

LEISURE & ENVIRONMENT COMMITTEE

19 NOVEMBER 2019

REVIEW OF GOVERNANCE ARRANGEMENTS - ACTIVE4TODAY

1.0 Purpose of Report

- 1.1 To secure approval of the Leisure and Environment Committee approval for changes to the governance and financial arrangements between the Council and Active4Today Limited.

2.0 Background Information

- 2.1 Active4Today was incorporated as a company, limited by guarantee, on 9 March 2015 with the Council as the sole shareholder. It commenced business on 1 June 2015, operating the Council's three leisure centres at: Newark; Dukeries; and Blidworth. It also provides sports development for the Authority and management support to the Southwell Leisure Trust.
- 2.2 The Council retains ownership of the three leisure centres and leases them, at a peppercorn, to A4T on 15 year leases. The provisions within the leases, coupled with the fact that the Company was 'set up' with philanthropic objects, enable the Company to benefit from taxation benefits and NNDR relief.
- 2.3 Under the leases, the Council is responsible for repairs and maintenance to the structure and fabric of the leisure centre buildings and the major fixed plant within them. The Company has responsibility for interior repair, maintenance, interior decoration and portable equipment.
- 2.4 The Council is accountable for ensuring that the leisure and sports development service is to the required standard across the District. Decision making by the Council, as sole shareholder, is undertaken by the Leisure and Environment Committee, which has the responsibility for: considering and approving the Company's 3 year Business Plan and pricing strategy; and monitoring overall management and performance of the Council's leisure company. The Council's representative under the contract and the main officer of the Council advising the Leisure and Environment Committee on A4T is the Director – Communities and Environment (Matthew Finch).
- 2.5 The Company is run on the basis that it is a 'not for profit' company, set up for the benefit of the community (i.e. that it has philanthropic purposes) and does not pay a 'dividend', promising that:
- it will invest any and all retained surpluses in order to enhance the service standards and develop the facilities in Newark and Sherwood; and
 - deliver a service to the public which is aligned to the Council's aspirations, aims and objectives.

The relationship between the Council and the Company is governed by a 15 year service contract to provide leisure services at the three leisure centres. There is a break clause on the fifth and tenth anniversary of the contract period enabling the Council to terminate the whole or any part of the contract by serving six months' written notice on the Company.

2.6 The Company is into its 5th year of operation and has built up a credible track record in delivering its services, with surpluses that exceed the projected returns under its original approved Business Plan. It has built up healthy reserves of £400k.

3.0 Governance Issues

Governance Agreement

3.1 There are various provisions contained within the Company's Articles that cover the balance of control and decision-making between the Council and the Company, for example the Council's reserve power to act by special resolution to direct the directors. However, there is no 'parallel' Governance Agreement between the Council and the Company similar to that which the Council has with Arkwood Developments Limited. This is a discrete document (separate from the Company's Articles), which covers in one place: the business plan; matters reserved to the Council for decision; accounting and financial provision; information; scrutiny and accountability. This is in contrast to the position with A4T, where the equivalent provisions are scattered between the Articles and the Service Contract.

3.2 Therefore, from a governance perspective there is a gap between the 'high level' requirements of the Company's Articles, and the commissioning role that the Council plays under the Service Contract. It would be good practice to have in place a governance agreement (which is like a shareholder's agreement) to plug this gap. The version for Arkwood is very clear and simple – and could be adopted without much further adaptation, save for recognising the different nature of the business of the Company and that fact that it is a company limited by guarantee. It would also include other provisions that would secure greater transparency between the Council and the Company and reinforce the Council's role as shareholder. These include the ability of the Council to have a representative (who would not be a director of the Company) to attend the Company's board meetings as an observer, and a requirement for the Company to provide full management accounts and financial forecasts to the Council etc. This is something that the Council has in place for both Arkwood and Newark and Sherwood Homes.

Elected Members and Officers as Directors

3.3 Directors are appointed by the Council by means of an ordinary resolution, and currently the Board comprises of:

- 2 council officer directors, (CEO and the Deputy CEO & S151 Officer);
- 3 member directors (Cllrs David Lloyd, Scott Carlton, & Mathew Skinner), and
- Managing Director of the Company (non-voting Director).

N.B. The Articles provide that there must be at least one director and a maximum of seven.

3.4 The general legal view is that it is easier to manage potential conflicts of interests with officer directors than it is with elected member directors. The Council and the officer

concerned can amend the employment contract in question to say that the Council has asked the officer to be a director and that when the officer director is acting in that capacity they are to put the interests of the company first.

- 3.5 It follows that the officer director should not then be involved in any Council decision making relating to A4T – whether making decisions or acting as an officer to advise those making decisions.
- 3.6 However, elected members are unable to allow any of their duties (whether to the Council or the Company) to prevail over the other. External legal advice given both at the time the company was set up and more recently is that elected members' involvement is usually best achieved through the shareholder function. This allows elected members to focus on the strategic and oversight decision making in respect of the company and eliminates the potential conflict issue.
- 3.7 As with officer directors, an elected member director should not be involved in the member/shareholder decision making undertaken by the Council. Therefore, if a member director is also a member of the L & E Committee, when an A4T matter arises they would need to declare an interest and not take part in the meeting when that matter is being decided.
- 3.8 The choice of which officers and/or elected members should be appointed as directors is important - to plan against conflicts arising. It is inadvisable to have both the Chief Executive and the Deputy Chief Executive on the Board as this takes both of them out of decision making on the part of the Council when A4T matters are being considered or formulated by officers.

Non-voting directors

- 3.9 Recent external legal advice has highlighted the unusual nature of having directors on the board with no voting rights. The general position in company law is that all directors are able to participate and vote in director decision making unless the law expressly prohibits it, for instance where a conflict of interest arises. It is most unusual to come across a position where a director does not have a vote at all. This is because any director taking on a role with no ability to vote is placed in a very difficult position. As a director they are subject to a number of statutory, fiduciary and equitable duties to the company. The most serious – in terms of likely liabilities - relates to wrongful trading. A director without a vote would be significantly hampered in complying with their duties and might be placed in breach of them against their will notwithstanding that they might have protested to the voting directors.
- 3.10 There is nothing in the *Teckal* requirements that would prohibit directors (who are not council officers or elected members) being appointed with a vote. The Company's decision-making arrangements still effectively remain under the Council's control. If the decision is made to alter the position regarding the 'non-voting' status of the Managing Director, the Articles will need to be amended to allow for this as they currently prohibit directors, who

are not officers or elected members, being appointed with a vote. This would also then make it easier to appoint other non-executive directors to the Board who bring a particular expertise to the Company as it continues to develop. These directors would bring a different perspective when considering how the business of A4T operates.

- 3.11 If giving a vote to non-officers/elected members is not something the Council wishes to consider then it might be appropriate to consider whether the Managing Director should be a director at all, but instead be the senior employee of the Company and attend the directors' meetings as an observer.

4.0 The Service Contract

- 4.1 The Contract between A4T and the Council is a public services concession contract. It provides that the Council make a payment to the Company at the beginning of each financial year to cover all the services provided. It then provides two mechanisms (one in-year and one at end of year) by which any 'surpluses' generated by the Company are shared between the two parties. This creates 'supplies' that generate VAT charges both ways. In practice over the five years since the establishment of the Company, and with the knowledge of the Council, rather than the sharing of surpluses - these have been utilised instead by the Company to generate healthy reserves to provide cover for its long-term sustainability as the operation of the Council Leisure Centres.

- 4.2 Now that the Company has generated a good balance sheet, and bearing in mind that in practice the Council has provided working capital and enabled strong cash/flow management in its support of the Company, it seems timely to review these arrangements. Instead of the 2-way payments it would be beneficial to explore whether the Company would be in a position to make a payment to the Council for operating the centres pursuant to the concession that the Service Contract puts into effect. This would 're-scope' the payment mechanism to enable better VAT treatment and to reflect the commercial reality between the Council and the Company. So in effect there would either be a 'management' fee paid by the Council to the Company in anticipation of the Company making an operating loss, or a 'right to operate' fee from the Company to the Council in the event of an operating surplus.

- 4.3 This would require the Contract Price Schedule in the Service Contract to be varied to allow for a new formula to be adopted for calculating the Contract Sum payable. The payment mechanism would be reviewed to reflect the proposals for payments either way, as set out in paragraph 4.2 above. There would be no need to retain the current clauses contained within the Service contract for sharing in any "Operating Surplus" of the Company. The timing and frequency of any payment either way should be an arrangement that is fair to both parties, but it is suggested that this could be agreed within the first two weeks following the end of the financial year. In the event that a payment is due to the Council, the Authority could determine, following an agreed consultation process, to expend this on further investment in the Council's Leisure Centres. This would be a better arrangement than the current provisions, which potentially involve a number of payments both ways, which is tax inefficient. It also addresses the issue that currently the Service Contract enables

the Company to direct the Council on what it spends shared surpluses on – which is inappropriate within the confines of a “Teckal” relationship.

5.0 Training

5.1 Once the governance of the Company is re-shaped in accordance with the recommendations contained within the report, it is suggested that training is provided both to the Council and the Company, at lead member and officer level, to ensure that there is a common understanding of how the Company is governed within the ambit of being a controlled local authority company, and the checks and balances in place for ongoing continued success in the business and the Services operated at the Council Leisure Centres.

6.0 Proposals

6.1 Based on the information contained in Sections 3 and 4 of this report, it is proposed that Leisure and Environment Committee approve the recommendations of this report in respect of the changes to the governance arrangements between the Council and Active4Today.

7.0 Equalities Implications

7.1 There are no equality implications in respect of the various protected characteristic groups in connection with this proposal.

8.0 Financial Implications (FIN19-20/2014)

8.1 Based on current arrangements the Council pays the management fee to Active4Today in two instalments, 50% at the beginning and 50% at the end of the financial year. The new arrangement would be one payment to or from Active4Today based on their operating outturn calculated as agreed in the management agreement.

8.2 The outturn for 2019/20 will be reviewed under the new arrangements and it is not expected at this time that the full 50% remaining management fee will be required.

8.3 The aspiration is the company will be self-sustainable. The £121,220 management fee budget for 2020/21 will be brought to Committee in January 2020 to be reviewed.

8.4 Regular reviews of Active4Today’s management accounts will allow the Council’s budget monitoring reports to accurately represent forecasted operating outturn to aid decision making.

9.0 Community Plan – Alignment to Objectives

9.1 The provision of the Council’s high quality and accessible leisure centres makes a significant contribution to the health and wellbeing of members of the community. Specifically the role that Active4Today performs for the Council by operating the leisure centres and sports development function attracts regular users each year thereby assisting the Council in the achievement of Objective 9, ‘Improve the health and wellbeing of local residents, with a particular focus on narrowing the gap in healthy life expectancy and other health outcomes’.

10.0 Comments of Director

10.1 The proposed recommendations of the review of the governance arrangements will enable the Council and Active4Today to strengthen its relationship moving forwards and enhance the delivery of positive outcomes for the community.

11.0 RECOMMENDATIONS

That Leisure and Environment Committee:

- (a) Agree a Governance Agreement between the Council and the Company, that sits alongside the Articles, that underlines the Council's role as shareholder in exercising a decisive influence over both strategic objectives and significant decisions of the Company;**
- (b) Agree to a review of the existing officer and member director appointments to the Board, given the conflict issues highlighted in section 3 of the report;**
- (c) Give director voting rights to the Managing Director;**
- (d) Review the payment mechanism within the Service Contract so that there a single payment mechanism either to or from the Company, with no separate clause for sharing in the 'operating surplus' of the Company;**
- (e) Approve any consequential minor amendments to the Company's Articles arising from the above recommendations; and**
- (f) Members note the aspiration for the company to be self-sustainable and hence the allocation of the management fee budget will be brought to the January Committee.**

Reason for Recommendation(s)

To ensure that the management and operational relationship between the Council and Active4Today remains appropriate and Teckal compliant.

Background Papers

NIL

For further information please contact Karen White – Director Governance and OD on Extension 5240.

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