case.

5. The Council's Commissioning and Procurement Service was established in 2011 to improve the way in which procurement was managed across the Council. Over the past five years the service has supported the Council to deliver cumulative savings totalling £40 million, improved compliance with our procedures and rules and helped the Council deliver against its policy aspirations.
6. The team has established an excellent reputation across the public sector in Wales and beyond. In the Welsh Government Procurement Fitness Check programme delivered by KPMG, the Council was rated as 'Developing to Advanced' overall and 'Advanced' in three of the eight fitness check categories, comprising Leadership and Governance; Procurement Strategy and Objectives and Performance Management.
7. The City of Cardiff Council has built up an award winning Commissioning and Procurement Team with skilled, knowledgeable and talented procurement professionals. The team has been award winners at both Welsh and UK level. Recent awards include:
  - Welsh Procurement Awards 2015/16 - 'Innovation in Procurement'
  - Society of Procurement Officers in Local Government (SOPO) Awards 2015/16 - Procurement Team of the Year and Outstanding Savings Delivery.
  - GO Procurement Awards 2016/17 - Highly Commended in the Procurement Team of the Year category.

## **Issues**

8. AS part of the Council budget deliberations, the Commissioning and Procurement service was given a three-year savings target of £307,000 to be delivered by 2017/18. It was acknowledged that a saving of £307,000 essentially equated to a reduction of eight to twelve posts within the service, and would necessitate a significant reduction and consolidation in the scope of service provision to Directorates.
9. In response to this savings target following consultation with employees the C&P Management Team submitted the following budget proposals:
  - Restructure the team to deliver £180,000 of savings (which was completed in 2015/16).
  - Trade procurement and commercial services externally to generate minimum external revenue of £160,000
10. These proposals were submitted on the basis that the Council could still retain access to experienced employees whilst still delivering the budget savings required. This also gave employees the opportunity to have a greater control over their future given the financial uncertainty facing the Council and an opportunity to develop existing skills and capability.
11. However, although the initial driver for this business case has been focused on retaining existing resources, the business case sets out a more ambitious case. The Council recognises that its workforce is its

most valuable asset and we believe that by investing in our current service and retaining and attracting the best talent that the Commissioning and Procurement can:

- Continue to effectively support the Council's contribution to delivering the seven outcomes contained in the "What Matters" strategy
  - Create an environment to develop creative and innovative solutions where we can learn from both the private and public sector
  - Develop a procurement and commercial service which is viewed as a 'centre of excellence' in procurement throughout the region, Wales and beyond
  - Respond to the procurement and commercial requirements across the South East Wales region and Wales resulting from Local Government Reorganisation and the increasing focus on provision of Shared Services
  - Contribute to and influence the procurement agenda for the UK Core Cities and Euro Cities
12. In terms of the options to generate external revenue three shortlisted options were considered in the Business Case (Appendix 1):
- Option 1 - "In-House" Team generating income by charging public sector bodies for services.
  - Option 2 – Employee Owned Mutual owned by current employees which trades with public and private sector bodies to generate income.
  - Option 3 - Establishing a Local Authority Trading Company which trades with public and private sector bodies to generate income.
13. Option 1 was ruled out as whilst the Council has the power to trade with public sector organisations at profit it does not have the power to trade with private sector organisations at profit. The market analysis indicates that this would close down significant opportunities to trade with and/or work in partnership with private sector partners.
14. Option 2 was ruled out as the independent external legal advice highlighted that there would be potential State Aid and Conflict of Interest issues if this option was followed with a mutual organisation being set up at a later date.
15. Option 3 was identified as the preferred option primarily because it allows the Council to rely on the general trading powers available under Section 95 of the Local Government Act 2003 and therefore the flexibility to trade with private sector organisations, the key opportunity as set out in the business case.
16. Competitor and Market Analysis has been undertaken and has shown that there is a shortage of experienced, high quality procurement professionals in both the public and private sectors. However, a key challenge for any new company is securing business and having a product or service that is marketable. Although there are opportunities to work directly with public sector organisations and the team has already

successfully completed two contracts for Welsh local authorities, the frequency and value of this work going forward is uncertain.

17. Through detailed discussions with private sector organisations it has become evident that there are significant opportunities for the Council-owned Company to work in partnership with private sector companies to deliver a range of procurement and commercial services. This would enable the Council-owned Company to build business expertise by working with partners who are already established in the market who have an existing client base, marketing and bidding skills.
18. This approach enables the team to gain additional skills, particularly commercial skills and the learning from this experience will be brought back into the Council.

### **Local Authority Trading Company**

19. This option proposes establishing a Local Authority Trading Company which would be wholly owned by the Council. The creation of this company would provide the general powers required to trade with private sector organisations. It is important to note that there would be no transfer of employees with this option and the Company would purchase employee time from the Commissioning and Procurement service at full cost. The Company will be required to 'purchase' all employee time spent involved on Company business including all non-rechargeable activities such as marketing and bidding. The Company would be able to charge both public and private sector clients the Council's full employee costs plus a mark-up to cover Company overheads and profit.
20. Although the primary driver for establishing a Company is the general power to trade, the creation of a trading company also provides a number of other benefits including:
  - Limited liability to reduce risk exposure to the Council
  - Defines clear boundaries between Council and external work
  - Opportunity to develop commercial and business skills
21. The external legal advice and market research also highlighted that a separate company to deliver commissioning and procurement services will provide the flexibility to react promptly and make quick commercial decisions to take advantage of time limited external opportunities.
22. The Council owned Company would be a company limited by shares incorporated under the Companies Act 2006. This form of company has been used by a number of Local Authorities and is the usual vehicle used by a Local Authority to set up a corporate structure providing services back to it, but also with the ability to trade. The principal advantages of using a Company Limited by Shares include:
  - **Limited liability** – as a separate legal entity, it can own and deal in assets, sue and be sued and contract in its own right. The circumstances in which shareholders (be it the Council or future

- partner(s)) can be held legally liable for a company's debts (beyond their unpaid capital contribution) are relatively limited;
- **Distribution of profits** – allowing profits (after deduction of tax) to be returned to the Council, as shareholder, by way of share dividend or reinvested in the company;
  - **Ability to attract investment** – in terms of overall control and financial and tax planning, the structure provides potential for flexibility through the creation of different types of shares and rights attaching to shares and loan capital.
23. The *Alternative Delivery Model – Infrastructure Services. Building a successful local authority company – Governance Options* Report to Policy Review & Performance Scrutiny Committee on 1 December 2015 (See Appendix 2) covered the governance issues that require consideration including:
- Company Constitution
  - Board and Membership
  - Reserved Matters
  - Conflict of Interest
  - Transparency/Scrutiny
  - Relationship between the Authority and the Company
24. The Company will be wholly owned by the Council which will also be the sole shareholder. There will be no requirement for the Company to rely on the TECKAL exemption as employees will remain employed by the Council and work for it will be delivered 'in-house' and not through the Company.
25. Employee time will be purchased at 'full cost' to cover budget savings and the Company will charge for external paid business at 'full cost plus mark-up'. As there remains a requirement for the C&P service to deliver the Council's priorities it is intended that the number of days 'purchased' by the Company in any financial year will be agreed in advance with the Council. Any variation in the number of days will need to be agreed by the Shareholder Representative.
26. It needs to be acknowledged that this delivery model is relatively simple and straightforward to establish particularly given there is no transfer of Council activity or employees and that initial trading volumes are circa £200,000 per annum. This equates to less than 600 days of employee time per annum being purchased by the Company, which includes the time spent delivering company work that is not rechargeable to the Company's clients, including marketing events and bid writing.
27. An initial equality risk assessment has been undertaken on the proposals and indicated that any risks were low. A full Equality Impact Assessment will be undertaken if Cabinet agrees to the Company being established.
28. The Proposal to establish a Council-owned Company to deliver Commissioning and Procurement Services was considered by Policy Review and Performance Management Scrutiny Committee on the 10<sup>th</sup>

May 2016. In his response to the proposals the Committee Chair stated that “overall the Committee accepts that the proposal to create a trading company is a good way forward for the Council; this view is based on diminishing delivery of services by the public sector, resulting in a lesser need for public sector procurement.” The comments and observations made by the Committee in their response of 16<sup>th</sup> May 2016 are accepted and will be actioned. The letter and response are attached as Appendix 3.

## **Governance Arrangements**

29. The board of directors of the Company will have responsibility for managing the Company and will shape the vision and the values of the organisation. The Council, being the sole shareholder, will appoint (and remove) directors to run the company. The directors will be appointed with the relevant skills and experience to deliver the procurement and commercial services.
30. The board of directors of the Company will meet as set out in the Articles of Association. The board of directors of the Company will produce:
- Annual budget
  - Annual business plan
  - Annual report and other documents required to set the strategic objectives of the company.

The Council will approve these strategic documents as the sole Shareholder on an annual basis and as and when required. The Corporate Director (Resources) and Section 151 Officer will act as the Shareholder Representative.

31. It is proposed that the Company Board of Directors shall comprise:
- Executive Chairman – Paul Orders, Chief Executive
  - Managing Director – Steve Robinson, Head of Commissioning and Procurement
  - Director – Chris McLellan, Senior Category Manager
  - Company Secretary – Ian Allwood, Chief Finance Officer and Deputy Section 151 Officer
32. There are a number of key constitutional and governance documents required to set up the Company and other documents relating to its operation and its relations with the Council. These will need to be finalised if Cabinet agrees to the creation of the Company to deliver Commissioning and Procurement Services.

## **Reason for Recommendations**

33. To gain Cabinet approval to establish a Local Authority Trading Company limited by shares to deliver procurement and commercial services to the public and private sectors.

## **Financial Implications**

34. The recommended option is the establishment of a Local Authority Trading Company (LATC) to enable the Commissioning and Procurement Service to work with external organisations and generate external income. The LATC would be a company limited by shares with the Council as the sole share-holder. A limited liability structure limits the Council's exposure to financial risk and provides the opportunity for an additional future income stream by way of dividend. The company's Articles of Association should set out the process for distribution of any dividend.
35. The Council's Budget and Medium Term Financial Plan includes an income target for Commissioning and Procurement (C&P) of £160,000 over the three-year period from 2015/16 – 2017/18. The plan was to achieve this through a staff restructure and the introduction of a trading ability. Under the proposed business case, this will be achieved by 2017/18 through the Council charging the LATC for the full cost of the employee time spent on company work. If the demand for work does not reach the level modelled in the business case, there is a risk that the income stream will not be achieved. The LATC pricing policy will need to be set at a level that covers employee costs, relevant council overheads and the LATC specific overheads.
36. The income stream generated for the Authority is a result of the LATC purchasing existing employee time and therefore the number of employee days purchased will need to be sufficient to generate the required income target. The associated reduction in C&P's capacity to undertake Council work will need to be managed and there will be a need to maintain an appropriate balance between conserving in-house capacity on one hand and the need to achieve income targets on the other.
37. The LATC would require a working capital loan of £20,000 to be provided by the Authority. This will need to be met from revenue in the year of issue. Interest on any loan would need to be charged at the appropriate market rate taking into account state aid regulations.
38. From a financial reporting perspective, as a wholly owned subsidiary of the Council, group accounting requirements, would apply. However, in early years of operation, it is likely that full consolidation may not be required on materiality grounds.
39. The different tax arrangements of the entity will need to be carefully managed. As a separate entity the LATC will be subject to the normal VAT recovery regime and will be subject to corporation tax.

## **Legal Implications**

40. The report recommends that the Council establishes a company that is able to provide procurement and related commercial services to public

and private bodies (i.e. to trade). Legal services prepared a report entitled *The Alternative Delivery Model – Infrastructure Services. Building a successful local authority company – Governance Options*, submitted to Policy Review & Performance Scrutiny Committee on 1 December 2015 (See Appendix 2). This report provided detailed legal advice on the establishment of local authority companies and the issues requiring consideration. That advice is relevant to the current matter and regard should be had to the same. Key aspects of that advice, which are particularly relevant to the recommendations in this report, are drawn out below.

41. In this case the Council already provides certain of the services concerned for a charge, based on existing powers but the instruction that a general trading power is sought points to the establishment of a company in order to rely on the trading powers available pursuant to the provisions of Section 95 of the Local Government Act 2003 ('Section 95'). Section 95 enables the relevant Minister (by regulation) to authorise relevant authorities to undertake commercial activities ('trading') in relation to their ordinary functions (section 95(1) (a)). In Wales the relevant order is, The Local Government (Best Value Authorities) (Power to Trade) (Wales) Order 2006 (SI 2006/979). ('2006 Trading Order').
42. Whatever level of trading activity is contemplated by a local authority, Section 95(4) provides that the activity can only be carried out by a company within the meaning of Part V of the Local Government and Housing Act 1989 (1989 Act). The 1989 Act provides for the following four structures (each has a different legal status): - A company limited by shares, a company limited by guarantee with or without a share capital, an unlimited company and a registered society within the meaning of the Co-operative and Community Benefit Societies Act. In this case it is proposed to establish a company limited by shares, which would meet the requirements of section 95 V (4).
43. The 2006 Trading Order provides that before exercising the power (to trade) the authority must prepare a business case and approve the business case. The business case is attached to this report and recommendation<sup>1</sup> seeks approval of the same. The business case is a very important document as an authority needs to act prudently before making any decisions to establish a company, given the potential commercial risks of trading. In particular, having regard to the Council's fiduciary duty and duty to act reasonably. The body of the report sets out the perceived benefits to the Council of establishing the company and why it is recommended, (i.e. in legal terms why the approach is perceived as a reasonable decision for the authority to take given the pressures faced).
44. The 2006 Trading Order also provides that the authority must recover the costs of any accommodation, goods, services, staff or any other thing that it supplies to a company. It will therefore be important that when the Council calculates the cost to be 'recharged to the company, that all costs incurred by the Council are taking into consideration. Put another way that the company's costs are not subsidised.



45. The detailed advice provided to Scrutiny committee considered issues such as a Company's constitution, board, its membership, reserved matters and the issue of conflict of interest. One point that requires particular consideration in this case is the potential for conflict of interest (perceived) in the following three areas.
- I. The terms and conditions on which the company is set up. To this end, it is proposed that those who will be involved in the company (potential directors) will not be responsible for determining the content of the various documentation required to establish the company. The recommendations delegating authority to the Corporate Director (Resources) and Section 151 Officer in consultation with the Council's Monitoring Officer to, agree the constitutional and governance documents required to set up the Local Authority Trading Company and all other documents required relating to the operations of the Local Authority Trading Company and its relations with the Council.
  - II. The potential for conflict, in terms of the Council's demand for procurement advice and time spent by procurement staff on company work. The body of the report sets out how this is to be managed so that clear parameters are set.
  - III. Directors. The individuals proposed to be appointed as Directors of the Company need to be mindful of any potential for conflict between their role as a Director of the Company and their roles as an officer of the Council. The report to Scrutiny provides detailed advice. The key with any matters that raise the potential for conflict interest is to be mindful of the same and take appropriate action to ensure the same do not arise.
46. The body of the report states that Option 2 was ruled out as the independent external legal advice highlighted that there would be potential State Aid and Conflict of Interest issues if this option was followed and a mutual organisation was set up at a later date. The key point to note here is that the legal advice related to the partial facts of the model as then proposed. Legal advice should be sought if at a future date the Council wishes to look at expanding the company or changing the nature of the company / its ownership.

#### General legal advice

47. All decisions taken by or on behalf of the Council must (a) be within the legal powers of the Council; (b) comply with any procedural requirement imposed by law; (c) be within the powers of the body or person exercising powers on behalf of the Council; (d) be undertaken in accordance with the procedural requirements imposed by the Council e.g. standing orders and financial regulations; (e) be fully and properly informed; (f) be properly motivated; (g) be taken having regard to the Council's fiduciary duty to its taxpayers; and (h) be reasonable and proper in all the circumstances.
48. The Council has to satisfy its duties under the Equalities Act 2010 (including the specific Welsh public sector duties). Pursuant to these

legal duties Councils must in making decisions have due regard to the need to (1) eliminate unlawful discrimination, (2) advance equality of opportunity and (3) foster good relations on the basis of protected characteristics. As such the decision on the recommendations in this report will need to be made in the context of the Council's equality act public sector duties. This will include undertaking an equality impact assessment in each case to ensure that the Council has understood the potential impacts of each decision in terms of equality so that it can ensure that it is making proportionate and rational decisions having due regard to the public sector equality duty.

### **HR Implications**

49. As the employees will remain employed by the Council on their existing salaries and terms and conditions of employment, there are no HR implications to the proposal to create a wholly owned Local Authority Trading Company as set out in this report, as nothing will change with the exception that the time they spend on specific projects will be charged to the LATC. This has no impact on the employees concerned. Expenses incurred in the course of undertaking projects for the LATC will be reimbursed at the rates agreed by the Council and these will also be charged to the LATC and any overtime worked will be paid accordingly.

### **RECOMMENDATIONS**

Cabinet is recommended to:

1. Approve the Commissioning and Procurement Local Authority Trading Company Business Case attached to this report and approve the establishment of a Local Authority Trading Company as generally described in this report to deliver procurement and commercial services to the public and private sectors
2. Approve the appointment of the Corporate Director (Resources) as the Council's Shareholder representative.
3. Note and recommend to Council approval of the officers as set out in paragraph 31 to be appointed as Directors to the Board.
4. Delegate authority to the Corporate Director (Resources) in consultation with the Council's Monitoring Officer to:
  - Agree the constitutional and governance documents required to set up the Local Authority Trading Company
  - Agree all other documents required relating to the operations of the Local Authority Trading Company and its relations with the Council

**CHRISTINE SALTER**

Corporate Director  
10 June 2016

*The following appendices are attached:*

- Appendix 1 – Commissioning and Procurement Local Authority Trading Company Business Case
- Appendix 1A – Commissioning and Procurement Local Authority Trading Company Financial Model
- Appendix 2 - *The Alternative Delivery Model – Infrastructure Services. Building a successful local authority company – Governance Options* Report to Policy Review & Performance Scrutiny Committee on 1 December 2015
- Appendix 3 – Letter from Chair of PRAP Scrutiny Committee dated 16 May 2016 and response from Cabinet Member for Corporate Services and Performance dated 7 June 2016

Commissioning and Procurement  
Local Authority Trading Company  
Business Case

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Steve Robinson

17<sup>th</sup> May 2016 Version 1.0

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This Business Case template has been developed using the Office of Government Commerce (OGC) “Five Case Model”, the best practice standard recommended by HM Treasury for use by Public Sector bodies when planning a public sector spending proposal.

You may need to obtain guidance and advice from central functions such as Finance, Procurement, Enterprise Architecture, ICT, HR and Legal as you develop your business case.

All Business Cases must be submitted to the Investment Review Board for approval.

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## 1. The Strategic Case

This section provides an overview of the strategic case for change.

### 1.1 Background and Brief Details of Proposal

The 2014/15 budget set the Commissioning and Procurement (C&P) service a target to deliver savings of £307,000 within three years, i.e. by the end of FY 2017/18. It was acknowledged that a saving of £307,000 would essentially equate to a reduction of eight to twelve posts within the C&P service, and would necessitate a significant reduction and consolidation in the scope of service provision to Directorates.

In response to this savings target the C&P Management Team submitted the following budget proposals:

- Restructure the team to deliver £180,000 of savings (which was completed in 2015/16).
- Trade procurement and commercial services externally to generate minimum external revenue of £160,000

	2015/16	2016/17	2017/18	Total
<b>Savings Target</b>	85	129	93	<b>307</b>
<b>Service Restructure</b>	180			<b>180</b>
<b>External Income Generation</b>	30	60	70	<b>160</b>
<b>Total Proposed</b>	210	60	70	<b>340</b>
<b>Variance</b>	125	(69)	(23)	<b>33</b>

The proposal to trade procurement and commercial services externally, rather than further reduce the number of posts was made taking into account the following Council and employee requirements.

#### What the Council wants?

- To reduce C&P budget – initially by £307,000 but potentially cut back to statutory only
- At the same time it wants to retain access to experienced and knowledgeable employees
- With flexibility to meet demand across a broad breadth of knowledge

#### What employees directly affected want?

- Control over their own future given level of uncertainty
- Opportunity to develop existing skills and capability
- Continue delivering value for Cardiff and the wider public sector
- Receive recognition and reward commensurate to effort and risk
- Eventual ownership of employee mutual

### 1.2 Why would organisations want to work with us?

Our research and discussions with potential private sector partners shows that there is a shortage of good public sector procurement capability within the public and private sectors across the UK.

The Councils’ Commissioning and Procurement Service was established in 2011 to support delivery of an ambitious strategy (Commissioning and Procurement Strategy 2011-2015) which aimed to improve the way in which procurement was managed across the Council and drive a more commercial mind set and approach. Over the past four years the service has supported the Council to deliver cumulative savings totalling £40 million, significantly improved our governance and risk management arrangements and helped the Council deliver against its policy aspirations through use of Community Benefits and innovative supply chain solutions.

At the heart of this change has been the adoption of new ways of working (category management and strategic sourcing) and the recruitment and development of an excellent team whose achievements have been recognised through a number of prestigious awards including:

- **PROACTIS** – won the Best Public Sector Procurement Project 2014.
- **Welsh National Procurement Awards 2015** – won the “Innovation through Procurement Award”. The Team was also shortlisted for three other awards.
- **SOPO Awards 2015** – The Team won two awards “Outstanding Savings Delivery” and “Procurement Team of the Year” at these UK wide awards.
- **GO Procurement Awards 2016** – The C&P Team was Highly Commended in the public sector “Procurement Team of the Year” category and also shortlisted in the public sector “Innovation of the Year” category in the UK’s premier procurement awards.

This improvement in performance was also recognised through a Welsh Government commissioned Procurement Fitness Check where the Council’s performance was assessed and compared to other public sector organisations across the UK and Wales by the accountancy firm KPMG in 2014. The Council’s overall procurement maturity was categorised as “Developing towards Advanced” and “Advanced” in three of the eight fitness check categories, Leadership and Governance; Procurement Strategy and Objectives and Performance Management.

Model Dimension	Comparison	Welsh Gaps	UK Public Sector Gaps	Comments
Procurement leadership & governance		29	42	Clearly defined procurement strategy driven by a central team, strong Head of Procurement
Procurement strategy & objectives		40	30	Procurement strategy defined and driving transformational journey
Defining the supply need		29	10	Still developing working with Directorates to define more flexible solutions/outcomes
Commodity/project strategies and collaborative procurement		21	15	Journey to maturity ongoing, increasing team skill sets in this area
Contract and supplier management		22	2	Is the next focus area of transformational procurement journey
Key purchasing processes and systems		17	23	Currently reviewing the functionality of PROACTIS for purchase by organisation to enhance outputs
People		26		Ongoing development of individual up-skilling within the centralised team
Performance management		43	28	Foundations in place, new systems being investigated will increase this score in the future

● Cardiff Average Maturity Grade    
 ● Average of Welsh Authorities    
 ● UK Public Sector Benchmark

These achievements have been increasingly recognised across the UK and beyond with requests to speak about them in Europe and beyond.

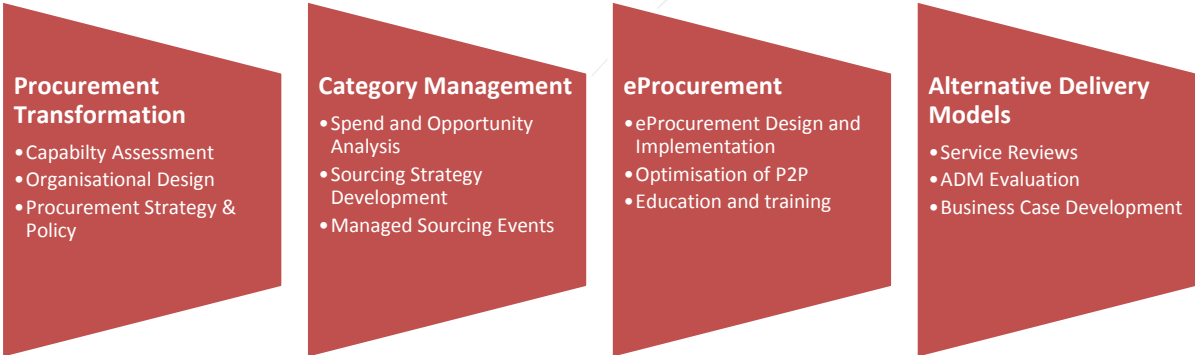
As a result of this increasing profile there have been ongoing discussions with a number of private sector companies who are keen to partner with the Commissioning and Procurement service to deliver procurement and commercial services to both existing and new public sector clients. These organisations are keen to utilise the skills and knowledge within the team, in particular the fact that we have successfully implemented category management within a public sector organisation and used technology to deliver a number of innovative procurement solutions.

In addition conversations with two Welsh Universities have also indicated that there are opportunities to work collaboratively across the UK, Europe and beyond.

**1.3 What services would we offer?**

It is our current intention that the Commissioning and Procurement Service will seek to sell a broad range of procurement and commercial services covering advice, guidance and support. It will focus on delivering improved value for public sector and improving the capability of organisations we work with.

The diagram below provides a high-level overview of the procurement and commercial services the offered.



Although we are confident that we have the capability to deliver these services it is acknowledged that our experience has been primarily limited to the Council and that our levels of maturity will vary. Therefore partnering with other private sector organisations that have a proven track record within these areas will allow us to gain access to business opportunities which may otherwise be restricted and provide an opportunity to build on existing capability and experience. It is important to recognise that the service will also be able to use this improved maturity to the benefit of the Council by bringing improved commercial knowledge and skills back into the Council.

**1.4 How does this fit with the Council’s strategic priorities?**



The City of Cardiff Council is committed to delivering a vision for Cardiff to be **‘Europe’s most liveable capital city’** against a backdrop of pronounced financial pressures and increasing demand for public services.

The Chief Executive’s May 2014 report *“Establishing a Programme of Organisational Change for the City of Cardiff Council”* set out the Cabinet’s response to the critical challenges being faced by the City of Cardiff Council (“the Council”). It stated that a business as usual mindset, alongside indefinite salami-slicing of budgets will simply lead to a decline in public services, dissatisfaction amongst users, and poor employee’s morale.

The Council’s Corporate Plan 2015/2017 recognised the need to identify business models that may be established to meet demand pressures and reflect budget realities and to identify how services can be effectively commercialised.

Although the initial driver for this business case was focused on retaining existing resources in the face of budget cuts, we believe that this model provides us with an opportunity to be more ambitious. The Council recognises that its workforce is its most valuable asset and we believe that by investing in our current service and retaining and attracting the best talent that we can:

- Continue to effectively support the Council’s contribution to delivering the seven outcomes contained in the What Matters strategy
- Create an environment to develop creative and innovative solutions where we can learn from both the private and public sector
- Develop a procurement and commercial service which is viewed as a ‘centre of excellence’ in procurement throughout the region, Wales and beyond
- Respond to the procurement and commercial requirements across the South East Wales region and Wales resulting from Local Government Reorganisation and the increasing focus on provision of Shared Services
- Contribute to and influence the procurement agenda for the UK Core Cities and Euro Cities

## **1.5 Business Needs**

This business case sets out the options to trade procurement and commercial services. The objectives that the Commissioning and Procurement service intends to achieve by implementing this proposal are set out below.

### **1.5.1 Objectives**

- To maintain the high quality services currently being delivered by the Council’s C&P Team to all Directorates within the Council.
- To put in place a structure of service delivery that aligns to the requirements of the Council’s medium and long term financial plan
- To ensure high performing Commissioning and Procurement employees have a long term, sustainable future contributing to the public sector in Wales.
- To ensure that the Council retains access to high quality and knowledgeable commissioning and procurement employees as required.

- To contribute high levels of procurement professionalism back into the public sector in Wales, and beyond.
- To meet the desires of the employees who are directly affected to have more control and certainty over their future in a climate of public sector budgetary cuts.
- To provide opportunities for employees to further develop their skills and capabilities whilst delivering value for money for the Council and the citizens and stakeholders of the City of Cardiff.
- To ensure that employees are valued and receive the recognition and reward that is commensurate with the effort and risks that they take to help minimise the risk of good employees leaving to join local competitors such as the National Procurement Service for Wales and Crown Commercial Services.

### **1.5.2 Planned Outcomes/Benefits to the Council**

- The retention of award winning commissioning and procurement expertise within the Council.
- An opportunity to invest and build upon the successes to develop a centre of procurement and commercial expertise to the benefit of the City of Cardiff Council and the wider public sector in Wales and beyond.
- The Company would be a new entrant into the UK market for commissioning and procurement advice and services. Whilst there are such advisers and service providers in existence, research suggests that there is an over reliance on accountancy houses and lawyers for the provision of such commissioning and procurement advice and services.
- No other local authority in Wales has delivered or achieved what the Council's current Commissioning and Procurement service has delivered. As it has been identified that local authorities are losing their most experienced procurement resources, there are likely to be opportunities across Wales as the public sector continues to manage fiscal consolidation and deploy category management to deliver savings. The published Fitness Checks show that there are likely to be opportunities to support local authorities to meet their Wales Procurement Policy Statement responsibilities.
- The creation of a new commercial ethos to the way commissioning and procurement advice and services are delivered within the Council.
- Opportunities for employees to develop new skills and to learn by working in different organisations which can be brought back into the Council.
- The establishment of a procurement and commercial service which delivers "from the public sector for the public sector" and which provides the opportunity to form strategic alliances with established private sector partners to access markets to deliver services to public and private sector customers.

### **1.6 Constraints & Dependencies**

*Outline the internal and external factors upon which the successful delivery of this change is dependant, and any constraints that exist.*

We need to consider some constraints / dependencies

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## **Internal**

The business case is dependent on:

- The Council acknowledging and accepting that there will be a reduction in the level of central support available from the C&P Team to deliver Council projects. Creating the capacity to develop and deliver business opportunities means that there will be a requirement to prioritise work and to ensure employees across the Council have the skills, knowledge and tools to be able to work more effectively and independently.
- Employees in the C&P Team being willing and capable of delivering work to the required standard. Although we are confident they have the capability to deliver it needs to be recognised that there will be a requirement to work in environments which will take them out of their 'comfort zone' and this will need to be supported and rewarded.

## **External**

A key challenge for any new company is establishing a market for its services and brand awareness. The Company proposes to adopt a twin track approach to secure work within and outside of Wales.

- Within Wales the Company intends to utilise existing professional relationships and contacts with public sector organisations to raise awareness of the services that can be provided. This has already secured work with two local authorities running a complex procurement and developing a business case supported by spend analytics.
- Outside of Wales the focus will be on developing strategic partnership arrangements with established private sector companies to enter markets. This approach provides real opportunities to secure business in the early years and develop the required commercial skills and name recognition outside Wales. This approach also minimises the costs of marketing the organisation.

Employees working on external contracts will utilise the skills that they have developed and will also develop new skills and knowledge by working with partners to deliver services for different clients. These skills will then be brought back and shared across the Council.

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**2. The Economic Case**

**2.1 Options Appraisal**

As part of any business case it is important to make sure that proper consideration is given to a range of options that can meet business needs set out in the Strategic Case.

As the Strategic Case is predicated on the generation of external revenue and retention of employees the options considered have been:

<b>Option 1</b>	To continue trading as the City of Cardiff Council, generating revenue by charging public sector bodies for services
<b>Option 2</b>	To create an Employee Owned Mutual which is owned by current Council employees which trades with public bodies and partners with private sector organisations to bid for and deliver services
<b>Option 3</b>	To create a Local Authority Trading Company, generating revenue by charging public sector bodies directly for services and partnering with private sector organisations to bid for and deliver services

Initially in respect of Option 3 it was intention that employees would TUPE transfer to a Local Authority Trading Company (LATC) which relied on the Teckal exemption. This would be on the basis that there would be an agreement for the company to transfer to an Employee Mutual within three years.

However, legal advice identified concerns over the lawfulness of the pre-agreed transfer to an employee mutual, in particular EU Public Procurement Directive and State Aid issues. As a result it was determined that there could be no pre-agreed transfer to an employee mutual which meant there was no requirement to transfer employees.

The table below is an analysis of the three shortlisted options that have been considered by the C&P Team for this business case:

Option 1: Trade as City of Cardiff Council

*This option would be to build upon the current approach where the in-house service delivers procurement and commercial services to public sector organisations and charges at full cost. This option would rely on the power to charge public sector organisations as set out in the Local Government Act 1970.*

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"><li>• A simple model which allows external income to be generated to cover the 'full cost' of employees involved in delivery</li></ul>	<ul style="list-style-type: none"><li>• Reliant on picking up business opportunities from other public sector organisations – this could result in major marketing / bidding investment</li><li>• Not able to take advantage of private sector partnerships to deliver consistent pipeline of business opportunities</li><li>• Limited to charging based on 'full cost recovery'</li><li>• Limited future opportunity for employees company ownership</li></ul>

Option 2 – Establish an Employee Owned Mutual

*This option would involve the creation of an employee owned mutual. The company would be privately owned by the nine members of the strategic team but with employees remaining employed by the City of Cardiff Council. The Employee Owned Mutual would purchase employees 'spare capacity' at full cost and a possible mark up. The delivery of external work would be undertaken completely separate to Council business.*

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"><li>• The ownership of the company would provide a clear incentive for employees to develop and deliver business opportunities</li><li>• This model would allow the fixed overheads of the C&amp;P service to reduce through the company purchase of 'spare capacity'</li><li>• Could facilitate an eventual transition to a future statutory only service if so desired by the Council</li></ul>	<ul style="list-style-type: none"><li>• The Council would not receive any additional income stream from 'profit' generated through external business</li><li>• Major concerns around conflict of interest as employees would remain employed by the Council and also be Directors of private company</li><li>• Key concerns would include:<ul style="list-style-type: none"><li>○ Clear separation between Council and company activity</li><li>○ Use of Council role to secure company work / contracts</li><li>○ No incentive for Council to invest in growth and development of the current in-house service</li></ul></li></ul>

**Option 3: Trade through a Council Owned Local Authority Trading Company (Preferred Option)**

*This option would see the creation of a Local Authority Trading Company which is wholly owned by the Council specifically for the trading of procurement and commercial service. Employees would remain employees of the Council with ‘spare capacity’ purchased at full cost to cover the required budget savings. Work delivered by the company would be charged at ‘full cost plus mark-up’.*

<b>Strengths</b>	<b>Weaknesses</b>
<ul style="list-style-type: none"> <li>• Able to trade with private sector clients – this is key opportunity to develop and build company</li> <li>• Able to recharge private and public sector external work at a ‘profit’</li> <li>• Model relatively simple and straightforward to establish</li> <li>• Manages the key conflict of interest issues</li> <li>• Allows wider range of Council employees (both within and outside of the C&amp;P service) to participate in trading activity</li> <li>• Potential for profit income stream for the Council</li> <li>• Flexible to allow services to be provided directly to public bodies by the Council if preferred</li> <li>• Subject to company trading it allows potential for Council to make investment in the C&amp;P service</li> <li>• Creation of LATC provides potential for Employee Owned Mutual at some point in future subject to Council approval</li> </ul>	<ul style="list-style-type: none"> <li>• Some conflict of interest between prioritisation of Council and private business work</li> <li>• Limited incentive or future opportunity for employees as potential for employee ownership is unclear</li> </ul>

**2.2 Preferred Option and further analysis**

The preferred option is Option 3 – Trade through a Local Authority Trading Company.

Although Option 2 was very appealing to the affected employees and would have provided the flexibility to work with private sector partners, it is acknowledged that the conflict of interest concerns are valid and that arrangements to manage these risks could have a detrimental effect on taking the company forward. Therefore, it is accepted that Option 2 is not practically viable at this juncture.

In considering Options 1 and 3 a number of key questions need to be considered.

### ***2.2.1 Why do we need a Local Authority Trading Company?***

Although it would be possible to 'charge' public sector organisations for the delivery of services the current legislation would restrict our ability to deliver services to private sector organisations. By creating a Local Authority Trading Company (LATC) we will be able to rely on the general trading powers available under Section 95 of the Local Government Act 2003.

Although the primary driver for establishing a LATC is the general power to trade, the creation of a trading company also provides a number of other benefits including:

- Limited liability to reduce risk exposure to the Council
- Potential for employee ownership in the future
- Definition of clear boundaries between Council and external work
- Opportunity to develop commercial and business skills to the benefit of the Council

### ***2.2.2 Why is it important we can trade with private sector companies?***

Although we will seek to deliver services directly to other public sector organisations, we believe that the level of business generated through this approach could be limited and irregular. Although we are fortunate to have a good, positive relationship with Heads of Procurement across the Local Authorities in Wales we do not feel that this would generate sufficient regular income at this time. However, we are aware that circumstances can and are likely to change with potential reorganisation and drive towards improved regional working. It will therefore be important that we maintain and hopefully grow a service which can respond to changes in demand as they arise.

By partnering with private sector companies who already have an established public sector client base, marketing and bidding skills, we believe the LATC will be able to commence generation of income more quickly and more consistently. We also believe this gives the management team an opportunity develop their commercial and business skills more rapidly by learning from partners who have already developed successful businesses of their own. This also gives us the opportunity to develop our expertise and knowledge by working with public sector organisations across the UK.

### ***2.2.3 Why do we need a company just for trading procurement and commercial services?***

As part of the Council Commercialisation agenda there are a number of areas where the Council is looking to develop external income generation opportunities, some of which could benefit from the general trading powers available through a LATC.

Although consideration has been given to trading through a more general trading company there are a number of key reasons why this business case is recommending a LATC dedicated for procurement and commercial services:

- **Partnerships** - relationships with Private Sector Business Partners are key to our business case and plan and therefore their relationship with the LATC board of directors will be crucial
- **Flexibility** – Directors will need to be able to respond quickly to commercial opportunities and change

- **Control** – the Board will need to be able to control company direction to maximise income opportunities
- **Simplicity** – this is a relatively simple model which does not require the transfer of a Council service and therefore does not require any TUPE transfer or change in employee terms or conditions or reliance on TECKAL exemption
- **Brand development** – we will need to establish a brand and identity which is appropriate for a company which will operate across the UK and potentially in Europe and beyond
- **Reputation and Clarity** – we will need to build a reputation for our unique service offering within the market place and have clarity about service offering
- **Ownership** – although the company will be wholly owned by the Council, the company structure does allow for changes in ownership to be considered over time, including possibility of, subject to Council approval, employee share ownership or transfer of company to an Employee Mutual

### 2.3 How would it operate?

The diagram below provides a high-level overview to illustrate how the preferred option would operate.



It is important to keep in mind that the preferred option is greatly simplified by the fact that employees will remain employees of the Council on the same terms and conditions and enjoying the same benefits as they currently have. Any expenses incurred in undertaking work for the LATC will be reimbursed in accordance with the agreed Council rates and any overtime worked will be paid accordingly.

The LATC will purchase employees time at 'full cost' and this will represent the income line to the Commissioning and Procurement Service budget line. 'Full cost' will be calculated on a day rate basis and will include:

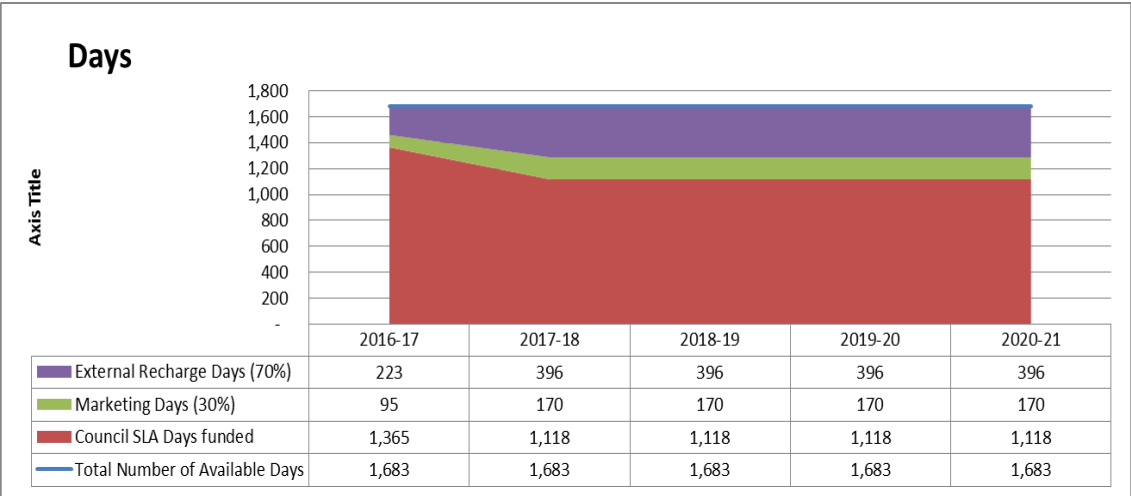
- Full Salary Costs including NI and Super
- An overhead charge to cover support charges including Premises and IT costs and a contribution to corporate support charges

As employees remain employees, no Council work will be delivered through the LATC unless the Council decides to put a discrete piece of work out to the open market.

Time spent on LATC activity will be recorded and recharged appropriately.



The LATC will be required to ‘purchase’ all time spent involved in LATC business including all non-rechargeable activities such as marketing and bidding. For the purpose of our financial model we have assumed that on average 30% of employees time ‘purchased’ by the LATC will be spent on non-rechargeable activities and 70% will be spent on rechargeable business. For the purpose of this business case we have calculated a minimum number of days which will need to be ‘purchased’ by the LATC in order to cover the targeted budget saving of £160,000. However, given that one of our key objectives is to grow the LATC it is expected that the actual number of days purchased by the LATC will continue to grow beyond the minimum number. The graph below illustrates the minimum number of days to be ‘purchased’ by the LATC.



Work with public or private customers will be charged at ‘full cost’ plus mark-up. The ‘mark-up’ will need to be sufficient to cover the cost of non-rechargeable ‘Marketing Days’, LATC specific overheads such as public liability insurance and marketing expenses, and profit. Although we have calculated an average daily charge out rate the actual rate charge will depend on a number of factors including the complexity and duration of assignment and contract award arrangements i.e. LATC lead or via subcontract arrangement.

The preferred option does allow for a profit dividend to be paid back to the Council as the sole shareholder. However, given key objective is to invest in and grow team it is envisaged that any profits will be used to support this investment.

**2.4 How will this impact on the Commissioning and Procurement Service?**

The current C&P service comprises of 26 staff across the following three teams:

Team	Number of Employees	Primary Role
<b>Strategic</b>	6	<ul style="list-style-type: none"> <li>• Leading the development and implementation of procurement strategy and supporting policies, guidance and systems</li> <li>• Leading the development of category and sourcing strategies</li> <li>• Spend analytics and opportunity analysis</li> <li>• Lead / support for strategic commercial and procurement projects</li> <li>• Provision of procurement and commercial advice</li> </ul>
<b>Operational</b>	10	<ul style="list-style-type: none"> <li>• Support development of category and sourcing strategies</li> <li>• Lead above and below OJEU tender activity</li> <li>• Manage corporate contracts and facilitate access to framework agreements and contracts</li> <li>• Provision of procurement advice</li> </ul>
<b>Transactional</b>	7	<ul style="list-style-type: none"> <li>• SAP Requisition Approval and Compliance Monitoring</li> <li>• SAP Purchase-to-pay management and administration</li> <li>• Catalogue Management</li> <li>• End User Support and Training</li> </ul>

For the purpose of this business case we have assumed that the LATC business will primarily be delivered by the Head of Commissioning and Procurement, the Senior Category Manager and the Strategic team – a total of 8 employees. On the assumption that a minimum of 565 days will need to be purchased by the LATC this equates to 63 days per employee member per annum. However, the preferred option will be flexible to allow for other employees within the Commissioning and Procurement Service to be involved in the delivery of LATC business particularly where they are able to contribute due to specialist areas of expertise and knowledge. This option will also allow other Council resources (in particular legal, finance and HR) to be engaged in the delivery of work where there is a requirement for their expertise and knowledge.

As any increase in the number of days ‘purchased’ by the LATC will impact on the delivery of City of Cardiff Council work it is proposed that the number of days is agreed

annually as part of the business plan refresh and that any in-year variation is agreed in conjunction with the Shareholder Representative.

## 2.5 Appraisal of Costs and Benefits

This business case is predicated on a reduction in the Commissioning and Procurement service budget of £160,000 per annum from 2017/18 onwards. The achievement of these savings will be dependent on the LATC ‘purchasing’ a sufficient number of days from the Council at a ‘full cost’ day rate.

Current estimates assume that by 2017/18 the Company will be required to ‘purchase’ between 550 and 600 days per annum from the Council. As already stated ‘purchased’ days will also include any time spent working on LATC business which are not rechargeable to clients such as marketing events and bid writing.

As already explained in 2.3 employee days will be purchased at ‘full cost’ on a day rate basis which will include full employee salary costs and an overhead charge which will make a contribution to the C&P service overheads including premises and central support costs. The estimated ‘full cost’ rates are shown in the ‘Financial Model’ in Appendix 1A.

In addition to the cost of purchasing employee days, our Financial Model contains the following estimates for costs which will be directly incurred by the LATC.

<b>General Company Expenses</b>	<b>£10,000</b>
<b>Insurance Costs</b>	<b>£3,000</b>
<b>Marketing Expenses</b>	<b>£5,000</b>
	<b>£18,000</b>

The average charge out rate for the LATC will therefore need to include an overhead contribution to cover these additional costs and the cost of the non-rechargeable days. The average charge-out rate is shown in our Financial Model contained in Appendix 1A. Details of non-financial benefits can be found in 1.5.2 of this business case.

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## 2.6 Cost/Benefit Analysis

It is estimated that the preferred model will incur additional expenditure of £18,000 to cover general company costs, insurance and marketing expenses. These costs will need to be recovered in addition to the ‘full cost’ day rate paid to the Council.

**2.7 Risk Assessment**

The risks associated with the recommended option are set out below.

Identified Risk	Position/ Proposed mitigation
<b>Employees leave the Council</b>	Establish a mechanism for recognising employees contribution Actively support development of employees
<b>Employees not given sufficient time to undertake external paid business</b>	Establish agree service level with Council Simplification of processes and better use of technology to devolve low value / low risk to Directorate employees Improve prioritisation of work Set expectation of employees availability to undertake Council work
<b>Employees not willing to undertake work</b>	Establish mechanism for recognising employees contribution
<b>Unable to secure external paid business</b>	Develop partnerships with private sector companies Continue to develop and pursue existing and new business development needs Continue to showcase work of the Council through case studies, speaking at events and submitting award applications
<b>Insufficient cash flow to fund early set-up / marketing / bidding costs</b>	Market rate loan from Council to cover operating costs in accordance with draft business plan – see Financial Case

**2.8 Sensitivity Analysis**

The success of the LATC will be subject to:

- 
- Generation sufficient business
  - Maintaining a minimum recharge ratio of 70/30
  - Managing additional company costs within budget
- 

Therefore any variation in our assumptions will impact of the financial viability of the preferred option.

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**3. The Financial Case**

This section will assess the affordability of the preferred option for implementing the change.

**3.1 Capital & Revenue Costs**

The preferred option will incur minimal capital costs for the purchase of:

- SAGE accounting software

The main revenue cost for the LATC will be the cost of employee’s time ‘purchased’ from the Council.

The preferred option will also incur the following non-employee related revenue costs:

<b>General Company Expenses</b>	£10,000
<b>Insurance Costs</b>	£3,000
<b>Marketing Expenses</b>	£5,000
	<b>£18,000</b>

**3.2 Cash Releasing Benefits**

The preferred option will allow the C&P service to reduce base budget by £160,000 by financial year 2017/18 as demonstrated in the Financial Model contained in Appendix 1A.

**3.3 Funding Sources**

It is anticipated that some funding will be required to cover cash flow requirements. It is proposed that the Council provides the LATC with a loan up to a maximum of £20,000. It is proposed that the loan is made on the basis that:

- The LATC shall only utilise the loan in accordance with the agreed business plan
- The LATC will draw down the loan as cash flow requires
- There will be a loan agreement which makes provision for the loan repayment terms and conditions and loan interest

**3.4 Cash Flow**

It is anticipated that the company will need to incur costs in relation to company set-up, insurance and marketing but that these can be kept to a minimum. The primary company cost will be for the ‘purchase’ of employee’s time from the Council and it is expected this will be paid within 60 days. There will inevitably be costs in relation to employee’s time which will not be rechargeable for marketing and bid work. It is also anticipated that the terms for payment for rechargeable work will vary dependent on the terms agreed in particular whether the work is fixed price or on a day rate basis. Once billed, we would expect to be paid within 30 days. A cash-flow forecast is contained within the Financial Model at Appendix 1A.

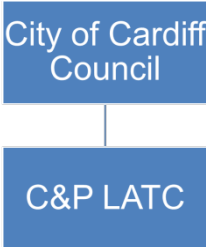


**The Commercial Case**

**4.1 Legal structure, governance and management arrangements**

**4.1.1 Legal Structure**

It is recommended that the following corporate company structure is adopted:



A Local Authority Trading Company (LATC) will be formed in accordance with section 95 of the Local Government Act 2003 and in Wales the relevant order is, the Local Government (Best Value Authorities) (Power to Trade) (Wales) Order 2006 (SI 2006/979). ('2006 Trading Order').

The Council will be creating a LATC specifically for trading of procurement and commercial services for a profit with any party (subject to legal constraints). Although the Council can already charge for services delivered to public bodies the requirement for general trading with private sector companies relies on the trading powers available under Section 95 of the Local Government Act 2003 (Section 95). The company will be a public company, incorporated under the Companies Act 2006 (CA 2006). This form of company has been used by a number of Local Authorities and is a usual vehicle used by a Local Authority.

The LATC will be wholly owned by the Council which will also be the sole shareholder.

There will be no requirement for the LATC to rely on the TECKAL exemption as employees will remain employees of the Council and work for the Council will be delivered 'in-house' and not through the LATC.

**4.1.2 Governance arrangements**

The board of directors of the LATC will manage the day-to-day decision making of it. The Council, being the sole shareholder of the LATC, will appoint (and remove) directors to run the company. The directors will be appointed with the relevant skills and experience to deliver the procurement and commercial services.

The board of directors of the LATC will meet as set out in the Articles of Association.

The board of directors of the LATC will produce a budget, a business plan, an annual report and other documents required to set the strategic objectives of the company. The Council will approve these strategic documents as the sole Shareholder of the company on an annual basis and as and when required. The Corporate Director (Resources) and Section 151 officer will act as the Shareholder Representative.

The board of directors of the LATC will require the Council's [or Shareholder Representatives] approval before they are able to alter the strategic objectives of the LATC. For example, the following strategic decisions will require the Council's prior approval as the directors of the company will not be able to:

- Change the name of the company
- Change its dividend policy
- Declare and / or pay any dividends
- Participate in activities which are incompatible with the business of the LATC
- Issue new shares in the LATC
- Make any amendments to the Memorandum and Articles of Association

These matters will be dealt with in the LATCs constitutional documents.

The LATC will:

- Operate in compliance with the governance requirements set out by the Council.
- Seek to maintain and enhance the Council's reputation and brand for high standards.
- Establish and maintain an effective service and financial performance management reporting system which will include effective reports to the LATC Board and the Council Shareholder Representative.
- Be subject to any audit and inspection requirements of the Council.

As there remains a requirement for the C&P service to deliver the Council's priorities it is intended that the number of days 'purchased' by the LATC in any financial year will be agreed in advance with the Council. Any variation in the number of days will need to be agreed by the Shareholder Representative.

It needs to be acknowledged that this delivery model is relatively simple and straightforward to establish and operate particularly given there is not transfer of Council activity or employees and that the initial trading volumes are only circa £200,000 per annum.

#### **4.1.3 LATC Board of Directors**

It is proposed that the LATC Board of Directors shall comprise:

- Executive Chairman – Paul Orders, Chief Executive
- Managing Director – Steve Robinson, Head of Commissioning and Procurement
- Director – Chris McLellan, Senior Category Manager
- Company Secretary – Ian Allwood, Chief Finance Officer and Deputy Section 151 Officer

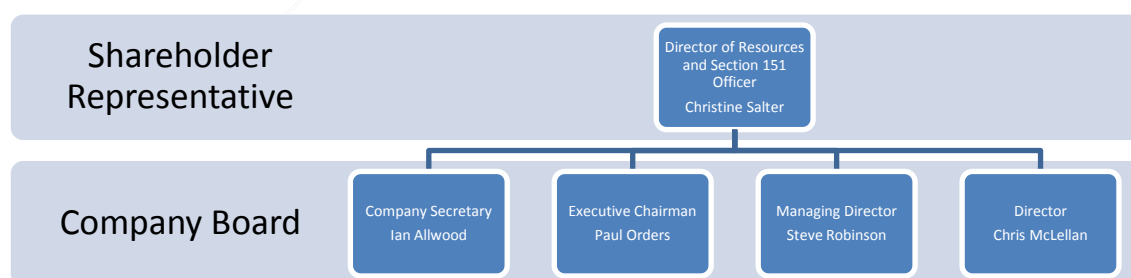
The table below provides a brief synopsis of the roles and responsibilities

<b>Executive Chairman</b>	<ul style="list-style-type: none"><li>• Provides leadership for the Board, ensures that the</li></ul>
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	<p>Board works effectively and performs its responsibilities, and that all key and appropriate issues are discussed by it in a timely manner</p> <ul style="list-style-type: none"> <li>• Primary responsibility for ensuring that good corporate governance practices and procedures are established</li> </ul>
<b>Managing Director</b>	<ul style="list-style-type: none"> <li>• Responsible for the business development and day-to-day management of the company</li> <li>• Responsible for the execution of the decisions as may be made by the board from time to time</li> <li>• Maintains regular dialogue with the Chairman on the Group's strategies and policies and, when necessary, put forward these issues to the Board for consideration</li> </ul>
<b>Company Secretary</b>	<ul style="list-style-type: none"> <li>• Ensures that an organisation complies with relevant legislation and regulation, and keeps Board Members informed of their legal responsibilities.</li> <li>• The company's named representative on legal documents, and it is their responsibility to ensure that the company and its directors operate within the law.</li> <li>• Responsible for registering and communicating with shareholders, to ensure that dividends are paid and to maintain company records, such as lists of directors and shareholders, and annual accounts.</li> </ul>
<b>Director</b>	<ul style="list-style-type: none"> <li>• Participate in board meetings to enable the board to make strategic and operational decisions</li> <li>• Support the Managing Director in the day-to-day management of the company and execution of board decisions</li> </ul>

The diagram below illustrates the proposed governance arrangements.



The quorum for board meetings shall be all four Board members. At Board meetings each Director shall have one vote. Board meetings shall be held at least quarterly on such dates as they may agree (failure to reach an agreement a decision will be made by the Chairman). An agenda for the meeting will be prepared and distributed not less than 5 business days prior to the meeting.

Except where the information is commercial sensitive, minutes of Board meetings will be provided to the Shareholder Representative.

## **4.2 Conflict of Interest**

When considering the governance arrangements it is important to be mindful of potential conflicts of interest.

A potential area of conflict would be the delivery of services by the LATC to the Council. As already stated, as the employees are remaining employees of the Council, any work for the Council will be delivered in-house as usual. It is also the intention that any work for the Council which is not covered by our base budget and agreed service level (generally for projects with additional funding) will be delivered by the in-house team with work charged at the same 'full cost' day rate which would be payable by the LATC.

However, should the Council wish to put a requirement out to competition the LATC would need to bid for this work. As this could represent a conflict of interest, given the C&P service would be managing the tender, it is proposed that bidding for this work would need approval by the Shareholder Representative.

The other potential area of conflict is the appointment of the Chief Finance Officer to the role of Company Secretary as he also acts as the Deputy Section 151 Officer. To manage any potential conflict the Deputy Section 151 Officer will not be able to deputise for the Section 151 Officer as Shareholder Representative.

## **4.3 Management and Support Services**

As already explained the employees affected by the preferred option will not be required to transfer to the LATC and will continue to be employed by the Council. When not involved in LATC activity, the current line management arrangements will continue.

When delivering Business for the LATC the day-to-day management and direction will come from the Managing Director and Director.

Support services will be provided by the current Council functions and a charge for support costs will be included in the 'full cost' day rate paid to the Council from the LATC.

Any support costs over and above that provided by the standard support cost charge will be agreed between the LATC and the support function.

## **4.4 Payment Mechanisms**

The transactions between the Council and LATC will be limited to:

- The 'purchase' of employees spare capacity
- Provision of support services (i.e. Finance, HR, Legal) which are considered to exceed the contribution made through the 'full cost' uplift

Employees will be required to record all activity related to LATC business and this record will be used to determine the number of days for each employee which need to be purchased by the LATC. This record of activity will be submitted on a monthly basis to allow the Council to invoice the LATC. The LATC will be required to pay the invoice within 30 days.

Payment for any additional services provided by the Council to the LATC will be paid for on a quarterly basis in arrears.

#### **4.5 HR Issues**

Under the preferred option there is no requirement for employees to transfer to the LATC and therefore salaries, terms and conditions and pension rights will remain unaltered.

However, it is acknowledged that the delivery of business through the LATC will involve an increase in travelling and overnight stays and a requirement to engage and work with key stakeholders with other public and private sector organisations.

As employees will remain employees of the Council all employee related matters including HR and Payroll will continue to be supported by the Council's HR People Services.

#### **4.6 Tax**

In order to facilitate the offsetting of any Corporation Tax losses and VAT on supplies within the group, a VAT and tax Loss relief group incorporating the LATC will need to be formed.

##### **4.6.1 Corporation Tax**

As a separate legal entity to the Council, the LATC will be subject to tax, including corporation tax on chargeable profits and gains arising to the LATC. In contrast the Council is not liable for corporation tax. Transactions between the Council and the LATC will need to be at arms-length to ensure the transfer pricing rules do not become an issue. The Council will need to charge market value for any goods and services it provides to the LATC to ensure the LATC obtains the maximum tax deduction and the Council's corporation tax position is unaffected. Similarly, the LATC will need to charge full market value for the goods and services it provides the Council given that its tax liability will be based on the market value of such goods / services.

##### **4.6.2 VAT**

The LATC will be subject to the normal VAT recovery regime.

#### **4.7 Accounting**

Annual accounts for the company will be prepared in accordance with relevant International Financial Reporting Standards and the UK Generally Accepted Accounting Practices.

## 5. The Management Case

This section will demonstrate that the preferred option is capable of being delivered successfully and in accordance with the Council's agreed programme & project management framework – PQA.

The creation of the new company will be managed by the C&P Management Team with support from colleagues in Legal, Finance and HR who have already input to the development of this business case.

If Cabinet approve the business case and creation of the LATC the table below provides an indicative action plan which will be delivered by a project team which will have representation from Legal, Finance, HR and ICT.

It is proposed that all matters associated with establishing the LATC are delegated to Corporate Director of Resources in consultation with the Council's Monitoring Officer and Portfolio Member for Resources.

The table below provides an indicative Action Plan

Develop and agree Articles of Association	June 2016
Develop and agree Shareholder Agreement	June 2016
Create company	July 2016
Develop and agree company name and branding	May / June 2016
Finalise and agree business plan	June 2016
Hold initial Board meeting	July 2016

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## Appendices

### A. LATC Financial Model

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## Business Case Approval

<b>Assurance Comments:</b>			
<b>Assured by:</b>		<b>Date of Assurance:</b>	

<b>Programme Manager Comments:</b>			
<b>Programme Manager:</b>		<b>Date of Assurance:</b>	

<b>Approval to Proceed to Next Stage</b>			
<b><i>Date approved – Investment Review Board</i></b>		<b><i>Decision Ref:</i></b>	
<b><i>Decision</i></b>	Request Amendment <input type="checkbox"/>	Refer to Organisational change Board Decision <input type="checkbox"/>	
	Approval to Proceed <input type="checkbox"/>	Reject & Cancel <input type="checkbox"/>	
<b><i>Comments</i></b>			

**CITY AND COUNTY OF CARDIFF**  
**DINAS A SIR CAERDYDD**

**POLICY REVIEW & PERFORMANCE**  
**SCRUTINY COMMITTEE**

**1 December 2015**

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**Alternative Delivery Model – Infrastructure Services**

**Building a successful local authority company – Governance Options**

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**Reason for the Report**

1. This report considers the options available as part of the Infrastructure Alternative Delivery Model Project and Full Business Case to build a successful local authority company and the related corporate governance issues that require consideration.
2. The purpose of the Report is to provide the Committee with information and opportunity to make comment or recommendation on the matters identified back to Cabinet.
3. The Report does not:-
  - (i) Comment on whether a company is the most appropriate future vehicle for the Council's Infrastructure Services. This matter will be the subject of consideration in a Full Business Case. It should be noted that there are restrictions on trading commercially, which restrictions are not addressed in this report but should be considered when looking at the full business case.
  - (ii) Provide detailed advice on the Companies Act 2006. The Companies Act 2006 regulates company law throughout the United Kingdom. It is a large Act with more than 1300 sections and 16 Schedules, and it is not practical in this report to set out detailed advice on the Act.

## Background

4. On 16 July 2015 Cabinet received a comprehensive report on the Outline Business Case which considered five alternative delivery models for a range of Council services including Waste Collection, Highway Operations, Parks Management and Central Transport Services. Cabinet agreed as follows;

- *the content of this report and the Outline Business Case, attached in Appendix 1, be approved;*
- *the conclusion of the report that the most appropriate future delivery model for the services in scope is a Wholly Owned Company (Teckal) be agreed;*
- *the establishment of a Full Business Case and Shadow Board to govern the company establishment be agreed and authority delegated to the Chief Executive to work with the Leader of the Council and the Cabinet Member for the Environment to define the appointments of the Directors and Non Executive Directors to the Shadow Board;*
- *the completion of a Full Business Case for the Wholly Owned Company model and also the Modified In-House Model be agreed and the findings be reported back to Cabinet early in 2016 together with recommendations as appropriate regarding:*
  - a) *The detailed financial analysis for delivering a full range of efficiency and income benefits against cost complete with sensitivity analysis;*
  - b) *The appropriate legal vehicle for the proposed trading company, for example, a company limited by shares or by guarantee;*
  - c) *The proposed governance of the company, including possible alternatives for the composition of the company Board;*



- d) *The proposed contractual arrangements between the Council and the proposed company, in particular, what company matters would be 'reserved' and require Council approval prior to implementation, and also performance management of the contract;*
- e) *The proposed arrangements between the Council and the company regarding the provision of support services, for example, the provision of HR, Finance, Commissioning and Procurement, and ICT services;*
- f) *Opportunities for increasing external trading and local market analysis;*
- g) *Whether or not it would be appropriate to remove some services currently in scope due to robust business alternatives and reasoning, or parts thereof due to strategy setting roles, and whether some other services should be included at this stage or set out phases in the following year(s);*
- h) *Requirements in relation to the proposed transfer of staff to the new company in accordance with the Transfer of Undertakings (Protection of Employment) Regulations 2006 as amended;*
- i) *Financial implications in respect of pensions, day to day management of the Wholly Owned Trading company, and taxation;*
- j) *The transfer of relevant assets, for example, relevant accommodation, vehicles and equipment, and;*
- k) *The initial investment required to fully establish the proposed Wholly Owned Company.*
- *The allocation of resources as identified in paragraph 68 of this report for the completion of Recommendations 3 and 4 above be approved and authority delegated to the Chief Executive in consultation with the Cabinet Member for Corporate Services and Performance and the Corporate Director Resources to*

*authorise amendments to these resources as necessary for the satisfactory completion of the Full Business Case, and;*

- *Consultation commence on and thereafter implement the saving opportunities identified for the Modified In-house and Wholly Owned Company Trading options to allow the financial benefits to be achieved within the timescales identified.*
5. Cabinet's decision was called in by a non-executive Member and on 26 August 2015 a joint Committee of the Environmental and Policy Review & Performance Scrutiny Committees unanimously agreed that the decision should not be referred back to Cabinet for reconsideration (see Section headed "Previous Scrutiny" later in this report).
  6. The Project Team then commenced work on the Full Business Case to assess the Wholly Owned Company and Modified In-House delivery options, to determine the preferred future delivery model for the services in scope.
  7. It is anticipated that Cabinet will be asked to consider the Full Business Case in February 2016.

## **Previous Scrutiny**

8. Scrutiny has engaged with the Cabinet proposals to deliver an Alternative Delivery Model as a mechanism to protect and deliver services since its inception.
9. A joint task and finish group of the Policy Review and Performance, and Environmental Scrutiny Committees delivered their findings in July 2015 following an extensive inquiry. The aim of the inquiry was to review the range of available alternative delivery models that could be used by the Council to deliver front line services, focussing on the potential range of services that could be delivered using alternative service delivery models; and operating models currently being considered by the City of Cardiff Council. The full report is available by following

this link:

<http://cardiff.moderngov.co.uk/documents/s4959/Item%208%20Cabinet%2016%20July%202015%20ADM.pdf>

10. The two Committees held a joint meeting on the 9 July 2015 to undertake pre-decision scrutiny of the Cabinet report on Infrastructure Services & Alternative Delivery Model Proposals, following which the Chairperson wrote a letter to the Cabinet Member for the Environment setting out the observations and concerns of both Committees about the proposals. The Cabinet Member for the Environment replied to this letter on 16 July. Copies of both letters have been attached to this report as **Appendices 3** and **4** respectively

11. Following Cabinet consideration of the Outline Business Case for Alternative Delivery Models on 16 July 2015, a non-executive Member submitted a request to Call In the decision. The report had sought approval to take the Wholly Owned Arms-Length Company and Modified In House alternative delivery models forward from the list of five shortlisted options for the development of a Full Business Case. The reasons given for the Call In were:

- To explore the extent of staff and trade union consultation around developing the Outline Business Case for identifying a suitable alternative delivery model for services in Cardiff;
- To establish if there is sufficient detail in the Cabinet report to take a decision on which alternative delivery model proposal is taken forward to the Full Business Case development stage;
- To establish at which point during the development of the Outline Business Case that Members had the opportunity to provide their views and feedback;
- To establish a timeline for the alternative delivery model process to include how and where (Cabinet, Council, etc.) decisions are taken.

12. Members voted unanimously not to refer the matter back to Cabinet and, therefore, the decision taken by Cabinet on the 16 July 2015 now stands.

However, in addition to supporting the Cabinet decision, Members stressed the importance of ensuring that detailed consultation and engagement with staff and trade unions was undertaken on a regular basis during the development of the Full Business Case, to help ensure that all parties remain in an informed position during this very important process. A copy of the Committee's letter to the Cabinet Member Environment, and the Cabinet Member's reply are attached at **Appendices 5 and 6** respectively.

### **Scope of the Scrutiny**

13. To facilitate the Committee's consideration of the governance options available to build a successful local authority trading company Councillor Bob Derbyshire, Cabinet Member for the Environment; Marie Rosenthal, Director Governance & Legal Services; and Tara King, Assistant Director Environment will give a presentation and respond to Members questions.

14. Members are invited to focus on the governance proposals contained in this report and presented at Committee. An opportunity for consideration of the Full Business Case will be afforded the Committee in January 2016. Members will also have an opportunity to consider the restrictions on trading commercially at that time. To be clear the purpose of this Scrutiny is not to consider whether a trading company is the most appropriate vehicle for the Council's Infrastructure services, but to ensure appropriate arrangements are put in place to provide effective governance to preserve and enhance Council services to the citizens of Cardiff.

### **Why is a company structure necessary?**

15. The Outline Business case (OBC) proposed that the most appropriate future delivery model for the services in scope is a Company wholly owned by the Council.

16. The OBC assumes that any such company would be able to trade for a profit with any party (subject to legal constraints), and the Council would be able to directly award (without open competition) services and works contracts to the company, so that the company could carry out such works and services on behalf of the Council. The Procurement regulations would therefore not apply to the award of such contracts.
17. The Council already charges for the delivery of some services within scope of the project, based on existing powers. But the requirement for a general trading power points to the establishment of a company in order to rely on the trading powers available pursuant to the provisions of Section 95 of the Local Government Act 2003 ('Section 95').
18. Section 95 enables the relevant Minister (by regulation) to authorise relevant authorities to undertake commercial activities ('trading') in relation to their ordinary functions (section 95(1) (a), 2003 Act). In Wales the relevant order is, The Local Government (Best Value Authorities) (Power to Trade) (Wales) Order 2006 (SI 2006/979). ('2006 Trading Order').
19. Whatever level of trading activity is contemplated by a local authority, Section 95(4) provides that the activity can only be carried out by a company within the meaning of Part V of the Local Government and Housing Act 1989 (1989 Act).

### **What form should the Company take?**

20. The 1989 Act provides for the following four structures (each has a different legal status):

#### **Structure 1: A company limited by shares ('CLS')**

These may be either public or private companies, incorporated under the Companies Act 2006 (CA 2006). This form of company has been used by a number of Local Authorities and would be the usual vehicle used by a Local

Authority wishing to set up a corporate structure providing services back to it, but also with the ability to trade. The principal advantages of using a CLS include:

- (i) Limited liability – as a separate legal entity, it can own and deal in assets, sue and be sued and contract in its own right. The circumstances in which shareholders (be it the Council or future partner(s)) can be held legally liable for a company's debts (beyond their unpaid capital contribution) are relatively limited;
- (ii) Distribution of profits – allowing profits (after deduction of tax) to be returned to the Council, as shareholder, by way of share dividend or reinvested in the company;
- (iii) Ability to attract investment – in terms of overall control and financial and tax planning, the structure provides potential for flexibility through the creation of different types of shares and rights attaching to shares and loan capital; and
- (iv) Through the issue of shares, the potential exists for other Local Authorities to take an interest in the company, for example if the company was to be used to provide services for more than one authority.

**Structure 2:**

**A company limited by guarantee with or without a share capital**

The guidance suggests that this type of vehicle is more suited to a not-for-profit company that may also be registered as a charity.

**Structure 3:**

**An unlimited company**

The problem is that this type of company is unlikely to offer the level of protection a local authority would want.

**Structure 4:**

**A registered society within the meaning of the Co-operative and Community Benefit Societies Act 2014**

Charitable trusts, non-charitable trusts, joint committees and limited liability partnerships or unlimited partnerships are not available for local authorities to trade commercially, since, inter alia, section 67 of the 1989 Act does not refer to these vehicles.

21. Given the above, a company limited by shares would seem the most appropriate form of company structure. Para 39 of the Wales Assembly Government Guidance January 2009 (General power for local authorities ... to trade in function related activities) provides:

*... Any of these forms may comprise a company for the purposes of section 95. However, it seems most likely that the company form taken will be a company limited by shares which provides more flexibility to trading companies, particularly with regard to distributions of profit and raising risk capital. The choice will have a fundamental impact on how people are employed, and the skills and numbers required.*

22. This report assumes that it would be the Authority that would establish the company, for its own purposes, so this report does not consider options such as entering into an arrangement with another local authority to use an established company or to set up a joint venture company for the purposes of providing services to both authorities and as a vehicle for function-related trading. As stated above, the structure of a company limited by shares offers flexibility in terms of future expansion should the Authority wish to look at working with other authorities through the company structure established, or in terms of future joint ventures with, or sale to, the private sector.

### **Potential legislative changes**

23. Companies under the control of local authorities are governed by the provisions in Part V of the 1989 Act (including financial and propriety controls). Part V of the 1989 Act is scheduled for repeal in its entirety by section 216 of the Local Government and Public Involvement in Health Act 2007. Section 212 of the 2007

Act introduces "local authority entities" in place of companies controlled by or under the influence of authorities, although an order under this section has yet to be made by the Secretary of State or Welsh Ministers. There is no indication that any such order will be made, and certainly not in the timescale to affect decisions on this project.

## **Control**

24. The structure and governance of the Company will also be dictated by the degree of control which the Authority will require to exercise over the company:

### **Procurement Regulations**

- (i) The requirement that the Council should be able to directly award contracts to the company (i.e. without procurement or competition) means that the Company and the degree of the Authority's control over the company, will have to meet the requirements of regulation 12 of the Public Contracts Regulations 2015 (SI2015 No 102).
  
- (ii) Regulation 12(1) (which is based on previous case law and is known still as the "Teckal" test) states that:

A public contract awarded by a contracting authority to a legal person governed by private or public law shall fall outside the scope of Part 2 of the PCR 2015 where **all** of the following three conditions are fulfilled:

**1. The contracting authority exercises over the legal person concerned a control similar to that which it exercises over its own departments.**

2. More than 80% of the activities of the controlled legal person are carried out in the performance of tasks entrusted to it by the controlling contracting authority or by other legal persons controlled by that contracting authority (i.e. more than 80% of the WOC's activities must be the delivery of



services back to its owning council and this figures must not be breached at any time).

**3. There is no direct private capital participation in the controlled legal person** with the exception of non-controlling and non-blocking forms of private capital participation required by national legislative provisions, in conformity with the Treaties, which do not exert a decisive influence on the controlled legal person.

25. In the case of the proposed WOC, the key test to explore further is Test One i.e. the control test. Control can be demonstrated through the overall arrangements which the Authority makes to control the company, through its constitution/articles and its operation. The key areas in the Council's Constitution which are central to showing control are:

- i. the reserved matters – decisions which only the Authority can make as owner and cannot be taken by the Board of the company alone and
- ii. the composition of the Board itself.

### **The Company's Constitution, Board and its membership (presuming the company would be wholly owned by the Authority)**

#### **Company Constitution**

26. A company's constitution and the rules governing its administration are set out in its memorandum of association (memorandum) and its articles of association (articles). The Company's directors and officers will derive their authority from the articles of association and the law relating to companies. The company will be run by its board of directors answerable to the shareholders in accordance with the articles. The articles are important documents and it is suggested that at the time when a decision is sought (on whether or not to establish a wholly owned company), draft articles are prepared and considered alongside the full business case. By way of example only, attached to this report as **Appendix 1** are the

articles of association of Cormac Contracting limited, which are publicly available from Companies House.

## **Board and Membership**

27. So far as Board membership is concerned, the Articles of Association would set out the rules for the appointment of directors. In respect of directors, issues to consider include; the number of directors, types of directors and quorum to be set for meetings of directors.
28. Government guidance suggests that a board of between three and eight directors is most likely to be practical (ODPM Local Authorities Trading Guidance, July 2004 (since updated but still in place in this respect) – and para 43 of WG Guidance). Many WOC have 7 or 9 directors to give an opportunity for a spread of skills and experience, whilst ensuring council control. A board must be able to respond quickly to commercial opportunities and change.
29. The articles could provide for the company to have both Executive Directors (that is a director who is engaged full time in the day to day running of the company) and Non Executive Directors (who are not engaged full time in the day to day running of the company but have the same company law responsibilities as Executive Directors), for example council officers or elected Members.
30. There are issues to consider in relation to potential conflicts for both elected Members and officers – see section below on conflicts.
31. The Authority may wish to consider the appointment of an Independent Director (who is neither an elected Member nor employee of the company), subject to ensuring the Authority retains sufficient control over the company. Independent directors can serve as a point of constructive challenge and bring further expertise to a Board.

32. It is important that Boards have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. (See UK Corporate Governance Code September 2014).
33. Quorum - by way of example in the case of Cormac Contracting Limited, the quorum for Directors meeting is 4, consisting of two Executive and two Non Executive Directors.
34. It is not imperative to ensure Teckal compliance that the Authority has an absolute majority on the board, but this is a clear way to help demonstrate it easily and would be recommended.

### **Reserved Matters**

35. In terms of decision making, demonstrating Teckal compliance and in order to provide the Authority with comfort, the Articles of Association would usually include for 'Reserved Matters'. This would require the shareholder's consent (that is the Authority, presuming the Authority is the sole shareholder) to be obtained before a decision could be made by the company as regards a Reserved Matter. Reserved matters, by way of example could include:-

- Agreement on the annual business plan;
- Expenditure ( limiting the amount of capital and revenue expenditure before consent required);
- Acquisition and disposal, (for example, acquiring or selling of fixed assets or property);
- Entering into contracts (above a certain value - not normal day to day activity);
- Loans and financing agreement;
- Litigation;
- Altering or ceasing business;
- Giving of guarantees and indemnities;

- Open or closure of bank accounts;
- Appointment and remuneration of Executive directors;
- Variation of business plan;
- Branding;
- Corporate matters – (allotment or issue of shares).

36. Attached as an **Appendix 2** is a longer list of potential "Reserved matters" showing the extent of control an Authority may exercise through this mechanism. There needs to be a balance between clear control of strategic decisions and the company board being given sufficient flexibility to make commercial decisions.

37. The Authority will need to arrange for its shareholder decision making to be carried out in an effective way. Decisions will include standard annual meeting business as well as reserved matters as required. Exercising the shareholder role is an executive decision but there are various options for how this is carried out in practice – for example by Cabinet jointly, individual portfolio holder, cabinet committee etc. There may be the need for a quick commercial decision to be taken to allow the company to take advantage of a time-limited opportunity and this should be factored in to the shareholder arrangements.

## **Conflicts of interest**

38. Any Members or officers of the local authority who are appointed directors of a company would have a fiduciary duty to the company. They have the powers and duties of company directors while they are appointed directors, and as directors, they are answerable to the membership of the company in accordance with the company's articles of association and company law.

39. Any elected Member appointed as a company director would, however, still be bound by the authority's code of conduct.

40. Paragraph 45 of the ODPM and WG guidance states:

*"Authority members and officers should be aware of potential conflicts of interest when carrying out their roles for their authorities, or when acting as directors of trading companies. The conduct of authority members is governed by their authority's code of conduct."*

41. The CA 2006 codifies existing duties on directors and explicitly imposes a general duty on directors to avoid conflicts of interest (though this can be mitigated by provisions in the Articles recognising certain inherent conflicts). Accordingly when considering who should be nominated as directors, it will be important to be conscious of the potential for conflict of interest. This has implications for all but especially Cabinet Members serving on the Board, given their role as a cabinet Member.

42. Best practice would be to appoint Council Directors who do not have a role or post within the Authority which would bring them into conflict with their director responsibilities or put them in a position of making (or advising on) a Council decision relating directly to the company (which could give rise to challenges based on bias and predetermination) . It is therefore prudent for any Member with a role in services provided by the Company, not to be on the Board and also for any officers who are (1) involved in a client role or (2) in a statutory role e.g. the s.151 officer not to be on the Board.

43. Any Members or officers who are to be Directors of the company may need to be given training on their new obligations and a protocol established on how to deal with conflicts.

### **Transparency /Scrutiny**

44. A local authority must ensure that a trading company is not used as a device for inhibiting legitimate public access to information about local government and local government services. The scrutiny committee of the authority must be able to exercise its powers in relation to the discharge of local authority functions under

the relevant legislation and when establishing a company appropriate provision should be made to facilitate scrutiny.

45. The financial and propriety controls that apply to local authority controlled companies, as set out in the 1989 Act, would need to be complied with.

### **Relationship between the Authority and the Company**

46. As explained above, the Authority will own the Company and there will be control of its activities through the governance arrangements put in place, primarily through roles on the Board and through the reserved matters list.

47. The Authority will also have a relationship with the Company through the contract(s) for services which it will enter (through direct award). It is unlikely that the Council will ever take action to enforce a contract against its WOC (if the delivery of service breaks down there will be other action the Authority can take including change in management, bringing services back in house, sale or joint venture of the business).

48. However there will need to be clarity as between the Authority and its service provider (the Company) as to what services will be delivered, to what standard and to what price. A specification and contract will therefore need to be agreed between the Authority and the Company to underpin the guarantee of appropriate levels of service delivery to the citizens of Cardiff.

### **Retained activities in the Authority**

49. The Authority has identified the scope of services it is considering arranging to be delivered through the WOC. It is, though, more complex than simply the current activities in this list (and the staff who deliver/support them) being transferred to the Company and run through a contract.

50. The Authority will need to make arrangements to retain sufficient staff and expertise to:

- Manage the contract with the Company;
- Deliver the strategic role the Authority has decided to retain; and
- Exercise the statutory functions which the Authority cannot legally delegate to a company.

51. The first two points should be self-explanatory. The third is based on the legal position that the duty to take a statutory decision is placed on the local authority and there is no general power for the decision to be taken by anyone other than the local authority (or part of it or another authority).

52. Under Section 101 of the Local Government Act 1972 (and the Discharge of Functions Regulations for executive functions) an authority may arrange for the discharge of functions (i.e. arrange for another body, here the WOC, to deliver services to support the exercise of the function) but the authority cannot transfer that decision-making power to anyone else. It can obtain supporting information and an expert opinion from others, but the final responsibility for taking the decision remains with the authority.

53. Whilst this is the general position in relation to decision making, Section 70 of the Deregulation and Contracting Out Act 1994 does enable the Secretary of State to make an Order which allows local authorities to arrange for the discharge of their functions.

54. It will be necessary to review the list of activities the Authority is considering arranging for the WOC to carry out to check if any are actually statutory functions in that list and then to check if there is any specific provision which allows them to be delegated to the WOC.

55. If there is no such ability, the usual position is that the Authority has to retain staff with the necessary skills and capacity to make those decisions. Some authorities have adopted a "joint employment" model to obviate the need for retained staff to carry out this role. This is based on staff having an employment contract with both the Authority and the Company so allowing them to "choose" which hat they are wearing at any one time, either to make statutory decisions (as the council) or to deliver services (as the company). This is a new model which has risks and has not yet been tested. This new model is put forward by way of information only and further detailed work would be required to assess the risks and suitability of such a model for Infrastructure Services.

## **Other issues**

56. There are a number of issues that require consideration when setting up a company and detailed proposals regarding the same should be set out in any report recommending the establishment of a company. In respect of company matters, by way of example:

- **Employment issues** - local government employees may be transferred to the new company and individuals may well be concerned as to the potential impact of working for a wholly owned company. There will need to be consideration of TUPE, equal pay and pension issues. These issues are not considered in this report but will be addressed in the Full Business Case.
- **Personal Liability of Directors** - Company directors may incur personal liability, for example in respect of breach of duty, wrongful trading, fraudulent trading, breach of a disqualification order and other specific liabilities such as corporate manslaughter. It is good practice for the company to insure against this risk and potentially for the Authority to indemnify any Council directors.
- **Tax issues** – there will need to be specialist financial advice on the tax issues of setting up and running a WOC to ensure tax consequences are mitigated.



- **State Aid** - when an Authority sets up a WOC it must be careful not to breach the rules on state aid. These require that a public body does not give aid to an undertaking (which would include a WOC) which could distort competition in the market. There are various exemptions and ways of mitigating this risk but this will need to be taken into account if the Authority is considering, for example, giving a loan to the WOC to assist with initial cash flow or allowing the WOC to occupy council premises.

## **Legal Implications**

57. The legal advice is reflected in the body of this report. There are a number of express and implied powers pursuant to which the authority could form a company.

58. The Scrutiny Committee is empowered to enquire, consider, review and recommend but not to make policy decisions. As the recommendations in this report are to consider and review matters there are no direct legal implications. However, legal implications may arise if and when the matters under review are implemented with or without any modifications. Any report with recommendations for decision that goes to Cabinet/Council will set out any legal implications arising from those recommendations. All decisions taken by or on behalf of the Council must (a) be within the legal powers of the Council; (b) comply with any procedural requirement imposed by law; (c) be within the powers of the body or person exercising powers on behalf of the Council; (d) be undertaken in accordance with the procedural requirements imposed by the Council e.g. Scrutiny Procedure Rules; (e) be fully and properly informed; (f) be properly motivated; (g) be taken having regard to the Council's fiduciary duty to its taxpayers; and (h) be reasonable and proper in all the circumstances.

## **Financial Implications**

59. The Scrutiny Committee is empowered to enquire, consider, review and recommend but not to make policy decisions. As the recommendations in this report are to consider and review matters there are no direct financial implications at this stage in relation to any of the work programme. However, financial implications may arise if and when the matters under review are implemented with or without any modifications. Any report with recommendations for decision that goes to Cabinet/Council will set out any financial implications arising from those recommendations.

## **RECOMMENDATIONS**

The Committee is recommended to:

- Consider the information presented in this report and at this meeting; and
- Decide whether it wishes to make any comments or recommendations to the Cabinet.

**MARIE ROSENTHAL**  
**Director Governance & Legal Services**  
**25 November 2015**

## **BACKGROUND PAPERS**

### **Reference**

- Sections 95 of the Local Government 2003 Act. ('Section 95').
- The Local Government (Best Value Authorities) (Power to Trade) (Wales) Order 2006 (SI 2006/979). ('2006 Trading Order').
- The Companies Act 2006. ('CA 2006').
- The Public Contracts Regulations 2015 ('Procurement Regulations').

- General power for local authorities, fire and rescue authorities and National park authorities to trade in function related activities January 2009 (Welsh Assembly Government ) –draft (‘WG guidance).
- Welsh Government guidance on the power in the Local Government Act 2003 ([www.practicallaw.com/0-501-9075](http://www.practicallaw.com/0-501-9075)) – published 1 January 2010.
- Previous Cabinet and Scrutiny Reports on this matter.

**SWYDDFA CYMORTH Y CABINET  
CABINET SUPPORT OFFICE**



Fy Nghyf / My Ref: CM34649  
Eich Cyf / Your ref: T: Scrutiny/PRAP/  
Comm Papers/Correspondence

Dyddiad / Date: 07 June 2016

Councillor Nigel Howells  
Chair, Policy Review & Performance Scrutiny Committee  
Scrutiny Services  
Room 263  
County Hall  
Cardiff  
CF10 4UW

Annwyl / Dear Councillor Howells

**Policy Review & Performance Scrutiny Committee: 10 May 2016 - Local Authority Trading Company for Commissioning and Procurement**

Thank you for passing on the Committee's comments and observations following the recent Scrutiny Committee meeting. I welcome that "overall the Committee accepts that the proposal to create a trading company is a good way forward for the Council; this view is based on diminishing delivery of services by the public sector, resulting in a lesser need for public sector procurement."

I should clarify that the market research undertaken to support the Business Case for the establishment of a Local Authority Trading Company (LATC) to deliver commissioning and procurement services highlighted that local authorities in Wales are cutting back their procurement functions as a result of budget cuts. There is a loss of procurement expertise in the sector, this does raise the potential of business opportunities for the LATC, particularly on complex procurements.

In response to the issues raised by Committee the following comments are made:

**ATEBWCH I /  
PLEASE REPLY TO:**

Swyddfa Cymorth Y Cabinet / Cabinet Support Office,  
Ystafell / Room 514, Neuadd y Sir / County Hall,  
Glanfa'r Iwerydd / Atlantic Wharf, Caerdydd / Cardiff,  
CF10 4UW Ffon / Tel (029) 2087 2479

*Mae'r Cyngor yn croesawu gohebiaeth yn Gymraeg a Saesneg a byddwn yn sicrhau ein bod yn cyfathrebu â chi yn eich dewis iaith boed yn Gymraeg, yn Saesneg neu'n ddwyieithog dim ond i chi roi gwybod i ni pa un sydd well gennych. Ni fydd gohebu yn Gymraeg yn creu unrhyw oedi.*

*The Council welcomes correspondence in English and Welsh and we will ensure that we communicate with you in the language of your choice, whether that's English, Welsh or bilingual as long as you let us know which you prefer. Corresponding in Welsh will not lead to any delay.*

- 1. is unclear what form staff recognition will take having heard that you will look at reward in the wider context of commercialisation;**

This is still work in progress. The Commissioning and Procurement Team are exploring how best to reward staff within the parameters laid down by HR. It should be noted that staff are already welcoming the opportunity to develop and enhance their skills by working with other organisations. These new skills will also benefit the Council.

- 2. reiterates the need for those staff involved to be using a specialist commercial time recording programme, rather than a Council-designed spreadsheet;**

This is accepted and a specialist commercial time recording programme will be purchased if Cabinet approves the establishment of a LATC and after further research has been undertaken.

- 3. reiterates the importance of factoring all overheads into the financial projections;**

This is accepted and has already been factored into the business case and financial projections developed by the Council's Finance Team.

- 4. reiterates that appropriate accountancy arrangements must be put in place;**

This is accepted and will be actioned if Cabinet approves the establishment of a LATC.

- 5. reserves the right to have sight of Cabinet reports and to request briefings on the company's progress if appropriate.**

This is welcomed and accepted.

I trust this information is of assistance.

Yn gwyir,  
Yours sincerely,



**Y Cyngorydd / Councillor Graham Hinchey**  
**Aelod Cabinet dros Wasanaethau Corfforaethol a Perfformiad**  
**Cabinet Member for Corporate Services & Performance**

Cc: Members of the Policy Review & Performance Scrutiny Committee  
Christine Salter, Corporate Director Resources  
Steve Robinson, Head of Procurement  
Claire Deguara, Cabinet Office