By:	**Mark Dance** **Cabinet Member for Economic Development** **David Smith** **Director, Economic Development**
To:	**Governance and Audit Committee - Thursday, 21st July 2016**
Subject:	**UPDATE ON THE GOVERNANCE OF THE DISCOVERY PARK TECHNOLOGY INVESTMENT FUND**
Classification:	**Unrestricted**

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1. Recommendation

1.1 On 23rd June 2016, the Leader of the Council approved the governance for implementing phase 2 of the Discovery Park Technology Investment Fund and the setting up of a new Investment Committee on the recommendation of the Expansion East Kent Investment Advisory Board ("IAB"). The details are set out in a report submitted by Narec Capital Limited ("NCL") to the IAB. This report is attached (Annex 4).

1.2 The Committee is invited to note and ratify these arrangements.

2. Issue

2.1 At its meeting on 27 April 2016, the Governance and Audit Committee Trading Activities Sub-Committee considered a Report on the Discovery Park Technology Investment Fund. The Sub-Committee resolved that the proposed governance for the Fund be endorsed subject to ratification by the Governance and Audit Committee at the next available opportunity (21 July).

2.2 The Sub-Committee was particularly concerned to establish that the Council had unqualified legal advice that the governance arrangements were robust and protected the Council's interests.

2.3 Two firms of legal advisers have signed off the arrangements (Hogan Lovells for the Fund and Geldards advising Kent County Council); the Council's Head of Legal has reviewed the arrangements; and the Council has appointed Directors to the Company Boards.

3. The governance and management of the fund

3.1 Kent County Council has invested £5 million from the Expansion East Kent Regional Growth Fund ("RGF") in the equity of companies eligible under the RGF rules applied by the Department for Business, Innovation and Skills ("BIS"). Each of those investments were made by KCC following advice from the IAB to the Leader of the Council.

3.2 Discovery Park Technology Investment Fund ("DPTIF") was established as a venture capital fund recognised by the British Venture Capital Association ("BVCA") and statutorily regulated by the Financial Conduct Authority ("FCA") operating under the rules of the European Securities & Markets Association ("ESMA ").

3.3 KCC's RGF equity investments are now held within this special vehicle company (DPTIF) to hold them in a manner that enables other investors also to invest in these companies as well as in other companies that meet the original RGF investment criteria ie companies that have significant potential to grow and create jobs in Kent and to generate future financial return to KCC as investor.

3.4 Narec Capital Ltd ("NCL") was appointed by Kent County Council ("KCC") as the fund manager for the DPTIF. The governance framework has two key features:

a) the RGF Investment Advisory Board (IAB) continues to advise the Leader of the Council on the RGF investment strategy, and

b) a new Investment Committee will manage the pool of DPTIF equity investments: this Committee will have five members two of whom are KCC appointments (Charlie Simkins and Nick Vickers) with a right of veto on all Committee decisions.

3.5 The DPTIF companies comprise:

a) A Limited Partner: KCC Initial LP Limited: this is the equity investment vehicle. This company is owned by KCC. The company has two directors appointed by KCC: the Director for Economic Development (David Smith) and KCC's Chief Accountant (Emma Feakins).

b) A General Partner: Discovery Park Technology Investments (GP) Ltd: This company is the manager of the fund, and is owned by NCL. The General Manager is responsible for the day to day management of the partnership and fund: the management of this company is accountable to an independent investment committee on which KCC has two representatives each holding the right of veto.

c) A Special Limited Partner: Discovery Park Technology Investments (SLP) Ltd. This company holds the equity 'carry' on behalf of the investment manager ie. the managers' performance incentive element. The SLP is owned by NCL.

4 Establishing the Fund

4.1 The report at Annex 1 submitted to the Trading Activities Sub-Group in November 2014 described the two phases for implementing these governance arrangements. In phase 1, the three DPTIF companies were set up, each wholly owned by KCC. In phase 2, the ownership of two of these companies was transferred to Narec Capital Ltd. This allowed the fund to start raising additional private capital and begin to expand the investment portfolio from the £5 million initially allocated by KCC to a target of £50 million by injecting funds from private sector investors.

4.2 On 23rd June 2016 the Expansion East Kent Investment Advisory Board (IAB) Chaired by the Leader of the Council approved the governance and appointment of the new DPTIF Investment Committee. The report submitted by Narec Capital Ltd (Annex 4) to the IAB explained the role of the three DPTIF companies, the terms of reference of the Investment Committee and the recruitment of the private sector members.

5. Narec Capital Limited (NCL)

5.1 NCL was procured by KCC to manage the DPTIF to undertake the following:

(a) Generate deal flow and filter investments so as to find companies which fit the specific fund mandate..
(b) Perform extensive commercial, financial and technical due diligence on selected companies.
(c) Negotiate investment terms (the term sheet) with prospective investee companies.
(d) Prepare due diligence reports and investment recommendations to be presented for approval to the investment committee.
(e) Manage investment transaction process including instructing lawyers to perform legal due diligence and negotiating and concluding investment documentation with investee companies.
(f) Manage external advisors to the business such as lawyers, auditors, insurance requirements and regulatory aspects
(g) Manage the cash flow requirement of the Fund to ensure that it remains a going concern.
(h) Preparation of quarterly management account and reporting to investment committee along the lines of the reporting obligations outlined below.
(i) Open and maintain a bank account for the partnership.

5.2 The key personnel within NCL responsible for day-to-day operations of the GP are as follows:-

- Jonathan Synett: Fund Manager DPTI and Investment Director - Narec Capital Ltd.
- Jerry Biggs: CEO - Narec Capital Ltd
- Martin Thorp: Director of Capital Markets - Narec Capital Ltd
- Alan Walker: Director of Technology – Narec Capital Ltd

5.3 NCL will report to the new Investment Committee as well as the IAB. The new Committee will consist of five members. Two of its members are being appointed by KCC; the other three will be chosen for his or her ability to assess high growth technology investments, proven track record of success and strong governance capability. The aim is to balance their skills and experience.

5.4 The job descriptions for members of the Investment Committee and the details of the selection panel are set out in Annex 4.

6. Background

6.1 Annex 1 is the paper submitted to the Sub-Committee in November 2014.

6.2 Annex 2 is the minutes of the Sub-Committee meeting held on 20 November 2014.

6.3 Annex 3 is the Report submitted to the Sub-Committee in April 2016.

6.4 Annex 4 is the Report submitted to the Investment Advisory Board by Narec Capital Ltd on DPTIF's Governance Structure.

6.5 Annex 5 is the minutes of the Trading Activities Sub-Committee meeting held on 27 April 2016.

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30th June 2016

Annex 1

By:	Mark Dance Cabinet Member for Regeneration and Economic Development David Smith Director of Economic Development
To:	Governance and Audit Committee Trading Activities Sub Group 20th November 2014
Subject:	The creation of a Discovery Park Technology Limited Partnership (LP)
Classification:	Unrestricted

Summary

This report sets out the governance arrangements for the establishment of an LP (LP) to make equity investments in small and medium enterprises where these have the potential to expand and create employment in East Kent. It is proposed that the activities of the LP will be financed by the Regional Growth Fund (RGF) and will complement existing RGF-funded loan schemes administered by KCC.

The Committee is recommended to approve the governance arrangements.

Recommendation:-

The Trading Activities Sub-Group is recommended to:-

(a) approve the governance arrangements as detailed below.

1. Background

1.1. Kent County Council currently administers £55 million from the Government's Regional Growth Fund for products offering direct access to finance for businesses seeking to expand and create jobs. This is delivered through three programmes:-

a) Expansion East Kent, worth £35 million operating in Ashford, Canterbury, Dover, Shepway and Thanet.
b) TIGER (Thames Gateway Innovation, Growth and Enterprise), worth £14.5 million and operating in Dartford, Gravesham, Medway, Swale and Thurrock.
c) Escalate (worth £5.5 million) (operating in Rother, Wealden, Hastings, Sevenoaks, Tunbridge Wells, Maidstone, Tonbridge & Malling).

1.2. Although Expansion East Kent, Tiger and Escalate are separate programmes with separate governance arrangements, they are all marketed as ‘repayable finance’ schemes. This means that they offer interest-free, normally unsecured, loans to eligible businesses on grant conditions which link the funding to a specific project and require employment and other outputs to be met. All repayments are reinvested in the programme to be recycled to future beneficiaries.

1.3. Expansion East Kent was launched in April 2012 and has, so far, issued loan agreements worth over £31 million, which will create over 1,800 jobs. Tiger and Escalate were launched in 2013 and have committed funds of over £19 million and will create 1,570 jobs.

1.4. While Expansion East Kent, Tiger and Escalate in the main offer debt finance, a number of business proposals have come forward seeking equity investment. In addition, the Expansion East Kent Investment Advisory Board[1] has considered a number of loan applications which could be better suited to equity investment. These equity investments may give a better return to the fund than the standard repayable finance model. In the case of three companies applying to Expansion East Kent, the Board has recommended equity investment as preferable.

1.5 Based on this, approval has been given to offer RGF-financed equity investment through the establishment of a Discovery Park Technology LP for the Expansion East Kent Programme only.

1.5. The proposed governance arrangements for an East Kent Investment Fund would operate according to the following principles:-

Principle 1: Source of investment

1.6. The company would only be able to invest Regional Growth Fund monies made available to it for the purposes of equity investment (i.e. it would not be able to invest KCC core funds or funding from other sources).

1.7. Because the Expansion East Kent RGF scheme is subject to separate grant agreements and governance arrangements, the company would operate separate funds for each, with the decision to make RGF funds available made by KCC as the accountable body for each scheme in accordance with the scheme investment strategy. This would mean that the LP would manage an Expansion East Kent Equity Fund in accordance with the grant agreements and investment strategy but could offer additional Equity Fund programmes if required at a future date.

Principle 2: Co-financing

[1] The Investment Advisory Board is the body established to consider applications to the Expansion East Kent fund and to make recommendations to KCC as the accountable body for the fund. It includes private sector representatives with a range of business experience and is chaired by the Leader of KCC.

1.8. All equity investments will need to be made on a commercial basis, with the same anticipated return as that sought by a private investor. Therefore, at least 50% of the proposed total equity funding must be secured through private sector investment.

1.9. There are various options available for ensuring the public sector equity funds are co-financed. Based on a preliminary assessment, it is proposed that private sector co-financing will be secured by Narec Capital prior to its application for funding[2]. Private investment sources may include business angels and angel syndicates, venture capitalists and potentially investment by the owners of the business.

Principle 3: Return and sustainability

1.10. The company will seek to make a commercial return on its investments, with an expectation that most shareholdings will be sold after 5 years.

1.11. All returns on investment will remain within the Expansion East Kent Investment LP and made available for future rounds of investment. The equity funds managed by the LP must therefore be *sustainable*, but they are not *perpetual*, as the decision on when and whether to close the funds rests with KCC but would be based on recommendations from the Sub-Committee.

1.12. In order to guarantee the sustainability of each fund, and to ensure that no illegal state aid is provided to business through the operation of the company, it will be necessary to charge an arrangement fee to cover management and administration costs. Typically, arrangement fees in public sector-backed equity schemes are between 2% and 5% of the investment amount; some schemes also charge annual monitoring fees. These charges will be at the cost of the fund and not KCC.

Principle 4: Transparency

1.13. The creation of a Discovery Park Technology Limited Partnership (LP) will mean that additional finance products can be offered by Expansion East Kent. It is proposed that the process for applying to the LP for equity investment will be marketed in the same way as the existing loan schemes, with criteria and application details published openly.

2. The case for offering RGF-financed equity investment

2.1. Expansion East Kent aims to address a general market failure, as banks remain reluctant to lend despite the range of Government initiatives designed to increase general lending. It also aims to provide direct support to those businesses with the potential and appetite for growth and job creation.

[2] The proposed arrangement is used by a number of public-sector backed equity funds, including Finance Birmingham and the Scottish Seed Fund (managed by Scottish Enterprise). Alternative arrangements include the creation of a 100% co-financed fund with a private sector investor, or the designation of a limited number of 'approved' private investment partners. The merits of these options need to be considered in further detail, although the flexibility of the proposed option appears (on an early assessment) to be preferable.

2.2. Successive national surveys have demonstrated that there is a gap in the supply of limited amounts of equity finance to SMEs with high growth potential. This is because the cost of assessing the likely risk and return on smaller investments encourages private investors to focus on more established, lower risk businesses at the expense of early stage venture capital, especially in a more risk-averse general economic environment. This means that potentially high growth businesses lack access to investment, with the gap commonly thought to be in market provision of investments between £250,000 and £2 million[3]. Although there are no specific local surveys of the equity gap, anecdotal evidence from High Growth Kent suggests that it is as prevalent as in the rest of the country and is likely to be especially challenging in East Kent. Limited supply of equity investment also has a circular effect in limiting demand, with many businesses lacking information on equity finance[4].

3. State aid considerations

3.1. Within the Government grant agreements for Expansion East Kent, Kent County Council is permitted to make equity investment with RGF funds where this is offered as 'aid in the form of risk capital'. This enables public funding to be invested in a company provided the investment is made on commercial terms. To provide assurance that that the investment is commercial, equity from the public sector fund may only be made available on an equal basis with finance from a private investor (i.e. the size of the investment made by the private investor should be at least equal to the public sector investment, and the terms of the investment should be identical). All public sector equity funds operate on this basis.

4. Legal Advice

4.1. Legal advice has been sought from KCC's Legal Team, Geldards (acting as a sub-contractor to KCC) and Hogan Lovell (specialist in corporate law) regarding the vehicle which would be required to enable KCC to make equity investments using RGF funding. The advice received states that the type of vehicle required depends on the purpose for which the equity investment is being made.

4.2. Firstly, if company shares are being acquired for a non-commercial purpose (for example, to improve general well-being), KCC could rely on Section 12(a) of the Local Government Act 2003, permitting the Council to invest directly without the need for a company to be established.

4.3. However, if shares are being acquired for a commercial purpose (i.e. if KCC intended to subsequently sell the shares at a commercial rate of return), Section 4(2) of the Localism Act 2011 states that a company would need to be established for that purpose.

4.4. Based on this legal advice, officers have considered that KCC's power to purchase shares should derive from **Section 4(2) of the Localism Act**, and that an LP should be established, for two reasons:-

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[3] BIS/ SQW Consulting (2009), The supply of equity finance to SMEs: Revisiting the equity gap

[4] BIS (2012) Economics Paper 16, SME Access to External Finance

4.5. Firstly, the state aid rules state that public sector equity investment should be made on the **'market economy investor principle'**. This states that KCC should invest in the expectation that it will receive a return in due course at the same level as that which would be acceptable to a private investor. The state aid basis of equity investment is therefore different from the interest-free loan products currently offered by Expansion East Kent, since while the latter are explicitly non-commercial forms of state aid. Consequently, it is considered that KCC's investment should be considered commercial, even though the reasons for establishing the fund are to support wider economic growth, rather than KCC's financial gain.

4.6. Secondly, analysis of existing schemes in the UK shows that where local equity investment funds have been established with public funding, they have usually been set up via separate company vehicles, investing alongside a private sector investor. This includes cases (such as Finance Birmingham) where the fund capital derives from the local authority[5].

4.7. Given that KCC's investment should be considered commercial to ensure compliance with state aid regulations, and based on experience elsewhere, establishing an LP as provided for in the Localism Act therefore appears preferable.

4.8. KCC has issued a Commitment Letter to Narec Capital ('NC') dated October 15, 2014 whereby it agrees in principle to commit £5 million into an Equity Investment fund ('Fund'), in which it will be the initial sole partner and of which Narec Capital will be manager. The Fund is to be established in accordance with the submissions and documents provided to KCC and prepared by the legal firm Hogan Lovells.

<u>Notes</u>

1. Narec Capital East Kent Incubator LP (the "Fund") should be established as a limited partnership. This is a tax transparent vehicle that PE and VC investors are familiar with (thereby facilitating raising third party capital in due course). The LP will also facilitate the grant of carried interest as this is in accordance with the BVCA and HMRC MoU on carried interest.

2. The General Partner and the Special Limited Partner (which receives the carried interest) will be established as wholly owned subsidiaries of KCC, so that all of the participants in the Fund are in the same corporate group. This ensures that the Fund is not a collective investment scheme for UK regulatory purposes during Phase 1.

3. ExEK Investment Advisory Board (IAB) will be the committee of the General Partner and will be responsible for the investment activities of the Fund during Phase 1. The Board will have the benefit of advice

[5] It should be noted that we have not undertaken an analysis of the legal basis for the establishment of the various publicly-backed equity schemes around the UK. However, in practice, these schemes conventionally operate through company structures.

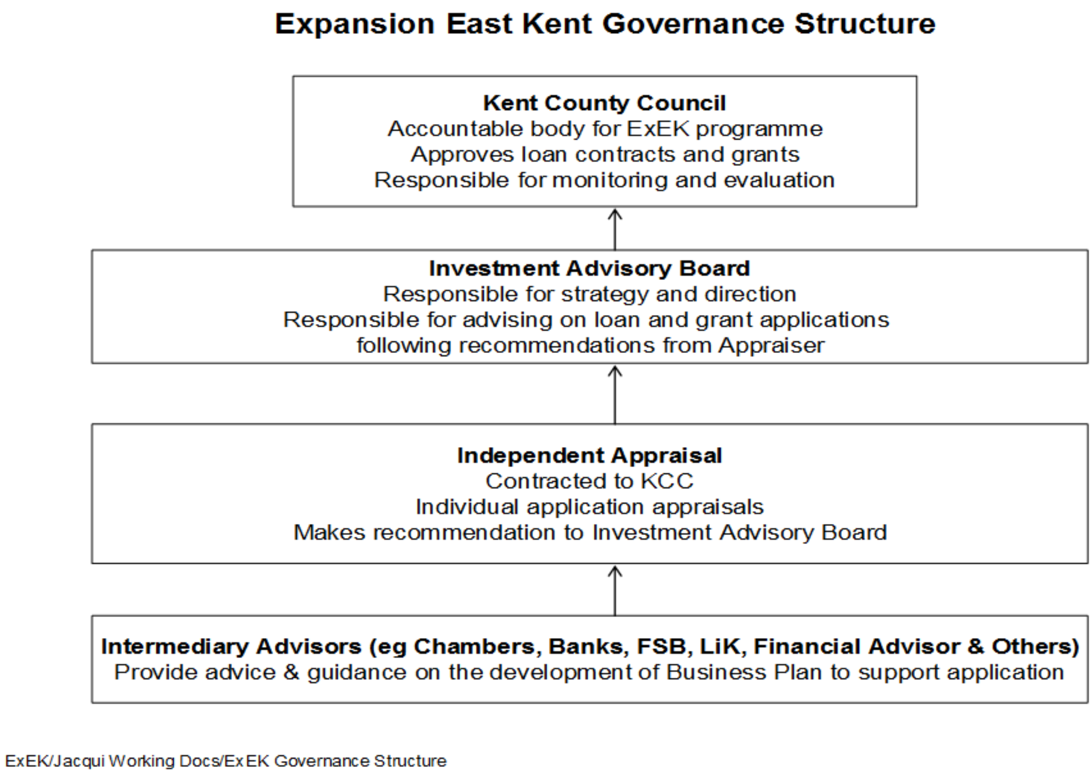
provided by Narec Capital in its capacity as an authorised representative of its FCA regulated parent company.

4. The Special Limited Partner will assign carried interest to the intended recipients on establishment of the Fund.

5. Governance Arrangements

5.1 In May 2012 KCC accepted the role of accountable body for the Expansion East Kent funding programme. The governance arrangements for the programme were also approved by the Cabinet Committee on 14th May 2012. The following paragraphs set out the proposed way in which the current governance arrangements will be maintained whilst incorporating the LP. The structure was formed following consultation with Legal and Democratic Services and is in line with the principles of the fund.

5.2 The diagram below sets out the governance structure that has been in place since 2012. This structure maintains a balance between independent, private sector advice and clear accountability.



5.3 The ExEK IAB will approve all investments. The proposals for equity investment will be presented to the Board (please see Annex 2 for structure diagram). The full membership of the ExEK IAB is as follows:-

Paul Carter (Chair)
Mark Dance (Vice-Chair)
David Smith
Miranda Chapman (Managing Director, Pillory Barn Creative - Media)
Ian Ellis (Director, McCabe Ford Williams - accountancy)
Professor Simon Howell (Kings College, London University)
Ron Roser (LBS Finance)
John Gilbey (Leader of Canterbury City Council)
Elias Dencker (Renewables Strategy)
Eliot Forster (Managing Director, Creabilis SA – pharmaceutical R+D)
Laura Sandys MP

5.4 The ExEK IAB will approve each investment and the Fund Documents must reflect that stipulation by the Board. In practice, IAB and Narec Capital shall work closely together with KCC to ensure that this process is efficient.

5.5 KCC has raised the prospect of grandfathering existing investments into the Fund. The Fund documents will therefore allow for the concept of KCC and Narec Capital agreeing that certain existing KCC equity investments may be grandfathered into the Fund and thus managed by Narec Capital under the Fund.

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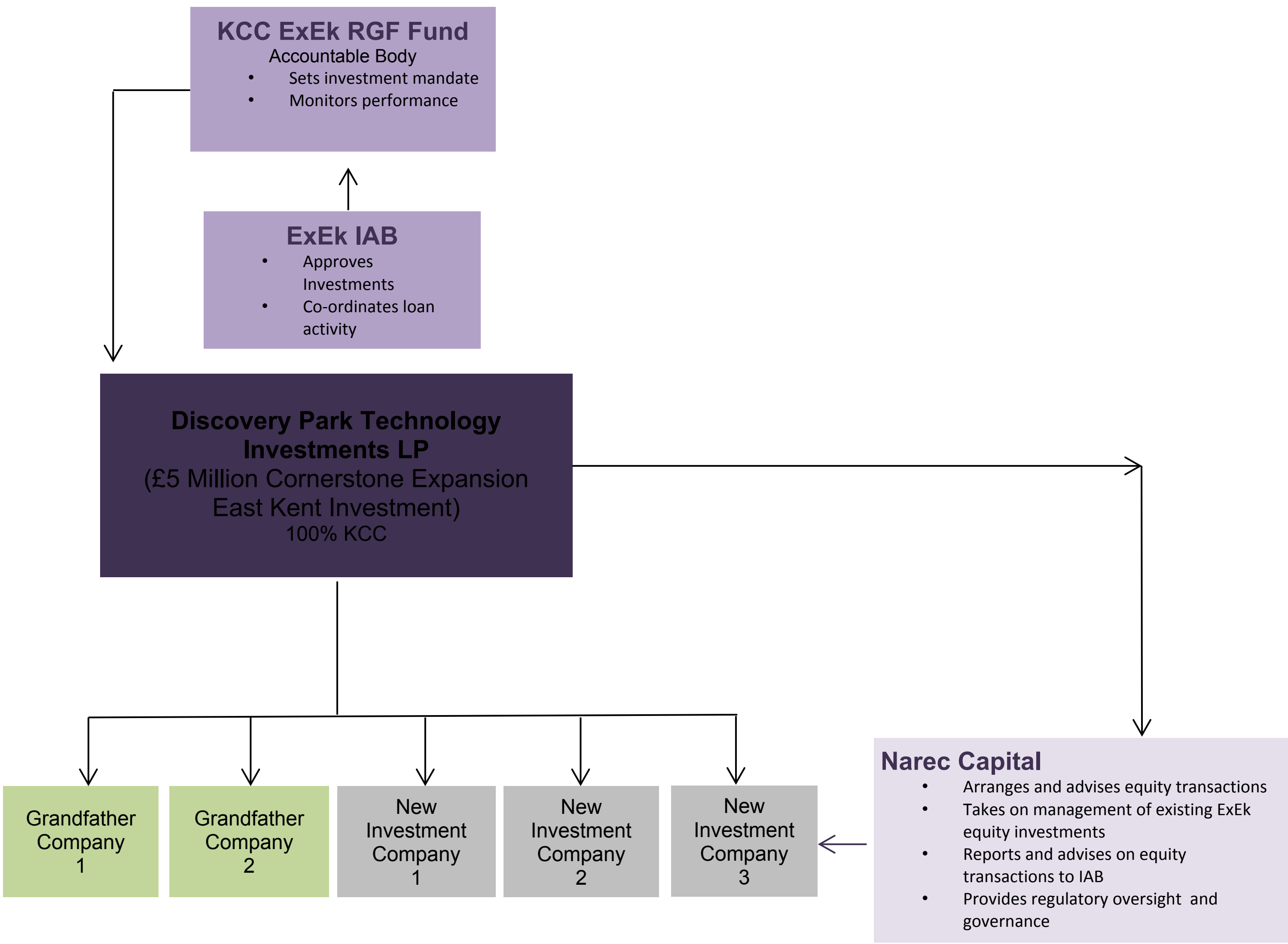
ANNEX 1

Fund Structure	English (regulated by English Law) Limited Partnership. Initially contained within a captive investment vehicle for Expansion East Kent, before converting to an AIFMD approved CIS scheme.
Investment Objective **Location** **Economic Impact** **Commercialisation**	To invest in high growth sustainable energy and lifescience / medical technology SME's, focused around the East Kent area. SMEs will locate at Discovery Park or the surrounding East Kent area. The fund will seek to maximise economic impact within East Kent (inward investment, tax returns, local employment). The initial tranche of £5m from ExEK will leverage £45m of private capital into the fund (on transformation to CIS status) and £150m of captive co-investment. The investment plan will generate 500+ high value jobs on exit, within the East Kent area. SMEs will be subject to a robust commercialisation process led by Narec Capital and agreed upfront with each company
Target Fund Size	Up to £50 million (£5m initial tranche from ExEK)
Minimum Fund Size	£5 million
Minimum Commitment	Minimum investment for any future Limited Partner is £500,000 (50 Participations)
Participations	Participations will be of £10,000 each consisting of £1 of partnership capital and £9,999 of partnership loan. Commitments to the Fund are legally committed on admission to the Partnership
Carried Interest	The Founder Partner is entitled to carried interest of 20% of net profits from the Fund after amounts contributed have been returned to investors. There is no hurdle
Term	10 Years
Investment Criteria	The Fund will invest in companies producing sustainable energy and life science / medical related technologies and products. The Investment Policy will be set out in accordance with the rules of the relevant RGF fund parameters.
Reporting	Investors will receive a six monthly update report on the investments in the portfolio and an annual report and accounts which will constitute periodic statements for

	the purposes of FSMA. In addition, ExEK IAB will also receive updates regarding economic impact analysis (jobs, leveraged investment) in order to track and monitor key RGF outputs.
Set-up Costs	1% of total commitments to the Fund up to a maximum of £500,000 (limited to £50,000 during initial ExEK tranche)
Management Fees	A management fee of 3% of total commitments to the Fund per annum whilst below £15m, moving to 2% when £15m+ is achieved. *(Both set-up costs and management fees will be taken from the fund allocation of £5 million)*
Operating Expenses	The Fund will be responsible for ongoing operating expenses relating directly to the Partnership, including the annual fees of the Operator and all audit, accountancy, valuation, legal and other professional fees
Investment Committee	The Investment Committee provides final approval of all investments. KCC will have the right to assign 2 x Directors to the committee (with veto rights). Details of the Investment Committee are set out in the accompanying legal documentation.
ExEk IAB	The ExEK IAB will advise set this investment mandate, maintain oversight of the performance of the fund and key economic outputs via regular updates from the funds Investment Committee.
Target Initial Closing Date and Next Steps	Initial tranche of £5m (ExEk) by September 2014. Remaining £45m once the permissions are in place to convert the fund to CIS status by April 2015.

Annex 2 – Proposed Fund Structure & Governance (Phase 1)



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.

Annex 3

By:	**Mark Dance** **Cabinet Member for Economic Development** **David Smith** **Director, Economic Development**
To:	**Governance and Audit Committee** **Trading Activities Sub-Committee** **27 April 2016**
Subject:	**DISCOVERY PARK TECHNOLOGY INVESTMENT FUND: DEVELOPMENT OF THE FUND AND CHANGES TO GOVERNANCE STRUCTURE**
Classification:	**Unrestricted**

Summary

Following the Governance and Audit Trading Activities Sub-committee held on 20th November 2014, *"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"*

This report provides details of the changes to the Governance structure of the Discovery Park Technology Investment Fund (The Fund).

It is proposed that the governance and structure of The Fund are changed to enable it to raise additional private capital and expand on investment.

This report sets out the business case for changing the structure of The Fund and details the proposed structure, the risks to KCC and how these will be mitigated; and the next steps in taking the proposed structure forward.

Recommendations

The Trading Activities Sub-Committee is recommended to:-

a) ENDORSE the proposed Governance structure for The Fund.

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1. Introduction: Equity Investments

1.1 On 30th April 2013 the Expansion East Kent Investment Advisory Board approved amendments to the Investment Strategy to allow applicants the opportunity to apply for equity investment finance. The Expansion East Kent programme has offered equity investments from May 2013 to the present day. The aim of the investments from this Regional Growth Fund allocation to KCC is to bring forward products from the research and development stage to commercialisation. This finance enables companies to upscale their developments when loan finance is not appropriate or available.

1.2 The other two Regional Growth Fund programmes, TIGER and Escalate, have adopted the same strategy as the Expansion East Kent programme. All three programmes are under the same KCC governance arrangements.

1.3 The Governance and Audit Committee taking place on Wednesday, 27th April at 2.00 pm has been presented with a report on KCC's investment strategy in respect of equity investments from its Regional Growth Fund.

2. Expansion East Kent equity funding allocation

2.1. The Investment Advisory Board agreed in 2014 to allocate £5 million from the overall Regional Growth Fund allocation to offer equity investments in accordance with the EU regulations governing state aid for industry.

2.2. In September 2014, the Investment Advisory Board endorsed an application from Narec Capital Ltd. (a fund manager regulated by the Financial Conduct Authority) to advise and to manage KCC's investments from the £5 million allocation, with a view to leveraging additional private funding in future years. Following independent appraisal, the Leader of the Council approved the commitment of £5 million in October 2014 for eqity investments under Narec Capital's management, subject to individual approval of each equity investment by Kent County Council.

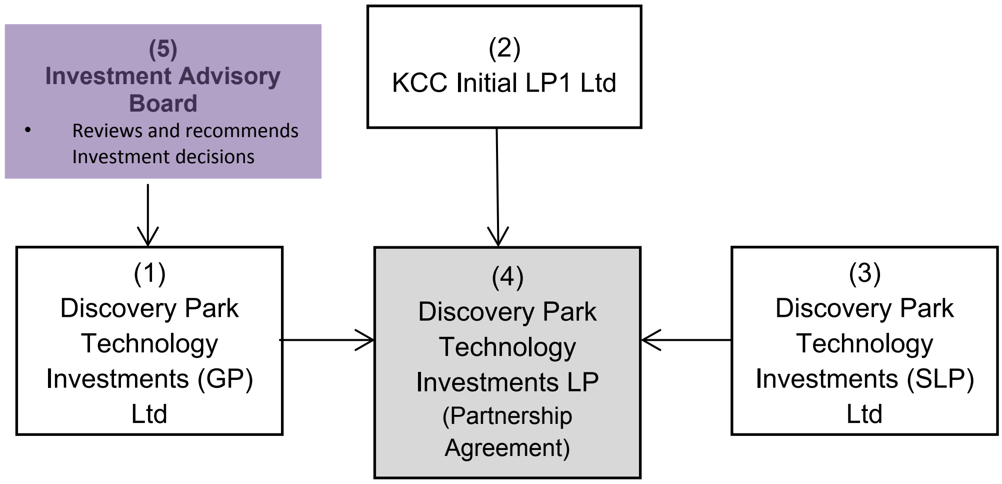
2.3. As the proposal required the creation of special purpose companies by KCC. This was reported to and endorsed by the Trading Activities Sub-Committee in November 2014.

2.4. The investments are made in the name of Kent County Council and Narec Capital Ltd. is overseeing the management of these investments. By June this year, it is anticipated that all of the allocation will have been invested.

The Discovery Park Technology Investment Fund

2.5. The **Discovery Park Technology Investment Fund (The Fund)** was formally agreed between KCC and Narec Capital Limited in December 2015. This structure has required the creation of three special purpose companies and a partnership agreement, the details of which are as follows:-

Fig. 1: Current Governance Structure



Roles and responsibilities:

1. **Discovery Park Technology Investments (GP) Ltd:** This is the 'General Partner', a limited company established to act as the manager of the Fund. This company is 100% owned by KCC, with investment advice provided by Narec Capital Ltd. The Director of Economic Development is the sole director of this company.

2. **KCC Initial LP1 Ltd:** This is a limited company established to act as the equity investment vehicle on behalf of KCC. This company is 100% owned by KCC. The Director of Economic Development is the sole director of this company.

3. **Discovery Park Technology Investments (SLP) Ltd.:** This is the 'Special Limited Partner', a limited company established to hold the fund manager's performance incentive. This company is 100% owned by KCC. The Director of Economic Development is the sole director of this company.

4. **Discovery Park Technology Investments (LP):** This is the Limited Partnership Agreement that legally connects the Companies (1, 2 & 3 above) and a separate agreement sets out the arrangements between Narec Capital and KCC.

5. **Investment Committee:** This is the Expansion East Kent Investment Advisory Board, chaired by the Leader. The IAB considers and recommends possible investments. Kent County Council is the accountable body.

3. The Discovery Park Technology Investment Fund: Proposed Changes

3.1. It is proposed as of 1st May 2016 that the governance of the Fund is changed, so that it can become open to external private investors, as well as KCC. The proposed structure is illustrated below. The structure is designed to preserve KCC's interests in respect of its RGF investment, while providing a legal framework which is familiar to private investors. We have been advised by Hogan Lovells that this structure is the same as that adopted by Venture Capital and other equity funds.

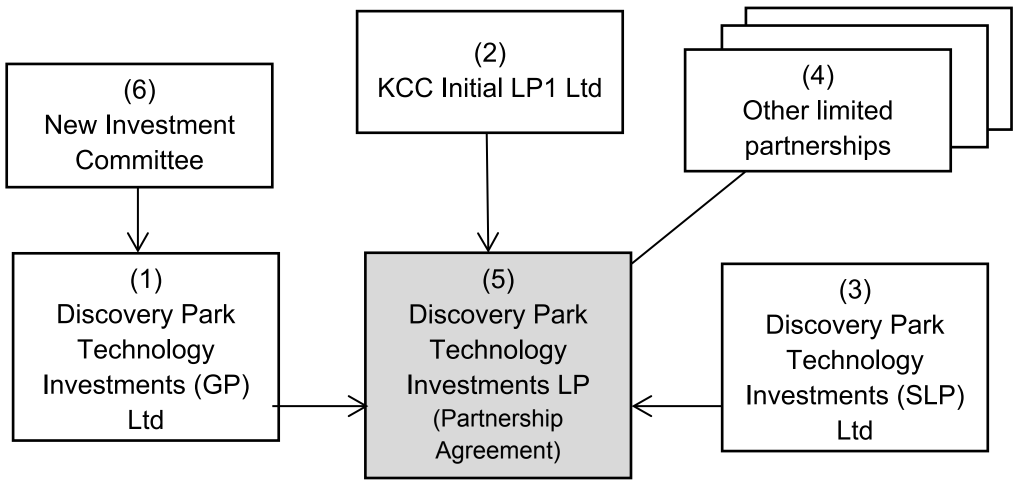
3.2. In order to open the fund to external investors, the ownership of the General Partner (1 above), responsible for fund management, and the Special Limited Partner (SLP) (3 above) will transfer from KCC to Narec Capital Ltd.

3.3. KCC will retain 100% ownership of KCC Initial LP1 Ltd., which holds KCC's investment in The Fund. Other limited partnerships can then invest in The Fund, alongside KCC, as investment agreements are reached with Discovery Park Technology Investments LP (see 5 below).

3.4. A new Investment Committee will be established to look after the interests of all limited partners, including (but not exclusively) KCC.

3.5.

Fig. 2: The Fund - Proposed New Governance Structure



Roles and responsibilities:

1. **Discovery Park Technology Investments (GP) Ltd.:** This is the 'General Partner', a limited company established to act as the manager of the Fund. This company will be 100% owned by Narec Capital Ltd.

2. **KCC Initial LP1 Ltd.:** This is a limited company established to act as the equity investment vehicle on behalf of KCC. This company is 100% owned by KCC. The Director of Economic Development will continue to be the Director of this company.

3. **Discovery Park Technology Investments (SLP) Ltd.:** This is the 'Special Limited Partner', a limited company established to hold the fund manager's performance incentive. This company will be 100% owned by Narec Capital Ltd.

4. **Other Limited Partnerships:** These are private investors, investing in The Fund alongside KCC.

5. **Discovery Park Technology Investments (LP):** This is the Limited Partnership Agreement that legally binds the partners (KCC and private) to the Fund.

6. **New Investment Committee:** This is the committee that makes investment decisions and monitors performance, with KCC and private sector members.

3.6. As The Fund will no longer be in the sole ownership of KCC, it is intended that Narec Capital will report into a new, independent, Investment Committee. The Leader will nominate two members for this Committee. In total, the Committee will be made up of up to five members, with a chairman who has a successful background in venture capital.

3.7. The members appointed by KCC will have veto rights over any investment made using KCC funds, and will report back to the Investment Advisory Board (or other structures that KCC may establish) to monitor KCC's investment portfolio.

3.8. Narec Capital Ltd. has initiated a recruitment process to appoint members of the Investment Committee. It is envisaged that private sector members of the Committee will receive remuneration, with a view to incentivising sustainable fund growth. This is likely to mean that remuneration will be based on a combination of monthly retainer, success fees for raising additional capital and equity carry.

3.9. The terms of reference for the Investment Committee will include assessing and making decisions on investments, ensuring that the Fund operates within FCA and other regulatory principles and ensuring regular performance reports.

3.10. Currently, Narec Capital Ltd. is required to provide monitoring reports on the investment portfolio to KCC via the Investment Advisory Board at least twice a year and the KCC members will report to the Investment Advisory Board and the Leader.

3.11. While KCC's representation on (and control over) the Investment Committee will be diluted, this will be compensated by the enhanced venture capital expertise that the Investment Committee is likely to attract, and by private sector investors joining The Fund. KCC will retain control in the new structure of decisions relating to those investments that are made utilising KCC funds.

3.12. As the Fund is structured as a limited company, it will be required to file publicly available audited accounts. The arrangements also require it to produce regular management accounts. It will also be required to procure an independent audit of all of its activities in accordance with company law.

4. Legal, procurement and matters relating to KCC's wider corporate responsibility

4.1. The proposed structure has been developed with advice from KCC Legal, Geldards (acting on KCC's behalf) and Hogan Lovells, a corporate law specialist. Prior to the transfer of ownership that the proposed new structure envisages, detailed terms of reference and operating procedures will be developed with KCC Legal and with Procurement advice.

5. Recommendation

5.1. The Trading Activities Sub-Committee is recommended to:-

a) ENDORSE the proposed governance structure for The Fund.

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5 April 2016

Annex 4

Discovery Park Technology Investment Fund

Governance and Appointment of Investment Committee

June 2016

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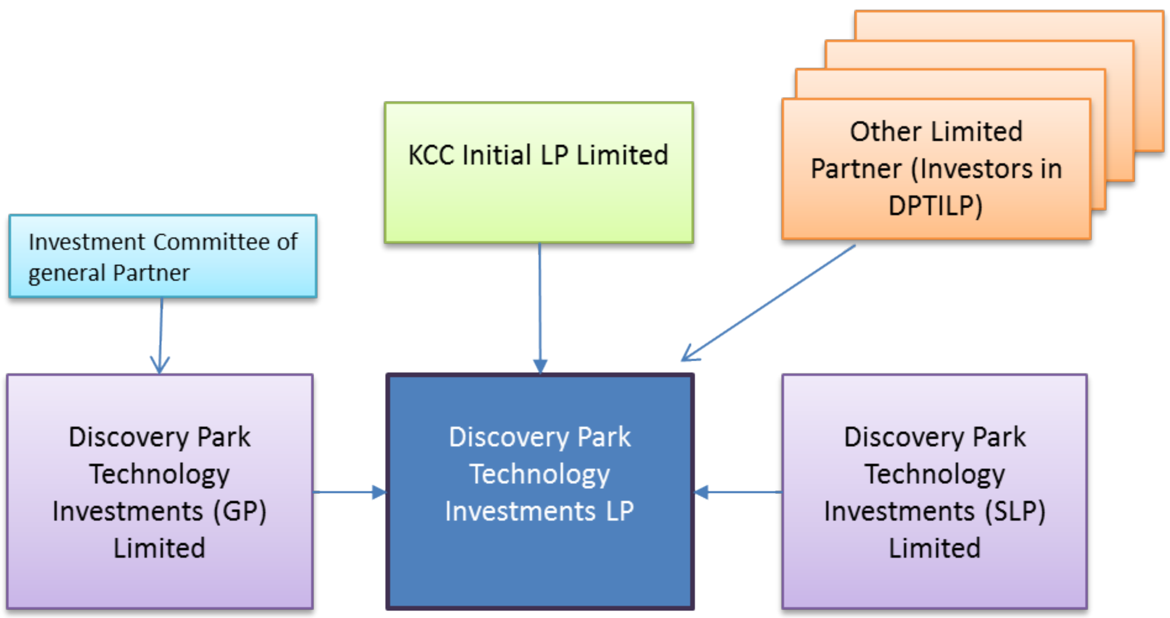
Section 1: Introduction

Discovery Park Technology Investments LP ("DPTI" or "Fund"), has been established to assist Expansion East Kent, in the deployment of equity capital into high technology SME's based in East Kent and to maximise the potential to attract inward investment via private funding sources. Narec Capital Ltd ("NCL") has been procured by KCC to act as the discretionary fund manager for the DPTI.

To successfully attract private finance, the DPTI has been established as a typical venture capital fund, as recognised by the British Venture Capital Association (BVCA) and Financial Conduct Authority (FCA). The fund has been established under a EuVECA structure and is governed by both the European Securities & Markets Association (ESMA) and the FCA. NCL is a Registered Alternative Investment Manager with the FCA.

The legal documentation has been prepared independently by Hogan Lovells Fund Management practice. The DPTIF is governed under a Limited Partnership Agreement ("LPA"), as shown in by the blue box, entitled Discovery Park Technology Investments LP. The LPA legally binds the partners to the fund.



There are three companies set up which form the partnership are as follows:

Limited Partner: KCC Initial LP Limited: A limited company established to act as the equity investment vehicle on behalf of KCC/ExEk. This company is owned by KCC.

General Partner: Discovery Park Technology Investments (GP) Ltd: A limited company established to act as the manager of the fund, owned by NCL. The General Manager is responsible for the day to day management of the partnership and fund and within its structure, the management are accountable to an independent investment committee (shown in the light blue box in the chart above). The details of this committee and the governance of that are outlined in Section 2 below.

Special Limited Partner: Discovery Park Technology Investments (SLP) Ltd: A limited company established to hold the equity 'carry' on behalf of the investment manager ie. the managers performance incentive element of their remuneration entitlement. The vehicle is owned by NCL.

One of the reasons that the structure has been set up in this way is to allow for other funders to join the limited partnership as shown in the orange box in the chart above. Those funds would then be co-mingled with KCC within the DPTI structure and be subject to the same governance provisions.

The DPTI has made 5 investments to date and the Investment Advisory Board of ExEK have approved a further three investments due to take place over the coming weeks and months, one of which is a second investment into a business in which the DPTI is already an investor.

Section 2: The General Partner

The General Partners is responsible for the management of the fund with a set of rights and obligations as set out in the LPA. Governance of the GP is broken down into three categories. Operational Management, Investment Committee and External Advisors

Operational Management

NCL were procured by KCC to manage the DPTI and have been doing so on an arms length basis via an investment advisory agreement for the last 18 months. The team at NCL is made up of seasoned investment professionals with skills across a variety of disciplines including investment management, corporate finance, commercialisation and engineering.

The key functions of NCL as owner and operator of the GP are as follows:

1. Generate deal flow and filter investments so as to find companies which fit the specific fund mandate as outlined in the LPA
2. Perform extensive commercial, financial and technical due diligence on selected companies.
3. Negotiate investment terms (term sheet) with prospective investee companies.
4. Prepare due diligence reports and investment recommendations to be presented for approval to the investment committee.
5. Manage investment transaction process including instructing lawyers to perform legal due diligence and negotiating and concluding investment documentation with investee companies.
6. Manage external advisors to the business such as lawyers, auditors, insurance requirements and regulatory aspects
7. Manage the cash flow requirement of the Fund to ensure that it remains a going concern.
8. Preparation of quarterly management account and reporting to investment committee along the lines of the reporting obligations outlined below.
9. Open and maintain a bank account for the partnership.

The key personnel within NCL responsible for day-to-day operations of the GP are as follows:

Jonathan Synett: Fund Manager DPTI and Investment Director - Narec Capital Ltd.

- Managed investment portfolios for two Ultra High Net Worth's, investing across a variety of sectors including technology, renewables and healthcare
- Selection and active Board Membership through to exit of several successful SME's
- Founder of high growth health and wellness business, EasyGroup new ventures business manager and developer of UKs first reverse auction website
- Holds an MBA from INSEAD.

Jerry Biggs: CEO - Narec Capital Ltd

- 15 years of investment management and direct technology investing experience
- Previously a founding partner of Ashberg Ltd, a private investment office focusing on technology and infrastructure projects
- Founded NCL after creating a spin out from the National Renewable Energy Centre
- Actively worked on the successful commercialisation of multiple disruptive technology SME's and projects,
- Holds various Board positions on a number of portfolio companies
- Previous experience as Sales Director with NTGI, HSBC and HBOS
- Holds the IMC, IAQ and is an FCA Approved Person (CF1/CF30).

Martin Thorp: Director of Capital Markets - Narec Capital Ltd

- 40 years of investment experience with technology SME's
- Founded and became Global MD of Arthur Andersen's global corporate finance practice, where he led numerous high growth SME transactions, debt structuring, IPOs and public placements, creating over $2bn in shareholder value; including start-up to FTSE 100 (Psion, Ultra Electronics) and numerous other private and public high growth, roll-up, MBO, MBI, trade sales and IPOs, restructurings and turnarounds.
- Has been an executive director and shareholder in several disruptive technology public and private companies, in both high growth and restructuring situations.

Alan Walker: Director of Technology – Narec Capital Ltd

- 35 years as an applied engineer, with a wide breadth of practical technology experience
- Previously Technology Innovation Director at Narec and was one of the founders of Narec Capital, before its spin out into NCL
- Specialist in rotating machinery, condition monitoring, process/pharmaceutical filtration and the integration of energy technology both conventional / renewable
- Acted as a technology diligence specialist for both public and private sector funds, with Pera Technologies
- Holds a degree in Aerospace systems.

Reporting Obligations

NCL are already mandated to monitor the portfolio on an ongoing basis via the Investment Advisory Agreement to KCC. In principle this means that we interact daily with the management teams of all of the companies, particularly as most of them have a physical presence within our incubator programme at Discovery Park.

Each investment made, under the shareholders agreement and articles of association for the company, imposes and acts on a series of investor rights. These rights are mainly to do with the disclosure of the relevant information necessary to make informed opinions about the state of the company and the risk to the investment at any particular point in time e.g. regular management accounts, financial forecasts, sales pipelines etc.

NCL imposes and acts on its right with each portfolio company to place either a Non-Executive Director, or observer on the Board of the portfolio company. The type of role and level of responsibility is negotiated with the company and other investors but typically depends on the size of the investment made and quantum of risk that the DPTIF is exposed too.

Within the legal constitution of the DPTIF, NCL is mandated to report to the Investment Committee (IC) or the IAB at present, at least twice annually. This report covers performance and risk within the portfolio. The fund will be audited by an independent auditor, whose report will also be included as part of the process.

NCL also report into the IC/IAB on a monthly basis to update them on fund progress, new investments, issues etc. The IC/IAB have full discretion over any investment decision taken and can veto an investment proposed by NCL at any stage.

The Investment Committee

NCL will report into an independent Investment Committee. The committee will be made up of five members and overseen by an experienced Chairman. Each member will be chosen for their ability to assess high growth technology investments, proven track record of success and strong governance capability. The members of the Investment Committee should complement each other in terms of their skills and experience.

The investment committee will have the following functions:

1. To monitor performance of the GP and the fund
2. To ensure adherence to the investment mandate and that veto's are taken into account
3. To assess and make decisions on any investment, as presented by the GP
4. To ensure that appropriate third parties (e.g. lawyers, auditors, accountants) are appointed by the GP on behalf of the fund
5. To ensure that audited reports and accounts are presented by the GP and scrutinised, as per the requirements set out for the GP on an annual basis
6. To ensure that formal reports are given by the GP every quarter outlining:
   a. Performance
   b. Financial statements
   c. Valuations
   d. Any other information reasonably requested by the LP's
7. To ensure that the fund and its partners remain solvent at all times and that appropriate fees and expenses are dispersed
8. To decide on any distributions by the fund made from investment income, in line with the investment mandate
9. Ensure that the fund and its partners operate inside the regulatory principles as set out by both the FCA and ESMA at all times
10. To ensure good governance and best practice is maintained for the fund and its partners

Of the five members of the investment committee, 3 of them, including the Chairman will be appointed by NCL. The remaining 2 will be appointed by KCC. These two members will be charged with overseeing any investments made utilising monies invested by KCC/ExEk, as well as providing public sector balance to the committee. The members appointed by KCC will have veto rights for any investment made, using monies from KCC/ExEk. The two members will report back to KCC/ExEk, either via the IAB or any future structure established to monitor KCC's ongoing investment portfolio.

A recruitment process will be run and managed by NCL to appoint the remaining three members of the investment committee. The full recruitment process together with job specifications for each position and an existing shortlist of candidates is detailed in the appendices to this document.

The target completion date for the recruitment of the investment committee is July 31st 2016. Until the full investment committee is in place, the Fund will not be authorised to make any new investments with the exception of those already agreed by the ExEK Investment Advisory Board.

The Investment Committee will, at a minimum, meet 9 times a year but may be requested to meet more regularly by NCL if it is necessary to assess a specific investment. Other than in situations described above where the KCC members have a veto right, the Investment Committee will act by majority with the Chairman carrying the casting vote.

External Advisors and Service Providers to the General Partner

Banking

Barclays Bank: Narec Capital Ltd are in the process of setting up a bank account in the name of the DPTI with Barclays Bank.

Legal

Hogan Lovells: An international law firm that specialises in fund structuring (Hogan Lovells) was appointed to give independent legal oversight for the establishment of the fund. Hogan Lovells prepared all the paperwork and contractual agreements which set out the legal framework for the operation and governance of the Fund.
Geldards: A second law firm - Geldards - were also appointed by KCC to give further independent legal opinion on the commercial terms being agreed with the manager.
Cripps: On a transactional level, Cripps have been performing due diligence on the investee companies and preparing the investment paperwork on behalf of the investee companies and the Fund. It is possible that in future the legal representation used by the Fund will change and if so, this will be on the recommendation of NCL and authorised by the Investment Committee.

Auditors

The GP is required to appoint an auditor the fund and ensure that the Fund accounts are audited annually. A shortlist of 3 possible auditors will shortly be drawn up based on their experience and suitability for the role and the most suitable of the three will be appointed on the recommendation of NCL and with the authorisation of the Investment Committee.

Regulatory

CPA Audit provide regulatory advice and framework to NCL and the Fund.

Appendices

Appendix 1: Job Specification – Chairman of the Investment Committee

Role Description

The Chairman of the Investment Committee is expected to lead the committee in performing the following functions:

- To monitor performance of the GP and the fund
- To ensure adherence to the investment mandate and that any veto's are taken into account
- To assess and make decisions on any investment, as presented by the GP
- To ensure that appropriate third parties (e.g. lawyers, auditors, accountants) are appointed by the GP on behalf of the fund
- To ensure that audited reports and accounts are presented by the GP and scrutinised, as per the requirements set out for the GP on an annual basis
- To ensure that formal reports are given by the GP every quarter outlining:
    - Performance
    - Financial statements
    - Valuations
    - Any other information reasonably requested by the LP's
- To ensure that the fund and its partners remain solvent at all times and that appropriate fees and expenses are dispersed
- To decide on any distributions by the fund made from investment income, in line with the investment mandate
- Ensure that the fund and its partners operate inside the regulatory principles as set out by both the FCA and ESMA at all times
- To ensure good governance and best practice is maintained for the Fund and its partners

Person Specification

- Track record of experience in strategic business leadership
- A strong understanding of corporate governance gained at board level
- Financial acumen and experience of the process of identifying, managing and mitigating risk in early stage businesses.
- Strong networking skills and a willingness to promote the activities of the Fund and seek new investors
- Experience and track record in the venture capital investment space, particularly working with small, early stage technology driven businesses.
- Ability to remain independent
- Experience of acting as a Non-Executive Chairman at Board level.

Commitment: The Chairman will be expected to attend all Investment Committee meetings, a minimum of 9 per annum.

Appendix 2: Job Specification – Member of the Investment Committee

Role Description

Members of the Investment Committee are expected to work together to ensure that the following functions are adequately performed.

- To monitor performance of the GP and the fund
- To ensure adherence to the investment mandate and that any veto's are taken into account
- To assess and make decisions on any investment, as presented by the GP
- To ensure that appropriate third parties (e.g. lawyers, auditors, accountants) are appointed by the GP on behalf of the fund
- To ensure that audited reports and accounts are presented by the GP and scrutinised, as per the requirements set out for the GP on an annual basis
- To ensure that formal reports are given by the GP every quarter outlining:
    - Performance
    - Financial statements
    - Valuations
    - Any other information reasonably requested by the LP's
- To ensure that the fund and its partners remain solvent at all times and that appropriate fees and expenses are dispersed
- To decide on any distributions by the fund made from investment income, in line with the investment mandate
- Ensure that the fund and its partners operate inside the regulatory principles as set out by both the FCA and ESMA at all times
- To ensure good governance and best practice is maintained for the Fund and its partners

Person Specification

- Track record of experience in strategic business leadership
- A strong understanding of corporate governance gained at board level
- Financial acumen and experience of the process of identifying, managing and mitigating risk in early stage businesses.
- Strong networking skills and a willingness to promote the activities of the Fund and seek new investors
- Experience and track record in the venture capital investment space, particularly working with small, early stage technology driven businesses.
- Ability to remain independent

Commitment: Members will be expected to attend all Investment Committee meetings, a minimum of 9 per annum.

Appendix 3: Remuneration

The members of the investment committee appointed by KCC will not receive remuneration. Those appointed by NCL will be remunerated for performing their duties in the following ways.

1. Low monthly retainer expected to start at £500 per month.
2. Equity carry in SLP to ensure that members are aligned to the success of the fund.
3. Success fees will be paid to members if they are able to raise additional capital into the fund.

All three members appointed by NCL will receive the same level of remuneration which will be negotiated in full with the members once a shortlist is identified. It is further anticipated that in time, as the fund grows in size, the level of retainer received by the members will increase.

Out of pocket expenses incurred by members whilst on fund business will also be reimbursed.

Appendix 4: Recruitment of the Investment Committee.

Process

Narec Capital are conducting a recruitment process to hire the members of the investment committee. At the present time external search firms have not been appointed as Narec Capital has a network of significant contacts within the industry and would prefer to keep costs to a minimum for the fund, unless this proves necessary at a later stage.

Candidates who express an interest in applying for the role of either Chairman or Committee Member will be asked to submit the following documents to cspring@nareccapital.com

- Full CV
- Supporting Statement
- Details of two references (though NCL will not make contact with the referees before speaking with the candidates and gaining their permission to do so.

The supporting statement should give evidence of how the candidate meets the requirements of the Person Specification relating to the role that they are applying for. The statement should also state clearly which role is being applied for and whether the applicant would consider either role.

Applicants that meet the criteria will be invited to meet an assessment panel made up of one representative from KCC and two representatives from NCL who will decide unanimously on the appointment of the Chairman and 2 additional members of the investment committee.

Timetable

July 8th: Deadline for applications
w/c July 11th: Discussion with panel
w/c July 18th: Appointment of Chairman and members

Appendix 5: NCL Potential candidates who have already expressed an interest in the role

Chris Phillips – Potential Chair or Member

Chris is currently Chairman of People for Places. Previously Chris was Managing Director of PB Securities, the UK subsidiary of Prudential Bache, for three years, before joining Lombard Odier as the Managing Director of its London broking business. He then joined Colliers International and after heading its residential consultancy business, became the first Managing Director of Colliers Capital (UK).

Chris has chaired a number of companies listed in the UK and Germany, and is currently non-executive Chairman of Hadleigh Waymoth, an independent advisory and fund management business, and London & Newcastle, a leading London-based mixed-use property development company.

Chris joined the Places for People Group Board in 2006 and was a senior independent director from 2008. He became Chairman in 2010.

Gilbert Chalk – Potential Chair or Member
Gilbert is the Chairman of Castle Private Equity. He is formerly the Chairman of the Baring English Growth Fund and prior to that the Managing Director of Hambro European Ventures (subsequently Duke Street Capital).

Professor Alan Lowdon – Potential Member

Professor Lowdon has more than 25 years' experience in the international energy and utilities markets working for multinationals including Shell, Suez, British Gas, Rolls Royce Industrial Power, Mott MacDonald and SKM s well as heading up three university spin-off companies. He currently acts as an advisor on energy to the UK and US governments and various UK universities and is a visiting professor at the University of Durham.

Appendix 6: KCC appointed candidates

Candidate 1: Nick Vickers - Member

Nick Vickers is a Man of Kent who joined Kent County Council in 1983. Since then Nick has undertaken a wide range of different posts in the finance function including, since 1997, the responsibility for the day-to-day management of the £3bn Kent County Council Superannuation Fund. As well as his KCC responsibilities Nick is also Chief Financial Officer of Swale Borough Council on a part time secondment arrangement.

Candidate 2: To be confirmed

ANNEX 5

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 Wednesday, 27 April 2016.

PRESENT: Mr R L H Long, TD (Chairman), Mr R J Parry (Vice-Chairman) and Mr C P D Hoare

ALSO PRESENT: Mr R H Bird and Mr D Smyth

IN ATTENDANCE: Mr A Wood (Corporate Director Finance and Procurement), Mr G Wild (Director of Governance and Law), Mr J Pigott (Head of Law), Mr D Smith (Director of Economic Development), Ms J Ward (Regional Growth Fund Programme Manager), Mr J Burr (Managing Director of Commercial Services), Mr G Singh (Barrister), Mr R Patterson (Head of Internal Audit) and Mr A Tait (Democratic Services Officer)

UNRESTRICTED ITEMS

5. Minutes - 29 February 2016
(Item 3)

RESOLVED that the Minutes of the meeting held on 29 February 2016 are correctly recorded and that they be signed by the Chairman.

6. Protocol relating to companies in which KCC has an Interest
(Item 4)

(1) The Director of Governance and Law introduced the report on the Companies Protocol which had last been reviewed in 2012. The current review needed to take account of the changes to the County Council's approach to commissioning.

(2) The Sub-Committee noted that paragraph 7 (d) of the revised protocol listed certain policies and procedures. It considered that as this could lead to a mistaken view that those which were not mentioned were relatively insignificant, this passage should be reinforced by the addition of the words "but not exclusively" after "with particular" at the end of the paragraph.

(3) The Sub-Committee also considered that new paragraph 17 should include a reference to the action that should be taken in the event that if a director who was also a Member or officer of KCC should have a conflict of interest. It therefore agreed to recommend the re-writing of the paragraph after "or an officer of KCC" to read "If it were to give rise to a conflict with the interests of KCC then reference should be made to *the Guidance on Local Authority Companies* referred to in paragraph (2) above."

(4) The Sub-Committee decided that its own role should be further clarified in paragraph 7 (d) through the specification that it "must be assured" that adequate policies and procedures were in place before a company commenced trading.

(5) RESOLVED that:-

(a) the draft amendments to the *Protocol for Companies in which KCC has an Interest* be recommended to the Governance and Audit Committee for approval subject to the revised paragraphs 7 (d) and 17 as set out below:-

(i) Paragraph 7 (d): "what Council policies (if any) are to apply to the company. Where a company adopts its own policies, before it commences trading the Governance and Audit Committee must be assured that adequate policies and procedures are in place with particular (but not exclusive) reference to anti-fraud, bribery, corruption, gifts and hospitality"; and

(ii) Paragraph 17: "As a matter of general principle, the overriding duty of any director in considering an item before the company is to vote in accordance with the interests of that company. In the case of a director who is also an elected Member, or an officer of KCC, if it were to give rise to a conflict with the interests of KCC, then reference should be made to *the Guidance on Local Authority Companies* referred to in paragraph (2) above"; and

(b) The Protocol and Guidance continue to be reviewed bi-annually, unless fundamental changes (for example, legislative changes) necessitate a review during the intervening period.

7. Discovery Park Investment Fund - Development of the Fund and changes to governance structure
(Item 6)

(1) The report which was unavailable on the date of publication had been circulated to all Members of the Sub-Committee as well as to Governance and Audit Committee Members.

(2) The Chairman declared this item to be Urgent as the governance arrangements needed to be in place by 1 May 2016 and this was the only opportunity for them to be considered by the Sub-Committee.

(3) The Director of Economic Development introduced the report which set out the changes to the governance structure of the Discovery Park Technology Investment Fund since the Committee had last approved the original governance arrangements in November 2014 (*Minute 2014/7*). At that time, KCC had allocated £5m from the overall Regional Growth Fund allocation to offer equity investments. KCC had not wished to be the sole equity provider and had therefore established the governance structure set out in Figure 1 of the report.

(4) The Director of Economic Development continued by saying that the point had now been reached where the new goal was to enable other private sector investors to invest in the fund.

(5) The Director of Economic Development replied to a question from Mr Bird by saying that each of the private investors was registered in England at Companies House. There was no intention to avoid any tax on the investments made by KCC. He could also give a complete assurance that the partner companies would remain subject to English tax and British legal procedures.

(6) The Director of Economic Development explained that due to state aid rules, KCC could not be a majority partner or shareholder in any of the companies. He agreed with the Chairman's understanding that whilst KCC could not control the affairs of the companies which invested, it would have the ability to withdraw its funding in the event that its registration or tax strategy did not comply with the standards that KCC was obliged to uphold.
Kent County Council took great pains to ensure that the companies in which it invested were of the utmost propriety and reputation. It would also have a veto and control over where that money was

invested. KCC had already turned down the opportunity to make some apparently attractive investments due to concerns over some aspect of the company's operation. This approach would continue. KCC could not approve the other shareholders. It could only approve the companies in which it invested. This always included scrutiny of the other shareholders whenever KCC was considering whether to invest.

(7) The Director of Economic Development replied to a question from Mr Hoare by saying that KCC's investment strategy was to take a minority shareholding of no more than 10% in order to ensure that the risk was shared. KCC was also constrained by the rules on state aid which specified that any investment by a public authority had to be on commercial terms using an independent manager who could decide what was and was not a commercial investment. KCC had committed itself to only make commercial investments.

(8) The Director of Economic Development then said that the new structure set out in Figure 2 of the report was recognised by the British Venture Capital Association and complied with the guidance of the European Venture Capital Industry. The reason that other authorities had failed in their attempts to create public authority investment companies was because they had not followed the commercial pattern. The advice obtained was that the structure was robust, both in terms of protecting the public authority and its interests as well as being recognisable to the market place. The structure avoided the pitfalls which often arose when a public authority attempted to upset the balance between its commercial and public goals by over-emphasising the latter.

(9) The Director of Economic Development replied to a question by Mr Parry by saying that the Independent Advisory Board would advise the Leader of the Council who would agree the detailed terms of reference and operating procedures. The advice provided to him (including on compliance) would be given by KCC Legal, KCC Procurement, Geldards and Hogan Lovells.

(10) The Chairman asked whether it was intended that the detailed terms of reference and operating procedures would be submitted to the Sub-Committee. The Director replied that it was not envisaged that they would be in conflict with the report that was under consideration. It was therefore not proposed to bring a further report. He offered to make them available after they had been put into effect. They would continue to be regularly audited by Internal Audit.

(11) It was agreed that the results of Internal Audit's audit of the detailed terms of reference and operating procedures would be reported either to the Sub-Committee or to its parent Committee.

(12) The Director of Economic Development replied to a question from the Chairman by saying that consideration had been given to the question of whether there should be more than one Director of the various companies. He said that Company Law did not require a company to have more than one Director or even a Company Secretary. He anticipated that once the new arrangements were in place there would be an increase in the number. This was because the current structure had been put in place to best enable KCC to transfer to the new structure. The new Directors of the company into which the assets were to be transferred had not yet been identified and would be carefully vetted before their appointment.

(13) The Director of Economic Development replied to a question from Mr Parry by confirming that one of the 5 members of the New Investment Committee would be an elected Member of Kent County Council, another would be a KCC officer. The other 3 members would be people with a private sector background drawn from outside KCC. Their eventual appointments would be made by the Leader following advice from the present Advisory Board. The recruitment process was currently underway

(14) Mr Parry asked for detail on the advertisement process for the three private sector members of the New Investment Committee as well as the qualities and skills that were being sought. This applied, too to the KCC representatives. He also asked who would chair the Company and how that appointment would be made.

(15) The Director of Economic Development replied that the specification was looking for people with the highest level of the requisite skills. This would include experience of successfully running large private sector funds. He was not sure whether the prospective elected KCC Member had actually been approached and could not therefore be identified. He did have considerable experience in the investment management world. The KCC officer was a very senior member of the Finance Team.

(16) Mr Bird said that performance assessment of the members of the New Investment Committee would be a key issue and that it was particularly important that the mechanism was in place to ensure timely replacement if the need arose.

(17) The Director of Economic Development replied that the County Council in the form of the Investment Advisory Board would receive quarterly reports from the Fund Manager. The Fund would last for 5 years (extendable to 10). An internal rate of return of at least 15% was expected. The remuneration rate for the managers was linked to the performance of the Fund and they would only receive remuneration once a trigger point had been achieved. There was also a separate mechanism for removing people if they failed to perform in other respects. He could give an assurance that, in respect of the new Investment Committee there would be absolutely no reward for failure.

(18) The Director of Economic Development said that the Investment Advisory Board was a long-standing informal body which had been set up when KCC first received its allocation of 35 m from the Regional Growth Fund in order that the County Council's decisions could be informed by a broad group of individuals acting in a personal capacity utilising their backgrounds in banking, the Law and a variety of commercial activities. It reported to the Economic Development Board on the loans that had been made using RGF monies as well as to the Leader.

(19) The Sub-Committee agreed the resolution set out in (20) below by 2 votes to 1. The Director of Governance and Law confirmed that this decision did not prevent the Director of Economic Development from putting the new governance arrangements into operation. The Director of Economic Development also confirmed that although there would be a change of ownership, this would not affect the ability to make any required changes to the way in which the process was managed.

(20) RESOLVED that the proposed governance for the Discovery Park Technology Investment Fund be endorsed subject to ratification by the Governance and Audit Committee at the next available opportunity.

EXEMPT ITEMS
(Open Access to Minutes)

(Members resolved under Section 100A of the Local government Act 1972 that the public be excluded from the meeting for the following business on the grounds that it involved the likely disclosure of exempt information as defined in paragraphs 3 and 5 of Part 1 of Schedule 12A of the Act.)

8. Legal Services - Alternative Business Structure
(Item 5)

(1) The Chairman informed the Sub-Committee that he had been invited to sit on the Board of the company which would be set up under the Alternative Business Structure. This was not a matter which qualified either as a Disclosable Pecuniary Interest or as an Other Significant Interest.

(2) The Director of Governance and Law briefly introduced the report on the Legal Services Alternative Business Structure (ABS) and confirmed that it would conform to the *Protocol for Companies in which KCC has an Interest* if the draft revisions to the Protocol (*see Minute 6 above*) received approval from the Governance and Audit Committee at its next meeting. He also drew the Sub-Committee's attention to the Section 151 Officer's Value for Money Report which was appended to the main report.

(3) During discussion of this item, the Sub-Committee asked for the Shareholder Board chart set out in Appendix 1 of the report to be amended to clarify that it was the Chairman of the Company who would report to the Chairman Head of Paid Service and for those members of the Senior Management Team who were also members of the Board of Directors to be identified with an asterisk. The Director of Governance and Law agreed to make these amendments.

(4) Members also asked for assurance in respect of the impact of the creation of the ABS on the overall Legal Services operation including those members of staff who were to remain in-house. This should include steps taken to ensure staff retention. It was therefore agreed that a progress report would be presented to the Governance and Audit Committee at its meeting in October 2016.

(5) RESOLVED that:-

(a) approval be given to the governance arrangements for the Alternative Business Structure as set out in the report and its Appendices; and

(b) a progress report be submitted to the October 2016 meeting of the Governance and Audit Committee with a particular emphasis on those issues set out in (4) above.

9. Consolidated Commercial Services 2014-15
(Item 9)

(1) The Managing Director of Commercial Services presented a report which had arisen out of the Sub-Committee's consideration of Statutory accounts for companies in which KCC has an interest (*Minute 2/2016*). He briefly summarised the current structure of the Commercial Services business.

(2) The Managing Director of Commercial Services reported that customers of the LASER frameworks had indicated that they placed strong value on KCC being the contracting authority for those frameworks.

(3) RESOLVED that the report be noted for assurance.