KENT COUNTY COUNCIL

GOVERNANCE AND AUDIT COMMITTEE TRADING ACTIVITIES SUB - COMMITTEE

MINUTES of a meeting of the Governance and Audit Committee Trading Activities Sub - Committee held in the Darent Room, Sessions House, County Hall, Maidstone on Thursday, 20 November 2014.

PRESENT: Mr R L H Long, TD (Chairman), Mr R J Parry (Vice-Chairman) and Mr H Birkby

ALSO PRESENT: Mr R H Bird, Mr A H T Bowles, Mr M C Dance, Mr C P D Hoare, Mr D Smyth and Mr M E Whybrow

IN ATTENDANCE: Mr A Wood (Corporate Director Finance and Procurement), Ms S Buckland (Audit Manager), Mr D Smith (Director of Economic Development), Ms J Ward (Senior Partnership Officer), Mr J Burr (Director Highways, Transportation & Waste and Principal Director of Transformation), Mr N Sarrafan (County Transport & Development Manager) and Mr A Tait (Democratic Services Officer)

UNRESTRICTED ITEMS

6. Minutes - 3 March 2014
(Item 3)

RESOLVED that the Minutes of the meeting held on 3 March 2014 are correctly recorded and that they be signed by the Chairman.

7. The creation of an East Kent Equity Investment Fund via a Limited Liability Partnership
(Item 4)

(1) Mr M C Dance, Cabinet Portfolio Holder for Regeneration and Economic Development introduced the report by explaining that KCC had been successful in its bid to the Regional Growth Fund (RGF) for three programmes including *Expansion East Kent*. This could have been funded through the straightforward mechanism of a grant. It had, however, been decided that a more positive approach would be achieved through offering a flexible 0% loan for a period of some 5 years. The best way to do this was through a bank which would take the first charge whilst KCC took the second if directors' loans were involved. There were more than 40 North American companies which were looking to locate to Kent provided that support could be offered for them to get started. He believed that Kent was already well placed to provide the right infrastructure and other incentives which would enable the county to compete with other parts of the UK for additional investment and employment. The East Kent Equity Investment Fund constituted the extra support that was needed.

(2) Mr Smith confirmed that the funding had come from central government by way of an endowment. They were managed by KCC subject to the rules prescribed by the Department of Business, Innovation and Skills. These rules permitted KCC to

make equity investments from that fund. The EU had State Aid rules (Market Economy Investment Principles) which prevented its member states unfairly subsidising businesses in their own countries. These rules required a local authority to set up a corporate vehicle if it wished to make equity investments so that such decisions were made on commercial grounds.

(3) Mr Smith went on to say that the corporate vehicle adopted in this instance had followed expensive legal advice from *Hogan and Lovells*, the UK's leading specialist in this particular sector. A second opinion was also taken from *Geldards* who were sub-contracted to KCC. The need for such external legal advice had been proven by the experience of other authorities when they had set up legal structures which had prevented them from adding other private investors to their equity fund when they had wished to do so.

(4) Mr Smith then said that as a result of the legal advice obtained, the Equity Fund had been set up in two phases. The first of these (which the Sub-Committee was being asked to examine) involved the only money invested (the £5m from the RGF) coming from KCC. Phase 2 would involve investment from other sources, requiring a changed structure and ownership.

(5) Mr Birkby asked for details of the amount being paid for legal advice. Mr Smith replied that payment to *Hogan and Lovell* was being made by *Narec Capital.* KCC itself was only paying *Geldards.*

(6) The Sub-Committee agreed that it did not need the full details of the actual amount paid at the meeting itself. This sum would be communicated to all Members of the Governance and Audit Committee at a later stage.

(7) Ms Ward explained that advice had been obtained from *Geldards* some 18 months before this meeting on structure under the Localism Act. The actual documents and legal agreements were still being awaited from *Hogan and Lovells*. *Geldards* would be asked to review these from an independent perspective.

(8) Mr Parry asked who the Members and Designated Members of the LLP would be. Mr Smith replied that the Partnership would be wholly owned by KCC. This would include all the liabilities and management responsibilities. The Leader of the Council had not yet been asked to make a decision on the actual identity of the designated Members. The recommendation to him was likely to be that there should be a mixture of KCC Members and Officers.

(9) The Chairman asked for the Governance and Audit Committee Members to be notified of the eventual Member and Designated Member appointments as well as of any changes to the governance arrangements.

(10) Mr Hoare asked how *Narec* had been chosen as partners of KCC. Mr Smith replied that they were wholly owned by the Department of Business, Innovation and Skills for the promotion of technology in the field of alternative and renewable energy. They were based in NE England and as a public sector body were a partner in governance to KCC. They were not a commercial body. *Narec Capital* had been set up for similar reasons to those which had led to KCC wishing to set up the Equity Investment Fund. *Narec Capital* was unique in this area as it was a combination of public sector capital finance expertise and the commercial contribution made by

Ashburton (the other partner in *Narec Capital*). They had been selected on the advice of the Technology Strategy Board, which was a body set up to report directly to the Department of Business, Innovation and Skills in order to provide grants and financial assistance on a non-commercial basis to companies in innovative engineering and technology sectors. *Narec Capital* had provided similar services to the Scottish Government. The selection process had been through a standard KCC procurement in 2012.

(11) Mr Smyth noted that paragraph 3.1 of the report stated that the public and private sectors could only provide funding on a 50/50 basis. Mr Smith had, however, suggested that this would not be the case. He also noted that the Investment Committee which approved investments would have 2 Directors who would have veto rights. He asked whether these veto rights were absolute or conditional.

(12) Mr Smith said that, in respect of the 50/50 question, a company which set itself up and was looking for equity investment would naturally have its own Board of Investors and a commercial strategy of its own. KCC would seek to invest in rather than direct that company. The EU state aid rules did not allow KCC to become a lead investor in such a company. The maximum amount that KCC could take was therefore 50%. He anticipated that KCC would only take a maximum of a 10% holding in any company in which it invested. This was a separate matter from the LLP whose funds would be 100% owned by KCC.

(13) Mr Smith then said that the veto rights in the Investment Committee were necessary because KCC would be seeking membership from people with technical expertise. KCC would have two out of the 5 members of this Committee, but they would have absolute veto rights. Every decision for this Committee would have to be considered by an Advisory Board which had already been set up, chaired by the Leader of the Council. Mr Dance was a Member of this Advisory Board which also contained a private sector Panel to advise on the overall strategy.

(14) The Chairman asked for assurance that either through shareholder agreements or through issuing different classes of equity shares with special rights, KCC would be able to ensure that matters it considered important required its consent as a shareholder. Mr Smith replied that he could give an absolute assurance to that effect. Each investment from the fund would be accompanied by a shareholder agreement.

(15) Mr Smith replied to a question from Mr Whybrow by saying that the aim was for the LLP to be operational in December 2014. He then explained that KCC had already agreed with three companies to make investments in three companies where KCC was a shareholder without going through the LLP. These three shareholdings would (subject to events proceeding as expected) be added to the Equity Fund.

(16) Mr Whybrow asked for assurance that KCC would be able to gain access to accounts direct from the company itself rather than from Companies House. Ms Ward replied that she could give that assurance because the due diligence process at the point of application required the company to make the accounts available to KCC with an update every three months.

(17) Mr Bird asked whether *Narec's* expertise extended to bio science, life science and other sciences in Discovery Park. Mr Smith replied by referring to the Mandate

for Investments set out in paragraph 5.10 of the report which stated that the Fund would invest in companies producing sustainable energy and life science/medical related technologies and products. *Narec* had considerable expertise in sustainable energy, technology and engineering, but acknowledged that it had none in bio science and medical technologies generally. It was therefore envisaged that *Narec Capital's* expertise would be as much in the investment management process and that, if required, they would be able to assist in identifying the necessary area of expertise from other organisations in evaluating proposals.

(18) Mr Hoare asked why KCC was getting involved so deeply in the failing renewable energy sector. Mr Smith replied that the government had set up *Narec Capital* ten years earlier for the purpose of investing in alternative and renewable energy. Since then it had widened its expertise and had become an engineering and technology research organisation.

(19) Mr Birkby asked how confident it was possible to be that the initial tranche of £5m from *Expansion East Kent* would leverage £45m from the private sector and then £150m from captive co-investment. Mr Smith replied that in the scheme, any company could fail. Early stage investment was very risky. The creation of a Fund would ensure that the successful investments would outweigh the unsuccessful ones. Although it was not possible to predict the eventual returns to the Fund, there was a financial incentive for the Fund managers to succeed rather than to make losses or simply retain the initial investment.

(20) Mr Smith replied to a question from Mr Parry by saying that there were two success factors. These were firstly that the funds allocated by the Government would be used to make an economic impact in East Kent. This would potentially be true even if a company failed after a few years of providing technological development and employment. The second success factor was that investment should increase over time. Returns from investment would be re-invested and not be used for other purposes.

(21) Mr Smith replied to a question from Mr Birkby by saying that the Internal Appraisal Board referred to in paragraph 6.3 of the report was an advisory board to the Leader of the Council. It consisted of a range of directors from a wide range of different business experiences. Should the political composition of the Council change, it would be more than likely that the composition of the Board would change too. Since publication of the agenda papers, two more appointments had been made. These were Mr John Gilbey, Leader of Canterbury CC) and Mr Ron Roser, formerly Regional Director of Barclays Bank.

(22) Mr Dance said that longevity would be provided by the structure that had been established and which was already being replicated for *TIGER* and *Escalate*.

(23) Mr Whybrow asked whether the governance arrangements in relation to job creation would allow measures to be taken if a company which had received a loan was unable to meet its job creation targets. Mr Smith replied that Equity Investment was different from Grant or Loan in that it was not a subsidy. Decisions were based on commercial considerations. Loans were given on the basis of targets being met. The monitoring of the Equity Investments was going to replicate that for the Loan to establish whether the investment had been successful. To state that an Equity

Investment was conditional upon the creation of jobs would be in breach of State Aid Rules.

(24) RESOLVED that subject to those details currently unavailable being communicated to the Committee, the governance arrangements set out in the report be approved.

8. Establishment of a Transport Related Local Authority Trading Company
(Item 5)

(1) Before consideration of this item commenced, Members expressed dissatisfaction that the Exempt report to Environment and Transport Cabinet Committee on this matter had been appended as an open report but with certain passages redacted. The Chairman said that it would be preferable if reports were prepared with the Sub-Committee in mind and without redaction but that, in the event that a report did have to appear in this form again, he would expect the Exempt version to be circulated to all Members of the Governance and Audit Committee in full.

(2) Mr Burr said that KCC had invested in the Trip Rate Information Computer System (TRICS) database 25 years earlier within a consortium which also consisted of Hampshire, Dorset, East Sussex, Surrey and West Sussex County Councils. This software system had been very successful, achieving a high share of the market and being nationally recognised as the best system to use in transport planning.

(3) Mr Burr continued by saying that *JMP Consultants Ltd* had been awarded the contract to operate the database. This company had run into financial difficulties, leading the consortium to reconsider its position. The decision had been reached by the partners to develop a LATCO. KCC would have had the option of withdrawing from the company and hiring the software whenever it wished to use it. The set-up costs would be provided by monies already in the company.

(4) Mr Burr then referred to the business case in the papers, highlighting that 4 members of staff would be employed. Three of these would TUPE transfer from the existing supplier. The other member of staff would be a manager.

(5) Mr Burr said that audited accounts would be produced annually, although this was not actually required by Law. Legal advice had been provided to the consortium by *BA Beachcraft*. KCC had taken its own advice from KCC Legal Services and from the Corporate Director of Finance and Procurement. The company was limited by share at an equity of £35k.

(6) Mr Burr summed up his presentation by saying that the company was limited by share, the software was a successful and well-proven product. There was very little risk attached to becoming a formal shareholder rather than stepping out of the company and buying into use of the product at a later stage.

(7) Mr Burr responded to a question from Mr Birkby by saying that as the consortium would now be delivering the product itself there would be no risk of a private company failing to deliver due to its own financial difficulties.

(8) Mr Sarrafan responded to a question from Mr Parry by saying that the legal position in respect of a potential breach of contract had been examined. There was no risk in this regard because the company to whom the contract had been awarded was no longer in existence. Although the parent company had been operating the service, there was no actual contract with them to do so. There had been no novation clause and therefore no significant risk of challenge. Since production of the appended report in September 2014, there had been no challenge and the new company would start trading on 1 January 2015. The insolvency of the *JMP Consultants Ltd* had made it possible for a change of control to take place.

(9) Mr Whybrow referred to paragraph 4 4.3.5 of the appended report. He asked whether the consortium would receive the customer database system. Mr Sarrafan replied that following negotiations, the consortium now owned the database, which was currently being managed by the private company but would come over to the new company when it started trading. No important intellectual property resided with the contractor.

(10) Mr Smyth asked whether it would be possible for the current managing company to set up a company in competition with the consortium using the names that the consortium itself was not entitled to use. Mr Sarrafan replied that the trademark, brand name and website belonged to the consortium even though they had been registered by the managing company.

(11) Mr Smyth referred to paragraph 10.6 of the appended report which stated that there was a requirement for decisions taken by the new company to be unanimous, whereas the next paragraph set out the requirement for the decisions made by the Board of Directors to be made by a majority decision.

(12) The Chairman suggested that the answer might be that decisions made by the parties as shareholders would need to be unanimous, whereas decisions made by directors (in a different forum) would be by a majority. Mr Burr said that he believed this to be the case and would confirm at a later stage.

(13) Mr Bird said that he was concerned that if all parties were obliged to agree, there was a possibility that the result could be an impasse. He asked what would happen if three of the parties had confidence in the managing director whilst the other three did not.

(14) Mr Bird then asked whether there was absolute certainty that all the intellectual properties would be transferred to the consortium in time. Mr Burr replied that he was confident that this would be the case because only the consortium would have the entitlement to use it. Anyone aiming to compete would need to start from scratch when the consortium itself had a two thirds market share.

(15) In response to a question from the chairman, Mr Burr confirmed that this would be a transfer of undertaking to which TUPE would apply. The three staff concerned would have the right to transfer if they so wished.

(16) Mr Birkby explained that he wished to abstain on the recommendation in the report as he was concerned over the redactions in the Appendix.

(17) On being put to the vote the recommendations were carried by 2 vote to 0 with 1 abstention.

(18) RESOLVED that the governance arrangements for the Transport Related Local Authority Trading Company be approved as set out in the report.