CHESHIRE EAST COUNCIL

Cabinet

Date of Meeting:	**24 March 2014**
Report of:	**Chief Operating Officer**
Subject/Title:	**Cheshire East Ltd – Group Structure and Governance Arrangements**
Portfolio Holder:	**Cllr Michael Jones**

1.0 Purpose of the report

1.1 In February 2013 the Council set out its three year plan to becoming a strategic commissioning council. The strategic commissioning model ensures a measured approach to achieving the Council's ambitions alongside the required financial savings. It also provides a platform to redefine and reinvent services and to sustain quality services to Cheshire East residents and businesses. The role of elected members is also strengthened - beginning and ending with councillors' democratic relationship with local residents, who should have a stronger voice and input into commissioning decisions in the future.

1.2 This new approach requires robust corporate leadership, innovation and for the Council and its partners to deliver more with less. In summary it requires a clear focus on identifying and prioritising local needs. Cheshire East Council then concentrates on meeting those needs in a cost-effective way by stimulating and managing a diverse local market of high quality local providers.

1.3 This report:

- sets out the proposed structure and mandate for creating a new wholly owned Council company – Cheshire East Ltd. This company will act as parent company to all other companies set up by the Council. Cheshire East Ltd will hold 80% of the shares in its subsidiaries with the Council holding the remaining 20%; and
- seeks approval for the governance structures under which the group will operate.

2.0 Recommendations

2.1 Cabinet is asked to approve:

i) The establishment of the wholly owned local authority parent company Cheshire East Ltd.

ii) The general principles of governance of the parent company and its subsidiaries and operation as set out in this report. This includes the appointment of the Deputy Leader as a non-executive director to act as Chairman of the Group Board.

iii) The re-organisation of the Council's existing companies as subsidiaries of Cheshire East Ltd. Cheshire East Ltd will hold 80% of the shares in its subsidiaries with the Council holding the remaining 20%.

iv) That each subsidiary apply to the government to be recognised under the Redundancy Payments Modification Order (RPMO). This will protect the continuous service for employees who transfer under TUPE and those who are appointed in future from another RPMO body.

v) A 1 April implementation date for Cheshire East Limited, Ansa and Orbitas. Beyond that date the Council will continue to review and refine the contract documentation - together with the governance arrangements set out in this report - for all its companies.

And to note:

vi) The appointment of Kevin Melling as the Managing Director for ANSA and Orbitas.

2.2 In addition to the specific recommendations, Cabinet approves the general approach laid out in this report and authorises the:

i) Chief Operating Officer as Section 151 Officer to take any necessary and consequential action arising from the above recommendations, in agreement with the Leader of the Council.

ii) Head of Legal Services and Monitoring Officer to enter into any necessary documentation to give effect to the above recommendations including the:

- articles of association;
- the shareholder agreement and mandate for the shareholder's representative; and
- Directors' mandate for each company.

3.0 Reasons for recommendations

3.1 The Council has realised the need to change the way future services are provided in order to create opportunities for innovation and provide service efficiencies. As a result, the Council has determined to take a more commissioning role.

3.2 The aspirations to deliver services and redefine the Council's role in core place-based services are set out in the Three Year Plan. The development of a group company structure forms part of that major change programme.

4.0 Wards Affected - All wards are affected by this decision.

5.0 Local Ward Members - All wards are affected by this decision.

6.0 Policy Implications

6.1 The recommendations are in accordance with the Council's plan to become a strategic commissioning council.

7.0 Financial Implications

7.1 The financial implications for the establishment of ANSA, Everybody Sport and Recreation (ESAR) and Orbitas were laid out in the detailed business cases presented to Cabinet on 4th February 2014. These business cases laid out plans to deliver savings of over £3.3m over the next three financial years. Further financial implications relating to directors' remuneration are set out in this report.

8.0 Legal Implications

8.1 The legal implications regarding the establishment of the companies were considered in reports to Cabinet in June and October 2013 and February 2014. The legal implications are considered further within the body of this report.

8.2 The Council can set up the companies under the general power of competence laid down by section 1 of the Localism Act 2011. In addition, section 4 of the Localism Act 2011 provides that "any enterprise be conducted through a company within the meaning of section 1 of the Companies Act 2006".

9.0 Risk Management

9.1 The risks within the Alternative Service Delivery Vehicle, (ASDV), programme are identified and managed at 3 levels: Project, Programme and Corporate.

9.2 The project risks for each of the new companies were detailed within the business cases presented to Cabinet in February 2014. The respective project boards - in managing the risks - have established appropriate mitigating actions and monitor each risk on a regular basis in accordance with the Council's project management methodology.

9.3 Programme risks are those that are common to more than one ASDV project. These risks are identified, managed and monitored by the ASDV Steering Group. Two of the programme risks are classified as corporate risks and have been escalated to the corporate Risk Management Group for consideration and monitoring and inclusion. These are:

- Contract and relationship management; and
- ASDV Business Plans

The Corporate Leadership Board ensures that actions and recommendations within the Corporate Risk Register are implemented.

9.4 The Audit and Governance Committee is responsible for keeping under review the effectiveness of the risk management, control and governance arrangements. That Committee receives a quarterly update on the Corporate Risk Register. Cabinet also receives quarterly monitoring reports and an annual report on the Corporate Risk Management.

9.5 The responsibility to manage operational risks after the 'go live' date rests with the individual company.

10.0 Background

10.1 It is clear that change is inevitable. Strategic Commissioning is about achieving even greater value for money, by doing things differently and using innovative new approaches to the way in which services are delivered, that achieve the outcomes desired by local people. It is not about simply reducing costs through arranging cheaper provision or about traditional outsourcing. The new approaches will be used to get the best from in-house services, from joint ventures between the Council and other providers, and from new delivery vehicles such as social enterprises or staff mutuals.

10.2 The Council already has two successful wholly owned companies in place – Engine of the North and Tatton Park Enterprises. In February 2014 it also approved the detailed business cases for two new companies - Ansa Environmental Services Limited and Orbitas Bereavement Services Limited.

11.0 Proposed structure and mandate of Cheshire East Ltd

11.1 The Council's group of companies will be structured under its wholly owned parent company, Cheshire East Ltd. The Council is the sole shareholder of Cheshire East Ltd.

11.2 Everybody Sport and Leisure is a charitable trust and, as such, is not part of the group. CoSocius, a joint venture with Cheshire West and Chester Council is also not part of the group.

11.3 Cheshire East Ltd will own the majority interest, (80%), in all of its subsidiaries. Cheshire East Council retains a minority interest, (20%), in each subsidiary. By holding a minority shareholding in the subsidiaries the Council retains more control over important decisions. Importantly, the minority shareholding also provides all councillors with access to the companies. The following companies will now become subsidiaries of Cheshire East Ltd:

- Tatton Park Enterprises Ltd;
- East Cheshire Engine of the North;
- Ansa Environmental Services Limited; and
- Orbitas, Bereavement Services Limited.

A diagram showing the proposed group structure is attached, appendix A.

11.4 Cheshire East Ltd and all of its subsidiaries, although separate entities, will continue to be held accountable by Cheshire East Council. The Council will have robust governance arrangements in place to ensure each company provides quality services for the residents and businesses of Cheshire East. Formal contracts, built around key outcome focused performance indicators, will be in place and will be monitored by an effective client function. Arrangements relating to the Council's strategic contract with Engine of the North will be considered by Cabinet in April 2014.

11.5 Each subsidiary will be required to apply to the government to be recognised under the Redundancy Payments Modification Order (RPMO). This will protect the continuous service for employees who transfer under TUPE and those who are appointed, in future, from another RPMO body. (RPMO refers to the Redundancy Payments (Continuity of Employment in Local Government, etc.) (Modification) Order 1999 (as amended)), commonly referred to as the redundancy payments.)

11.6 The legal framework for all UK companies is enshrined in company law. Cheshire East Ltd will be a company limited by shares. The Council is the sole shareholder. All of the Council's powers as shareholder will be exercised by the Cabinet. The Cabinet will hold directors to account to ensure the proper use of public money. The objects of the parent company and its subsidiaries are clearly set out in their articles of association.

11.7 Cheshire East Ltd's primary objective is to provide a forum for strategic decision-making across the group. Its board of directors will set the overall strategy in relation to the activities of its subsidiaries. In setting the overall strategy for the group Cheshire East Ltd will also sign off all business plans and hold its subsidiaries to account. However the Cabinet, representing the shareholder, will approve any decisions which would have an effect on the shareholder's rights.

11.8 Cheshire East Ltd also provides a 'natural home' for roles that could be common across the group – company secretary, finance and HR. The subsidiary companies will be expected to adopt a common 'group' approach using existing Council policies and strategies where appropriate. For example, these will include group financial procedure rules, fraud and whistle-blowing policies, urgent decisions, disciplinary procedures, health and safety. The group expects to appoint Grant Thornton as its auditors and its accounts will be consolidated into the Council's financial statements.

11.9 The Deputy Leader of the Council, as portfolio holder for strategic outcomes and delivery will be the chairman of Cheshire East Ltd. The new service commissioning portfolio holder will also be a non-executive director providing an explicit link with the Council's new commissions.

11.10 The appointment of directors to Cheshire East Ltd is not yet complete. At this stage it is anticipated that the Strategic Director of Commissioning will sit on the board. The Leader of the Council, the finance portfolio holder and the Chief Executive should also attend but will not have a vote.

11.11 The Council's Chief Operating Officer and Head of Legal Services will also advise the board from time to time. The Head of Legal Services will also act as company secretary for all companies in the group unless agreed otherwise in consultation with Cabinet.

11.12 There are some risks associated with the Council's statutory officers involvement with Cheshire East Ltd – whether as directors or advisors. The Council has sought external legal advice in relation to those risks. In summary, given that the Council will wholly own Cheshire East Ltd it is unlikely that there will be a potential conflict of interest between it,(or its subsidiaries), and the Council at least in the early years.

11.13 In the event that there were a potential or actual conflict of interest the Council's statutory officers may still act for both partiers – subject to certain provisions. These include:

- the need for the Council's Scheme of Delegation to specifically provide for these new roles and that relevant contracts of employment are amended to accommodate them - including appropriately worded specific indemnities against potential non-fraudulent personal liability; and
- that where those officers feel in any doubt as to whether there is a potential or actual conflict of interest between their statutory role to the Council and their advisory role to the companies then they should be allowed absolute discretion to seek external advice from an appropriately qualified professional if they wish; and
- company directors should accept that in light of the fact that they are receiving advice from the Council statutory officers, it will be even more important that the Company remains solvent and complies with the law.

11.14 In addition those officers must be allowed sufficient time to devote to their statutory duties. In the event of any conflicting demands between the Council and its companies the officers should prioritise those of the Council.

11.15 While the Cheshire East Ltd group is unique in its range and scope of services, a number of other public sector companies operate in a similar way. Examples include:

- The Norse Group – bringing together property services, commercial services – covering a wide range of services including waste management, environmental services, building maintenance, transport, catering - and residential and housing with care service across Norfolk and further afield.
- Kent Commercial Services – a range of trading companies providing energy purchasing, temps/agency staff and minor building works in Kent .
- Essex Cares – a trading company for disability and homecare services.
- The Barnet Group - bringing together a trading company to manage 15,000 council homes and a social care provider for people with learning and physical disabilities.

12.0 Governance

12.1 The Council's overriding principle for the governance, stewardship and control arrangements for its ASDVs is to be resident and business led, and to ensure accountability to residents, service users, businesses and local councillors. However, the Council remains responsible for ensuring that it uses public funds properly and that it can demonstrate value for money.

12.2 Maintaining accountability to residents, service users, businesses and local councillors is vital. The arrangements introduced will ensure this and will remain under regular review.

12.3 Cabinet’s control over the parent company and its subsidiaries is exercised through a number of key documents:

- articles of association;
- directors’ mandate;
- shareholder’s agreement;
- mandates for the shareholder’s representatives; and
- the contract.

12.4 The content of the **articles of association** is governed by company law. Put simply they set out the objectives of the company and what its directors can and cannot do. Typically they will also include specific powers reserved for the Cabinet as shareholder. They will also ensure that the Council’s internal and external auditors - and other employees/advisors - can inspect all records held by the company.

12.5 A **directors’ mandate** is used to set out a more detailed ‘set of rules’ under which the company board can operate. They are particularly helpful in the context of local authority companies where the over-riding objective is to retain transparency and openness. They also have a key role in ensuring each company continues to benefit from the *Teckal* exemption - at least initially. (The *Teckal* exemption enables the Council to award contracts directly to its subsidiaries without going through a public procurement process.)

12.6 The **shareholder’s agreement** is a key document between the Cabinet and the companies. It will set out, in some detail, how the Cabinet will exercise control and influence over the group. The Cabinet will have the key role of holding directors to account to ensure quality delivery and proper use of public money.

12.7 The shareholder’s agreement will set out the governance principles set out in this report. It will include a range of issues which are subject to prior approval by the shareholder before a decision can be made by the company boards. These are described as ‘reserved decisions’. For example:

- appointment and removal of directors and auditors;
- remuneration of directors;
- non-executive directors must be serving councillors;
- approval of business plan and any subsequent (significant) changes;
- requirement to meet in public;
- expectations re performance reporting;
- engagement of consultants.

12.8 The agreement is the key mechanism for ensuring that the Council, through the Cabinet, or via appropriate delegations, exercises decisive control over its companies and continues to approve significant decisions. These proposals will also ensure that relevant decisions remain subject to the Council’s scrutiny arrangements – including the new commissions.

12.9 Cabinet will also nominate **shareholder's representatives** for each company. In summary, this person observes the companies' decision making processes and represents the interests of the shareholder. Given the range of companies involved, this is likely to be more than one person. They will be able to attend board meetings across the group – as the shareholder's eyes and ears. This 'access' is secured through the minority shareholding the Council has in the subsidiaries. Without the minority shareholding the Council's access to the subsidiaries would have been restricted to the parent company board. In turn this could have limited its ability to demonstrate decisive control.

12.10 The shareholder's representatives will, in most cases, be an officer. Cabinet will authorise its representative to communicate its wishes to the company as required. Where issues arise in relation to a *non-executive* director, (a councillor), the shareholder's agreement will provide Cabinet with the necessary powers to act.

12.11 The **contract** is intended to empower rather than constrain the companies. In summary, the Council will specify the broad outcomes it requires the contractor to deliver and include key performance indicators. In contrast, the contractor is required to produce detailed statements setting out how it will meet the Council's requirements.

12.12 The contract will also include the agreed payment mechanism and clear triggers and sanctions if either party does not meet its obligations. The overall terms and conditions will be the same for each contract.

12.13 Each of the documents listed at paragraph 12.3 need to be carefully drafted to protect the companies' *Teckal* exemption – at least in the early years. Taken together these arrangements will demonstrate that the shareholder has decisive control over the group. (This is an important *Teckal* test.) Over time a company may well wish to trade more widely. At that stage the Council and the company will need to reconsider these arrangements – not least to ensure that the companies do not get caught by public procurement legislation in future.

12.14 The implementation date for Cheshire East Limited, Ansa and Orbitas is 1 April 2014. However, beyond that date the Cabinet will continue to review and refine the documents set out in paragraph 12.3 and the wider governance and scrutiny arrangements set out in this report.

13.0 Company Directors

13.1 Each company board will have:

- a managing director; and
- three non-executive directors (Councillors).

Cabinet will agree outline job descriptions for each of the above roles.

Each company will also have a staff representative (nominated by the employees). That person will be expected to attend management and Board meetings as an observer. It will be for Cabinet to determine whether the staff representatives, or any other operational managers, are appointed as directors.

13.2 In addition, the shareholder's representative will be expected to attend the Board as an observer. The shareholder, staff representatives and any other operational manager regularly attending board meetings will need to be alert to the risks of becoming a shadow director under company law.

13.3 The roles and responsibilities of company directors are governed by company law. In summary, a director must act in the way he considers is most likely to promote the success of the company.

13.4 A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. In the context of a local authority company the articles of association will expressly state that a director is not to be regarded as having a conflict of interest by virtue of being a member of the Council alone.

13.5 Company directors can be paid. Under company law the nature of any payments are for each board to determine. Under local government law the role of company director cannot be classed as a special responsibility allowance. They are not special responsibilities in relation to the Council.

13.6 In principle any payment to a *non-executive* director through a council owned company should be pitched at a level of similar/comparative duties in the Council. For example being the chair of a company may be considered as being over and above the role of a Council committee chair but less than a Cabinet member. To ensure transparency and consistency in relation to any such payments the shareholders agreement will set out the Council's expectations in relation to any remuneration offered. The Council expects all companies to:

- offer councillors acting as the chair of a company payment of up to £10,000. It will be for each councillor to decide whether to accept this payment; and
- offer other councillors acting as *non-executive* company directors a payment of up to £5,000. It will be for each councillor to decide whether to accept this payment.

13.7 In each case where any individual councillor is also entitled to a special responsibility allowance in respect of their wider responsibilities the total amount paid is subject to the limits set out in paragraph 13.6. This ensures that a councillor does not 'benefit twice' by receiving an income from the company in addition to their special responsibility allowance.

13.8 Directors' remuneration accrues from day to day. It is also generally accepted that such accrual is from the day the company was incorporated/became active. It is for each board to determine what their remuneration is and from when it falls due in agreement with Cabinet. This will be reflected in the shareholder's agreement.

13.9 The Council's Chief Executive proposes to appoint a single managing director for ANSA and Orbitas. Following the recent recruitment exercise Kevin Melling will be appointed to that post.

14.0 Scrutiny

14.1 While the Council is setting up a group company structure to provide services it remains committed to being open and transparent. The Cabinet will ensure that all services remain directly accountable to residents and elected members by offering them the chance to influence, scrutinise and propose changes to how services are run. The Cabinet will set out its expectations for all of its companies in the shareholder's agreement.

14.2 For example, that agreement will empower the new commissioning portfolio holder to:

- hold periodic meetings with the chairs and vice chairs of each company;
- present joint reports to Cabinet alongside the shareholder's representative, any scrutiny committee and, where appropriate, the company boards;
- ensure regular public meetings and quarterly reporting of outcomes and performance; and
- in exceptional circumstances, have the right to recommend the removal of a *non-executive* director to the Leader of the Council and Cabinet.

14.3 The Council is currently reviewing its scrutiny arrangements. Led by the Constitution Committee, the detailed review is being done by a cross-party working group, Chaired by Councillor Peter Groves. The terms of reference for the review have recently been agreed and expert advice is being provided by Professors Steve Leach and Colin Copus of De Montfort University.

14.4 The working group has agreed that the review must take into account the emerging ASDV landscape including issues of accountability and transparency. One potential outcome is the creation of cross-party commissions with *scrutiny-like* powers. It is envisaged that these new commissions will be both forward looking and retrospective, whilst allowing for ultimate scrutiny powers to be held by the Council's corporate scrutiny function.

14.5 Commissions will be cross-party, and member-led. They will assist in policy development and also scrutinise the performance of each subsidiary. They will present join reports to the Cabinet alongside the commissioning portfolio holder and subsidiary company boards where appropriate. The lead officer will be the Strategic Director of Commissioning.

14.6 Cheshire East Ltd will require its subsidiaries to provide regular performance monitoring reports. In most cases these will be quarterly. Those reports will form the basis of public reporting to Cabinet as the shareholder and also to the Commission. The precise frequency of reporting and public meetings will be set out in the directors' mandate for each company. Cheshire East Ltd will also prepare an annual report and hold its annual general meeting in public – together with those of all of its subsidiaries.

14.7 Cheshire East Ltd will meet in public at least once a quarter – it will also hold private meetings. At the request of the chairman of Cheshire East Ltd, the Leader of the Council, the Chief Executive, or other invitee will be expected to answer questions from members of the Public or from other elected members.

14.8 Each subsidiary will be required to hold:

- a quarterly public meeting; and
- a monthly management meeting - minuted but not public, unless the Board agrees otherwise.

14.9 All councillors will have the right to attend all public meetings with the right to speak with the agreement of the chair. All papers for public meetings will be made available electronically, on request.

14.10 The business cases for each company have been reviewed through the Council's usual Technical Enabler Group, (TEG), and Executive Monitoring Board, (EMB), processes. Their day to day activities, beyond the 'go live' date will not be subject to further review by TEG or EMB. Ongoing contract monitoring will be done by the Strategic Director of Commissioning. However, the Council's usual checks and balances, including TEG and EMB, will continue to apply in the following instances:

- business cases proposing significant changes in scope for an existing company;
- proposals to establish a new vehicle; and
- any specific projects with a total value on £250,000 or more.

These requirements will be set out in the shareholder's agreement.

14.11 In addition EMB will receive regular reports summarising all new contracted spend of £250,000 or more. EMB will reserve the right to seek clarification on, and review of, any such expenditure. This information will also be included in EMB's regular update reports to Cabinet.

14.12 The Cabinet and its advisors have the power to visit and inspect the books and records of the new delivery companies at any time. In particular, the Council's internal and external auditors will have open access to every company in the group. The Council's internal auditors will continue to:

- provide independent assurance on arrangements;
- evaluate and assess strategic risks; and
- evaluate reliability and integrity of information

15.0 Conclusions

15.1 The Council's overriding principles for the governance, stewardship and control arrangements for its ASDVs are:

- to be resident and business led; and

- to ensure accountability to residents, service users, businesses and local councillors.

The arrangements set out in this report will ensure this. They will be regularly reviewed so that they provide the appropriate balance between proper governance and stewardship of public money alongside doing things differently and using innovative new approaches to service delivery.

15.2 The Cabinet will also take the opportunity to reflect upon its experiences in setting up ASDVs to date. This will include officers continuing to review and refine the contract documentation for ANSA and Orbitas beyond the 1 April 'go live' date. This will ensure that the learning from these two vehicles, and from ESAR, will be applied to the next phase of ASDVs.

16.0 Access to Information

There are no background papers relating to this report. The report author is:

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