

**Legal Appendix provided by external solicitors Trowers & Hamlins LLP on the instruction of Suzanne Malcolm, Acting Deputy Chief Executive and Pat Connell, Legal Services Manager**

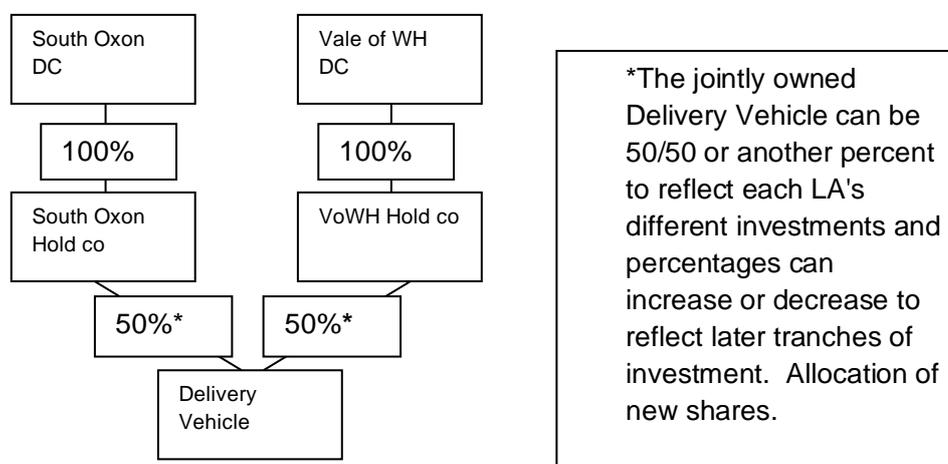
We have been instructed by South Oxfordshire District Council and Vale of White Horse District Council (the Authorities) to provide legal advice on each Authority establishing stand-alone arm's length companies/delivery vehicles (the Delivery Vehicle). The Delivery Vehicle is expected to deliver a wide range of regeneration and community benefits, including housing delivery, but also commercial and community facilities, such as community hubs and health facilities.

We understand that both Authorities wish to collaborate but have different financial situations. Accordingly, we are suggesting that each Authority sets up its own wholly owned holding company and then both authorities' wholly owned holding companies have shares in a jointly owned subsidiary trading company.

Although there can be several kinds of corporate vehicle, we have proceeded on the assumption that companies limited by shares will be used as these are most commonly used for these situations and are the most flexible vehicle with clear powers in local government law to establish. (We are happy to advise on the relative pros and cons of other types of vehicle at a later stage if you wish).

The holding companies and the Delivery Vehicle can be incorporated with limited liability will be ring-fenced as far as the Authorities' legal liability is concerned.

**1 Potential corporate structure**



1.1 The reasons for this recommendation are that this structure allows for:

- 1.1.1 greater transparency and traceability of each Authority's own investment which helps each Authority comply with its common law fiduciary duty to obtain value for money, for that particular Authority's tax payers;
- 1.1.2 more efficiency, as neither Authority will be constrained by the decision making process of the other Authority in establishing its holding company and the Delivery Vehicle hence less risk of a fetter on each Authority's respective discretion;

- 1.1.3 greater flexibility for each Authority to establish its own sub companies/other trading subsidiaries, which provides for less fetter on each Authority's respective discretion less of a fetter on their discretion;
- 1.1.4 greater flexibility for each authority to invest different amounts or use different legal powers;
- 1.1.5 greater potential to maximise use of exemptions from public procurement and State aid law; and
- 1.1.6 greater resilience in the event of devolution (e.g. Tricuro in Dorset and CIFCo in Suffolk which we set up with similar structures before devolution in those counties).

## 2 **Shareholders' agreement**

- 2.1 The Authorities would be able to retain control of each Authority's respective wholly owned subsidiary holding company and the Delivery Vehicle through a shareholders' agreement (if required) and through the articles of association. These can be tailored so that each Authority has control of particular matters and governance and to ensure the Delivery Vehicle is compliant with the propriety controls affecting local authority companies and any Teckal exempt status (if desired-see below for more detail).

## 3 **Proper Purpose**

- 3.1 Just to be clear, we are not suggesting either Authority is acting for an improper purpose. However, it is as well to be aware in creating the paper trail leading up to the decision to form the companies, that the proper purpose rule means that that the courts do not allow local authorities to do something for the express purpose of circumventing the law or any legal constraints which Parliament has imposed on local government.
- 3.2 Therefore, even though a consequence or by-product of a local authority setting up a separate company (e.g. Delivery Vehicle) might mean that the company itself does not have to follow the same rules as the local authority (right to buy legislation, for example), it would not be lawful for a local authority to set up a company with the deliberate aim of circumventing that legislation as it would be regarded as acting for an "improper purpose".
- 3.3 Acting for an improper purpose is by its very nature, potentially vulnerable to legal challenge as "ultra vires" (acting outside the Authority's legal powers). The Authorities should therefore be careful with regards to their stated objectives to justify the establishment of a company to ensure that the decision to establish a company / Delivery Vehicle is less vulnerable to challenge.

## 4 **Best Value consultation**

- 4.1 Each Authority as a "Best Value authority", has a duty to conduct consultation with council tax and business rate payers, interest groups and service users before making a decision as to a change in the arrangements for the delivery of services.<sup>1</sup>
- 4.2 Recent case law on this requirement<sup>2</sup>, indicates that if a Best Value authority does not consult before making a decision to change a service delivery route (e.g. a decision set up

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<sup>1</sup> Section 3, LGA 1999

a company to deliver services formerly delivered by the Authority) then that decision could be quashed by a court in the event a judicial review challenge were to be brought against the Authority's decision.

## 5 Legal Powers/Vires

5.1 For many years, English local authorities have had clear legal powers (vires) to establish companies and hundreds of local authorities have set up companies at different times for many different purposes.

5.2 There are two principal legal powers (either of which the Authorities could rely on) to establish Delivery Vehicles. These are the "general power of competence"<sup>3</sup> and the "trading power"<sup>4</sup>.

5.3 Nowadays most of our local authority clients elect to use their general power of competence, as the legal power on which to found their decision to establish a company as this is arguably more flexible than the trading power

## 6 The General Power of Competence

6.1 Where an Authority wishes to set up a company it can do so under its general power of competence<sup>5</sup> for "the benefit of the authority, its area or persons resident or present in its area"<sup>6</sup>.

6.2 Where a local authority wants to exercise its general power of competence for a **commercial** purpose, it must use a **company** but it may not use any other type of corporate vehicle such as a as a limited liability partnership (commonly known as an LLP).

## 7 Vehicle to Deliver Non-Commercial Objectives

7.1 Each Authority could also use their general power of competence to set up a non-commercial corporate vehicle to provide non-commercial objectives. Provided the corporate vehicle's role is limited to delivering solely non-commercial objectives, the relevant Authorities would not be acting for a "commercial purpose" and in this situation the relevant Authority would have the flexibility to use either a company or another type of vehicle (such as an LLP). This has been confirmed in recent case law.<sup>7</sup>

## 8 Trading Power

9 The alternative trading power<sup>8</sup> allows the Authorities to trade at a profit and may also be exercised through a company.<sup>9</sup>

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<sup>2</sup> R v LB Barnet ex parte Maria Nash, Peters v LB Haringey

<sup>3</sup> Sections 1 and 4 of the Localism Act 2011.

<sup>4</sup> Section 95 of the Local Government Act 2003.

<sup>5</sup> Section 1 of the Localism Act 2011.

<sup>6</sup> Section 1(4)(c) of the 2011 Act

<sup>7</sup> Peters v LB Haringey v Lendlease Europe Holdings Ltd [2018] EWHC 192.

<sup>8</sup> Section 95 of the Local Government Act 2003.

<sup>9</sup> The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009.

## 10 **Business Case**

- 10.1 Before each Authority can decide to set up a delivery vehicle in order to trade at a profit, each Authority must prepare their own individual Business Case to set out the rationale for the decision,<sup>10</sup> and the Authority must then formally approve their own Business Case.<sup>11</sup> The Authorities should be aware of the operational risks, for example, the risk of loss resulting from inadequate or failed internal processes and people and systems supporting it.
- 10.2 Each Authority should ensure that it recovers all its costs of "*accommodation, goods, services, staff or any other thing*" that the Authority supplies to each company in pursuance of any agreement or arrangement to facilitate the exercise of the power to trade.<sup>12</sup> This means that the Authority cannot legally give the company premises, staff or anything else for free or at a discount but must charge the company at true cost price.
- 10.3 This is also necessary for compliance with State aid law unless an exemption applies (see below).

## 11 **Funding**

The subsidiary Delivery Vehicle should ensure that it has the necessary financial resources in place. Consideration will need to be given as to how the Delivery Vehicle will be funded in order to ensure it has sufficient working capital to operate its business. Will this be funded by way of debt or equity into the Delivery Vehicle?

## 12 **State aid**

- 12.1 The Authorities would need to ensure that they do not fall foul of the State aid rules in relation to any benefits they might wish to bestow on each company such as grants, premises or staff.
- 12.2 If the Delivery Vehicle wished to rely on the services of general economic interest (SGEI) exemption, then each authority would need to ensure that it kept accurate and separate accounts of overheads and income produced as a result of the Delivery Vehicle providing SGEI services to the Authorities.
- 12.3 We would recommend that the Authorities conduct market analysis to ascertain the market price of any services that the Delivery Vehicle would be providing to the Authorities. Information on determining market price/benchmarking can be found in Competition and Markets Authority materials.

## 13 **Public Procurement**

The public procurement rules mean that local authorities must subject certain contracts over threshold values to competitive tender.

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<sup>10</sup> Under Section 2(2) (a) of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009.

<sup>11</sup> Section 2(2) (b) of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009.

<sup>12</sup> The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009

## 14 **Body Governed by Public Law**

14.1 Just as a local authority is a "contracting authority" and as such has to comply with the public procurement rules, so are some local authority owned companies if they are classified as a "body governed by public law".

14.2 It is possible to establish a wholly owned local authority company which is not a body governed by public law" and hence does not itself have to purchase its supplies and services using public procurement. In order not to be classified as a body governed by public law", the Delivery Vehicle would need to be established for a "commercial purpose" and operate in a way which is entirely driven by commercial motives and not to fulfil policy objectives.

## 15 **Teckal Exemption**

15.1 The default position is that the Delivery Vehicle (just like any other supplier of services from the private or voluntary sector) would have to bid in a competitive public procurement process if the Delivery Vehicle wished to be paid to provide any services, works or supplies to the Authority or its holding/parent companies, (if the holding/parent companies are classified as "contracting authorities" because they are bodies governed by public law).

15.2 However companies owned by local authorities or by holding companies which are wholly owned and controlled and get most of their funding from local authorities can benefit from the "Teckal exemption" from the procurement rules. If each company were set up to satisfy the conditions of the Teckal exemption, those companies would not need to competitively tender to provide services to the relevant Authority or their parent company.

15.3 The requirements of the Teckal exemption are:

15.3.1 **Ownership test:** each company has to be wholly owned by the Authority/ies (there should be no private shareholders);

15.3.2 **Control test:** the Authority/ies which own the each company must control each company as if it were one of the relevant Authority's own departments, including having control (i.e. a right of veto) over each company's strategic direction and all significant decisions made by the board of directors; and

15.3.3 **Turnover test:** each company needs to generate over 80% of its turnover from providing services to the Authorities, or to a holding company wholly owned by the respective Authority.

## 16 **Holding company structure and Teckal**

16.1 Some local authorities have established trading companies with group structures in order to maximise the potential turnover from external customers. Well-known examples are The Norse Group, Optalis (which operates in Wokingham and Windsor) and Tricuro which operates in Dorset. The premise of these group corporate structures is that one company "PublicCo" meets all the conditions of the Teckal exemption and in particular, derives less than 19.9% of its turnover from external customers. A sister company, "PrivateCo" does not meet the Teckal exemption but has a business focused on external/private sector

clients and if PrivateCo wants to bid for contracts from contracting authorities, then PrivateCo must submit a winning bid under a public procurement process.

16.2 If PublicCo wishes to win public sector business from other contracting authorities, then PublicCo has the option of inviting its public contracting authority client to become a new shareholder/co-owner of PublicCo in order to meet the "joint Teckal" exemption.

16.3 As mentioned above, some local authorities have included a holding company in their corporate group structure to enable assets, staff and resources to be employed by HoldCo and then shared between a PrivateCo and PublicCo using service level agreements. In order to maintain the Teckal exemption, the holding company would need to be Teckal compliant and hence more than 80% of the holding company's average total turnover (over a three year period) would need to be derived from a Teckal compliant subsidiary Delivery Vehicle (i.e. PublicCo). Hence, the Authorities would need to ensure that the dividends payable by PublicCo to HoldCo were 80% or more of holding company turnover. This could be achieved if the majority of PrivateCo's dividends were payable directly to the Authorities and the Authorities and HoldCo were joint shareholders in PrivateCo.

## 17 **Directors' duties**

17.1 Any individual who is appointed as a director of a company (e.g. the Delivery Vehicle) takes on a range of legal duties for which the director still remains personally legally responsible to the company, even if the director delegates some or all of their tasks.

17.2 The legal duties owed by a director to the company to which s/he is appointed derive from the Companies Act 2006. Other legal responsibilities are imposed through employment, health and safety, safeguarding, environmental, tax and other legislation and English case law (known as "the common law").

## 18 **Directors' Duties under the Companies Act:**<sup>13</sup>

18.1 These are:

18.1.1 to act within powers in accordance with the company's constitution and to use those powers only for the purposes for which the powers were conferred;

18.1.2 to promote the success of the company for the benefit of its shareholders;

18.1.3 to exercise independent judgement;

18.1.4 to exercise reasonable care, skill and diligence;

18.1.5 to avoid conflicts of interest;

18.1.6 not to accept benefits from third parties; and

18.1.7 to declare an interest in a proposed transaction or arrangement.

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<sup>13</sup> Sections 171 – 177 of the Companies Act 2006.

## 19 **Director Training**

- 19.1 A director's failure to comply with the law can lead to their own personal liability to make good the loss caused to the company out of that director's own pocket, and can also lead to criminal or other sanctions (e.g. if health and safety or environmental legal obligations were breached).
- 19.2 Therefore it is vital before assuming office, that any company director has a full understanding of all the responsibilities the director is taking on and the necessary skills, experience and capacity required to fulfil a directorship position, together with sufficient time to undertake the role and ensure that they and the company comply with the law 24 hours a day, 365 days a year. We therefore recommend that directors complete training before their appointments are confirmed and we are happy to provide training if helpful.
- 19.3 Also note that a director's full name, private residential address and date of birth appears on the public record at Companies House.

## 20 **Skills Audit**

- 20.1 The Authorities will need to ensure that each subsidiary company has sufficient expertise to operate any services. Directors should only be recruited to the board of a company if they have the requisite skills. It is good practice nowadays to undertake a skills audit before deciding which directors should be appointed to the board of a company. This involves assessing the requisite skills required for the board of the company to ensure that the company is efficient, successful and acts within the law. For example, this could include ensuring that directors have financial / accountancy experience, legal skills, or relevant experience in the company's area of business (e.g. property development / health and safety etc.). This may mean that the relevant Authority has to open up some director roles to external recruitment
- 20.2 As the company's business evolves, the skills required on the board may need to change too.

## 21 **Prevention of conflicts of interest**

- 21.1 Company directors have a personal, non-delegable, legal duty to act at all times in the best interests of the company (unless and until the company is in financial distress when the directors' duties are owed to the company's creditors). Directors owe this primary duty to the company in priority to the body/shareholder e.g. the Authority who has appointed them.
- 21.2 Therefore, if an elected member or officer of the Authority is appointed as a director, that individual is likely be conflicted if they are also involved in their role as a member or officer of the Authority with regard to any decisions or transactions affecting the Delivery Vehicle.
- 21.3 In addition to the personal legal consequences for that individual, a conflict of interest would taint any Authority decision rendering the Authority potentially vulnerable to judicial review, allegations of predetermination or bias and adverse reputational consequences.
- 21.4 It is possible to overcome conflict of interest issues by ensuring that the Authorities' appointed individual(s) relinquish from their Authority role any responsibilities which might potentially affect the Delivery Vehicle (for example, input on decisions with regard to the

commissioning, award, renewal, variation or termination of contracts with the Delivery Vehicle, decisions with regard to town planning, building control, environmental health, which may affect premises the Delivery Vehicle occupies or is likely to occupy).

21.5 In any event, any directorships in Delivery Vehicle should be declared in the Authorities' respective registers of interests and kept up-to-date.

## 22 **Separate and Distinct Roles of the Authority as Shareholder / Funder / Commissioner**

22.1 It should be borne in mind that when establishing and continuing to be involved in a company, the Authorities will typically be exercising a number of distinct roles which are:

22.1.1 Acting as **shareholder/business owner**, where the Authorities have a legal duty to be business-like and to ensure they are getting a return on their investment which represents value for money;

22.1.2 Acting as a **lender** where the Authorities have a duty not just to obtain value for money but also to ensure they do not grant unlawful State aid to the company;

22.1.3 Acting as a **commissioner / purchaser** of services from the Delivery Vehicle, where the Authorities have a legal duty to ensure Best Value (economy, efficiency and effectiveness) and to monitor performance standards;

22.1.4 Appointing **directors** onto the board of each company who will owe distinct personal legal duties to the company including the duty to promote the company's success and hence should be suitably skilled and experienced and without conflict of interest (as set out above).

## 23 **Common law fiduciary duty to obtain value for money**

24 As you will be aware, the Authorities are public bodies and are therefore bound by the common law requirement to obtain value for money, which is part of the fiduciary duty placed on public bodies under the principles of administrative law<sup>14</sup>.

25 The Authorities' fiduciary duty to its Council Tax payees and ratepayers<sup>15</sup> is analogous to that of a trustee. This means that the elected members and officers of the Authorities are "*charged with the administration for definite purposes of funds contributed by taxpayers, and as such owes... a legal duty to taxpayers to conduct its administration of funds in a business-like manner with reasonable care, skill and caution, and with a due and alert regard to the interests of taxpayers*"<sup>16</sup>.

26 It is in light of the above, that we make the observations below in relation to shareholder duties.

## 27 **Shareholder duties**

27.1 The Authorities as shareholders must fulfil a prudent investor function as the steward of public assets in relation to the companies. In the light of the constrained public sector

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<sup>14</sup> The Law of Public and Utilities Procurement, S. Arrowsmith (volume 1, 3<sup>rd</sup> edition, Sweet & Maxwell), p 21.

<sup>15</sup> Local Government Audit Law, R. Jonas (2<sup>nd</sup> edition) (1985), p158; *Prescott v Birmingham Corporation* [1955] Ch.210, p235

<sup>16</sup> *Ibid*, p595-6.

financial climate, the manner in which each Authority discharges its shareholder / investor function merits particular focus.

- 27.2 The Authorities should therefore actively require regular delivery of information from Delivery Vehicle, whether in relation to progress against business plans and strategic aims, ongoing performance, robust reporting requirements or ensuring that each Authority is seeking a return on its investment, which is a legal requirement given each Authority's common law fiduciary duty to obtain value for money which requires them to act in a business-like (rather than a politically motivated) manner and to avoid giving potential unlawful State aid to the company.
- 27.3 It is important to note that each Authority in its capacity as shareholder is subject to various duties and responsibilities including monitoring the performance of the companies it holds shares in and minimising any loss of shareholder value<sup>17</sup>. Investors of public money and shareholders of companies owned by public bodies are accountable for taxpayers' money and must have in place clear procedures for evaluating the performance of an investee company and demonstrating value for money<sup>18</sup>.
- 27.4 We would recommend that the Authorities have regard to and apply disciplines set out in The UK Stewardship Code<sup>19</sup> which aims to enhance the quality of engagement between investors and companies to help improve returns to shareholders<sup>20</sup>. A shareholder is expected to act where it believes that the directors are not best serving the shareholders' interests or the interests of the beneficial owners (in the case of the Authorities these are the Council Tax Payers and Business Rates payers) and therefore, shareholders are provided by law with voting and other rights to enable them to be proactive in this respect<sup>21</sup>.
- 27.5 The Institutional Shareholders' Committee's Statement of Principles, which applies by analogy to shareholders and investors of Authority-owned companies, sets out best practice in relation to shareholders' responsibilities and states that shareholders should<sup>22</sup>:
- 27.5.1 regularly monitor the performance of investee companies;
  - 27.5.2 establish a regular dialogue with investee companies;
  - 27.5.3 intervene where necessary;
  - 27.5.4 evaluate the impact of their engagement;
  - 27.5.5 set out their policy regarding discharge of responsibilities;
  - 27.5.6 report back to beneficial owners (i.e., the electorate/public).

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<sup>17</sup> Institutional Shareholders' Committee, Code on the Responsibilities of Institutional Investors, November 2009, p3

<sup>18</sup> House of Commons Committee of Public Accounts, *Accountability for public money*, Twenty-eighth Report of Sessions 2010-2011, HC 740, April 2011, p5

<sup>19</sup> The UK Stewardship Code is aimed at institutional investors but applies by analogy to shareholders and investors of Council-owned companies.

<sup>20</sup> UK Stewardship Code: <https://www.frc.org.uk/investors/uk-stewardship-code>

<sup>21</sup> UK Stewardship Code explanation: [https://uk.practicallaw.thomsonreuters.com/6-502-2065?originationContext=document&transitionType=DocumentItem&contextData=\(sc.Default\)&navId=B88961EF1DDE054BE5427643B0E49E26&comp=pluk&firstPage=true](https://uk.practicallaw.thomsonreuters.com/6-502-2065?originationContext=document&transitionType=DocumentItem&contextData=(sc.Default)&navId=B88961EF1DDE054BE5427643B0E49E26&comp=pluk&firstPage=true)

<sup>22</sup> The Responsibilities of Institutional Shareholders and Agents – Statement of Principles, Institutional Shareholders' Committee, June 2007, paragraph 1, 3

- 27.6 Each Authority in its capacity as shareholder should review and approve business plans prepared by the companies' boards of directors, ensure the business plan is reviewed on a regular basis and contains key performance targets and milestones for the year immediately ahead<sup>23</sup>. This is good practice as set out in the framework document for UK Government Investments Ltd, the Government's centre of expertise in corporate finance and corporate governance, and which applies by analogy to shareholders and investors in Council-owned companies<sup>24</sup>.
- 27.7 The UK Corporate Governance Code issued by the Financial Reporting Council recommends that there should be a nomination committee made up of members which should lead the process for board appointments and make recommendations to the board<sup>25</sup>. All directors should be subject to election by shareholders at the first annual general meeting after their appointment and then to re-election thereafter at intervals of no more than nine years<sup>26</sup>.
- 27.8 We recommend that the Authorities apply the Institutional Shareholders' Committee's Statement of Principles in relation to the companies in which the Authorities are a member/shareholder and establish an Investments Committee which:
- 27.8.1 regularly monitors the performance of Authority companies;
  - 27.8.2 establishes timescales to facilitate the regular dialogue with investee companies;
  - 27.8.3 sets out triggers where it will intervene (e.g. reappoint directors if there is no progress against the Business Plan for say 2 years or if the company is dormant);
  - 27.8.4 evaluate the impact of the company;
  - 27.8.5 set out a clear policy on discharge of responsibilities;
  - 27.8.6 timetable public reports back on how the companies are performing against their business plan.
- 27.9 The Authorities should establish an annual 'shareholder audit framework' which seeks information from companies in which the Authorities are a shareholder or has an investment. This information should at the very least, comprise the annual accounts, reports and statements that are required under the Companies Act 2006. We recommend that once the annual information is obtained, the Lead Councillor for each Authority should present a report to the Committee, highlighting relevant information, including business plans for the following year and progress towards achieving targets. This is good practice<sup>27</sup>.

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<sup>23</sup> UK Government Investments, Framework Document, April 2016, page 20.

<sup>24</sup> UK Government Investments, Framework Document, April 2016

<sup>25</sup> UK Corporate Governance Code (April 2016), paragraph B.2.1

<sup>26</sup> UK Corporate Governance Code (April 2016), paragraph B.7.1

<sup>27</sup> UK Government Investments, Framework Document, April 2016

## 28 **Propriety controls**

28.1 These are controls which impose certain public accountability safeguards on companies which are wholly or partly owned by local authorities

28.2 Each Authority has a legal duty to ensure each company complies with the propriety controls applicable to any company which the Authority controls or over which it has a dominant influence.<sup>28</sup>

28.3 For example, the company's paperwork has to identify the fact that it is local authority controlled/influenced, the remuneration of local authority representative directors is limited, the company has to provide information to each Authority's external auditors of the company has to answer elected members' questions on company affairs, the company's external auditor appointment has to be approved by the Authorities' auditor and the minutes of the company's meetings have to be available for public inspection.

28.4 In our experience, these controls can sometimes be overlooked, so it is prudent to conduct an annual check to ensure the companies are still complying with the propriety controls.

## 29 **Employment**

This element of the Report considers the employment implications of a "Councils-owned" delivery vehicle which could be used to deliver new affordable homes, [together with the potential of a property development element].

## 30 **TUPE**

30.1 TUPE may apply to the transfer of functions or services from either Authority. TUPE may apply to employees of the Authorities (and any relevant sub-contractor) who are assigned to any services that are transferring to the Delivery Vehicle. This will include all the employees who are "assigned" to those services.

30.2 TUPE however will not apply if the services being delivered by the new provider are new services (for example potentially property development) or, services that fundamentally changed in the hands of the Delivery Vehicle, which will be a question of fact.

30.3 In addition, if in theory, services for housing delivery are split, then TUPE may not apply as there is not an organised grouping of employees who could be assigned to the services, either being maintained by the Authorities or undertaken by the Delivery Vehicle; and/or the services would be fragmented.

## 31 **Effect of TUPE**

31.1 In the absence of a new, fragmented, different, or split service, any employees who are wholly or mainly assigned to services that will be undertaken by the Delivery Vehicle may transfer, unless they object. If employees object, their employment terminates at the point of transfer as if they had resigned.

31.2 If employees transfer, will inherit the contracts of employment of the employees who transfer, along with all pre-existing employment rights and liabilities. So, for example, if an

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<sup>28</sup> Set out in LGHA 1989, Part 4 and the Local Authorities Companies Order 1995 (as amended)

employee is alleging race discrimination whilst employed by one of the Authorities, liability for that potential claim would transfer to the Delivery Vehicle.

- 31.3 There are also restrictions on redundancies and restructures, together with changing terms and conditions of employment, which would need to be considered in detail.
- 31.4 In addition, if TUPE does occur, the transferor employer (i.e. the Authorities in this situation) must inform the representatives of the employees about the fact of the transfer and the implications for the affected employees. If there is a recognised trade union, they will be the appropriate representatives.
- 31.5 Both employers must consult the representatives about any measures which the relevant employer proposes.
- 31.6 The transferor employers must provide certain due diligence information to the transferee employer. This information must be provided at least 28 days before the transfer.

## 32 **Ability to recruit new employees**

The Delivery Vehicle will be a legal entity in its own right and will be able to employ new staff, on new contracts, with new length of service from wider industry.

## 33 **Equal pay**

- 33.1 The Authorities must be mindful of the potential for equal pay comparisons to be drawn between employees of the Authorities and any subsidiaries, in particular if any changes to pay or benefits are proposed by the new employer. **It is possible that the Delivery Vehicle will be an associated employer of each Authority, unless it can demonstrate that it has complete authority to manage its own affairs, although further thought would need to be given to how that impacts on the Teckal exemption from public rules described above. This is on the basis that an element of that exemption requires the company to be controlled by each Authority.** Two employers are associated if one is a company of which the other has control or if both companies of which a third person has control.
- 33.2 The law on equal pay is set out in the Equality Act 2010 which sets out the principal of equal pay for male and female workers. If terms and conditions come from a "single source" but the employees are employed by different employers, the employee may still have a cause of action.
- 33.3 The law on equal pay is designed to prohibit differences in pay and benefits because of sex.
- 33.4 In order for an employee to show that he/she has been treated less favourably on account of his/her sex with regard to terms and conditions of employment, he/she must identify a suitable comparator of the opposite sex, in the same employment or employed on like work, work rated as equivalent or work of equal value.
- 33.5 The employer will have a genuine material factor defence (a **GMF**) if it is able to show that the variation in pay is for a reason which is:
- 33.5.1 not the difference of sex; or

33.5.2 if tainted by discrimination is objectively justified.

33.6 Where differences in terms arise because of protection under TUPE, the employer generally has a GMF defence. This could protect the Authorities where comparisons arise because new recruits are employed on different terms from the transferring employees, if any.

33.7 GMFs which rely on market forces may be tainted by discrimination where they have been shaped or influenced by sectors which have traditionally been male or female dominated.

33.8 Subject to the comments above regarding Teckal exemption, the Authorities could mitigate the risk of an equal pay comparison arising out of differences in terms and conditions between the Delivery Vehicle and the Authorities by giving the subsidiaries complete authority to make decisions about terms and conditions for their respective employees so that the Authorities do not have the power to rectify any difference in terms should one arise. This would provide the basis for any defence to any claim arising out of a "single source" argument and, in addition ensure that any changes to terms and conditions are supported by a fully developed business case with reasons which are not gender or gender-related.

#### 34 **Joint employment**

Potentially some employees could be jointly employed by the Authorities and the Delivery Vehicle. Joint employment is where you have a single employment relationship with multiple employers. There is a single contract of employment and each organisation would be jointly and severally liable for the entirety of the employment relationship. Joint employment would enable the employees to be deployed across services on a flexible basis. There would need to be agreement as to how those employees are managed, including all practical matters such as payroll, pension administration, absence management, holiday, disciplinarys, grievance, performance management.

#### 35 **Staffing SLA**

36 Another alternative would be to TUPE transfer the employees into either PublicCo or PrivateCo / Delivery Vehicle in their entirety, and then have a new staffing services SLA between PublicCo / Delivery Vehicle and PrivateCo. This would enable, in a similar way, the staff to be deployed flexibly across both companies. The entity which is not the employer, would have to reimburse the other at cost for the use of the employees under the staffing services SLA. We would expect also that both employers would indemnify the other for their own acts or omissions in relation to the employees.

#### 37 **FOIA**

Companies which are wholly-owned by local authorities are subject to the requirement to disclose information under FOIA<sup>29</sup> in the same way as local authorities. It is also standard for local authorities to ensure that in any contract between the Authorities and the company, there are provisions which impose response deadlines which are shorter than the statutory 20 days to enable the Authorities to respond expeditiously to FOIA requests where it concerns a service being delivered by the company.

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<sup>29</sup> Freedom of Information Act 2000

38 **Human Rights Act**

39 If the Delivery Vehicle will be delivering any "public functions", it will be accountable under the Human Rights Act<sup>30</sup> to the Authorities' service users and potential service users. Therefore, the Authorities should be careful to ensure appropriate prior consultation with:

39.1.1 service users;

39.1.2 potential service users;

39.1.3 residents;

39.1.4 businesses in the Authorities' areas;

39.1.5 and community and other groups,

39.1.6 before making any decision which may impact on those individuals or groups of individuals, particularly where the decision might engage or interfere with rights under the Human Rights Act. We can advise further on this in due course.

40 **Next Steps**

40.1 We would recommend that each Authority considers the following next steps:

40.1.1 Compile and consider a business case for establishing each company;

40.1.2 Carry out a Best Value consultation;

40.1.3 Consider relevant decisions / delegations of authority which need to be in place to establish each company (we have produced a guide to company decisions for other local authorities which we would be happy to tailor for the Authorities if this would be useful);

40.1.4 The names of each company;

40.1.5 The date of each companies' accounting referencing date;

40.1.6 Who each Authority wishes to appoint to the board of directors of each Company;

40.1.7 Whether the each company will have a company secretary

40.1.8 Whether any company will have a company seal;

40.1.9 How much share Capital each Authority each company will have;

40.1.10 How each Authority proposes to fund each company;

40.1.11 What registered address each company will use; and

40.1.12 Whether each Authority requires specific controls / checks on the Delivery Vehicle's activities, or reserved matters for Shareholder approval only (these

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<sup>30</sup> Human Rights Act 1998

will need to be reflected in the Shareholders' Agreement and possibly the Articles of Association).

**Trowers & Hamlins LLP**  
**Ref HZR/HVM**