

Bristol City Council

Audit Committee

29 January 2016

Report of: Interim Service Director: Legal and Democratic Services

Report Title: Governance of Council Interests in Companies - A Code of Practice

Ward: City Wide

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Recommendation

Audit Committee is requested to:

- (a) consider the Bristol City Council Code of Practice for the Governance of Council Interests in Companies as now adopted;
- (b) note the role of the Code of Practice, and the principles within it, in relation to the Council's own Code of Corporate Governance and the annual governance statement process;
- (c) review the operation of the Code of Practice in due course and make recommendations to Cabinet accordingly; and
- (d) note the role of the Audit Committee of Bristol Holding Limited in that process.

Summary

This report invites the Committee to consider the revised approach to the governance of the Council's subsidiary companies and, in particular, the part that the introduction of a *Bristol City Council Code of Practice for the Governance of Council Interests in Companies* has in promoting and ensuring good governance in relation to those company interests.

Policy

The Code of Practice is a consolidation of existing policy as adopted, together with further decisions as now made.

Consultation:

The report is a referral from the Cabinet decision of 15th December 2015 and meeting of 16th January 2016 to Audit Committee.

1. Background and Context

- 1.1 At the meeting of the Cabinet of 15th December 2015 the Mayor and Cabinet considered an exempt report concerning the business planning update of companies which the council wholly owns and governance of managing those companies.
- 1.2 In summary, that report sought and obtained approval of
 - (a) the annual business plans of Bristol City Council's current wholly owned trading companies, namely, Bristol Waste Company, Bristol Energy & Technology Services (Supply) Limited, trading as Bristol Energy, and Bristol Energy & Technology Services Limited, to be re-named Bristol Holding Limited.
 - (b) Implementation of a new set of governance arrangements for the above companies, providing for
 - (i) the existing parent holding company to become the parent company for both subsidiaries and, where considered appropriate and possible following any review of the Council's interests in companies, ownership of the Council's interests in other companies to be transferred to be managed through Bristol Holding Limited; and
 - (ii) the adoption of a shareholder agreement and articles of association; based upon; and
 - (c) underpinning those governance arrangements, the adoption of a Code of Practice to set out how the authority will establish and govern local authority trading companies in the future.
- 1.3 In taking this governance approach, it was recognised that, to be successful, local authority trading companies will need to obtain from the Council the right balance between their needs as new ventures for freedom (for example, to excel in the open market, to have specialist tools and to develop a culture that enables success), whilst also acknowledging the need for democratic accountability, a commitment to the sponsoring organisation's goals, and compliance with that organisation in systems and data terms. Above all there was recognised that, however ambitious and worthy the ventures might be, those ventures, be they jointly or by the Council alone, involve the expenditure of public money and the stewardship of public resources.
- 1.4 Consideration was therefore given to how to organise the establishment and continuing governance of these company ventures, not just individually but on a more planned and co-ordinated basis.

- 1.5 That debate began with the detailed report concerning governance options for Bristol Energy discussed at the Cabinet meeting of 6th July 2015 and at the Overview and Scrutiny Management Board of 22nd April 2015 and the 26th June 2015. Whilst pertaining to just one company at the time, it was acknowledged that this debate should lead to a model for all such companies. This was then allied to a review of the Council's trading company interests conducted by a legal specialist in local authority governance matters in July of this year.
- 1.6 The result was a recommendation that a code of practice for the governance of council interests in companies be adopted. The intention of such a code of practice is to provide a reference point to the Council and interested parties (Councillors, officers, company representatives, etc.) in understanding the requirements of the Council in setting up a local authority company, and a local authority trading company (LATC) in particular, and how the governance arrangements for those companies are expected to work once set up.
- 1.7 Attached as Appendix A, is the Bristol City Council Code of Practice for the Governance of Council Interests in Companies as now adopted.
- 1.8 The Code sets out
- the way in which the Council wishes to organise its company interests
 - how those interests may be best governed according to a set of principles
 - how decisions will be taken as shareholder
 - how scrutiny is to be conducted and
 - how regulatory matters and conflicts of interest may be best managed.

2. Relationship to Audit Committee

- 2.1 In a similar manner to the Council's wider Code of Corporate Governance, it is envisaged that the operation of the Code of Practice, and the authority's performance against the principles contained within it, will be included in the Annual Governance Statement and be subject to periodic review by the authority's Audit Committee and recommendations to Cabinet.
- 2.2 The Code itself refers to audit in three places
- At para 3.5 *"The Council itself has adopted a Bristol City Council Code of Corporate Governance and the approach of this Code of Practice will fall to be associated with the provisions of that Code.*
 - At para 10.5 *"The Bristol Holding Limited Bristol Holding Limited's will have two standing committees, which will be as follows: ... The Audit Committee, which will fulfil the same role and function as the Council's Audit Committee, the outputs of which will feed into the holding company board, the company business plans and the Council's own statement of accounts and Annual Governance Statement.*
 - The terms of reference of the Shareholder Group, which provides that the Shareholder Group may: *"make reports to and consult the Audit Committee, in relation to that Committee's particular functions"*

3. Annual Governance Statement and the Companies

- 3.1 Good governance of those companies in which the Council has an interest is an integral part of the governance arrangements of the Council as a whole. As such, the governance of the Council's subsidiary companies should be reported in relation to the Council's Audit Committee functions and are likely to form a thread through the annual governance statement process.
- 3.2 All subsidiary companies will have their own system of governance relating to that company, and the group of Council owned companies in the case of Bristol Holding Limited, which is the responsibility of their Board of Directors and designed to give those Directors adequate information to review the activities of the companies and review and control the business risks.
- 3.3 In this process Bristol Holding Limited will have a key role as the holding company for the Bristol City Council's group of trading companies and as the company upon which the Council's Directors will sit. This is especially so in relation to the company's audit committee as referred to at Paragraph 10.5 of the Code of Practice quoted at 2.2 above.
- 3.4 Input from Bristol Holding Limited's audit committee will accordingly be referenced within the Authority's annual governance statement when it comes before the Council's Audit Committee.

Other Options Considered

Not applicable.

Risk Assessment

There are no risks arising directly from this report, although a number of opportunities and risks do arise out of the Council's approach to local authority trading companies, which are dealt with elsewhere.

Equalities Impact Assessment

None necessary for this report

Legal and Resource Implications

None directly. Wider legal and resource implications are dealt with in the Code and the previous Cabinet reports.

Appendices

Appendix A - Bristol City Council Code of Practice for the Governance of Council Interests in Companies

Appendix B – Shareholder Group Terms of Reference

Appendix C – Shareholder and Company Agreement

Local Government Access to Information

Background Papers

No papers have been relied upon in the writing of this report that are not otherwise in the public domain or exempt information under the Local Government Act 1972.

BRISTOL CITY COUNCIL

GOVERNANCE OF COUNCIL INTERESTS IN COMPANIES
A CODE OF PRACTICE

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1. Introduction

- 1.1 The purpose of this Code of Practice is to provide a reference point to the Council and interested parties (councillors, officers, company representatives and contractors) in understanding the requirements of the Council in setting up a local authority company, and in particular a local authority trading company (LATC), and how the governance arrangements for that company will work once set up.
- 1.2 The OECD/G20 helps define corporate governance by saying that it:
- *“involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders; and*
 - *“provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”*.¹
- 1.3 This Code of Practice therefore sets out how the Council will normally go about managing those relationships and ensuring that a company will go on to deliver the objectives established for it by the Council. It also briefly explains and makes reference to the law and basic requirements placed upon a local authority in establishing or owning companies.
- 1.4 The Code of Practice is set out as:
- an explanatory background;
 - a set of guiding principles; and then
 - a set of working expectations.
- 1.5 Attached, as appendices, are also key documents used in this process.

2. Background

(a) Local authority trading and the local authority trading company²

- 2.1 There are long-established powers for councils to trade. Among the most important is the Local Authorities (Goods and Services) Act 1970, which authorises councils to enter into agreements with other local authorities and other designated public bodies, for the provision of goods, materials and administrative, professional and technical services, for the use of vehicles, plant and apparatus and associated staff, and for the carrying out of maintenance. Payment terms are set out in an agreement. These are not limited to cost recovery. The 1970 Act is the bedrock of trading within the public sector and there is substantial experience of its operation. But the Act is limited in scope. For example, it does not allow trading with the private sector or the public at large. Other established trading powers are specific in nature,

¹ “G20/OECD Principles of Corporate Governance - OECD Report to G20 Finance Ministers and Central Bank Governors” - September 2015

² Source: Local Government Association Briefing



such as the Local Government (Miscellaneous Provisions) Act 1976, which enables councils to enter into agreements with anyone for the use of spare computer capacity.

- 2.2 The Local Government Act 2003 added new possibilities to charge for services, to both provide extra services at cost and to trade with the private sector. Under the 2003 Act, the Government authorizes trading by means of a trading order. The Trading Order currently in force was made in 2009³, which permits all councils in England to trade or "to do for a commercial purpose", anything which they are authorised to do for the purpose of carrying on their ordinary functions, which includes use of the granted general power of competence.
- 2.3 Under that 2003 Act and Trading Order, as augmented by the Localism Act 2011, for a local authority to exercise the power to do things for a commercial purpose (which the authority couldn't otherwise do), then it must be done through a company. Councils are thus enabled to establish a company by which they can trade with the private sector for a profit - that is to enter into commercial contracts. The profits may then go back to the council through dividends or service charges.
- 2.4 The reason given for this legislative requirement is that:

"local authorities and their trading arms have to be on a level playing field with the private and commercial sector in both a positive and negative way. They should not be at a disadvantage, but they should not have an outstanding advantage. Taxation is a particular issue. It is right to carry forward the requirement that such bodies should be companies and trading as such."
- 2.5 To exercise the power to establish a company and trade, a local authority must first approve a business case ('a comprehensive statement') covering:
 - the objectives of the business;
 - the investment and other resources required to achieve those objectives;
 - any risks the business might face and how significant these risks are; and
 - the expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve.
- 2.6 That business case is then implemented and refreshed by way of a business plan, which should be updated and submitted for approval each year, to guide the company in carrying out its continuing activities.
- 2.7 The local authority must also recover the costs of any accommodation, goods, services, staff and anything else they supply to the company under any agreement or arrangement. This is an absolute requirement and distinct from the various rules on procurement or providing state aid.
- 2.8 Other important legal, commercial and financial considerations for councils or



³ The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009

fire and rescue authorities setting up a trading company include company law issues, the cost of bidding for contracts, tax liability (corporation tax and VAT), EU procurement law and state aid rules and employment law (TUPE and pensions).

(b) The Local Authority Company

- 2.9 The kind of company that must be utilized to enable the Council to trade in this way is defined in Part V of the Local Government and Housing Act 1989 ('LGHA 89'). That lists:
- a company limited by shares;
 - a company limited by guarantee and not having a share capital;
 - a company limited by guarantee and having a share capital;
 - an unlimited company;
 - a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965.
- 2.10 The LGHA 89, and the current Order⁴ made under it, places local authority companies into one of three categories, being controlled or influenced by the local authority (a regulated company) or a company in which the local authority has a minority interest. It then goes on to set out a number of additional restrictions and requirements to which the local authority and the companies must adhere.
- 2.11 The reasons for these limitations were described by the Government of the day, when setting out the reasons for the LGHA 89, as being that:
- "when a company is effectively under the control of a local authority... the most significant controls that Parliament has laid down for the conduct of local authorities should apply to that company."*
- 2.12 A regulated local authority company and any subsidiary of it, for example, is required to state on all correspondence that it is "**a local authority controlled company**" or "**a local authority influenced company**" (as the case may be) and name the relevant authority or authorities and is subject to rules concerning access by the Council's auditors and for delivery of information to the authority and its members.

(c) Other Local Authority Entities

- 2.13 If it isn't needed as a means by which it can trade, a local authority is free to involve itself in any one of a number of different forms of sole and joint ventures to best assist it in achieving its goals and aims, which may or may not involve establishing an entity that has a separate legal personality. These may also be as above, companies as defined by the Companies Act and which can include an industrial or provident society or a community interest company. They may alternatively be established as a distinct trust, with the council or appointees as trustee. They may be embodied as limited liability partnerships. They may also exist simply as unincorporated partnerships, with



other public bodies or private persons (that can often act as if they were a distinct entity), such as the Local Economic Partnership.

- 2.14 There are certain rules yet to be brought into force, and the Secretary of State holds reserve powers, that may require, prohibit or regulate the taking of specified actions by entities connected with a local authority and those appointed to or representing the local authority at them⁵. In this respect:
- “entity” means any entity, whether or not a legal person, and
 - an entity is stated to be “connected with” a local authority if financial information about that entity must be included in the local authority’s statement of accounts.
- 2.15 Whilst this Code of Practice will apply to all companies in which the Council has an interest, it may not be as appropriate for the governance of the Council’s relationship with other entities which it is connected to, is a member of or has an interest in. In these instances, regard will be had to this Code but its application will be determined on a case by case basis.

3. Guidance

- 3.1 In exercising the power to establish a local authority trading company (LATC), local authorities were obliged under the 2003 Act to have regard to Statutory Guidance. The “*General Power for Local Authorities to Trade in Function Related Activities Through a Company*”⁶ was issued and it is to this document that this and other councils in establishing the companies have had regard to.
- 3.2 That Statutory Guidance is now out of date, however, and was withdrawn as of 17th June 2014. Whilst new guidance is awaited, the withdrawn guidance nevertheless remains useful and largely very relevant. Where it is still relevant, this Code has had regard to it and, where associated with the principles of this Code, accompanying direct quotes from the Government Guidance are included throughout.
- 3.3 All listed companies are subject to the *UK Corporate Governance Code*⁷. The Council will expect all of its companies and their subsidiaries, and indeed any company with which it is associated, to adopt the “comply or explain” approach of the UK Corporate Governance Code as a demonstration of best practice in corporate governance.
- 3.4 The *Corporate Governance Guidance and Principles for Unlisted Companies in the UK*⁸ and also the *Corporate Governance Handbook*⁹ have additionally been utilised in the compiling of this Code of Practice.

⁵ S.212 *Local Government and Public Involvement in Health Act 2007*

⁶ First published: 29 July 2004: UK Govt Archive

⁷ September 2014: Financial Reporting Council

⁸ First edition: November 2010: Institute of Directors (IoD) and European Confederation of Directors’ Associations (ecoDa)

⁹ Third edition 2013: Institute of Chartered Secretaries and Administrators (ICSA)



- 3.5 The Council itself has adopted a Bristol City Council Code of Corporate Governance and the approach of this Code of Practice will fall to be associated with the provisions of that Code.

4. Principles of Governance of Council Companies

- 4.1 In setting out the governance relationship between the Council and its companies, group of companies and organisations it has invested in, this Code has three key underpinning principles. These are as follows, preceded by a relevant quote on the subject from the Government Guidance.

I. Controls and Freedoms

The Guidance:

- 4.2 *“A successful company will be one that works alongside the authority in delivering joint objectives. The authority will have to consider how to balance the need to assist the company to achieve its trading objectives with the principles of transparency, accountability and probity.”*

The Principles

- 4.3 It is recognised that, whilst appreciating this should not be unfettered, a trading company needs to be given commercial freedoms to enable it to succeed.
- 4.4 Accordingly, governance arrangements will seek to ensure that:
- the company will be provided with sufficient freedoms to achieve its objectives; and
 - the Council will retain sufficient controls to ensure that its investment is protected, that appropriate social and financial returns on investment can be obtained and that the trading activities of the companies are conducted in accordance with the values of the Council.

II. Relationship, Integrity and Accountability

The Guidance:

- 4.5 *“It is important that trading companies can operate on an equal footing with their competitors, but it is equally important that they are not used as a device for inhibiting legitimate public access to information about local government and local government services.”*

The Principles



4.6 It is recognised that, whilst appreciating its procedures operate in a way that protects the company's commercial interests, those procedures should ensure that the Council can carry out its functions as an investor, as a trustee of public funds and a local authority committed to both due responsibility for the exercise of its functions and for providing a vision for the City.

4.7 Accordingly, governance arrangements will seek to ensure that:

- the executive can make investment decisions based upon complete and accurate consideration of business cases and business plans;
- the executive can evaluate social and financial benefits and returns on investment; and
- the Council's overview and scrutiny committees are able to exercise their powers in relation to the executive's decision making

in a manner that ensures the companies can provide full and frank financial and business reporting against their business plans and be open to an appropriate level of scrutiny without fear of commercial confidentiality being breached.

III. Understanding of role

The Guidance:

4.8 *"A trading company will be a separate legal entity from a local authority. It will derive its legal authority from its Memorandum of Association and the Companies Acts. Its directors and officers will derive their authority from the articles of association and the law relating to companies.*

...

"Those "who are appointed directors will participate directly in the activities of the company, and are answerable to the company and have the powers and duties of company directors whilst they do so.

...

"Local 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 Principles

4.9 It is recognised that, as company ventures have a separate legal personality to the local authority, the success and good governance of the company venture depends upon those involved understanding their role and responsibilities collectively and individually.

4.10 Accordingly, governance arrangements will seek to ensure that there is sufficient induction, training and other materials in place so that:

- their legal duties;



- stewardship of assets;
- the provisions of the governing documents;
- the external environment; and
- the total structure of the organizations and the venture

are appropriately understood by Members of the Council in their role as part of the executive or of overview and scrutiny, by officers of the Council associated with these duties and by the directors of the companies.

5. Ownership and control of the company

- 5.1 Bristol City Council, the local authority as a corporate body, will be a member of the company. The membership will be as guarantor if a company limited by guarantee or, as will be the norm if a LATC, the holder of shares (perhaps the only share) in a company limited by shares.
- 5.2 The rights and duties as a member of the company will, however, almost always fall to be exercised as an executive responsibility. This means that, at BCC, decisions to be taken as a member of the company (as shareholder) fall to be decided on by the elected mayor. In the normal way, therefore, these functions may be delegated by the mayor to the cabinet or an officer and will be subject to key decision and access to information rules, call-in and review by overview and scrutiny committee.
- 5.3 For ease of use, where decisions are to be taken by the local authority as a member of a company, those decisions are referred to in this Code as being taken by 'the executive'.
- 5.4 The authority of the shareholder is exercised where decisions of the company are reserved for approval of the executive before they can be implemented, but also directly in the form of a shareholder's written resolution or at the company's general meetings.
- 5.5 At the company general meetings the executive will be present and voting as a member of the company, where this presence and voting will be in the form of a single person known as the 'shareholder representative'.
- 5.6 Decisions to be made by the executive, rather than left to the company itself, are known as 'reserved matters'. Reserved matters cover such things as the approval of the company's annual business plan or mid-year amendments to it, the appointment of directors, certain key financing decisions and so forth. These are established either through agreement with the company, known as a shareholders agreement, or as set out in the company's governing articles of association.
- 5.7 The relationship between the local authority (and the companies it is a member of) is governed by these and other key documents that are required to establish a local authority company, and a trading company in particular. In establishing the local authority's company and then in governing the



relationship with what is now a separate legal personality, the executive will need to put in place the following documents:

- The **business case** which assesses the risk involved in the proposed trading enterprise and decides whether or not it should be established and proceed to trade. It starts the process of business planning.
- The **articles of association**, or the memorandum and articles of association as it used to be called, which is the constitution of the company. This is the legal documents required to set up a limited company and give details of its name, aims and authorised share capital, conduct of meetings, appointment of directors and registered office.
- The **shareholders agreement**, or management agreement, which sets out the rights of the Council as the sole or co-shareholder and how it can exercise those rights. It details the powers of the board of the company and how and when the shareholder might influence those powers. It is important to note that the shareholder agreement is capable of being developed and added to as the company develops.
- The **financial agreements** which are the commercial agreements that set out what assistance is to be provided and on what terms. This may be purely financial, such as a direct loan or a facility such as a parental guarantee, and made on commercial terms. It may also be in the form of goods, services or staff to be provided and set out in a resourcing agreement or a service level agreement, which is likely to be on a service charge or cost recovery basis. The agreements may require regular and detailed access to information and financial reporting to the Council and/or holding company.
- The **business plan** which sets out the objectives of the business, how they are to be achieved and standards met adjusted in the light of experience and changing circumstances. It is a comprehensive analysis of the business situation at a particular point in time. It is often referred to as the annual business plan because it is expected to be submitted for shareholder approval annually.

5.8 A model shareholder agreement for use with the holding company, setting out the principal decisions reserved for the executive's approval, including subsidiaries of the company as a group, is outlined at Appendix 2.

6. Shareholder Group

6.1 The structure described above creates a governance process whereby, so far as appropriate under this Code's Principles, the company is left to get on with its business. Following the UK Corporate Governance Code, the companies will utilise a unified board, with appropriate non-executive directors providing outside expert help and with board committees (such as an audit committee) to provide oversight and ensure delivery.

6.2 The Mayor, in turn, will seek to inform the executive decisions and holding the company to account utilising a reflection of the company board structure in the



form of a Shareholder Group, including external expertise and sub-groups. The role of this group is to provide the necessary oversight from a shareholder's perspective that the parameters, policies and boundaries that the executive as the shareholder has established for the company are being adhered to. In it, the Mayor (or his or her appointee) remains the decision maker but the Group act as advisors in the making of those executive decisions.

6.3 Such a Shareholder Group is considered to be an effective means of governance of the companies. This is because it allows for decision making and discussion in an informed atmosphere, which also provides the executive with:

- a mechanism to communicate the shareholders' views to the company; and
- a means to evaluate the effectiveness of the company board and the delivery of the company performance against strategic objectives.

6.4 It is intended that the Mayor (or his/her appointee) will make most decisions concerning the executive's role in respect of company interests at meetings of the Shareholder Group (in a similar manner to the Mayor's executive decisions made at various partnership boards and the health and well-being board). It is envisaged that key decisions concerning the companies will, however, still normally be made at meetings of the Cabinet.

6.5 The Terms of Reference for the Shareholder Group are set out at Appendix 1.

7. **Scrutiny**

7.1 The overview and scrutiny committees have a significant role to play to ensure that the company is able, and the executive has properly required the company, to make sufficient returns for the investment to be worthwhile and, indeed, ensure that the social objects set for it are not lost in the drive towards the overriding and essential requirement for the company to be economically successful.

7.2 It is the executive, the Mayor and Cabinet, who is responsible for approving the business case to establish a company, of setting the right balance between the economic, social and environmental objects of a company when it is established and of subsequently exercising the Council's powers as shareholder.

7.3 Once established, the company must then get on with the business of delivering the objectives with which it has been tasked, within the parameters set for it. It must be otherwise free, however, to operate in its own best interests and to compete on an even basis with its competitors in the marketplace.

7.4 Again, it is the executive, either generally or when considering reserved matters, to whom the company must answer and by whom it is held to



account for its success, or failure, in achieving the objectives set for it.

7.5 The key role of overview and scrutiny is then to advise the executive and hold it to account on behalf of the wider public interest and its role within the Council.

7.6 This creates a flow of information and accountability, in which

- the company needs to get on with the business of delivery;
- the executive needs to make the company decisions reserved to it and to hold the company to account for performing against them; and
- Members as part of overview and scrutiny need to advise on or scrutinise the decisions of the executive.

This needs to be done in a trading environment that requires them all to make speedy and reactive commercial decisions and to handle often highly valuable and commercially sensitive information.

7.7 Overview and Scrutiny, to fulfil its role, requires a means of access to the sensitive information and debate that inform the Shareholder Group and the Mayor's decision making, without either oppressing that process or endangering its own strictly non-executive role.

7.8 To this end it is considered that the Chair of Overview and Scrutiny Management Board (OSM) is best placed to be involved, use his/her knowledge of this committee and its remit to sift the information and be alert to those matters that need to be brought to the overview and scrutiny committees' attention and be investigated further. Accordingly, the Chair will be invited to the forum created to handle this crucial information flow, the Shareholder Group. To retain the independence required of the OSM Chair, this is not membership as direct advisor as part of the decision making, but as an informed observer.

7.9 Overview and Scrutiny committees may then review any matter concerning the Council's companies and make proper use of its full powers and function, having had these matters drawn to its attention by, and with the benefit of, a fully informed Chair.

7.10 In carrying out any such review, the Government Guidance states that:

"The local authority should ensure that its overview and scrutiny committees are able to exercise their powers in relation to the discharge of local authority functions under the relevant legislation.

7.11 To this end, the legal framework for local authority companies includes an express requirement concerning the provision of information to Members of the Council, which reflects the similar provision in relation to local authorities generally. This states that a local authority regulated company "*shall provide to a Member of the Council such information about the affairs of the company*



*as the member reasonably requires for the proper discharge of his duties.*¹⁰

- 7.12 The exception here is that the company cannot be required to provide information in breach of any enactment, or of an obligation owed to any person.
- 7.13 It is also worth noting that, where a Member or an officer has become a member or director of a local authority company, the local authority must make arrangements for them to be open to questioning about the company's activities by Members of the Council at a meeting of the authority, or a committee or sub-committee, or by cabinet members in the course of proceedings of the cabinet or a committee of the cabinet. Importantly, the Member or officer is not required to disclose confidential information about the company.

8. Investment and Finance

- 8.1 The balance of how each company venture may be financed will be assessed and set out in the business case, required at the very beginning of the venture and the incorporation of the company as described above, and in business plans as made or amended and agreed by the executive. Each decision will take into account state aid implications and such matters as where legislative and regulatory requirements demand full cost recovery or standard commercial terms to be applied.
- 8.2 Where the purpose of a company is to better utilise assets owned by the Council, for example, the principal investment in the company is likely to be those assets. The assets may then be made use of by the company through their being transferred in their entirety from the Council to the company or by being provided to the company by the Council under a lease, loan or use agreement.
- 8.3 Investment at the initial stage of a trading company will normally be by way of purchase of share capital, either directly in the company or, more likely, via Bristol Holding Limited, often together with a loan or loan facility on commercial terms. This is to fund those costs which arise at the start of the company or company joint venture, including the holding company and its subsidiaries, to cover initial set up costs, working capital costs and collateral costs. For purchased company interests, share value should reflect the fair value of the going concern.
- 8.4 Direct investment may well also be by various other forms of agreement. This may be for the supply of monies, directly as a loan or under a parental guarantee, credit agreement, facility and so forth, which should be on standard commercial terms. It may also be for the supply of goods, property or staff, as described above and at section 12 below.



9. Companies Structure

- 9.1 The principal means by which the local authority will normally own and hold interests in its trading and other forms of company will be through a single holding company. Wherever practically feasible and advantageous to the authority, each of the individual company ventures will then be a subsidiary of the single holding company and they will operate together as part of the Bristol Holding Limited's group of companies.
- 9.2 The primary objective of a group structure is that the holding company is able to provide a single 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.
- 9.3 In doing so, the board of Bristol Holding Limited will also sign off all business plans and hold its subsidiaries to account. The executive, supported by the Shareholder Group, will approve any decisions that would have an effect on the shareholder's rights and hold the group of companies to account as a whole.
- 9.4 The subsidiary companies will, therefore, be expected to adopt a common 'group' approach. This will involve the group companies using existing Council policies and strategies where appropriate. In particular, the Council will require the holding company and its subsidiaries, wherever practicable, to adopt a common approach across the group on branding and its finance, ethics and procurement policies and practices. For example, the Council will require the holding company to approve the procurement and authorisation of spend levels set by each company for its directors and staff.
- 9.5 More detailed matters will also be set as a common approach for itself and its subsidiaries by the holding company, where it considers that that will increase effectiveness, efficiency and engender common understanding. This is likely to include such things as group financial procedure rules, fraud and whistle-blowing policies, decision making levels and procedures, capability and disciplinary procedures, health and safety practices and so forth.
- 9.6 The holding company similarly provides a natural home and conduit for support and control roles that will be common across the group, such as company secretarial services, procurement, finance and human resources. These fall into two groups. The first is those services that would be better employed directly by the holding company, such as financial and payroll systems for example. The other are those provided as managed services to the companies by the Council, under a resourcing agreement (or service level agreement), because this is more cost effective, appropriate or is a demand of the shareholder, such as HR or company secretarial and legal services. (This is described further at section 12 below).
- 9.7 The secondary purpose is financial, in that group companies can share VAT registration where appropriate and can be treated as holding group accounts.



The latter means that reporting is as one set of accounts and that profit and loss can be distributed across the group, setting one off against another, as might be desired to meet the aims and values set for the group.

- 9.8 The executive will approve the appointment of auditors for the group and its accounts will appear as part of the Council's financial statements.

10. The Company's Board

- 10.1 The Government Guidance advised that a local authority company will be run by its board of directors answerable to the shareholders, in accordance with the articles of association, and goes on to suggest that a board of between 3 and 8 directors is most likely to be practical (although this will be dependent on the circumstances of each company). The participating Local Authority should be represented on the board of its company.

- 10.2 The representatives who are appointed directors by the executive will participate directly in the activities of the company and are answerable to the company and have the powers and duties of company directors whilst they do so. Accordingly, the Government Guidance goes on to suggest that this requirement in a trading company and the accompanying conflict of interests that may arise means that officers are better placed to fulfil this role.

- 10.3 As the holding company for the group, the Bristol Holding Limited's board of directors will be formed of:

- Executive directors, being:
 - the managing director (who will ordinarily be a BCC officer); and
 - the managing directors of the authority's principal trading companies
- Non-executive directors, being:
 - the BCC City Director (Chair of the Board); and
 - other BCC senior officers as appropriate.

(At the time of adoption of this Code, the board of directors of Bristol Holding Limited's numbered six, being the managing director, the managing directors of two companies and three further Bristol City Council officer appointees as the Chair and two non-executive directors)

- 10.4 The Chair of the board of directors, as Council appointee, will have a deciding say to be exercised through means of a 'golden vote' procedure on the board. This approach is to ensure that the Council's officers will always be able to out-vote the directly appointed directors on the holding company. Such matters as the quorum requirement for board meetings of the company and the like will be expected to reflect that objective.

- 10.5 The Bristol Holding Limited Bristol Holding Limited's will have two standing committees, which will be as follows:

- The Remuneration Committee, which will conduct appointments and remuneration decisions and recommendations to the Council (where an



appointment is not wholly reserved to the Council).

- The Audit Committee, which will fulfil the same role and function as the Council's Audit Committee, the outputs of which will feed into the holding company board, the company business plans and the Council's own statement of accounts and Annual Governance Statement.
- 10.6 In respect of the individual wholly owned trading companies, non-trading (Teckal) companies and joint ventures, the appointment of directors of the company will be as are considered best to meet the requirements of the subsidiary or venture concerned.
- 10.7 Where an officer is placed on a company board, he or she will be provided with an indemnity for their actions in that role. This is provided for under the Local Authorities (Indemnities for Members and Officers) Order 2004. It should be noted, however, that any such indemnity only covers actions taken honestly and in good faith.

11. Conflicts of interest

- 11.1 The Government Guidance states that "*Local 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.*"
- 11.2 There will always arise a point where, in matters of reporting, contractual discussion, investment requests or resourcing agreements, there is potential for the same person to be a decision maker or advisor both for the Council and the company.
- 11.3 This is a reflection of the position of each company as a separate legal entity and that the directors of each company are subject to. As the Corporate Governance Guidance and Principles puts it:

'An important principle of Company Law is that directors have a duty to promote the success of the company as a whole. They are specifically prohibited from directing the activities of the company in favour of themselves or particular shareholders and/ or stakeholders'.

- 11.4 Appendix 3 sets out a briefing for directors' duties.
- 11.5 An essential element of this in terms of this Code is that, whilst changes to the Companies Act and current articles of association allow for appropriate provisions dealing with conflicts of interest and the ability of company directors to authorise them, an officer of the Council or a Member can never waive their duty to act in the public interest in exercising their responsibility for functions of the Authority. This will, on occasion therefore, create an inescapable conflict of interest between someone's role as a Member or, more likely, as an officer of the Council and as a director of a company, of which those involved need to be aware.



- 11.6 There are also natural points where it is expected that the Council and one of its trading companies will take a different approach. In this respect, the Government Guidance states that:

“The local authority should consider appointing a ‘contract officer’ and/or ‘contract member’ with primary responsibility for liaison between the company and the authority, and for access to information about it. It might wish to place limitations on these individuals to ensure that they are fully accountable to the authority as a whole and to ensure that the Section 151 Officer/Monitoring Officer countersigns major decisions about the company’s operations.”

- 11.7 This is the role of the Shareholder Group. In support of that function, the Council will appoint a lead authority and client-side officer to lead on managing contractual arrangements with the companies and in holding of the companies to account.

- 11.8 A certain form of wholly owned local authority also exist to provide services directly to or for the Council (known as a ‘Teckal’ company). The relationship between the authority and the company are set out in a contract for services. In this scenario, clear separation is required between commissioner and provider and there will be a requirement for further support to be provided, beyond the position of lead authority and client officer.

- 11.9 Officers placed into any of these roles are, at some point, likely to find themselves in a position where they are, or are negatively seen to be, acting against the interest of their own authority and also challenging the Council as their employers or senior managers to whom they might normally answer to. As a result of such activities, their performance in the company or actions they feel are required of them by the company, some of those officers may even find themselves in a position where it is no longer felt tenable that they can be appointed by the authority as a director of a company. The Council as an employer, from the viewpoint of both the executive and overview and scrutiny, wholly recognises these unusual positions that such officers may find themselves. The Council therefore undertakes that no officer will suffer any ill affect to his or her employment or career with the authority for fulfilling these activities to the best of their ability or in undertaking these actions asked of them.

12. Managed Services, Support Arrangements and Employees

- 12.1 The authority is required under the 2009 regulations to recover the costs of any accommodation, goods, services, staff or any other thing it supplies to a company in pursuance of any agreement, or arrangement in place. It cannot subsidise the operation of the company in this way.

- 12.2 The Government Guidance in addition clarifies that

“Because the power to trade is subject to a restriction requiring it to be exercised through a company, it follows that the authority has the requisite



power to enter into arrangements with a company in order for the trading power ... to be exercised. It is not necessary therefore, for the company to be expressly designated as a public body under the Local Authorities (Goods and Services) Act 1970, in order for the authority to be able to provide it with staff, goods etc, for the purpose of exercising the power to trade.”

- 12.3 This means that the authority may enter into an agreement with the companies to provide services at cost or as a surplus service charge and that staff time and resources utilized for company purposes should be carefully accounted for. Where this is done at cost, which shall be the norm, it is helpfully stated in the Guidance that the approach should be in accordance with the CIPFA definition of ‘whole cost’.
- 12.4 Referred to above as the ‘managed services’, those areas of the authority’s resources so utilized might include project management, initial set-up staff, human resources, audit, business continuity, communications, procurement, legal or finance and so on. It is for the company and the executive to agree what is the appropriate level of authority led resource that is appropriate, should or can be delivered to the company in each case. The parameters of those services can be agreed through a Resourcing Agreement or what is known as a Service Level Agreement (SLA).
- 12.5 The authority as shareholder, however, does need to be assured that there are effective and robust support services in place in certain areas. This is to satisfy itself that sufficient standards of operational governance, legal and company secretarial compliance and effective financial management within the company are adhered to. The authority will reserve to itself the ability under the Shareholder Agreement to insist on supplying these services to a controlled company, at cost, if it feels that these standards are not otherwise being met or are not in its opinion likely to be met.
- 12.6 In particular, the Company Secretary role should have a consistent approach across all of the companies or group of companies. This is to ensure consistent interpretation of the compliance standards across the companies and of the governance relationship between the companies and between the companies and the Council. In addition, it ensures that appropriate and proper intelligence is shared across the companies and the authority. In relation to all authority controlled companies and their subsidiaries, therefore, the position of company secretary as an officer (not a director) of each company in the group is to be fulfilled by the Council’s Monitoring Officer, being the equivalent corporate governance, assurance and general counsel position for the Council. All company secretarial and general counsel duties for the companies will then be carried out through that office, either directly or through the position of an assistant company secretary, with the exception of where a conflict of interest is identified and is acknowledged by that officer.
- 12.7 In relation to company staffing, it is expected that staff of the local authority trading companies will be directly recruited and employed by the companies themselves, with the exception of those support staff supplied by or seconded



from the authority as described above. Where the business case includes that staff are transferred, however, this will be subject to full reporting and then consultation and requirements under TUPE legislation and guidance.

Adopted in accordance with the Cabinet decision of 15th December 2015.

[To be] Presented to the Bristol City Council Audit Committee of 29th January 2016.



BRISTOL CITY COUNCIL
SHAREHOLDER GROUP - TERMS OF REFERENCE

Overview

The purpose of the Shareholder Group is to advise the Mayor in the exercise of his/her responsibility for the Council's functions as corporate shareholder of a company or group of companies and in their role to represent the interests of the Council as Shareholder Representative at meetings of a company.

Decision making

The Mayor (or other Cabinet member appointed by the Mayor for this purpose) may make decisions concerning companies in which the Council is or is proposed to become a shareholder, either:

- (a) in Cabinet; or
- (b) in the presence of the Shareholder Group.

Membership and Arrangements

The Shareholder Group shall consist of the Mayor (or other Cabinet member appointed by the Mayor for this purpose) in the presence of:

- (a) Such Members of the Cabinet as are appointed by the Mayor (which shall be at least two);
- (b) Two co-opted members, who will be independent persons providing relevant expertise and appointed on merit (but which process may be carried out in association with the Audit Committee's arrangements for co-opted appointments); and
- (c) Relevant senior officers of the Council as are appointed by the head of paid service (or their deputies); together with
- (d) The Chair of Overview and Scrutiny Management Board, as a Member of the Council from outside of the Cabinet, to act in the capacity of Observer.

The Service Director for Finance (s151 officer) and the Service Director for Legal and Democratic Services (monitoring officer), or their deputies, will be advisors to the Group to provide open and strong advice.

Other members of the Cabinet (who are not directors of any of the companies concerned) may attend and vote as substitutes in the event that an appointed member of the Shareholder Group is unable to attend



Restrictions on Membership

As the Shareholder Group is to advise discharges executive functions in relation to company matters and the role of the Shareholder Representative, only Cabinet members can be members of the Shareholder Group Shareholder Group with voting rights, although other Cabinet members and non-Cabinet members can be invited to attend, without voting rights.

Meetings

The Shareholder Group shall meet on a basis agreed by itself and normally in private.

The quorum shall be the Mayor (or other Cabinet member appointed by the Mayor for this purpose) in the presence of a minimum of:

- (a) one other Cabinet Member;
- (b) one independent co-optee; and
- (c) one senior officer appointed to the Group (or their appointed deputy).

An invitation to attend must have been provided to the Chair of Overview and Scrutiny Management Board/Committee (or their nominated deputy) at least three clear days in advance of the meeting taking place. This notice period may be waived if the Chair of Overview and Scrutiny Management Board/Committee (or their nominated deputy) so agrees.

An invitation to attend must also have been provided to the section 151 officer and the monitoring officer (or their nominated deputies), which will normally be at least three clear days in advance of the meeting taking place.

The Mayor (or appointee) will chair the Shareholder Group and a Vice Chair will be selected from the elected members of the Shareholder Group.

Sub Groups

To assist it in its functions the Shareholder Group:

1. may establish and consult standing sub-groups, such as might be required in respect of:
 - (a) Audit and Risk;
 - (b) Ethical practices; or
 - (c) Nominations and Remuneration
2. may establish and consult ad-hoc or task and finish sub-groups in respect of any matter; and
3. may establish and consult stakeholder groups on any particular aspect or the generality of the objects of the trading companies



A sub-group or stakeholder group may contain such co-opted members, advisors or observers as the Shareholder Group sees fit.

Functions

1. Monitor the performance of a company in relation to its Business Plan and, in particular, the company's performance:
 - (a) in financial matters
 - (b) against the social goals of the company as set out in the company's Objects, Business Case or Business Plan; and
 - (c) against the values of the Council.
2. Evaluate and monitor:
 - (a) the financial and social returns on investment (be that shareholding, loans or direct investment); and
 - (b) risks and opportunities including those arising from joint ventures or new opportunities.
3. Consider matters reserved to the Council for shareholder approval, such as:
 - (a) Varying Articles of Association
 - (b) Varying ownership and structure
 - (c) Variations to shares (number of, rights, etc.
 - (d) Entering contracts that:
 - (i) have a material effect on Bristol City Council business (including other companies within the group)
 - (ii) are outside of the business plan or do not relate to the business
 - (iii) significant in relation to the size of the business, the business plan, etc.
 - (e) Material legal proceedings outside of ordinary business
 - (f) Adopting and amending business plans each year and strategic plans (3 years)
 - (g) Appointment, removal and the remuneration of directors (members of the company board)
 - (h) Selection of the chair of the board
 - (i) Appointment of auditors
 - (j) Issue of dividendsas more particularly set out in a company's Articles of Association or Shareholder Agreement.

Relationship

The Shareholder Group as it considers appropriate in accordance with its functions described above, may:

1. report and make formal recommendations to the Mayor, directly or to the



wider Cabinet;

2. make reports to and consult Overview and Scrutiny (including full Council) or
3. make reports to and consult the Audit Committee, in relation to that Committee's particular functions.



OUTLINE OF THE
SHAREHOLDER AND COMPANY AGREEMENT

1. DEFINITIONS AND INTERPRETATION
2. FINANCING THE COMPANY
3. DIVIDEND POLICY
4. SUBSIDIARIES
5. MANAGEMENT OF THE COMPANY
6. SHAREHOLDER GROUP
7. THE BUSINESS PLAN AND COMPLIANCE WITH THE BUSINESS PLAN
8. REPORTING AND ACCOUNTING MATTERS
9. BANKING ARRANGEMENTS
10. TERMINATION
11. UNLAWFUL FETTER ON THE COMPANY'S POWERS
12. ASSIGNMENT AND SUB-CONTRACTING
13. FURTHER ASSURANCE
14. REMEDIES AND WAIVERS
15. ENTIRE AGREEMENT
16. VARIATION
17. CONFLICT WITH THE ARTICLES
18. SEVERANCE
19. CONFIDENTIALITY
20. NOTICES
21. NO PARTNERSHIP OR AGENCY
21. COUNTERPARTS
22. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999
23. GOVERNING LAW AND JURISDICTION



Guidance Note to Bristol City Council Officers when acting as Directors of Council Companies

1 INTRODUCTION

- 1.1 This note contains guidance for Bristol City Council Officers who are appointed as company directors to the boards of companies either owned by Bristol City Council ("the Council") or in which the Council has an interest.
- 1.2 As further companies are established (for example, any one or more intermediate holding companies - as subsidiaries of the Council but sole shareholders in service companies - and the waste company), this note will need to be reviewed and checked to ensure it applies to all companies, roles and appointments.
- 1.3 When this note refers to "directors" it means company directors, not directors in the sense of senior officers of the Council.
- 1.4 This note covers the following areas:
 - 1.4.1 Statutory duties of company directors under the Companies Act 2006;
 - 1.4.2 Other statutory duties;
 - 1.4.3 Duties of directors if the company is facing insolvency;
 - 1.4.4 Company secretary issues;
 - 1.4.5 Conflicts and
 - 1.4.6 Liabilities, insurance and indemnities

2 RESPONSIBILITIES OF COMPANY DIRECTORS AND COMPANY OFFICERS

- 2.1 Directors are subject to a large number of duties and obligations as set out in the articles of association of the company, statute, common law and at equity (based on principles and case law decided by the courts over time). In the context of the Council companies, these duties (and the potential liabilities imposed on directors of companies) fall into the following three broad categories:
 - 2.1.1 General duties under the Companies Act 2006
 - 2.1.2 Duties under other legislation
 - 2.1.3 Insolvency legislation
- 2.2 These are now considered in turn below.

3 GENERAL DUTIES UNDER THE COMPANIES ACT 2006

- 3.1 These duties are contained in sections 171-177 of the Companies Act 2006 and are:
 - 3.1.1 to act within the powers of the company
 - 3.1.2 to promote the success of the company
 - 3.1.3 to exercise independent judgment



- 3.1.4 to exercise reasonable care, skill and diligence
- 3.1.5 to avoid conflicts of interest
- 3.1.6 to not accept benefits from third parties
- 3.1.7 to declare interest in proposed transactions or arrangements with the company
- 3.2 The duties can be described more fully as follows:
 - 3.2.1 **To act within the powers of the company** – directors must ensure that the company is operating within its objects, its constitution and within its general legal powers
 - 3.2.2 **To promote the success of the company** – a director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.
 - 3.2.3 **To exercise independent judgment** – directors can seek advice but they must exercise their own judgment in deciding whether or not to follow that advice. They can also delegate their powers to others providing this is authorised by the company's constitution.
 - 3.2.4 **To exercise reasonable care, skill and diligence** – a director must exercise the general knowledge, care, skill and experience that can reasonably be expected of a person carrying out the functions of that director in the company and the specialist knowledge, skill and experience that the particular director actually has. So there are two parts to this test – an objective and subjective element.
 - 3.2.5 **To avoid conflicts of interest** – a director must avoid situations in which he has or could have a direct or indirect interest that conflicts with the company's interests (for example a director should avoid a situation where he sits on the board of two companies who are competing for business unless this situation is known to both parties and authorised). Unless a "situational" conflict is authorised, a director cannot act. This relates to the underlying situation where a director is conflicted not to specific transactions or arrangements which give rise to a "transactional conflict". (this is dealt with further below).
 - 3.2.6 **To not accept benefits from third parties** - a director must not accept any benefit from a third party, which is conferred because he is a director or he has done anything or not done anything as a director.
 - 3.2.7 **To declare interests in proposed transactions with the company** – a director must declare to the other directors any interest he has in a proposed transaction or arrangement that involves the company before the company enters into the transaction or arrangement. This could be the case, for example, where a director is also a board member of the Council and the company is entering into a transaction with the Council.
- 3.3 Where more than one duty applies in a given case, the directors must comply with each applicable duty. The general duties also do not require or authorise a director to breach any other law.
- 3.4 The general duties apply to all the directors of a company. "Director" is defined in the Companies Act 2006 to include any person occupying the position of director, by whatever name called. The Companies Act makes no distinction between executive and non-executive directors. Whether the general duties will apply to a person who is not formally appointed as a director will depend on his, her or its functions and the way in which he/she acts. Shadow directors are persons in accordance with whose directions or instructions the directors of the company are accustomed to act (s.251 CA 2006). De facto directors are persons acting as directors without being formally appointed. Both shadow directors and de facto directors are subject to the general duties.



3.5 Only the company will be able to enforce the general duties, although in certain circumstances individual members may be able to bring a derivative action on the company's behalf.

3.6 As a general principle, a director is (and remains) liable for his acts and omissions carried out whilst he was a director and so can be found liable for such acts and omissions even if he is no longer acting as a director.

4 DUTIES IMPOSED BY OTHER LEGISLATION

4.1 As well as the general duties under the Companies Act 2006, there is a range of legislation and general law which imposes further duties on directors, including:

4.1.1 **Companies Act 2006** - The Companies Act contains multiple provisions which govern the way in which directors manage the company including proper record keeping, the filing of accounts, maintenance of capital, etc.

4.1.2 **Company Directors' Disqualification Act 1986** - An application can be made to the court to disqualify a person from acting as a director under the Company Directors' Disqualification Act 1986 where (1) the director is found guilty of failing to comply with legislation in relation to the filing of documents three or more times during the preceding five years; (2) the director was a director of a company that has become insolvent and his conduct makes him unfit to be concerned in the management of a company; and (3) the director is found guilty of wrongful or fraudulent trading. If successful, courts can disqualify directors from being concerned or taking part in the promotion, formation or management of a company for up to fifteen years.

4.1.3 **Health and Safety at Work etc. Act 1974** - Directors can be held criminally responsible for a health and safety offence where the company is found guilty of an offence and the offence was committed with the consent or connivance or was attributable to any neglect on the part of the director.

4.1.4 **Corporate Manslaughter and Corporate Homicide Act 2007** - Companies can be prosecuted under the 2007 Act if failings by a company's senior management causes (1) a person's death and (2) a duty of care to that person to be grossly breached. Companies can receive unlimited fines for such prosecutions as well as orders demanding compensation, payment of costs, payment towards victims, orders to publicise the conviction and orders to take steps to remedy the management failure.

4.1.5 **Duty of confidentiality** - as well as legislation, there are also duties contained within common law and equity. Directors have a duty of confidentiality to the company. The duty of confidentiality can be particularly difficult to comply with where directors are sitting on multiple boards.

5 DIRECTORS' DUTIES IN INSOLVENCY

5.1 Directors' duties are modified where a company is or may become insolvent – in these circumstances, directors must act in the interests of creditors, with a view to minimising losses to them. In particular directors must avoid wrongful or fraudulent trading of the company. These cover, amongst other things:

5.2 **Wrongful trading** (section 214, Insolvency Act 1986). This occurs in the following circumstances.

- *A company is in insolvent liquidation and*
- *A Director knew or ought to have concluded that there was no reasonable prospect of avoiding liquidation; and*
- *The Director failed to take every step to minimise loss to creditors*



- 5.2.1 The "ought to know" standard is assessed both objectively and subjectively. What he *ought to have* known (given his circumstances, knowledge, skills, etc.) and what he *actually* knew. No dishonesty is required - being "honest but incompetent" is no defence.
- 5.2.2 The onus is on the director to prove that he took every reasonable step to minimise the potential losses to creditors.
- 5.2.3 In circumstances of wrongful trading directors can be personally liable to contribute to the company's assets
- 5.3 **Fraudulent trading** (section 213, Insolvency Act 1986 and Section 993, Companies Act 2006). This occurs in the following circumstances:

The business of a company is carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose.

- 5.3.1 The Insolvency Act provision only arises if "*in the course of the winding up of a company it appears [that the business of the company is carried on, etc.]...*". However, the equivalent provision in the Companies Act can be triggered at any time – no insolvency is required.
- 5.3.2 The Insolvency Act carries a civil penalty and a director found liable may be required to contribute to the company's assets. The Companies Act carries additional criminal penalties of a fine as well as a potential jail sentence (maximum sentence of 10 years).

[17/5/2015]

