

REPORT TO ILFRACOMBE TOWN COUNCIL
CREATING A LEGAL STRUCTURE FOR THE DELIVERY OF NEIGHBOURHOOD
COMMUNITY BUDGET ACTIVITY

1. Summary

1.1. This report outlines the issues in considering the establishment of a new legal entity to deliver the neighbourhood community budget programme in Ilfracombe.

1.2. The rules around public procurement create two alternative approaches:

1.2.1. the creation of a new organisation which is “Teckal” compliant, and can therefore provide services to the public sector partners without the need to tender those services, but which probably cannot therefore receive an asset transfer of the car parks, or be charitable in nature; or

1.2.2. the creation of a body which is **not** controlled by the public sector, which can potentially be a charity, own assets and act independently, but which may in some circumstances have to go through open competition to tender for the provision of public sector contracts.

1.3. Further advice may be needed on the state aid implications of any transfer of assets.

1.4. The choice of legal structure will be affected by the procurement options. There may be some benefit, if an independent body is created, in using a company limited by guarantee with the potential to obtain charitable status. If the “Teckal” option is followed, then a community interest company may be the best route. Further consideration, given the requirements of each option, will need to be given to the composition of the membership and directorship of the new body.

1.5. The Town Council should satisfy itself that it has the necessary powers to set up a separate company.

1.6. Further advice may also be needed on the staffing arrangements for any new body, and on a range of practical issues which are outlined in the report.

2. Purpose

2.1. The purpose of this overview report is to review the options for setting up a separate organisation to deliver the neighbourhood community budget programme in Ilfracombe.

2.2. This report is not intended to be an exhaustive summary of all the detailed issues involved, and we have indicated in the report where Ilfracombe Town Council (“ITC”) should consider taking further advice before deciding on the final form of externalisation.

3. Background

3.1. ITC have been considering whether or not to set up a separate organisation to deliver aspects of the neighbourhood community budget programme which ITC has been developing with its partners. That organisation is referred to in the draft operational plan for the programme as the Neighbourhood Commissioning Board, or NCB. We have used that name in this report for ease of reference, although it is not yet clear exactly what form any commissioning activity may take.

3.2. Anthony Collins Solicitors met with colleagues from ITC on 1st October 2012 to discuss these issues. It was agreed at that meeting that we would present a report to ITC setting out the outcome of those discussions and in particular detailing the issues involved in the NCB delivering elements of services currently provided by other public sector partners in Ilfracombe.

4. Issues common to creating a new organisation

4.1. There are a number of issues which would affect ITC each time you consider setting up a new organisation, whether that organisation is wholly owned by ITC, part owned by ITC, or completely independent. These issues are interrelated. They include:

4.1.1. procurement;

4.1.2. legal structure;

- 4.1.3. vires issues;
- 4.1.4. staffing; and
- 4.1.5. practical legal matters.

5. Procurement issues

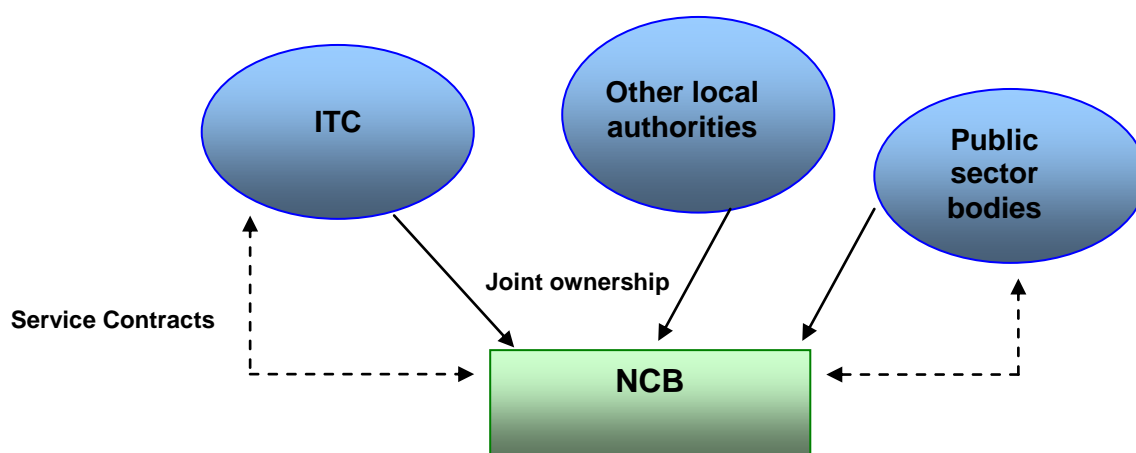
- 5.1. Any local authority (including ITC itself) is regarded for procurement purposes as a “contracting authority”, and therefore governed by the EU Procurement Rules. Therefore, if a local authority wishes to enter into a contract for services with another organisation – here, the NCB - it must at least consider whether that contract comes under those rules. Depending on the value of any particular contract, and the nature of any services or works to be provided, this can require a full tender process.
- 5.2. If the total value of any contract for services, over the whole life of the contract, is more than a particular threshold – currently £173,934 - then the contract is potentially subject to the EU rules.
- 5.3. In each situation where ITC is creating a new organisation which will provide services either to ITC itself, or to other contracting authorities, then ITC will have to consider whether or not the rules apply. The exact nature of the services will be relevant, as if the services to be provided fall into the category of “Part B” services – or at least the major part of the services in terms of value – then the full tendering rules will not apply.
- 5.4. If the total value of the individual contracts with any new organisation is less than the threshold amount then, again, there will be no requirement to tender according to the EU rules. If, however, the full procurement rules apply, then the contract will need to be tendered with no guarantee that the relevant new organisation will succeed in any bid it makes.
- 5.5. However, if the new organisation is a wholly owned subsidiary of ITC, or is owned by a combination of contracting authorities including ITC and other public sector partners, then the “Teckal” exemption – the name deriving from a case in the European courts - may assist here.

5.6. The Teckal case provides that where:

- 5.6.1. a contracting authority exercises “decisive control” over the strategic objectives and significant decisions of another organisation, equivalent to the control that it is able to exercise over its own internal departments; and
- 5.6.2. that other organisation carries out the “essential” part of its activities for the contracting authority; then
- 5.6.3. a contract for services between the contracting authority and that other organisation is exempted from the procurement requirements.

5.7. This principle has been extended to cover arrangements between multiple contracting authorities. Therefore, where a number of different local authorities and other public sector bodies working together control another organisation in the same way, the same exemption applies.

5.8. This could give rise to the following model:



5.9. The control element of the Teckal test would require, in practice, the relevant local authorities and public bodies to be the sole owners of the NCB. Any involvement of commercial organisations which dilute that ownership would mean that the new body no longer met the Teckal test. It would also require that, between the public sector bodies involved, they appoint at least the majority of the board.

5.10. The new body would also need to carry out the essential part of its work for the partners. There is relatively little authority on the question of what proportion of activity constitutes the “essential” part but one European

case found that 91.5% of business activity was acceptable. We suggest that it is probably safe to assume that, as long as 90% of any new organisation's business is carried out for ITC and the other authorities involved in owing the NCB, then the activities element of the Teckal test will also be met.

5.11. An important practical point to note here is that if the car parks are transferred to the NCB, then as the NCB would be engaging directly in running the car parks (with an annual turnover of, we understand, around £500,000) then this would place the NCB outside of the Teckal exemption, irrespective of the ownership arrangements, because a substantial part of the NCB's work would be trading with non public sector partners (i.e., car park users) directly. If it is decided to form the NCB as "Teckal compliant", therefore, an alternative approach may need to be found to car park management.

5.12. If the Teckal test is satisfied then any contracts between ITC (or any other partner public body) and the NCB will be exempt from tendering. However, one implication is that the NCB would almost certainly **itself** then be a contracting authority, for European procurement rules purposes, and would have to follow those rules for its own purchases or contracting.

5.13. The implication of these issues is that many local authorities and other contracting authorities, when considering the externalisation of part of their activity, will use a wholly owned subsidiary structure if the key part of the new organisation's work will be with the parent authority.

5.14. At the meeting we discussed the implications of either using the Teckal exemption, or of deciding to set up the NCB outside of the scope of Teckal. We noted that there were a number of key factors to consider:

5.14.1. the first, and obvious, point to make, is that if the NCB is within the scope of the Teckal exemption, then the various public bodies involved in setting it up can **award contracts** to the NCB without having to go through a tender process. Conversely, if the NCB is outside the scope of the exemption, then there may be occasions when contracts have to be tendered according to the full procurement regime;

- 5.14.2. if the NCB is looking to develop **new business streams** which are outside of delivering services to its partner public authorities, and this new business was likely to form more than 10% of its turnover, then this of itself would probably take it outside of the scope of the exemption. We have noted above the issue around the transfer of the car parks;
- 5.14.3. not all transactions are “caught” by the procurement rules. In particular, we noted that **land transactions** are generally exempt. Local authorities have to follow certain guidelines when transferring physical assets to independent organisations, but the procurement rules do not generally apply;
- 5.14.4. the award of **grants** to third sector organisations is also outside the scope of the procurement rules. However, care must be taken in the terms and conditions of any grant awarded. If the arrangement is challenged then it could be held to be a contract for services by the courts, if the key characteristics of a grant award are not present;
- 5.14.5. there may scope for considering the use of a **joint venture arrangement** between ITC and an independent NCB, which again may assist with the procurement implications;
- 5.14.6. finally, if the advantages of **charitable status** for the NCB are significant, then it should be noted that a Teckal compliant body may well struggle to obtain this status from the Charity Commission. Guidance from the Commission is clear that they expect charities to independent from “the state”, which for these purposes included local authorities.

5.15. Finally we should note that the transfer of the car parks could constitute illegal **state aid** under EU rules. The ITC should consider taking further advice on this issue.

6. Legal Structure

6.1. There are a number of legal structures that could be adopted for any organisation that ITC might choose to set up. The choice of structure will be affected by the following factors:

- 6.1.1. whether the NCB will generate surpluses and, if so, how these will be dealt with (in particular, whether they will be retained by the NCB or distributed out to the members);
 - 6.1.2. whether the NCB wishes to adopt a structure which would generally be recognised as a “social enterprise”; and
 - 6.1.3. to what extent, and in what way, ITC and any other partners wish to invest in the NCB.
- 6.2. The legal structures available broadly divide into those which enable the distribution of surpluses made to the members, and those which require the retention of any surplus within the NCB, with those allowing distribution to the members being:
- 6.2.1. a company limited by shares;
 - 6.2.2. a Limited Liability Partnership;
 - 6.2.3. a community interest company (“CIC”) limited by shares; or
 - 6.2.4. a co-operative.
- 6.3. Structures requiring the retention of any surplus within the NCB would include:
- 6.3.1. a company limited by guarantee;
 - 6.3.2. a CIC limited by guarantee;
 - 6.3.3. a community benefit society; or
 - 6.3.4. a charitable incorporated organisation (“CIO”).
- 6.4. At the meeting it was clear that the view of ITC is that the NCB should be non profit distributing, both to reassure the public and also to be eligible for grant funding if appropriate. We also noted that the CIO is not yet available, but that a charitable company limited by guarantee will be able to convert to become a CIO in due course.
- 6.5. This raises the linked question of seeking charitable status for the NCB. In order to be considered charitable, any NCB would have to show that it was being established for wholly charitable purposes, and would carry out only charitable activities.

6.6. Charitable purposes must fall within one of the accepted purposes acknowledged by the Charity Commission further to the Charities Act 2011. These are fairly wide ranging. We discussed at the meeting the question of whether the NCB could be constituted as charitable in nature.

6.7. We noted the following key streams of activity which the NCB may be asked to undertake:

6.7.1. receiving the **transfer** of assets from public sector organisations currently providing services in Ilfracombe. This may include car parks and other assets. The NCB would then provide a range of services itself, either by directly employing staff or engaging with contractors. The services under consideration are listed in the draft operational plan;

6.7.2. being involved in local **commissioning** of services, including NHS services, where full transfer of assets and delivery is not considered appropriate. We noted at the meeting that it is not yet clear exactly what form the involvement of the NCB will take; it could be that the NCB is a consultative body in the commissioning process, or it could have a more formal role in the design, scope or procurement of such services;

6.7.3. **coordination** of public services provided to the town that do not fall into one of the above categories.

6.8. The following charitable purposes could be relevant:

6.8.1. the promotion of health and the relief of sickness, in relation to health promotion work in the town;

6.8.2. the charitable relief of unemployment;

6.8.3. community capacity building, which is recognised as a charitable purpose in its own right;

6.8.4. the promotion of the effective use of resources for charitable purposes by charitable and non-charitable bodies for the benefit of the public;

6.8.5. the promotion of urban or rural regeneration; and

6.8.6. the relief of the public purse, though the Commission are wary of any attempt to register a charity to carry out functions which a local authority (or other public body) is obliged to deliver (as opposed to any activity in relation to which they have a discretion).

6.9. When the key activities of the NCB are more clearly defined, it will be possible to reach a definitive view on whether charitable status can be obtained.

6.10. Key consequences of becoming a registered charity include the following:

6.10.1. **regulation** by the Charity Commission – which can be a fairly onerous burden;

6.10.2. different **tax treatment** from that accorded to normal companies - charities are exempt from most forms of corporation tax and enjoy other tax advantages, as long as the rules about trading are not breached. This includes the ability to reclaim tax on donations through the **gift aid** scheme;

6.10.3. charities enjoy a mandatory 80% reduction in **business rates**;

6.10.4. restrictions on **trading**. The turnover from non-primary purpose trading must not exceed 10% of the total turnover **and** must be less than £50,000 in any given tax year. If this ‘de minimis’ rule is breached the whole of the charity’s trading surpluses are taxed, including any primary purpose trading. However these restrictions can be mitigated through the setting up of a trading company subsidiary;

6.10.5. charity status allows access to **sources of funding** not available to non- charities, although this distinction is less significant than previously (particularly with the advent of CICs).

6.11. While charity status does bring certain advantages, it is important to bear in mind that it is very difficult to “de-register” a charity. Registration as a charity should only be sought where ITC is satisfied that this will continue to be the appropriate form for the new organisation for the long term.

6.12. Charitable status may not be possible to obtain, or it may be that a decision is made to use the Teckal exemption. In these situations, if ITC wished the NCB to be recognised as a social enterprise, then we suggest that using a CIC structure, or alternatively a structure which complies with the criteria for the Social Enterprise Mark, is used. The mark has six criteria, the most important of which are that:

- 6.12.1. at least 50% of any distributable profits must be reinvested or used for community benefit; and
- 6.12.2. if an enterprise is wound up, then any surplus is used for the benefit of the community (not distributed to the members).
- 6.13. A CIC limited by guarantee may not, generally, distribute any profits it makes to its members, but must use them for the benefit of the community and for the purposes for which it was set up.
- 6.14. A CIC limited by shares may distribute surpluses to shareholders, but only up to a maximum percentage of its profits. Using a CIC limited by shares would allow ITC to take the amount of shares corresponding to its investment. It is possible to use a CIC limited shares but not allow for the payment of dividends to shareholders, which would fulfil the strategy group's wish for the NCB to be non profit distributing.
- 6.15. Either CIC structure would also confirm that the NCB was acting for the benefit of the community because the NCB would have to demonstrate that it was doing so, both at registration and going forward.
- 6.16. A CIC structure or, alternatively, charitable status, would also give some reassurance to third party organisations with whom the NCB might work. At the meeting we touched on the question of community asset transfer; use of a CIC or a charity would help promote confidence in the long term safeguarding of any assets transferred into the NCB.
- 6.17. Linked to legal structure will be other governance matters, such as who will serve on the board of any NCB, and how these individuals will be appointed. These arrangements may vary on a case by case basis. At the meeting we discussed various scenarios, including noting that organisations themselves need not be in membership of the NCB, but could have the right to nominate an individual as a member / director.
- 6.18. If ITC wishes to avoid the NCB becoming a "contracting authority" itself, then it should be noted that even if the NCB is created an independent entity, it can still be held to be a contracting authority if it is:

6.18.1. financed wholly or mainly by another contracting authority (meaning more than half its turnover comes from public bodies);

6.18.2. subject to “management supervision” by another contracting authority;
or

6.18.3. more than half of the board of directors or members are appointed by another contracting authority.

6.19. Thus, to avoid being a contracting authority, less than half the turnover of the NCB would need to come from the public sector, and less than half the board could be public sector appointees.

6.20. These issues will also have tax implications. We recommend that ITC consider seeking tax advice before making a final decision on any such structure. We also noted at the meeting on 1st October the importance of obtaining specialist VAT advice. In general terms, it should be noted that neither charities nor CICs have any general exemption from VAT. Town councils, however, **do** benefit from the VAT exemption under section 33 of the Value Added Tax Act, which may be significant.

7. Vires issues

7.1. As a local authority, the ITC can only carry out those activities which it can show it has the power to undertake.

7.2. Town and parish councils have not yet been granted the power of general competence under the Localism Act. However, it may be that ITC can use the “well being” power under the Local Government Act 2000.

7.3. Town and Parish councils are eligible to exercise that power if they meet the requirements in the Parish Councils (Power to Promote Well-being) (Prescribed Conditions) Order 2008. The conditions relate to:

7.3.1. there being at least two thirds of the seats on the parish council filled at the most recent scheduled set of elections;

7.3.2. the clerk having received certain training;

7.3.3. 80% of the councillors also have received the relevant training; and

7.3.4. the council having published a statement of intent as to community

engagement.

7.4. We have not considered whether ITC is able to meet these conditions.

However, before seeking to form the NCB, ITC should satisfy itself that it has the appropriate powers to do so.

8. Staffing

8.1. There are a number of options in relation to staffing any NCB. One option would be for ITC to continue to employ the staff involved in the relevant activity, but make them available to NCB under the terms of a secondment or services agreement. Alternatively, the NCB could employ all the staff involved in delivery. There is also, of course, the possible application of the TUPE regulations which may involve the transfer of employment to the NCB by operation of law. The scope of this report does not allow more than the highlighting of these issues. At the meeting, we noted that it will be important, when the detail of the transfer of any assets or services to the NCB is clearer, to consider the employment issues raised further.

9. Practical legal issues

9.1. Having established a new organisation, there will then be a number of other practical issues that will arise which have a legal dimension, including:

9.1.1. **formalising contractual arrangements** with ITC and instituting a system of contracts and invoicing;

9.1.2. a **scheme of delegations** for any NCB, allowing, for example, for decision making between board meetings, and putting in place other necessary delegations;

9.1.3. **financial regulations, and policies and procedures** for the NCB;

9.1.4. the transfer or arrangements for the use of any relevant **assets**, including IT and other infrastructure, and any mechanisms for re-charging this;

9.1.5. linked to this, **premises** and office provision.

Anthony Collins Solicitors
5th October 2012
DSA.39705.0002