

## Commercial Trading

### Report of the Chief Fire Officer

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#### 1 Purpose of Report

This report outlines a business case and business plan, leading to the formation of a commercial trading company wholly owned by Shropshire and Wrekin Fire and Rescue Authority.

#### 2 Recommendations

The Fire Authority is asked to:

- a) Consider the contents of the report;
- b) Agree to the establishment of a trading arm, as described in the business plan (paper 15 - to be considered in closed session);
- c) Agree to the provision of a loan at commercial rates to the new company;
- d) Appoint three Members of the Fire Authority to sit on the Board of Directors of the company (having referred to the bullet points in section 6, page 4 of the report); and
- e) Delegate authority to the Chief Fire Officer, Treasurer, Monitoring Officer and Head of Finance jointly to agree the start-up date of the company.

#### 3 Background

Shropshire and Wrekin Fire and Rescue Authority (the Authority) continues to face a further period, when its funding from Government grant will reduce. For some years the Service has been seeking opportunities to reduce spending through efficiencies but over time this will become increasingly difficult without direct reductions to frontline and support services. The Service has, amongst other schemes, reduced budgets to drive out unnecessary expenditure, reviewed and changed crewing levels on stations and has taken steps to reduce its officer cadre by 25% to an absolute operationally effective minimum.

To offset the impact on service provision income generating opportunities could be exploited for the benefit of the Authority and Shropshire taxpayers. One currently untapped option is to sell services to other organisations, in either the private or public sector, with a view to generating profit and contributing to the Service's income.

This report outlines the business case for the Authority to establish a limited company in order to capitalise on this potential opportunity. The report is supported by a more detailed business planning document, which will be referred to throughout. As this document contains financial and business information of a commercially sensitive nature, a numbered, exempt copy has been issued to Members, which will be considered at item 15 on the agenda for this meeting in private session, under paragraph 3 of Schedule 12a of the Local Government Act 1972.

Taking a more commercial approach within the Fire Service nationally is not without precedent and now almost all Fire Services are engaged in some form of commercial activity, for example:

- Devon and Somerset Fire and Rescue Service has agreed a partnership with a private company and established a limited company (Red One Ltd), providing training and other services;
- Cleveland Fire and Rescue Service has developed a mutual organisation to provide a fire and rescue service and to sell services, and has already secured a multi-million pound contract for the next five years;
- Essex Fire and Rescue Service has a long-established, trading company to exploit specialist skills, including fire safety and trading / disposal of fire appliances; and
- Lancashire and West Midlands Fire and Rescue Services have set up commercial arms, with activities including training, fire safety risk assessment, fire-engineered solutions, and fire equipment maintenance.

## 4 The Legal Framework

There are a number of options available to generate income for Shropshire and Wrekin Fire Authority. The options make a distinction between **trading** (acting for a commercial purpose to generate a profit) and **charging** (to recover the costs of providing a discretionary service).

This Fire Authority is already involved in various areas of charging, e.g. sharing premises and special service calls. This report deals with trading for profit.

The Local Authorities (Goods and Services) Act 1970 gave local authorities general powers to enter into agreements with certain designated public bodies. Whilst these provisions enable an Authority to generate a profit from that agreement, the range of organisations, with whom an authority can contract, is limited to prescribed public bodies and is an option generally only for authorities with capacity within large back-office functions.

The effect of Section 95 of the Local Government Act 2003 (the 2003 Act) (taken together with an order made by the Secretary of State in 2009<sup>i</sup>) is to enable local authorities (including fire authorities) to do for a commercial purpose anything, which they are empowered to do under their statutory functions, i.e. a power to trade in function-related activities. This is an extension of the position under the 1970 Act, as authorities are no longer restricted to contracting with other public sector bodies; services can now be provided to the private sector.

However, this wider power to trade can only be exercised through a company, established in accordance with the statutory rules on local authority companies<sup>ii</sup>.

The Localism Act 2011 does not extend the 'general power of competence' to a stand-alone fire authority. It has, however, further extended the scope of the power to trade, to include a wider range of activities that are incidental to the authority's core statutory functions, by amending the Fire and Rescue Services Act 2004 (the 2004 Act).

## **5 Business Case for Forming a Company**

Under the 2003 Act the Authority is required to prepare and approve a business case for forming a company<sup>iii</sup>. The business case should cover:

- The objectives of the business;
- The investment and other resources required to achieve those objectives;
- Any risks the business might face and how significant those risks are; and
- The expected financial results of the business, together with any other relevant outcomes that the business is expected to achieve.

These are detailed in the accompanying Business Plan and Outline Business Case 2013-18 (see exempt paper 15).

## **6 Form of the Company**

The primary objective of the company would be to provide services to other bodies on commercial terms to generate income for reinvestment in the core services of Shropshire and Wrekin Fire and Rescue Authority. The company would be set up to benefit the Fire Authority and, therefore, the area and residents of Shropshire.

To simplify any later developments it is proposed to set up a company called Shropshire and Wrekin Fire Authority (Trading) Ltd in the first instance and then to develop various delivery arms of that company over time. The first of these would be called Shropshire Fire Risk Management Services.

The proposed scope of this company would be to deliver activities outlined in the Business Plan and Outline Business Case 2013-18. However, the company's structure and governance would permit other activities or services to be incorporated in the future.

It is proposed that there should be flexibility to enable the company to develop as potential opportunities are identified and the company would not be limited to the fire sector, for example, health and safety or first aid training could be provided to public and private organisations.

There are various forms of company, including limited by shares, limited by guarantee and partnerships. The most advantageous form would be a company limited by shares, since this would provide the best options for distribution of profits via dividends and for raising capital in the future.

In order to ensure that the Fire Authority retains control of the company it is proposed that it would be 100% owned by the Authority and would be defined as a 'Local Authority Controlled Company'<sup>iv</sup>.

It is proposed that there should be a small Board of Directors, made up of three Fire Authority Members, one of whom would be the Chair or Vice-Chair of the Authority, with officers of the Service acting as advisers. Should the Fire Authority agree to set up a company, it is asked to decide whether it wishes:

- To have a free vote on who the Directors should be; or
- To specify the number of Directors from each constituent authority, for example a 2:1 split; or
- To have a 1:1 split with a free vote on the third Director.

Members appointed as directors would participate directly in the activities of the company, would be answerable to the company and have the powers and duties of company directors, whilst they did so. These and other matters of governance for the company are incorporated within the Articles of Association.

## **7 Resource Implications**

### **Legal**

The company would need to comply with the regulatory requirements of the Companies Act 2006 and the regulatory regime under the Local Government and Housing Act 1989. This is likely to require ongoing legal advice and support to ensure compliance with statutory provision.

The proposed company would be a 'controlled' company, since it would effectively be a subsidiary of the Fire Authority. The Authority would be able to control meetings of the company and / or the Board of Directors. Being a 'controlled' company involves certain governance and accountability requirements, including the provision of information to the Fire Authority, appointment of an auditor and Directors' remuneration.

Establishing a commercial organisation would require a commitment from the Service in terms of people and expertise. Under the model proposed, all such commitments would be paid for by the company from gross profits.

## **Human Resources**

The work involved in establishing a commercial organisation has to this point been met from within existing capacity of the Service.

As, to begin with, the company would not be employing staff directly, TUPE would not apply initially. This position would need to be kept under review, particularly if the scale of the business were to increase and the company planned to employ staff or transfer them from the Service.

Employees from the Service would be seconded into the trading company as and when required to carry out individual projects, at a cost to the company. A charging policy, including a transparent and auditable pricing structure, would be developed, which would be used to determine charge-out rates for resources attributed to delivering the company's business.

In future, if some staff were directly employed by the company, possibly as the result of staff transferring from the Service, this would require the company to establish its own terms and conditions, including pension arrangements, and to undertake appropriate consultation. This may also amount to a transfer under the Transfer of Undertakings (Protection of Employment) Regulations 2006.

In some cases, local authority companies have applied to become part of the local government pension scheme as an admitted body but this has not yet been considered. Implications under the Redundancy Payments Modifications Order and other applicable legislation have also not yet been considered.

It is not currently envisaged that Directors would receive remuneration for their work with the company. However that position would be kept under review, particularly if non-executive directors were appointed.

## **Financial Implications**

Under current arrangements the Service can sell spare capacity and generate an income from this but only to the extent of recovering its costs. For the Service to generate a profit for reinvestment requires the Fire Authority to establish a company. There would be officer time, including legal services, to create the company. Initial set-up costs, including company formation and legal fees, would be met from existing resources and recovered against expected company profits.

There are 'State Aid' rules, which are designed to avoid a public body subsidising a company, which it has established, and thereby distorting competition with the private sector. In effect, the Fire Authority must treat the company as any other third party contractor. One consequence of this is that the Authority must recover the full costs of any accommodation, goods, services, employees or anything else it supplies to the company to facilitate its trading.

Although it is difficult to quantify accurately the financial benefits of establishing a company, there is considered to be a significant potential market for services. Our reasonable assumptions, financial predictions and expectations are detailed in the Business Plan. The intention would be that the Service would benefit from the success of this work and income returned to the Fire Authority. This would partially offset the reductions in Government funding.

The legal powers to establish a limited company do not give any additional powers to borrow money. Initially the company would not have resources of its own to finance its spending and is unlikely to be able to borrow money without an established trading history. In agreeing to establish the company the Fire Authority would need to agree to provide a loan to cover the initial trading period, including set-up costs.

A loan of £20,000, repayable with interest at a commercial rate agreed with the Treasurer, is proposed. The loan would not need to be provided in full at the outset. The Authority, through its control of the company, would be able to review the business prospects of the company periodically, before agreeing additional loan instalments. There would need to be a written loan agreement and provision for interest to be paid.

There will be VAT implications arising from setting up the company and, based on predicted turnover, the company would need to register for VAT. In addition any profits would be subject to corporation tax.

Assuming the company is wholly owned by the Fire Authority, any net profits generated could be returned to the Authority, and applied in any area of the Authority's activities.

## **8 Conclusion**

The Business Plan provides evidence that there would be merit in establishing a commercial arm for the Fire Authority, which would allow it to exploit other areas of work in the fire sector and beyond, and potentially secure long-term benefits. The benefits would be primarily financial but, in addition, may provide scope to retain our existing backroom staffing levels.

A company could provide a financial return to partially offset future grant reductions and also develop the capacity and capability of the Service for the future.

## **9 Financial Comment**

Other than officer time, which would ordinarily have been incurred by the Fire Authority, a total cost of £200 has been incurred by the Authority in setting up the company. No costs have still to be incurred by the Fire Authority for set up of the proposal.

The financial risk to the Fire Authority, associated with this proposal, is limited to the provision of a loan of £20,000 to the company. This would be recorded as a liability on the Fire Authority's balance sheet, to represent the limit of the financial risk to the Authority.

A corresponding amount would also be set aside in the General Reserve to mitigate the risk to the Fire Authority, should the proposal be unsuccessful.

The Fire Authority has made no assumptions about the profitability of the proposal, and currently assumes that (with the exception of the £20k loan provision) no costs or profits are included within financial projections for future years (including the charging for back-office functions and other Fire Authority staff).

The company would voluntarily register for VAT purposes at the start of trading, and payment of VAT would impact the modelling within the business case. All accounting entries for VAT would be incorporated within the accounting package used by the company.

It is expected that profits would be generated in line with projections within the business case. Following review by the Board, projected profits would be incorporated within the Fire Authority budget-setting process.

Officers of the Fire Authority will agree the costing and charging process for recharging services into the company. The capacity of officers providing services to the company will be monitored to ensure that their primary functions are not compromised.

It is intended that the company will hold bank accounts that are completely separate to those of the Fire Authority.

## **10 Legal Comment**

In establishing the proposed trading company it is advised that the Fire Authority follow the requirements of the section 95 of the Local Government Act 2003 trading regime. The trading company must also follow the requirements in section 18B(1)-(8) of the 2004 Act, if, and in so far as, when acting for a commercial purpose, a charge is imposed for any service provided.

The use of a company for trading under section 95 of the 2003 Act will place the Authority in the same position as any other commercial undertaking as to the need to meet costs and make a profit. If the proposed trading operation were to prove successful, it could reasonably be expected to lead to new economic opportunities, as well as possible disadvantages for small businesses, as suppliers or in specialist markets. The Authority will have to consider any proposed trading activities very carefully against the requirements of competition law.

Members of the Authority, who are appointed directors of the company have a fiduciary duty to the company, not to the Authority. They have the powers and duties of company directors, while they are appointed directors, and as directors, they are answerable to the membership of the company in accordance with the company's articles of association.

However, any Member elected as a director is still bound by relevant Authority codes of conduct, in so far as these codes do not conflict with their legal obligations under company law.

Given that directors may incur personal liability and that some or all of the directors of the company will be Authority Members, it is recommended that the company take out insurance in relation to their liabilities as a director. It is good practice to issue guidance to nominated directors on the responsibilities and liabilities of being a director of a company. Any such guidance should cover the following matters:

- Directors' duties to act in the best interests of the company.
- The provision and use of information.
- Duty to employees.
- Fiduciary duty to creditors.

Any financial assistance, provided by the Authority to the proposed company, whether in cash or in kind, should be for a limited period with an expectation of returns at a later date. Providing such assistance should be formalised by an agreement entered into for a commercial purpose between the Authority and the company.

The Authority should also note that the European Union procurement rules may apply in any of the following situations:

- The Authority provides services, supplies or staff to the trading company.
- The Authority buys services, supplies or staff from the trading company.
- The company itself buys the services.

## **11 Risk Monitoring**

A risk analysis and Initial Risk Register are included in the Business Plan (see exempt paper 15).

## **12 Equality Impact Assessment**

Officers have considered the Service's Brigade Order on Equality Impact Assessments (Personnel 5 Part 2) and have decided that there are no discriminatory practices or differential impacts upon specific groups arising from this report. An Initial Equality Impact Assessment has not, therefore, been completed.

## **13 Appendix**

Exempt Shropshire Fire Risk Management Services Business Plan and Outline Business Case 2013 – 2018 to be considered in closed session under the provisions of the Local Government Act 1972 Part 1 Schedule 12(A) section 100A(4) paragraph 3



## 14 Background Papers

There are no background papers associated with this report, other than the document referred to in section 12 above.

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<sup>i</sup> SI 2009 No. 2393 The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009

<sup>ii</sup> Part V Local Government and Housing Act 1989

<sup>iii</sup> SI 2009 No. 2393 The Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 and Section 5B(2) Fire and Rescue Services Act 2004 inserted by Section.9 Localism Act 2011)

<sup>iv</sup> Provisions relating to companies under the control of local authorities and subject to their influence are scheduled for repeal to be replaced by 'local authority entities'. An Order, implementing this change has, however, yet to be made (section 212, Local Government and Public Involvement in Health Act 2007).