

Audit Committee – 18 December 2020

Title of paper:	Report in the Public Interest - Appointment of Councillor Directors	
Director(s)/ Corporate Director(s):	Malcolm Townroe – Director of Legal and Governance	Wards affected: All
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Other colleagues who have provided input:	Beth Brown – Head of Legal and Governance	
Recommendation(s):		
1	That Audit Committee note the work undertaken so far on the review of the use of Councillors on company boards.	
2	That Audit Committee provide any comment they may have for inclusion in the final review due to be considered by Full Council in January 2021.	

1 Reasons for recommendations

- 1.1 Recommendation 1: The Action Plan produced in response to the report of the External Auditor issued in the public interest committed that an audit and review of NCC's approach to councillor membership of each subsidiary company board and any other similar organisations NCC Councillors are appointed to, will be undertaken. This report seeks the views of Audit Committee on the review so far, with assurances that comments from the Committee will be included in the review considered by Council in January 2021.
- 1.2 Recommendation 2: On 9 November 9 2020, Council approved a revision to the existing Action Plan that stipulated the above review work be presented for recommendations and comment to the next Audit Committee meeting before the Report's formal consideration by Council in January 2021.

2 Background

- 2.1 The review identified all companies in which Nottingham City Council has an interest, based on internal records of appointments. These were cross referenced with Companies House records to provide a list of companies, the relationship to NCC, current NCC directors (Councillors and Officers), non-NCC directors and the provisions of their articles of association with regard to director appointments.
- 2.2 This list also identified the area of business activity of each company.
- 2.3 Each company was classified as being either within a) the primary scope – subsidiary companies, b) the secondary scope – companies with directors acting for and on behalf of Nottingham City Council, or c) out of scope – inactive companies or companies that no longer have directors acting for and on behalf of Nottingham City Council.

- 2.4 In parallel, a review of best practice guidance has been undertaken, including previous work commissioned by Audit Committee and completed in 2018. A best practice library has been created pulling together 23 separate documents produced by a range of external bodies.
- 2.5 These documents cover a range of issues relating to Corporate Governance, Local Authority and Public Sector Governance, and specific guidance relating to the governance of Local Authority controlled companies. This includes guidance on the role and requirements of executive and non-executive directors in general, the practice and key considerations of appointing Councillors as directors, and best practice in managing potential conflicts of interest.
- 2.6 Of particular relevance; the Lawyers in Local Government Governance of Council Interests in Companies Codes, the UK Corporate Governance Code 2018, the Grant Thornton Review of Company Governance at Birmingham City Council and the Grant Thornton report on alternative service delivery models in local government.

3 Ongoing review

- 3.1 The establishment of an Executive Sub-Committee to oversee the business of Council owned companies is consistent with best practice. Committees of this kind are typically expected to consolidate the rights and powers of the Council as shareholder or (in the case of companies limited by guarantee) member.
- 3.2 In order to ensure the Companies Governance Executive Sub-Committee is able to exercise the full powers of shareholder over all matters they wish to reserve including the appointment and removal of directors, it is recommended that the articles of association of all subsidiary companies be reviewed and, where necessary, amended. Members of the Companies Governance Executive Sub-Committee could consider recommending that the work to put in place Shareholder agreements between the Council and each of its subsidiary companies limited by shares be expedited and undertake the work necessary to fulfil the auditors recommendation.
- 3.3 The establishment of robust controls for the shareholder may afford the Council a greater degree of influence over a company's strategic and policy objectives than direct engagement at a board level does, albeit with less immediacy.
- 3.4 A review of the articles of association for all subsidiary companies has been undertaken as part of this work. This initial review has found five of the eight subsidiary companies whose articles do not exclusively reserve the right of appointment to Nottingham City Council as shareholder. These are:

Company	Appointment
Nottingham Ice Centre Limited	Directors may appoint without approval of members. Directors have some veto power over shareholder appointments.
Nottingham Revenues and Benefits Ltd	Model articles post 2009 meaning appointment does not require shareholder consent.
Nottingham Science Park Management Company Ltd	Model articles pre 2009 no change to appointments.
Robin Hood Energy Limited	Directors or shareholders may appoint

	board. Appointments do not require shareholder consent however shareholder has right to remove.
Thomas Bow Limited	Model articles post 2009 no change to appointments.

- 3.5 The review has found no reason that Councillors should not serve as board members, however further consideration could be given to the use of independent directors.
- 3.6 Executive Councillors appointed to director positions have a legal requirement that they do not participate in any Council decisions in relation to the company on which they serve. In particular, this requirement could effectively prevent the majority of Companies Governance Executive Sub-Committee members from participating in decisions that affect the entire group of Council-owned companies. Potentially, this could significantly impact the Companies Governance Executive Sub-Committee in fulfilling its current stated purpose.
- 3.7 For the reasons given above, Executive Councillors could choose to not serve as members of subsidiary boards where the functions of the organisation in question falls within the remit of their portfolio of responsibilities. Further consideration should also be given to the premise that no Executive Councillor who is also a member of the Companies Governance Executive Sub-Committee should serve on the board of a subsidiary company.
- 3.8 Consideration is being given to the relationship of the Procurement and Commissioning Executive Sub-Committee to NCC companies where contracts are awarded for the supply of services. This element of the review has not been concluded at this stage.

4 Board Composition

- 4.1 Of the eight companies falling within the primary scope of the review, four had boards comprised of between 25% and 37.5% NCC appointed Directors. These are:
- NCH
 - NCT
 - Nottingham Ice Centre
 - Thomas Bow
- 4.2 The boards of the other four are either comprised entirely of NCC appointees or in the case of Nottingham Revenue and Benefits, four out of six NCC appointees and one former NCC Councillor and one former NCC employee. These are:
- Nottingham Revenue and Benefits
 - Enviroenergy
 - Robin Hood Energy

- Nottingham Science Park Management

- 4.3 NCC subsidiaries have less than 50% of the board voting rights in the case of three of these companies. In some cases for example, Nottingham City Transport, which has four NCC appointees (all Councillors) out of 12 current directors, there are limitations set in sector specific legislation – in this case the Transport Act 1985.
- 4.4 Where the required level of industry specific skills and experience are not available for the Council, it should seek to recruit appropriately qualified Independent Non-Executive Directors to ensure the management of the company are held to account.
- 4.5 Lawyers in Local Government have produced a governance code of best practice guidance note that highlights the possible applications including; ensuring sufficient standards of operational governance, legal and company secretarial compliance and effective financial management within the company are adhered to by reserving the right to insist that it provide those services to the company.
- 4.6 Agreements are currently in place between NCC and two of its non-subsidiary companies; a management agreement with Futures and a shareholder agreement with Blueprint. The text of a shareholder agreement for NCC subsidiaries has also been produced, and whilst discussions with companies are ongoing, this has not been adopted by any company to date. The significant variations between the activities and aims of the eight subsidiaries are incompatible with a singular standard agreement and in this respect some degree of tailoring is required.

5 Councillors as Directors

- 5.1 Where NCC has appointed directors to company boards, they are overwhelmingly drawn from the elected members rather than Council Officers, with two Officer appointments out of 25 NCC appointees. Of those Councillor directorships, eight are held by Executive Councillors, three of whom are members of the Companies' Governance Executive Sub-Committee.
- 5.2 The Lawyers in Local Government governance code of best practice guidance note states that "whilst it will therefore be the norm that officers, not members, will be appointed as directors, this should not prevent the Council from appointing Members as directors where that is considered to be in the best interests of the company and the Council."
- 5.3 Similarly, the 2016 Grant Thornton review of group governance at Birmingham City Council included in its recommendations that "entity boards will remain a combination of elected members and Non-Executive Directors."
- 5.4 In both cases however, the guidance highlights the inability of Councillors to waive any conflict of interest they may have in their role as Councillor, thereby preventing them from participating in any decision making process in relation to the company.
- 5.5 Given that eight of the ten current Executive Councillors hold directorships in the eight subsidiary companies, the practical exercising of Executive decision making in relation to all subsidiaries could be impacted upon. Although it is not necessarily inconsistent with best practice for an Executive Councillor to hold a directorship of this kind, consideration needs to be given as to whether the current level of Executive Councillor Directorships is appropriate.

- 5.6 The number of Executive Councillors serving on subsidiary boards also has implications for the effectiveness of the Companies Governance Executive Sub-Committee. Three of the five current Councillor members are also directors of subsidiary companies. The Leader of the Council and Chair of the sub-committee also holds a directorship on the board of Blueprint, a non-subsidiary company limited by shares. The stated purpose of the Sub-Committee is; “to approve and oversee the Council's strategic objectives across the Nottingham City Council group of companies, and to support the development of the Group in line with the Council's regulations and ambitions”.
- 5.7 It is possible to take the view that conflicts of interests may be resolved by individual Councillors abstaining from participating in decision making relating only to the company or companies on whose boards they serve. This does not however resolve conflicts arising from decisions which may impact the entire group. For example, decisions relating to reporting and performance management standards across the group, or the issuing of directives that apply to all subsidiaries.
- 5.8 It is therefore appropriate that further consideration be given to Executive Councillors serving as members of subsidiary boards where the functions of the organisation in question falls within the remit of their portfolio of responsibilities. Consideration should also be given to the premise that if feasible no Executive Councillor, who is also a member of the Companies Governance Executive Sub-Committee, should serve on the board of a subsidiary company.
- 5.9 Any subsequent changes to the Terms of Reference for the Companies Governance Executive Sub-Committee and/or Constitution will be presented to Council in due course and it is also anticipated that any subsequent changes to board membership will need to be implemented in a measured and orderly manner to avoid destabilising company boards. During this period the Leader of the Council and Executive Councillors should continue to exercise the rights and powers of shareholder or member.
- 5.10 Consideration is being given to the relationship of the Procurement and Commissioning Executive Sub-Committee to NCC companies where contracts are awarded for the supply of services. This element of the review has not been concluded at this stage.

6 Background papers other than published works or those disclosing exempt or confidential information

- 6.1 None.

7 Published documents referred to in compiling this report

- 7.1 A1 PIR Action Plan Amended
- 7.2 Lawyers in Local Government Example Best Practice Codes
- 7.3 UK Corporate Governance Code 2018
- 7.4 Grant Thornton Review of Company Governance at Birmingham City Council
- 7.5 Grant Thornton report on alternative service delivery models in local government.

8 External bodies

- The Financial Reporting Council (FRC)
- Lawyers in Local Government (LLG)
- The National Audit Office (NAO)
- National Commission on the future of governance in the public sector
- Norse Group
- Bristol City Council
- York City Council
- South Holland District Council
- Grant Thornton