Monmouthshire County Council ADM

Commentary on Board Structure and Make-up

1. The Boards of Directors

1.1 We set out below:

1.1.1 a detailed explanation of the duties owed by directors to a company, the impact of breaching these duties, and some practical steps to take to assist in ensuring directors comply with these duties;

1.1.2 suggestions for the Boards of the Teckal company, trading company and charity, including recommendations in terms of numbers and make up of each Board.

DIRECTORS' DUTIES

1.2 The board of directors is ultimately responsible for running a company, and directors have a range of core statutory duties. These general duties are set out in sections 171 to 177 of the Companies Act 2006 and are:

1.2.1 **the duty to act within powers** – to act within the company's constitution and only to exercise the director's powers for the purposes for which they are conferred;

1.2.2 **the duty to promote the success of the company** – the director's primary duty is to the company and it is important that those directors appointed by the Council understand this. Directors must act (in good faith) in a way which would be most likely to promote the success of the company for the benefit of the members or shareholders as a whole. In so doing, directors must have regard to a non-exhaustive list of matters;[1]

---

[1] These are:
- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

1.2.3 **the duty to exercise independent judgment** – although this does not stop a director from acting in accordance with any agreement entered into by the company that fetters the directors' discretion;

1.2.4 **the duty to exercise reasonable care, skill and diligence** – the duty of care is that of a reasonably diligent person with the general knowledge, skill and experience reasonably expected of somebody in the director's position, and the director is expected to us the general knowledge, skill and experience that s/he personally has;

1.2.5 **the duty to avoid conflicts of interest** – directors must avoid situations where they have (or might have) a direct or indirect interest that would or could conflict with the interests of the company. However in some situations, a board or members can authorise a conflict situation and set parameters around a director's activities, or manage the conflict in other ways. This is discussed further in context of the suggested make-up of the Boards below;

1.2.6 **the duty not to accept benefits from third parties** – directors must not accepts benefits where these are conferred by reason of their being a director of a company;

1.2.7 **the duty to declare interests in proposed actions or transactions** – where a transaction or arrangement is being considered or entered into by the company, directors must declare to their fellow directors if they have any direct or indirect interest in that transaction or arrangement. This would commonly result in the director with the interest being excluded from the decision making process for that transaction or arrangement.

1.3 These general duties must always be complied with, save for a few limited exceptions:

1.3.1 the Companies Act 2006 expressly allows directors to make provision for certain employees (or former employees) in connection with the cessation or the transfer of the company's business, even where to do so would otherwise be a breach of one of the general duties; and

1.3.2 in certain circumstances directors (or members/shareholders) may authorise matters that would otherwise be a breach of duty – e.g. in relation to conflicts of interest, directors or members may authorise directors to continue to act despite a conflict.

1.4 These general duties cannot be excluded or diluted by the company's constitution.

IMPACT OF BREACHING THE GENERAL DUTIES

1.5 If a director breaches one or more of the general duties:

1.5.1 the company may have grounds to bring a civil action against the director; or

1.5.2 the director may be disqualified if they are shown to be unfit to be concerned in the management of a company as a result of the breach.

Action for breach of duty may be taken by the Board on behalf of the company. However, the Board may be unwilling, or unable, to take action against a fellow director. In such a case, the company itself can take legal action against a director (or former director) for breach of duty through a derivative claim brought by one or more members. A member/shareholder can also bring an action for unfair prejudice in his own right.

WIDER LEGAL DUTIES

1.6 The general duties set out in the Companies Act 2006 are not meant as an exhaustive list, and are in addition to wider legal duties. For example, while directors are not generally personally liable for a company's debts, they can become so if they give personal guarantees (something which we consider is extremely unlikely in the circumstances). Directors might also incur direct liability where there is fraudulent trading, wrongful trading, misfeasance or breach of the director's fiduciary duty to the company.

PROTECTING A DIRECTOR FROM LIABILITY

1.7 The Companies Act 2006 contains a general prohibition against exempting or indemnifying directors against any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust. However, there are statutory exceptions to this general prohibition, which provide that:

1.7.1 a company may acquire and maintain insurance for its directors, or those of an associated company, against such liability; and

1.7.2 a company may provide an indemnity for its directors, of those of an associated company, against certain liabilities, provided that such indemnity is a qualifying third party indemnity or a qualifying pension scheme indemnity under the Companies Act 2006.

1.8 Directors can also be relieved from liability by the members or shareholders of the company ratifying conduct that amounts to negligence, default, breach of duty or breach

of trust, subject to such conduct being capable of ratification, or by the court in certain circumstances.

PRACTICAL STEPS TO COMPLY WITH DIRECTORS' DUTIES

1.9 While directors each have a personal responsibility to comply with their duties, practical steps can be taken to assist the directors in their compliance and to give assurances to a company as to the compliance of its directors with those duties through creating the right corporate culture. These include:

1.9.1 providing training to new directors on the extent of their general duties, potentially as part of a wider induction programme (see further below in the context of the options available to the Council in terms of who is appointed to the Boards);

1.9.2 ensuring that directors are briefed on their duties before (or as) they are appointed, and that they are also briefed or refreshed at regular intervals following appointment;

1.9.3 regularly taking the directors' duties into account in the company's strategies and operations;

1.9.4 review or draft company policies (especially in the context of corporate responsibility and compliance) in the light of the directors' duties;

1.9.5 making reference to the general duties in each director's terms of appointment (or services contracts where there are any) and in the terms of reference for any committee to which the board delegates.

MAKE-UP OF THE BOARDS – GENERAL

1.10 The Boards of both the *Teckal* company and the trading company can comprise officers, Members and independent non-executive directors (for example, individuals that are recruited to bring a specific skill set). The companies could also directly employ executive directors engaged full time in running the company. There is no legal requirement to have a managing director or finance director, but the Council may wish to consider allocating portfolios of responsibility to individual directors. In addition, there is obvious benefit in one individual having responsibility for leadership and for making key decisions about the company's activities.

1.11 In terms of numbers, we would recommend an odd number of directors (and a minimum of three) to avoid deadlock situations in decision making, and a maximum of around 12 directors to avoid decision-making becoming unwieldy.

MAKE-UP OF THE BOARDS – MEMBERS AND OFFICERS AS DIRECTORS

1.12 The Council will need to consider who it appoints to the Boards of each company. As mentioned above, this can be made up of officers and/or Members, and third parties, in differing proportions.

1.13 Should the Council decide that any Members should be appointed as directors, care should be taken to manage conflicts of interest between the duties to act in the best interests of the company or companies they are directors for (see paragraph 1.2 above) and the duty to act in the Council's best interests. Neither of these duties can be either avoided or delegated which can mean that an individual Member who is a director may find that in reality they must be excluded from decision making on one or both sides of the relationship.

1.14 We therefore advise the Council to consider whether Member involvement is better suited at a shareholder/Member level where the same conflict should not arise because the Council as shareholder is only required to act in its own best interests.

1.15 If there is a desire for individual Members to be appointed directors of the *Teckal* or trading companies, we would advise the Council to consider carefully which Members these are in the context of the Council's internal decision making processes. For example, if the Council takes the view that Cabinet should act in the shareholder capacity, then ideally no Member that sits in Cabinet should be appointed as a director. If they are, then they are likely to have to regularly declare a conflict of interests, and this is likely to lead to their being ineffective as decision makers, either within the Council or on either company's Board.

1.16 Officer directors will, of course, also owe duties to the Council. However, these duties arise from their terms and conditions of employment and, as such, it is possible for the Council as their employer to amend these terms and conditions to say that the officer may act as a director of the company and that, where they so act, the officer should put the interests of the company first (as the law relating to directors requires).

1.17 Where officers are appointed then consideration should still be given to their position and responsibilities within the Council. Officer directors should not advise the Council as shareholder on action or decisions to take relevant to the company. We generally also advise against Section 151 Officers being appointed to boards where they may be making recommendations in the Budget that benefit the company (although this can happen where the Council is happy for a deputy Section 151 Officer to deal with such recommendations).

1.18 In practice, many officers serve as directors of local authority companies without any problem. What is of most importance when setting up the companies is that the Board will provide the needed qualities and experience, and that the Council is satisfied that its interests as the sole shareholder/member are being properly served.

1.19 It is however important that a consideration of the practical points and potential conflicts of any appointment is undertaken beforehand, as it is frustrating to all if a director is frequently prevented from acting due to conflicts arising.

1.20 Furthermore, of course, the existence of apparent bias or predetermination towards the company by the Council when decisions are made (whether by officers or Members) can give rise to actions for judicial review.

REMUNERATION OF DIRECTORS

1.21 Another relevant point which sometimes has a bearing on Board membership concerns any payment for acting as a director:

1.21.1 Member directors are limited by the Local Authorities (Companies) Order 1995 as to the level of remuneration and expenses they can receive (allowances must be comparable to an equivalent role under the Scheme of Allowances and any payment by the company reduces any allowance due to the Member from the Council);

1.21.2 the Local Government Act 1972 prevents Officers from accepting any direct remuneration from a company, although nothing prevents the Council from directly remunerating an Officer for taking on additional responsibilities on its behalf and at its request, even though those additional duties are through and with the company;

1.21.3 Officers and Members should be aware that when they are acting as directors they are not normally protected by their usual statutory immunity, or by the

Council. The Council should consider whether the nature of the company in question provides protection and whether this covers the personal liability of Directors. The Council should take particular care in granting any indemnity to an officer or Member and ensure that they are acting within their powers as set out in statute. Any indemnity / insurance should be taken out by the company rather than the Council.

THE BOARDS OF THE TECKAL AND TRADING COMPANIES

1.22 Given the requirements under *Teckal* / Regulation 12 rules the Council needs to maintain a degree of control over at least the *Teckal* company, and so it is important to consider how directors on the Board of the *Teckal* and trading companies are appointed and removed.

1.23 As mentioned above, the Board could include Members, officers, and externally-recruited non-executive directors. We anticipate that the Board of the *Teckal* company would be entirely appointed by the Council, at least at the outset.

1.24 The Council may be comfortable for the Board of the trading company to recruit and appoint non-executive directors itself. Initially, though, the Boards of the *Teckal* company and the trading company can be the same.

1.25 From the perspective of Regulation 12, sufficient control of the *Teckal* company can be demonstrated simply by ensuring that the Council appoints the Board; this does not preclude directors being found from the private sector. In terms of proportions, a helpful model might be local authority arms-length management organisations (ALMOs). These typically divide their Board three ways: one third appointed by the Council (often but not always also being officers or Members), one third being tenant board members, and one third being independent board members recommended by the Board to the parent local authority – so fully two thirds of the board members are <u>not</u> directly council appointed. In this scenario the parent local authority also has the ability to <u>remove</u> any director. A similar situation might be created for the *Teckal* company. If the majority of the directors were to come from private sector, then measures need to be put in place to protect the Regulation 12 exemption. This might include, in a similar way as is seen in ALMOs, the Council having the ability to remove any director at will. While this might create a Board of Directors which feels slightly more consultative in nature than the norm for a company, this would enable the *Teckal* company to benefit from private sector expertise while protecting the Regulation 12 exemption.

HOW MANY BOARD MEMBERS?

1.26 Again, the ALMO model may give some helpful guidance – in many ALMOs the Board typically has 15 Directors. Given the *Teckal* and trading companies will have the Council as their sole member / shareholder, a sensible number for the Boards may be 9 or 11:

1.26.1 the Chair;

1.26.2 5 Non-Executive Directors;

1.26.3 3 or even 5 Executive Directors – so potentially a CEO, an FD, and one or more others.

THE CHAIR

1.27 The chair is a director appointed to take responsibility for procedural control over meetings of the company's Board (and often shareholder meetings also). As a rule the chair would be expected to be responsible for:

1.27.1 leadership of the board, ensuring its effectiveness on all aspects of its role and setting its agenda;

1.27.2 ensuring that the directors receive accurate, timely and clear information;

1.27.3 ensuring effective communication with shareholders;

1.27.4 facilitating the effective contribution of non-executive directors and ensuring constructive relations between executive and non-executive directors;

1.27.5 ensuring that there is a quorum present before a meeting proceeds;

1.27.6 keeping order;

1.27.7 ensuring the business of the meeting is dealt with (in essence ensuring that an agenda is kept to).

1.28 To ensure that this happens the roles of the chairman and chief executive should be separate roles.

1.29 Where a decision must be made as to whether or not a director is able to participate in a meeting or vote on a particular decision (for example if that director has a conflict of interests) the chair is generally called upon to make that decision. The chair can also be given a casting vote to manage situations in which a deadlock arises.

1.30 The role of chair is therefore an important one, and we advise the Council to give consideration to the appointment of a chair, and to whether or not that chair should be given a casting vote over decisions made. If the chair does not having a casting vote, then the number of directors should be odd, and the quorum for meetings should be an odd number, to minimise the opportunities for deadlock.

COMPANY SECRETARY

1.31 There is no longer any requirement for a private limited company to have a named company secretary, and the company secretarial duties can be undertaken by anybody – for example any director of the company. In our experience, most local authorities do appoint a company secretary and that person is, typically, a member of the in house legal services team or the authority's monitoring officer. This allows a secondary check on the activities of the company.

1.32 Provision of company secretarial services can be dealt with through the support arrangements between the Council and the companies. The Council could choose to appoint one company secretary for the *Teckal* and trading companies to assist in unifying the governance structure.

RECOMMENDATIONS

1.33 In the circumstances, we recommend that:

1.33.1 either Cabinet, or relevant Members with delegated authority, exercises the shareholder function, with appropriate support from officers;

1.33.2 the Boards of the *Teckal* and trading companies are made up of a mixture of officer directors and, if it is felt that there is a need to look externally for specific experience or expertise, independent non-executive directors. At least to begin with, the Boards of the *Teckal* and trading companies can be identical;

1.33.3 if the Council decides that it will appoint any Members as directors of either the *Teckal* or trading companies or both, there should be sufficient other directors appointed to mean that, even if a Member director has a conflict of interest, a quorum is still possible for meetings and decisions can still be taken. Equally, if any Members are appointed then the Council will need to be confident that it can continue to take decisions effectively itself;

1.33.4 the companies together appoint a group company secretary.

THE CHARITY

1.34 There are two options for a charitable company limited by guarantee, in terms of its membership and board:

1.34.1 the charity's company members and its board of directors are the same people; or

1.34.2 the charity's company members include the directors, but also other individual or corporate trustees.

1.35 Local authorities are sometimes corporate trustees for charities which hold or manage public facilities, including leisure centres, parks, libraries and town halls, for example. In a company context, the local authority as corporate trustee is a member of the company, as well as the individuals that are directors.

1.36 If the Council chose to be a member of the charitable company (and therefore a trustee) then it would need to bear in mind the distinction between the Council and the Council as charity trustee and manage any conflicts of interest, as well as ensuring that in its capacity as trustee it acted in the best interests of the charity. The Council could choose instead to nominate trustees – officers or Members that would be members of the company and on the board of directors.

1.37 The significance of the charity's need to apply its objects is a need for greater independence than will be given to the *Teckal* and trading companies. This may indicate it has a different Board (entirely or partially) to the other two companies. There can, however, be some overlap, and this does not mean that the Council cannot nominate or appoint directors. Indeed, in many Leisure Trusts, the local authority appoints a portion of the Board.