

## **Governance Review of Stone Circle companies**

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(Section 151 Officer)**

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### **Background**

Cabinet requested a review of the Governance arrangements for the Stone Circle companies at its meeting on 2 February 2021 [Agenda for Cabinet on Tuesday 2 February 2021, 10.00 am | Wiltshire Council](#)

### **Terms of reference**

The terms of the governance review were expressed by Cabinet as follows:

As the business of the companies grows a review of governance will be undertaken and reported to the July cabinet meeting. This will follow best practice and learning from other Councils and include:

- the company governance in relation to the shareholder requirements as set out in the shareholder agreement;
- a clear process for decisions, performance and risk reporting from the companies through to CLT and Cabinet;
- the role of the Council as shareholder in holding the company to account on its business plan objectives;
- shareholder representation on the Boards;
- clear separation of roles between the council as shareholder and the companies and minimising the scope for conflicts of interest;
- role of the Audit and Governance Committee in overseeing the effectiveness of the governance arrangements;
- role of Overview and Scrutiny.

### **Background to Company set up**

1. The Stone Circle Holding Company was incorporated on 6 September 2019. The Housing and Development Companies were incorporated on 9 September 2019. The Energy Company was incorporated on 2 March 2020.
2. The Cabinet considered the establishment of the Housing and Development Companies at its Meeting on 15 January 2019. The full details can be viewed here (item 9) :

<http://moderngov.wiltshire.council/ieListDocuments.aspx?CId=141&MId=11671&Ver=4>

3. Following a decision to proceed, external advice from legal and finance specialists was obtained and a 2019/20 Business Plan and a range of draft documentation was presented to the Council's Cabinet at its Meeting on 23 July 2019. The Holding, Housing and Development Companies were incorporated following approval of the 2019/20 Business Plan and draft documentation at this meeting. The full details can be viewed here (item 108) :  
<http://moderngov.wiltshire.council/ieListDocuments.aspx?CId=141&MId=12816&Ver=4>
4. The 2020/21 Business Plan was approved at a meeting of Cabinet on 7 January 2020. The full details can be viewed here (item 11) :  
<http://moderngov.wiltshire.council/ieListDocuments.aspx?CId=141&MId=12506&Ver=4>
5. The 2020/21 Business Plan was adjusted due to the ongoing covid-19 pandemic and it was approved at a meeting of Cabinet on 14 July 2020. The full details can be viewed here (item 15):  
<http://moderngov.wiltshire.council/ieListDocuments.aspx?CId=141&MId=13070&Ver=4>
6. The 2021/22 Business Plan was presented and approved by Cabinet earlier this year: [Agenda for Cabinet on Tuesday 2 February 2021, 10.00 am | Wiltshire Council](#) Item 31.
7. A Business Plan for Energy Company is yet to be produced and presented to the Council for approval. At present, Energy Company is dormant and no independent director has been recruited. A Business Plan will be presented to the Council for approval before any activity is commenced.
8. At the meeting of 23 July 2019, the Council's Cabinet approved the following governance arrangements:
  - a. The appointment of the Cabinet member responsible for Housing (currently Richard Clewer) to the Board of Directors;
  - b. The appointment of the Cabinet member responsible for Highways, Transport and Waste (currently Bridget Wayman) to the Board of Directors;
  - c. The appointment of a member of the opposition (currently Ian Thorn) to the Board of Directors;
  - d. The appointment of an independent director to each of Housing and Development Companies with relevant expertise in housing and development respectively (currently Nicholas Samuels and John Terry respectively);

- e. The appointment of two independent directors to Holding Company (currently Nicholas Samuels and John Terry); and
  - f. The appointment of the then Executive Director of Growth, Investment and Place (Alistair Cunningham) and acting as shadow chairman. Upon the senior management restructure which resulted in Alistair Cunningham retiring from the Council, the Council's Cabinet at its meeting on 14 July 2020 approved the appointment of Alistair Cunningham as an additional independent director of all Stone Circle companies. Alistair was then appointed as the first Chairman of the Board by the Directors, a role which is subject to an annual appointment process in each October.
9. The Shareholder's Agreement between the Council and the Holding Company sets out the inter-relationship between the two organisations. Most notably, it includes the following:
- a. The requirement for a Business Plan to be presented to the Council and approved on an annual basis. The Business Plan must include:
    - i. An annual operating revenue plan and capital expenditure requirements;
    - ii. Funding sources;
    - iii. Balance sheet forecast;
    - iv. A minimum 5 year financial strategy plan inclusive of proposed investments, borrowings, key risks and new business;
    - v. Long term projections;
    - vi. Identification of any surpluses and any distribution of any profits;
    - vii. An annual profit and loss account; and
    - viii. Any other such content as the Council may require.This is presented at a meeting of Cabinet in January with a view to it taking effect for the period 1 April – 31 March of each year. The 2021/22 Business Plans were presented to Cabinet on 2 February 2021. Essentially, the Companies are required to deliver what is set out in each Business Plan.
  - b. In respect of the Development Company, a requirement for a Project Plan in respect of each proposed site to be developed to be presented to the Council and approved. This has been delegated to the Corporate Director for Resources, in consultation with the Cabinet Member for Finance & Procurement, Commissioning, IT Digital and Commercialisation Two Project Plans have been approved and two more have been presented for approval.
  - c. A list of 'reserved matters' which must be referred back to the Council for approval. A copy of these are set out in Annex 1 and include changes to the Board, changes to the Business Plan, creation of security over company assets, payment of dividends and acquiring (or

disposing of) assets with a value of over £30k not approved in the Business Plan.

- d. The Council is entitled to receive copies of reports, accounts and information submitted to the Company, annual accounts and Board Meeting minutes. The Council may also request any other information reasonably required and/or request to inspect books and records.
10. The Council can, as shareholder, pass a special resolution to direct the Directors to take, or refrain, from taking specified action. In addition, the Council can require the directors to convene a general meeting and propose resolutions and circulate statements.
  11. The Companies currently borrow loan finance from the Council under the terms of the Housing Company Loan Agreement and Development Company Facility Agreement. These documents were approved by the Council's Cabinet at its meetings on 23 July 2019, 7 January 2020 and 14 July 2020 and is reflected in the relevant Business Plan.
  12. Under Company Law, the Shareholder is entitled to attend and participate in General Meetings. The Company is not required to hold a General Meeting unless the Shareholder or Directors require a General Meeting to be convened. Notwithstanding this position, representatives from the Council are invited to attend board meetings of the Directors. Currently, Councillor Pauline Church and Wiltshire Council Chief Executive, Terence Herbert, are invited to attend the meetings on behalf of the Council. In addition, Council officer's Leanne Sykes (from a Company and Council finance perspective), Mike Dawson (from an Company estates perspective) and Simon Hendey (as Council director responsible for housing and estate) attend meetings of the Directors. In addition to members of the Board, these individuals also have access to the Stone Circle SharePoint site where the statutory registers, reports, papers, contracts, meeting agendas and minutes are available to view.
  13. Each Director is aware of their statutory duties and duties in respect of conflicts of interests. At meetings of Cabinet, the Directors of Stone Circle who also attend Cabinet declare conflicts of interest and leave the meeting. The Company holds a declaration of interests register and, at each meeting of the Company, members of the Board are invited to declare any conflicts of interest.

## **Methodology**

The Director of Legal & Governance, conducted an initial review of the following:

- the information provided to Cabinet about the setting up of the companies

- the information provided to the Cabinet about the performance of the Stone Circle companies
- the information available in the Stone Circle Sharepoint site
- Consulted with the Leader and Deputy Leader, the Chief Executive, Director for Housing & Commercial, colleagues from Legal Services who provide the company secretary role and legal advice to the companies.
- Considered some academic literature and other best practice information available about the operation of Council owned companies (see references)

The Corporate Director of Resources and Deputy Chief Executive and the Director of Legal & Governance then collaborated in the completion of the review to provide observations and recommendations to Cabinet set out below. The report follows the order of the Terms of Reference.

## **1. The company governance in relation to the shareholder requirements as set out in the shareholder agreement**

In order to consider whether the shareholder's requirements are being met (as set out in the shareholder agreement), it is helpful first to define what is meant by company or corporate, governance.

The seminal definition adopted by the Institute of Chartered Secretaries and Administrators (ICSA), the professional body for company secretaries, is:

'Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.' (This is from the *Cadbury Report (1992) page 14.*)

### **Observations**

The Council as shareholder, through Cabinet, has demonstrably exercised its role in appointing Directors and Auditors. As part of this review Cabinet has the option to change those appointments. This could reflect the development of the Stone Circle companies and the shareholders wish to see new approaches. It could also reflect the issue of company capacity and the wish to see greater commercial drive from within the companies.

In addition, through this review the Council as shareholder can assure itself that an appropriate governance structure is in place. As a Council shareholder there are other factors that need to be considered and most of those are set out below, such as the role of other functions of the wider Council, such as the role of Overview and

Scrutiny, which are unique to local (and central) government and not a normal feature of corporate governance.

#### **a) Shareholder agreements.**

The Council took specialist legal advice in the drafting of the Shareholder agreements which appear to provide appropriate safeguards for the Council as shareholder. The Council has been able to exercise its role as shareholder under the terms of the three agreements.

#### **b) Control**

The separate legal entity that a company enjoys, raises issues of control. The Council as a shareholder and funder of the Stone Circle companies, and pursuant to the Shareholder Agreements, has a high level of control. This should not stifle commercial activity or entrepreneurial endeavour but does reflect the public accountability the companies have to the residents of Wiltshire.

#### **c) Risk**

The Council is taking most of the risk with the activity of the companies. It is the Council who appoints the Directors, who steer the companies to deliver against their Business Plans, which are presented to approval to Cabinet. The Council funds the activity of the companies, through borrowing. The Council currently provides staff to service the companies' activities. The company secretary role, some legal, financial and property roles are conducted by Council officers, charged out to the companies at subsidy control (formerly state aid) compliant rates.

The Business Plans that the companies are working to deliver are short in detail. Details of a format used at another Council owned company, Treveth in Cornwall, attached at Appendix 1 show the scope for providing a more detailed Business Plan. Over time as the concept of the Council owned status of the companies is understood, the focus for the Business Plans could be the commercial performance. A second example of a Business Plan with for example some detailed market analysis, performance and risk from another Council owned company, Goram Homes, in Bristol, is attached at Appendix 2.

**Recommendation 1 (R1)** a Business Plan with greater detail including market analysis, risks, sensitivity, performance and forecasting should be produced by the companies especially Stone Circle Housing and Stone Circle Development.

## **2. A clear process for decisions, performance and risk reporting from the companies through to CLT and Cabinet**

### **Observations**

Reporting has taken place to Cabinet in line with the terms of the Shareholder agreements. The reporting could be enhanced to mark the move into a delivery phase for the companies.

**Recommendation 2 (R2)** There should be quarterly performance reporting by the companies to the Council in the order Corporate Leadership Team (CLT), an appropriate Task Group or Scrutiny Select Committee and then Cabinet (through the Shareholder Group).

### **3. The role of the Council as shareholder in holding the company to account on its business plan objectives**

#### **Observations**

The Council through Cabinet has the role of holding the companies to account for delivery against their business plan objectives. If Recommendation 1 is implemented that would be a good opportunity to enhance the role of Cabinet in acting on behalf of the shareholder to hold the companies to account. The professional body for local authority lawyers, Lawyers in Local Government (LLG) issued a Code of Practice for the Governance of Council Interests in Companies in (2018). It refers to the option of a Shareholder Group to hold the Board to account with the inclusion of commercial expertise if necessary. The Shareholder Group could be a sub-Committee of Cabinet with the enhanced Cabinet role delivered either through bespoke commercial training for the Shareholder Group to enable areas of focus for their attention, or the adding of some external commercial expertise to the Shareholder Group, as a non-voting co-optee.

**Recommendation 3 (R3)** create a Shareholder Group as a sub-Committee of Cabinet with the Leader as Chair with two other Cabinet Members as members with the option to co-opt external commercial expertise to enable the Shareholder Group (after consideration of performance reporting by CLT and Scrutiny) to conduct its role on behalf of the shareholder.

### **4. Shareholder representation on the Boards**

#### **Observations**

There is currently no definitive critique of the makeup of the Boards of Council owned companies. Anecdotal information suggests that Councils take a mix of approaches to Board membership. Councils often appoint Cabinet Members to the Boards of companies they own. This is a mechanism to provide a link between the executive leadership of the council and the activity and direction of the company. Councils also appoint professional officers and, in some cases non-executive directors with industry expertise. A director of a company has a legal duty to promote the best interests of that company. This can conflict with their other roles. They have a duty to resolve any such conflicts. This has implications for councillors who are also Cabinet Members, therefore having strong links to the shareholder but also a duty to promote the success of the company. This has led to some Councils not including any members on the boards of their companies. The LLG Code of Practice is clear on this point, that although conflicts of interest can be waived by the company, as a matter of law they cannot in a local authority setting, so that a Councillor Director would always have to resolve a conflict of interest in favour of the company. That is because they have a legal duty at all times to act in the best

interests of the company. The LLG Code of Practice therefore counsels against Councillor Directors being appointed, which is consistent with previous Government guidance on the same issue.

There is some academic study on the success or otherwise of companies with Councillor Board members as opposed to those that include for example non-executive directors with commercial proficiency. One study suggests that majority owned Council companies are more likely to succeed. It also theorises that greater political control is a factor in company mortality. This uncomfortable finding is echoed in some of the recent public interest reports issued for considering some of the problems that Council companies have encountered, including Nottingham, Croydon and Liverpool.

The Robin Hood Energy (RHE) Ltd public interest report into the governance arrangements by Grant Thornton

<https://www.nottinghamcity.gov.uk/media/2835756/report-in-the-public-interest-rhe.pdf>) focused amongst other things on the role of councillors on the board.

They made the following comments:

More generally, it is not seen as good practice for councillors to be on the boards of local authority companies, with other mechanisms used to ensure that the company meets the Council's policy objectives. This reflects the above issues in relation to the expertise and experience of many councillors, and the potential for conflicts of interest between the councillors' commitment to the interests of the company, which has to override other interests when they are on company 'business', and their wider responsibilities as councillors. Having councillors on company boards can lead to a failure to properly separate the two sets of interest – of the company and of the Council – and it appears that this occurred in relation to the expectation that the Council would continue to fund RHE indefinitely.

Councillor Clewer has resigned as a director of Stone Circle Holding Company, on his becoming Leader of the Council. Due to other changes in Cabinet membership, the Council has no Cabinet member on the Board of Stone Circle Holding Company and no senior Council officer. It is suggested that there is room for a re-setting of the Board makeup.

There is no Corporate Leadership Team (CLT) representation on the Board. Best practice suggests that if appointing a senior officer to the Board of a Council owned company, that should not be the Chief Executive, the Section 151 Officer or the Monitoring Officer so as not to conflict with their statutory roles.

If recommendations are implemented with the creation of new governance arrangements by the shareholder, it is now the time to move from set up to focus on delivery with the right commercial and housing experience and composition on the board to enable that to happen. It is also good practice and governance for the role of Chair to be appointed annually but also time bound to allow for consistency but critically to focus on the delivery of the business plan and delivery as the company continues to grow.

**Recommendation 4 (R4)** to amend the articles of the company to introduce a three year term for the Chair.



**Recommendation 5 (R5)** review the appointments to the Board. Now is the time to focus on delivery and therefore the current appointments although assisting in set-up and initial trading activity, should be amended over a 12-month transitional period. This should include replacing the elected Members on the company Boards, with the advent of the Shareholder Group which will carry out a scrutiny and challenge function, expanding the membership of non-executive appointments with specific housing sector commercial experience and increasing the general non-executive membership to the Housing and Development companies by two. The Director of Housing and Commercial Development also be appointed to the companies.

## **5. Clear separation of roles between the council as shareholder and the companies and minimising the scope for conflicts of interest**

### **Observations**

If the recommendations for the Shareholder Group and the changes to the Board appointments are made there will be a clear separation at a strategic level of the shareholder and the company.

At an operational level, those officers who are currently undertaking company activity are also employed by the Council. The work done for the company is limiting their capacity for Council work and vice versa. As the companies enter the next phase of delivery, it is self-evident that the amount of work necessary will increase. For example if Recommendation 1 is to be implemented, someone will need to write a fuller set of Business Plans, which under Recommendation 2 and 3 will then require detailed performance reporting. These need to feature commercial acumen and insight. This activity, if conducted under the current model by Council officers, will deplete Council capacity.

The company could counter this by employing staff. One of the benefits of Council owned companies is that they can employ staff on commercial rates to carry out the work of the companies. This would increase the current capacity where, council officers who already have considerable council workloads are being asked to conduct company work. The productivity of the companies and the speed of delivery would inevitably increase if staff were employed within the companies. Their costs could be charged against specific projects as a normal overhead.

The roles could start with, for example, the single appointment of a Head of operations, to drive the next phase of delivery. The Council could resist at this stage a Managing Director role, until the scale of activity and turn over justified such a senior position. What a Head of Operations would bring is sufficient commercial knowledge and insight to start to drive commercial performance and delivery.

Such appointments would bring pension costs and human resource requirements of the company would increase.

This could sit alongside some continued “buying back” of other Council services to enable the companies to keep costs down and to provide financial benefit to the Council.

**Recommendation 6 (R6)** request the company to develop and implement an appropriate staffing structure for the companies, to oversee the operations and to drive commercial delivery at pace. This structure could be resourced incrementally and phased against specific trading data.

## **6. Role of the Audit and Governance Committee in overseeing the effectiveness of the governance arrangements**

### **Observation**

There have been some high-profile Council company failures, with perhaps the most significant to date being Nottingham City Council's Robin Hood Energy which will cost the local taxpayers an estimated £38 million in losses.

Audit and governance issues should therefore be a priority to ensure the correct structure is in place. This review provides assurance around the governance. The audit framework should also be considered.

The company could present its governance arrangements to the Audit & Governance Committee annually so that the Committee, on behalf of the Council, could be assured that they are appropriate.

The direction of travel is for the companies' accounts to be consolidated within the Council's accounts from the 2020/21 financial year, with the materiality and disclosure increasing as the company grows.

**Recommendation 7 (R7)** annual presentation of governance arrangements to the Audit & Governance Committee.

## **7. Role of Overview and Scrutiny.**

### **Observations**

With the correct timing and allowing for commercial confidentiality, pre-decision scrutiny of the Business Plans of the companies could occur in advance of Cabinet approval. This would allow more democratic accountability of the companies. It would also be another check and balance to encourage commercial success.

This could be coupled with regular performance reporting against the Business Plans to either a Task Group or one of the Select Committees.

Any scrutiny of the companies needs to recognise the commercial separation of the Stone Circle companies and the difference between their interests the Council's interests.

See R2.

## **Conclusion**

The foundations for the newly formed Stone Circle companies are broadly sound. With the shift to a delivery phase from the set-up phase, now is an appropriate opportunity to amend representation and take other steps to ensure delivery of the bold and ambitious plans. More reporting of performance, greater scrutiny of the governance framework and a shift to professional employees should start to offer a step change in delivery.

## **References**

Cadbury Report (1992) (The Committee on the Financial Aspects of Corporate Governance)

LLG Code of Practice for Local Authority Companies (2018)

House of Commons Briefing Paper (2019) Local Government Alternative models of service delivery

Performance of municipally owned corporations: Determinants and mechanisms (2019) Voorn, B. et al

Organizational Publicness and Mortality: Explaining the Dissolution of Local Authority Companies (2020) Andrews, R.

Public Interest Reports London Borough of Croydon, Liverpool City Council and Nottingham City Council.