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PRIME MINISTER

REGULATING LOCAL AUTHORITY INVOLVEMENT IN COMPANIES

Colleagues have generally responded with approval to the proposals set out in my minute to you of 15 April. There are however, a few points which I need to come back on.

I entirely agree with your point, recorded in your Private Secretary's letter of 3 May, that careful consideration needs to be given to the definition of what constitutes a "controlled company" as distinct from a "minority interest" or a "parallel company". I also agree that a test of 50% shared ownership would not be sufficient. Instead, I am proposing that a company should be regarded as controlled by a local authority where the authority can either in its own right, or indirectly, control a majority of the votes at a company general meeting or can control the appointment of a majority of the directors of a company. A more detailed statement of the proposed definition of "controlled company" was set out in Annex A of the officials' report, and I attach a copy of that for convenience.

The rules proposed for "controlled" companies will require the local authority to use its powers of control to achieve certain results. This means that the definition must be restricted to cases where there is some clear, formal power of control which can be used.

As you suggest, however, there will be cases where effective control can be held by an authority with a minority interest but no such formal power of control. Here some other "lever" to apply the rules must be found. My proposal is that such minority interests should be treated in the same way as the "parallel companies" where the authority is not formally participating in the company at all but has a dominant influence; the local authority would be required to include in its legal relations with the



company (contract, grant, lease or licence) conditions that the company will observe certain rules; and other steps would be taken, for example to bring borrowing by the company within the limits on borrowing by the authority. In such cases, then, both the rules on parallel companies and minority interests would apply. The definition of those cases would be as for "parallel" companies.

I hope that you can agree that such arrangements will effectively cover the whole spectrum of companies that need to be brought within the controls.

Paul Channon suggested in his letter of 29 April that his proposals on the privatisation of public transport companies should be included in the Housing and Local Government Bill next session. As you know, I am very much in favour of his proposals and want to help. It is primarily a matter for the Lord President as to whether adding this further set of proposals will be manageable in Parliamentary terms. It may be that a decision could be taken a little later when the state of readiness on the various elements to be included in the Bill is clearer. However this is very much a matter for the Lord President and QL colleagues. I hope it will be possible to include them.

Kenneth Baker, in his letter of 9 May, accepts that Companies Act companies formed by local authorities under their powers under the Further Education Act 1985 should be included in the proposals governing minority interests but argues that where, as is possible, local authorities control such companies they should be exempted from the regime proposed for all other local authority controlled companies.

I do not believe that this can be justified. If the local authority is in the position to control a company, then the fact that the company may be exploiting the work of a further education establishment is not, of itself, sufficient reason to exempt it



from the regime which I propose. Accepting Kenneth Baker's proposal would mean that such companies would remain free under the 1985 Act regime, among other things, to provide councillors with employment sinecures, to allow councillors to vote as directors on matters in which they had personal pecuniary interests, and to use the income of the company for any activity they like (including party-political publicity). I would not recommend such a loophole in the set of controls that I am proposing, particularly as there is nothing to restrain such companies to work in relation to further education establishments: once they are exempt, they could be used for any other purpose the local authority wanted a company for to evade controls.

I do not believe that my proposals will cause any problems for a properly run local authority controlled company in the further education sector. I hope we may agree, therefore, that the proposals should apply across the board. If there are likely to be any difficulties consultation should bring them to light and I should certainly be willing to discuss the issue further with colleagues at that stage.

I accept entirely the force of Kenneth Clarke's comment in his letter of 29 April that we need to make it clear that we are not creating a new category of company and that we need close liaison with his Department over details. I confirm that such are my intentions.

I should be glad to know if in the light of the above the proposals set out in my minute of 15 April can now receive policy approval. I am copying this minute to the other members of E(LF), the Attorney General, Sir Robin Butler and First Parliamentary Counsel.

NR

13 May 1988

SUMMARY OF REPORT OFLOCAL AUTHORITY COMPANIES STUDY

1. The basic problem with the use of companies by local authorities is that the various rules which are applied to local authorities ensure that they do not exceed their allotted role, and that they conduct their business with propriety do not apply to such companies.
2. The study includes a detailed description of the various ways in which it is possible to become involved with a company, of the existing powers of local authorities to undertake such involvement (both those specifically providing for such involvement and the more general powers which permit a local authority to become involved if it so wishes), and of the existing extent of local authority involvement. This last is based on a survey of all, English principal councils, and shows that the majority of counties, metropolitan districts and London boroughs have such involvement, but that only just less than a third of shire districts are involved. Only one-third of the interests reported appear to be sufficient to give control of the company.
3. The study notes the advantages for local authorities in using companies (clear management structure, ease of involving the private sector, separate identification of resources and results of an activity) and the various central Government initiatives which are likely to demand the use of companies by local authorities. These factors point to, on the one hand, not putting obstacles in the way of the use of companies and, on the other hand, ensuring that companies cannot be used to evade controls on local authorities.
4. The study then argues for separate treatment of three categories of involvement:
 - a. l.a. controlled companies (where the local authority is formally in a position to get the company to behave as it wishes): here the local authority would be required to use its powers of control to get the company to observe various rules; the definition of control would be in terms of a list of specified cases giving control, with a power to add to the list should any other arrangements of this kind be invented;

b. minority interests (where the local authority is formally involved in the company but does not have powers of control): here there would be restrictions on the type of companies in which a local authority could participate and on the behaviour of the local authority and its members with respect to the company;

c. "parallel companies" (where the local authority is not formally involved in the company but has substantial influence over the company): here the local authority would be constrained in its dealings with the company, and would be required to impose certain conditions on its contracts, grants, licences or leases to the company.

5. The study then sets out definitions of these three categories. L.A. controlled companies are defined in terms of the ability of the local authority to control a majority of votes at company general meetings or to appoint a majority of the directors. Minority interests are then defined as all other cases where local authorities control votes at company general meetings or appoint directors. Parallel companies are defined in terms of a conjunction of a significant proportion (20%) of the members or directors of the company having links with the local authority and of a majority of the company's business being linked to the local authority. These definitions are developed in detail.

6. The study then considers the ultra vires rule. It proposes that local authorities should be required, like nationalised industries, to use their powers of control over l.a. controlled companies to ensure that the companies do not do anything that the controlling authority cannot do. Exceptions are proposed to resolve a problem under the Local Authorities (Goods & Services) Act 1970 and to give the Secretary of State power to license other activities as a preparation for privatisation.

7. A list of permitted cases for holding minority interests is proposed. This would cover, public transport companies, public airport companies, companies under the Further Education Act 1985, approved housing initiatives, non-profit-making companies to provide a local facility, supported by the local authority, enterprise agencies, companies to deal with common parts of let buildings, "golden shares" to prevent changes in company constitutions, joint ventures for the development of land, statutory undertakings, and professional etc associations. There would be a further power to approve additional cases.

8. It is not necessary to consider the question of ultra vires in relation to parallel companies, as the local authority's involvement would have to be under existing powers.

9. The study then considers the other controls to which local authorities are subject. In the case of l.a. controlled companies, the aim is to ensure that local authorities use their powers of control to ensure compliance with the same rules as local authorities themselves: in this way there is no improper advantage to be gained from using a controlled company, and therefore no need to prevent local authorities using this type of machinery if it is sensible to do so. Proposals are therefore developed in detail for applying

a. the new capital expenditure control rules;

b. other rules on borrowing, finance, accounts and audit;

c. rules on the personnel involved (the exclusion of those disqualified from council membership, pay of councillors, preventing employees sitting on their employing body, pecuniary interests, corruption offences);

d. other rules on the proper conduct of business (ban on party-political activity, contracts standing orders, non-commercial contract conditions, compulsory tendering, disposal of land, under used land, Local Ombudsman, rights of public access to meetings and information, limit on section 137 expenditure, Crichton Down rules, National Code of Local Government Conduct);

e. proposed new rules for local authorities flowing from Widdicombe (restrictions on public political activity by senior staff, restrictions on councillors being involved in junior staff appointments).

10. Some of these developments are inappropriate for companies which are genuinely run as separate commercial undertakings. A definition is therefore developed of "arms' length companies". These would be excluded from the requirements for contracts standing orders, compulsory tendering, the local ombudsman, and access to meetings and information.

11. The main control on minority interests is the limitation on the cases in which they can be held. Some further controls are required, however, to ensure proper accounting for the local authority's interest, the possibility of questioning of the local authority's representatives on the company, exclusion (as far as possible) of those disqualified from council membership, and controls on payments to councillors, pecuniary interests, and provision of information held by representatives.

12. In the case of parallel companies it will be necessary to bring them within the new capital expenditure control system, and to require certain conditions to be imposed on borrowing, audit information and some of the controls listed in paragraphs 9(c), (d) and (e) above.

13. In order to ensure that the obligations of those who represent local authorities at company meetings are clear, and that failure to control such representatives cannot be used as a means of evading the controls, a code of procedure for these relationships is proposed.

14. As the ultimate means of enforcing the local authority's obligations to control its companies, it is proposed that it should be made clear that any payment by a local authority to a company where the local authority is in default of some obligation to exercise control should be unlawful, and should thus attract the sanctions for any unlawful local authority expenditure.

15. There are then a number of separate additional problems:

a. where several local authorities, rather than one, are involved in the company, their interests are, in general, proposed to be aggregated for the purposes of the proposed controls;

b. a system of long-term exemptions may be needed for companies such as Municipal Mutual Insurance Ltd;

c. industrial and provident societies, unlimited companies, and non-charitable trusts would also need to be brought within the net of controls;

d. controls would be needed on the investment of reserves and superannuation and charitable funds; the approach proposed is that of a code of practice, backed up by reserve powers;

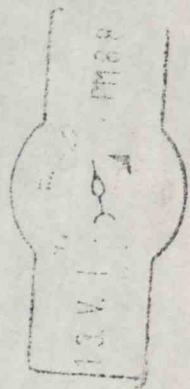
e. participation in overseas companies should be prohibited except where the Secretary of State's consent is given.

Transitional provisions are needed for existing companies:

a. for l.a. controlled companies, few transitional provisions will be needed, since the proposal simply requires local authorities to start exercising their controls in a certain way;

b. for minority interests, there would have to be a provision for divestment where the interest was not in a permitted category and the Secretary of State was not prepared to sanction it;

c. for parallel companies, transitional provisions depend on the assessment of the risk of local authorities entering into long-term contracts or agreements before the new rules are in force in order to evade them; one possibility would be to provide for the determination of all such contracts or grants a year or so after the rules come into effect, so as in effect to force them to be renegotiated on the new basis, but this would have complications and (given that the capital expenditure of parallel companies would anyway be brought within the controls on local authority capital expenditure) the risk may not be sufficient to justify such complications).



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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

18 May 1988

Dear Rose,

REGULATING LOCAL AUTHORITY INVOLVEMENT IN COMPANIES

The Prime Minister was grateful for your Secretary of State's further minute of 13 May.

On the basis of the further explanation of the proposals, the Prime Minister accepts that the arrangements will effectively cover the whole spectrum of companies which need to be brought within the controls. The Prime Minister also agrees with your Secretary of State that it would not be appropriate to make the exemption from the new arrangements proposed by the Secretary of State for Education and Science in his letter of 9 May. The Prime Minister has also commented that it will be for the Lord President and QL colleagues to consider whether the Secretary of State for Transport's proposals on the privatisation of public transport companies could be included in the forthcoming Housing and Local Government Bill.

I am copying this letter to the Private Secretaries to members of E(LF), the Attorney General, Sir Robin Butler and First Parliamentary Council.

*Yours,
Paul*

PAUL GRAY

Roger Bright, Esq.,
Department of the Environment.

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PRIME MINISTER

REGULATING LOCAL AUTHORITY INVOLVEMENT IN COMPANIES

Mr. Ridley minuted you on 15 April seeking agreement to a package of proposals to regulate the activity of local authority companies. You indicated you were content subject to ensuring that the proposals covered cases where although local authorities held less than 50% of the shares of the company they nonetheless were able to exercise effective control.

Mr. Ridley's further minute of 13 May (Flag A) comments further on this point and on some issues subsequently raised by other colleagues:

- (i) A proposal by Mr. Channon (Flag B) that his earlier proposals for privatisation of public transport companies (Flag C) should be included in next Session's Housing and Local Government Bill;
- (ii) A proposal by Mr. Baker (Flag D) that companies formed by local authorities under their powers under the Further Education Act 1985 should be exempted from the regime for other local authority controlled companies.

Mr. Ridley's minute suggests:

- (i) The details of his proposals do provide adequate powers over dominant local authority minority interests in companies;
- (ii) He sympathises with Mr. Channon's proposals on privatisation of public transport companies, but suggests that whether this could be included in the Bill is a matter for QL;

(iii) The exemption proposed by Mr. Baker for certain companies in the education area should be resisted.

Peter Stredder's note (Flag E) advises that Mr. Ridley's proposals do adequately cover your earlier concern on minority interests, and also supports Mr. Ridley's line on the Channon and Baker proposals.

Content now to accept the package put forward in Mr. Ridley's minute of 13 May (Flag A) but indicating that whether or not legislation to cover privatisation of public transport companies will be included in the next Session must be a matter for QL?

ASB
Dory/Clare

Yes mt

PP. (PAUL GRAY)

17 May 1988

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PRIME MINISTER

16 May 1988

LOCAL AUTHORITY INVOLVEMENT IN COMPANIES

Nicholas Ridley has minuted ^{attached} you again about outstanding points on his proposals for regulating local authority involvement in companies.

Definition of Control

You were concerned that the definition of control should not neglect the fact that in some cases the owner of substantially less than 50% of the shares in a company can exercise effective control over its activities. In fact, Nicholas Ridley's original proposals took a wider definition of control - this is set out in Appendix A to his letter - which I attach to this note.

However, there may still be other circumstances in which a local authority can exercise effective control (eg it may be the largest single shareholder) but where its ability to exercise control is not sufficiently clear in law for the legislation to require the local authority to exercise that control in a certain way.

Local authorities will only be able to take a minority interest in certain specified companies. Moreover, Nicholas Ridley's minute makes it clear that his original proposals deal with this sort of dominant minority interest in exactly the same way as they deal with other 'parallel' companies - by controlling the local authority's relations with them.

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We agree that Nicholas Ridley's proposals provide adequate powers over dominant local authority minority interests in companies.

Privatisation of Local Authority Transport

Nicholas Ridley supports Paul Channon's proposal that next session's Local Government and Housing Bill should include a clause enabling local authority transport companies to be privatised. We recommend that you support this proposal, subject to the Lord President confirming that space can be found in the Bill.

Companies formed under the 1985 Further Education Act

However, Nicholas Ridley does not want to accept Kenneth Baker's proposal that companies formed by local authorities to exploit the activities of their further education colleges (eg to provide training or to exploit a technical invention) should be exempt from the arrangements where they are a controlled company. Kenneth Baker's letter says that the 1985 Further Education Act provides a framework for regulating the activities of such companies, in particular to ensure that they are not able to compete unfairly with the private sector. But I understand from his officials that they now accept that that is not the case.

DES officials were also unable to explain how it would be possible to exempt such companies without driving a coach and horses through the purpose of the legislation.

Moreover, it is not necessarily desirable to seek to exempt such companies from the legislation, even if they are not to be deliberately used to evade the new Act. For example, it seems perfectly reasonable that where such a company is controlled by a local authority its borrowing should come within the local authority capital control system.

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We therefore recommend that you support Nicholas Ridley in resisting this proposal.

Conclusion

We recommend that you agree to Nicholas Ridley proceeding with his proposals on regulating local authority involvement in companies on the basis set out in his latest minute.

Peter Stredder

PETER STREDDER

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b. in the case of a company limited by guarantee, through the holding of votes at a general meeting of the company by either

i. a group of members of the company, the composition of which is controlled by the local authority; or

ii. persons who have contractually bound themselves to vote as instructed by the local authority.

4. Although the local authority is not a member of the company, it has power to control the composition of the board of directors.

MEDIATE CONTROL

5. A power of control (in any of the above senses) is vested in a company which is controlled, immediately or mediately, by a local authority.

6. In any of the foregoing cases, the power of control over the composition of the controlling group of members or of the board of directors of the company is held by any group of persons whose composition is controlled, directly or indirectly, by the local authority.

All other cases where a local authority is involved directly in a company will be cases of a minority interest.

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LOCAL AUTHORITY CONTROLLED COMPANIES : DEFINITION

The full definition of a local authority controlled company would cover the following cases.

IMMEDIATE CONTROLI Where the company is a subsidiary in the sense of the Companies Act:

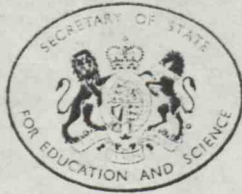
1. The local authority is a shareholder in the company and holds more than half the nominal value of the equity share capital.
2. The local authority is a member of the company and controls the composition of the board of directors.

II Where the company is NOT a subsidiary in the sense of the Companies Act:

3. All cases where the local authority controls a majority of the votes at a general meeting of the company in any of the following ways, or by any combination of any of the following ways:
 - a. in the case of a company limited by shares, through the holding of equity share capital, or (where different) of votes at a general meeting of the company, by shareholders who are either
 - i. nominees of the local authority; or
 - ii. persons whose right to hold the shares inevitably involves some action (or the refraining from exercising a right of veto) in their favour by the local authority and who can be required to transfer their interest to another person by some action by the local authority (whether or not action by some other person is also required); or
 - iii. persons who have bound themselves contractually to vote in accordance with the local authority's instructions;

LOCAL GOVT : Retalians PT35

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NBM
REC
W/S

25 May 1988

Jim Smith

REGULATING LOCAL AUTHORITY INVOLVEMENT IN COMPANIES

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Thank you for sending me a copy of your further minute of 13 May to the Prime Minister on this.

Despite my concerns about the possible impact of our proposals on companies established by local authorities under the Further Education Act 1985, I am content that we should now proceed with consultation as you propose.

I am copying this letter to other members of E(LF), the Attorney General, Sir Robin Butler and First Parliamentary Counsel.

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[Handwritten signature]

LOCAL GOVT Relations pt 35.

