

## Appendix 1

1.1 Section 95(1) of the Local Government Act 2003 (**2003 Act**) authorises the Secretary of State to make an order allowing relevant authorities to “do for a commercial purpose anything which they are authorised to do for the purposes of carrying on any of their ordinary functions”. This has been exercised most recently through the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (**the Order**).

1.2 There are a number of restrictions in the scope of the Order. Whilst expressed as restrictions or limitations on the Order itself, they should be seen as similarly restricting or limiting the Councils from achieving certain ends through the proposed trading company (**the Company**). The three principal restrictions are:

- (a) The Councils cannot do in relation to a person anything which it is required to do in relation to that person under its ordinary functions (Section 95(2)(a)). In other words, the Councils cannot convert a service which it has duty to provide into a traded service;
- (b) The power cannot be used where the Councils are already specifically authorised to act for a commercial purpose (Section 95(2)(b));
- (c) The power is only exercisable through a company.

1.3 Under section 96 of the 2003 Act, the Councils are obliged to have regard to guidance issued by the Secretary of State. Such guidance has been issued by the Office of the Deputy Prime Minister in July 2004, which was partially amended by the Department for Communities & Local Government in April 2007. The guidance is titled “General Power for Local Authorities to Trade in Function Related Activities through a Company” and it is confirmed within its text that it is statutory guidance to which the Councils must have regard.

1.4 The Order contains two important provisions:

- (a) Before exercising the power, the Councils are required to prepare a Business Case in support of the proposed exercise of the power which must be approved by the Councils;
- (b) Where the Councils provide the Company with assistance in the way of accommodation, supplies, staff etc, it shall recover the costs thereof.

1.5 The ordinary functions to which the trading activities relate consist of those governing the particular services described in the business plan.

1.6 Whilst section 95 provides the necessary statutory power to establish a trading company, it is important to recognise that the company will be subject to regulatory controls under both the Companies Act 2006 and Part V of the Local Government and Housing Act 1989 (**LGHA 1989**).

1.7 Whilst the Company is a “controlled” company for the purposes of Part V and the Local Authorities Companies Order 1995 (**the 1995 Order**), the requirements associated with such are largely administrative. Formerly, the status as a controlled

company meant that local authority trading companies were caught by the same capital controls as applied to the local authority itself, as found in Part IV of the LGHA 1989, but these provisions were repealed in 2003. The remaining requirements are found in the 1995 Order and cover issues such as the fact that the Company is controlled to be mentioned on all relevant documents, information to be provided the local authorities' auditors and members and matters affecting directors regarding remuneration and disqualification.

- 1.8 The proposals for the Council to provide financial support to the Company by way of a loan or facility need to satisfy state aid rules. EU law prohibits Member States from granting State aid that distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods insofar as it affects trade between Member States.
- 1.9 The concept of "aid" is extremely broad. It can cover direct financial measures (e.g. grants and subsidised loans), indirect financial measures (e.g. exemptions from payment obligations), guarantees and grants of security (where these enable the undertaking to obtain better credit terms than would otherwise have been available) and provision of assets or services at an undervalue or on preferential terms (including the sale of land).
- 1.10 However, where a public body acts on terms that would be acceptable to a private sector investor, this is not regarded as conferring an economic advantage, and therefore does not involve State aid. In these circumstances, the public body is said to be satisfying the Market Economy Investor Principle and the transaction concerned does not need to be notified to the Commission. In other words, the question is whether the Company has obtained an advantage that it could not have obtained on the private market.