

Report of the Director of Resources and Housing

Report to Executive Board

Date: 17 July 2017

Subject: WEST YORKSHIRE JOINT SERVICES TRADING COMPANY

Are specific electoral wards affected? If yes, name(s) of ward(s):	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Is the decision eligible for call-in?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Does the report contain confidential or exempt information?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

Summary of main issues

This report sets out the background to the proposed establishment of a trading company, with a business case to support that which has already been approved in principle by the West Yorkshire Joint Services Committee and seeks approval for Leeds City Council to participate in that company.

Recommendations

It is recommended that Executive Board

1. Notes the legal position as set out in Appendix 1 in particular that the company will be a controlled company for the purposes of the Local Government and Housing Act 1989;
2. Notes that the Council provides an indemnity to its appointed representative under the terms of The Local Authorities (Indemnities for Members and Officers) Order 2004"
3. Considers and approves the Business Case at Appendix 2 in support of the proposal to trade though the establishment of a trading company;
4. Agrees to the formation of a Holding Company to be limited by shares wholly owned by the founding members of the West Yorkshire Joint Services Committee,

i.e. Bradford, Calderdale, Kirklees, Leeds and Wakefield which will protect the business of the West Yorkshire Joint Services Committee, and to 4 subsidiary companies for Materials Testing, Calibration Services, Archaeological Services and Business Hive, to be owned by the Holding Company;

5. Agrees to the Council being involved as shareholder in the West Yorkshire Joint Services Trading Company and its' subsidiaries, on the basis set out in this report;
6. Agrees to participate as Directors of the Company on the basis set out in this report;
7. Notes and agrees the proposed governance and funding arrangements for the company as set out in the report;
8. Agrees to participate through a shareholders agreement on the terms set out in draft in this report, and authorise the City Solicitor to agree final terms and execute the agreement on behalf of the Council which should be on the same basis as the contribution rates payable to West Yorkshire Joint Services.
9. Delegates authority to the City Solicitor to agree terms and enter into an agreement with the other 4 constituent authorities to indemnify Wakefield Council against any loss incurred as a result of making a working capital and investment loan to West Yorkshire Joint Services HoldCo up to a value of £1m. This indemnity will be provided on the same basis as the contribution rates payable to West Yorkshire Joint Services.

1. PURPOSE OF THIS REPORT

To seek approval for Leeds City Council to the establishment of a trading company by West Yorkshire Joint Services

2. BACKGROUND INFORMATION

Within WYJS, there are four scientific services or commercial services as they have more recently become known. These services grew up from providing services largely based around the trading standards regulatory function, and provided services to the public sector. However, as public sector finances have reduced, opportunities have arisen and been taken to develop more work for the private sector. These services are Calibration, materials testing and archaeological services, all of which have a track record of trading and are projected to provide surpluses. The fourth is the Business Hive, recently established to maximise the opportunity to raise income from spare capacity in recently renovated meeting room space.

The level of this work has now developed to the extent that in 3 of the 4 areas, that work can no longer be provided under the local authority general powers to trade – Local Authorities (Goods and Services) Act 1970. This is due to the increase in value of private sector work. Wider trading with the private sector is permitted by section 95 of the Local Government Act 2003 BUT that power to trade must be exercised through a company. Further legal background is given at Appendix 1.

3. MAIN ISSUES

The Proposal

3.1 A number of key principles will be established as follows:

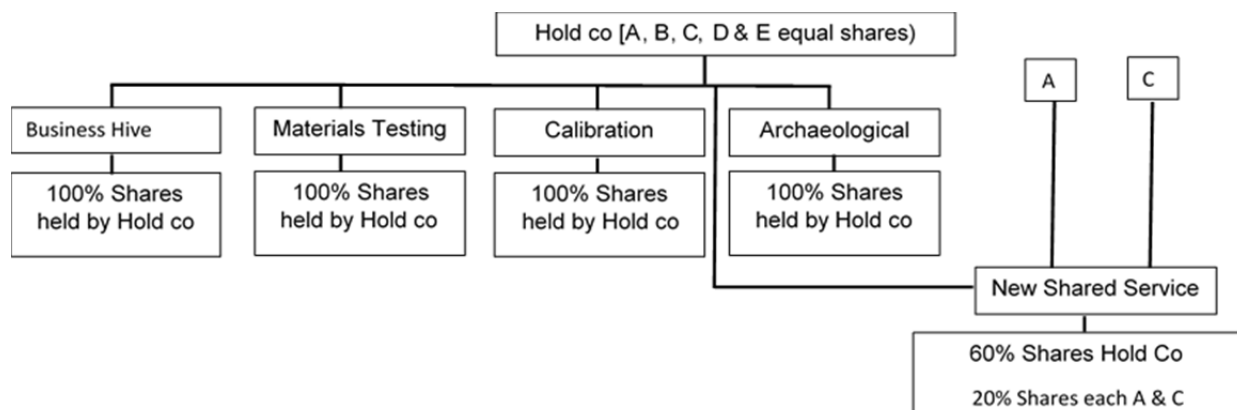
- It is proposed to establish a trading company structure to allow certain activities to be sold to the private sector only where there is no power to trade through the WYJS Joint Committee;
- Work to the public sector will continue to be provided through the WYJS Joint Committee structure;
- Staff will not TUPE to the new company;
- Work done for the private sector will be undertaken by the trading company using staff and equipment loaned to it by the WYJS Joint Committee at commercial rates;
- The Articles of Association for the Company will be drawn widely however the Contractual and Financial Procedure rules will provide appropriate levels of delegation and authority for managing the business of the trading company, as they do through the WYJS Joint Committee arrangements;
- Any profits generated may be subject to corporation tax. Advice is being sought on transfer pricing, taxation and profit distribution. Any profit will be payable to the constituent authorities in accordance with the appropriate distributions policy to be agreed.
- There will be a service level agreement between the trading company and the WYJS Joint Committee to manage the terms on which staff and equipment are loaned, support services are provided, and service standards connected to those;
- Initial set up costs of £100k have been factored into the financial forecasts and there is an anticipation that this will be funded by a loan between the Joint Committee and the trading company at the prevailing rate of interest. As some of those set up costs are already being incurred there may well also be a charge between the Joint Committee and the trading company and this will affect the profitability of the company in the initial months and impact upon any tax liability;
- The Joint Committee will charge an appropriate fee to the trading company to cover the usage of staff and assets and this will be formulated in such a way as to satisfy any transfer pricing arrangements. There will be a balance when recharging costs as too low could be classed as state aid and too high could be seen as a mechanism to avoid corporation tax. A robust methodology will therefore be devised prior to start up.

- 3.1.1 A group structure, with a holding company (Holdco) and a series of subsidiaries is the model used by YPO. It allows a single layer of control and direction, with each distinct area of activity being undertaken through a distinct subsidiary company. As the services within WYJS are so diverse, with different customer bases and brands, it is particularly suitable. It will also allow other services to be added into the structure in the future.

3.2 Future Proofing the Model

- 3.2.1 There is ongoing discussion between the 5 constituent authorities around services that may be shared in the future and delivered through this model. WYJS have the governance structure in place, and this might be more attractive than setting up separate trading vehicles in each local authority. The two are not mutually exclusive and there is definitely NO commitment on the part of the constituent authorities to share further services. This merely allows them to do so, as long as 2 or more Councils want to share services and use WYJS as the delivery vehicle to trade them.

Shareholding and Distributions Policy – How it would work



- 3.2.2 In the diagram above, which is for illustration purposes only, the new shared service option is a collaboration between A & C only. To maintain the group structure the Holding Company must retain at least 51% of the shares but (60% has assumed for simplicity in this illustration) with the remainder owned by the participating councils A & C. The table below sets out an option for the shareholdings and distribution policy.

Company	Shareholding	Distribution
Hold Co	20% each A,B,C,D,E	In accordance with each Council's contribution rate – Leeds is 35.25%

Materials Testing	100% Hold Co	100% Hold Co
Calibration	100% Hold Co	100% Hold Co
Archaeological	100% Hold Co	100% Hold Co
Business Hive	100% Hold Co	100% Hold Co
New Shared Service	60% Hold Co 20% A 20% C	10% Hold Co 45% A 45% C

- 3.2.3 To maximise flexibility and “future proof” the company, it is possible to establish a mixed shareholding arrangement so that 2, 3 or 4 of the Councils can put additional services into a shared delivery arrangement as a subsidiary trading company.
- 3.2.4 The subsidiary would then have Holdco as a shareholder, but would also offer shares to the relevant participating Councils. The benefit of this is that it would allow only those participating Councils to have direct benefit and control in the company in which they have a stake and where services are provided back to them.
- 3.2.5 Holdco would remain the majority shareholder, and the precise shareholding between the other councils can be negotiable. A distributions policy would then be drafted to reflect the appropriate profit to be shared between the participating Councils and Holdco and will be based on the contribution rate each council pays to West Yorkshire Joint Services
- 3.2.6 A shareholders’ agreement would be needed in respect of Holdco and this would also cover each wholly owned subsidiary and how it operated. For any future shared services where only 2, 3 or 4 Councils are participating, there would need to be a separate shareholders’ agreement managing that relationship between the participating councils and Holdco as the relevant shareholders.

3.3 Structure

3.3.1 Shareholding

The 5 Councils will be equal shareholders in Holdco.

3.3.2 Directors

It is recommended that the Directors of Holdco are the Leaders of each Council or their nominee and that WYJS officers are appointed as directors of the subsidiaries – this would allow daily and operational business to be undertaken quickly and efficiently by officers, with key strategic direction and decisions made by elected members. If a new shared service subsidiary is established, then those participating Councils may expect to have board representation to support their individual shareholdings – this can be agreed at that point.

3.4 Shareholders Agreement

There will be a shareholders’ agreement between the 5 participating Councils in Holdco. If further subsidiaries are established then a separate shareholders’ agreement will be agreed in which only those participating would be a party to.

3.4.1 Reserved Matters

Amongst other things in the agreement, there will be “reserved matters” which will include:

- Approval of business plan
- Entry in to major contracts (level and type can be specified)
- Borrowings, loans etc
- Issue of new shares
- Appointment or removal of Directors
- Issuing and transfer of new shares (to allow additional local authority “partners” to be brought on board)
- Distribution of profits
- Dispute resolution procedures
- Exit arrangements including potential sale of shares

By reserving matters to the shareholders, it means that the Directors of the company cannot make certain decisions without assent of all of the shareholders. For Holdco, this means the five Councils. For a subsidiary, it means that certain decisions are reserved to Holdco (the overarching shareholders’ agreement in Holdco can then ensure that matters are further reserved to the Councils as shareholders in Holdco). This type of agreement is more straightforward than it appears, both to draft and to operate.

Details of shareholders agreements are confidential between the parties (potentially subject to Freedom of Information Act), whereas the Articles of Association are held at Companies House and are freely available.

3.5 How Would Other Councils Come On Board?

- 3.5.1 It may be that other Councils would wish to share similar services to those currently provided by WYJS or to be included in any future shared service arrangements.
- 3.5.2 Those other Councils could simply become customers of the Company (in the same way that they can be now as customers of WYJS using powers under the Local Authorities (Goods and Services) Act 1970.
- 3.5.3 However, if those Councils wanted something more, then they could be invited to join the company arrangements. Shares could be offered in a relevant subsidiary company, or through Holdco (reflecting the fact that any such Council wasn’t involved in the original WYJS arrangements, these could be offered as different share classes giving different rights and profit distributions.

3.6 Procurement Issues and Teckal

- 3.6.1 Members may be familiar with “Teckal” companies. The Teckal Exemption allows contracting authorities to award contracts to entities they control without having to go through procurement procedures. There are restrictions on the level of third party business such a

company can undertake without losing the exemption– at 20% of turnover.

- 3.6.2 Teckal is not an issue here, as any work that the Councils themselves wish to procure can be done through the WYJS committee structure (see below for how this will work). Furthermore, if there was a desire to merge all work, whether for the Councils or the Private sector in the company arrangements then because work undertaken for third parties already exceeds 20% this would mean that Teckal might be failed in any event.

3.7 Business Case

- 3.7.1 Under the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009, members must consider and approve a Business Case which is a comprehensive statement that sets out:

- The objective of the business including current activities and proposed activities
- An assessment of risks faced
- A SWOT analysis
- Long terms trends
- Costing and charging policies
- Resource requirement in terms of staff and operational resources
- Online start-up costs and investment required
- Sources of finance

- 3.7.2 A Business case was considered by the WYJS Joint Committee in December 2016 and a summary is attached at Appendix 2. The current proposal is to transfer four existing service areas into the trading company, these being Archaeological Services, Materials Testing, and Calibration Services. These are well-established income earning service areas or cost centres within WYJS. All services are operating as commercial services in support of its' budget strategy. Regular monthly business reviews take place with all these service areas with the revenue position reported to the Joint Services Committee at each meeting. Based on the trading position as at the end of March 2017, all 4 of these service areas are projecting a surplus revenue out turn position. In this regard the transfer of these areas to a trading company is considered low risk.

- 3.7.3 The fourth service which is proposed to transfer into the trading company is the refurbished conference and meeting room facilities branded as the WY Business Hive. Whilst this is a new venture before the refurbishment these facilities they were rented out to customers, local businesses on a smaller scale. This service is not currently making a surplus but has a business plan in place to achieve that.

A summary of the Business Case, which was considered and approved by the WYJS Joint Services Committee in December 2016 is attached at Appendix 2.

3.8 Finance

- 3.8.1 In addition to the trading company requiring capital to fund start-up costs, there will also be a significant working capital requirement. A number of models have been explored and more detail is included in the business case at Appendix 2. The maximum additional working capital that the trading company could require is £1m in period 5 of trading. The intention is to manage that cash requirement through a mixture of a loan, favourable trading terms with the Joint Committee (i.e. making payment 90 days in arrears) and offering incentives to customers for faster payment with the aim of reducing debtor days from a current average of 60 to closer to 30 days.

In addition to a working capital requirement of £550k, it is sensible to allow some headroom up to £1m which can then be used to fund any equipment purchases or other requirements.

The loan including the commercial rate of interest will be made by Wakefield Council as host authority to the Company. As all 5 constituent authorities support WYJS, then there will need to be a legal agreement in place where all 5 Constituent authorities indemnify Wakefield for any loss incurred as a result of making that loan. The terms of such indemnity to be on the basis of each Councils contribution rate to West Yorkshire Joint Services.

4. CORPORATE CONSIDERATIONS

4.1. Consultation and engagement

This proposal has been twice to the West Yorkshire Joint Services Committee for consideration and approval. Leeds have member representation on that committee.

The proposal has also been considered in outline at meetings of the 5 West Yorkshire Chief Executives and Leaders

4.2. Equality and diversity / cohesion and integration

There are no issues that conflict with the Councils' policies on equality and diversity/cohesion and integration

4.3. Council policies and best council plan

There are no issues that conflict with the Councils' policies and best council plan

4.4. Resources and value for money

The proposal does not require financial commitment from the Council.

The proposal will support the 4 year budget strategy of West Yorkshire Joint Services which has been approved by the Leader of Council

4.5. Legal implications, access to information, and call-in

The legal implications are set out in Appendix 1

The Councils' Solicitor is aware of the legal implications

Appendix 2 of this report is a summary of the business case considered by the WYJS committee in December 2016

4.6. Risk management

Officers of West Yorkshire Joint Services are managing the risks involved with the establishment of the trading company.

Wakefield Council are the responsible body in terms of Monitoring Officer and Section 151 responsibility for West Yorkshire Joint Services and are actively engaged in and monitoring this

5. CONCLUSIONS

This proposal should be supported as part of the strategy to deliver the budget strategy which will reduce the financial contribution that Leeds makes to West Yorkshire Joint Services.

6. RECOMMENDATIONS

It is recommended that Executive Board:

1. Notes the legal position as set out in Appendix 1 in particular that the company will be a controlled company for the purposes of the Local Government and Housing Act 1989
2. Notes that the Council provides an indemnity to its appointed representative under the terms of The Local Authorities (Indemnities for Members and Officers) Order 2004"
3. Considers and approve the Business Case at Appendix 2 in support of the proposal to trade through the establishment of a trading company;
4. Agrees to the formation of a Holding Company to be limited by shares wholly owned by the founding members of the West Yorkshire Joint Services Committee, i.e. Bradford, Calderdale, Kirklees, Leeds and Wakefield which will protect the business of the West Yorkshire Joint Services Committee, and to 4 subsidiary companies for Materials Testing, Calibration Services, Archaeological Services and Business Hive, to be owned by the Holding Company;
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10. BACKGROUND DOCUMENTS¹

None

¹ The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.