

<b>Report to:</b>	Sutton Shareholdings Board	<b>Date:</b>	01 May 2019
<b>Report title:</b>	Review: Non-Executive Director Appointments in Council Companies		
<b>Report from:</b>	Jessica Crowe, Monitoring Officer		
<b>Ward/Areas affected:</b>	Borough-wide		
<b>Chair of Committee/Lead Member:</b>	Councillor Sunita Gordon, Chair Councillor Jayne McCoy, Vice Chair and Chair of the Housing, Economy and Business Committee		
<b>Author(s)/Contact Number(s):</b>	Fiona Bywaters, Committee Services Team Leader, 0208 770 5122		
<b>Corporate Plan Priorities:</b>	<ul style="list-style-type: none"> <li>Smarter Ways of Working</li> </ul>		
<b>Open/Exempt:</b>	Open		
<b>Signed:</b>		<b>Date:</b>	16 April 2019

## 1. Summary

- 1.1 At its meeting of 12 September 2018, the Sutton Shareholdings Board agreed that “*the need for further Independent Non-Executive Director (‘NED’) appointments be reviewed across all Council companies to ensure from the shareholder perspective that all companies have sufficient skills, expertise and experience on their company boards.*” This report initiates that review and invites comment from members.

## 2. Recommendations

The Sutton Shareholdings Board is recommended to:

- 2.1 Note the current composition of each board of directors of companies in which the council has a shareholding interest attached at Appendix A.
- 2.2 Agree the abbreviated board evaluation questions to be sent to companies in which the council has a shareholding interest attached at Appendix B.
- 2.3 Agree the terms of reference of the review as outlined under section 4 of the report.
- 2.4 Note that a summary of responses to the board evaluation will be reported to a future meeting of the Sutton Shareholdings Board alongside the outcome of the review.

### 3. Background

3.1 The Code of Practice - Governance of Council Interests in Companies, recently approved at the September 2018 meeting of the Sutton Shareholdings Board, states that a “*starting point for consideration in establishing a board of directors for a company may be that it will be formed of:*

- *executive directors, being:*
  - *the managing director;*
- *non-executive directors (NEDs), being:*
  - *a chief officer of the Council (Chair of the Board);*
  - *independent person(s) appointed to bring oversight, experience and skills that would be advantageous and appropriate for the companies;*
  - *other senior officers of the Council as appropriate;”*

3.2 As commercial activity increases however, it is recognised that the composition will likely need to adapt to changing requirements. As the companies in which the council has a shareholding interest have become operational, it is now considered an appropriate time to conduct a review of whether, from the shareholder perspective, the companies have sufficient skills, expertise and experience on their company boards. The appointment of non-executive directors can broaden the knowledge and expertise of a company board with regards to developing and implementing the annual business plan. Non-executive directors allow a company to draw on specialist skills which in turn, informs decision-making: for example in the legal, financial or property fields.

3.3 In contrast to executive directors, who usually have extensive delegated powers due to their role (with an employment contract separate from their director appointment), non-executive directors (‘NEDs’) do not have an employment contract or executive management responsibilities. They are however, subject to the same legal framework as their executive counterparts, including directors’ duties under company law. The role of a NED is to provide constructive challenge, strategic guidance, offer specialist advice and hold management to account, further protecting the shareholder interest. According to the UK Corporate Governance Code (principally aimed at public companies but from which smaller companies may take inspiration):

- NEDs should ‘constructively challenge and help develop proposals on strategy.’
- NEDs should scrutinise the performance of management, and its reporting, of agreed goals and objectives.
- NEDs should satisfy themselves as to the integrity of financial information produced, and that financial controls and systems of risk management are ‘robust and defensible.’

Constructive challenge from NEDs is an essential part of good corporate governance. As ‘an outsider’, the non-executive director may be able to contribute a clearer or wider view of

external factors affecting the company and its business environment than those with executive responsibilities.

- 3.4 It must be noted that appointment of directors is a matter reserved to the shareholder for decision, as outlined in each company's constitutional documents. However, under the Council's constitutional terms of reference for the Sutton Shareholdings Board, this is a decision which may be made by the Shareholder Representative, or their nominee, subject to consultation with the Chair and each political group represented in its membership, rather than reserved exclusively to the Board.

#### **4. Issues**

- 4.1 A Non-Executive Director ('NED') should bring judgment and experience to board deliberations that executive directors on their own may lack. To be effective, a NED has to understand the company's business - this may include: executive directors in other companies, holders of NED positions in other companies, holders of relevant professional qualifications and/or those with experience in working with local government. Some NEDs (those who are council officers) can also ensure a balance of power on the board which can be helpful in evidencing that a company is Teckal exempt.
- 4.2 This review specifically refers to *independent* non-executive directors ('INED'). These directors are defined as persons who, apart from directors' fees and shareholdings, are independent of management and free from any business or other relationships which could materially interfere with the exercise of their independent judgement. Independence also means that the director is not a representative of any shareholder who has the ability to control or significantly influence management or the board, which excludes council officers.

#### Review Terms of Reference

##### *Composition of the Boards of Directors*

- 4.3 In reviewing whether the companies have the right balance of skills, expertise and experience in their independent NEDs, the review will also need to look at the wider composition of each company board, to obtain a holistic picture of whether the independent NEDs appointed provide a sufficiently complementary mix of different perspectives on each board.
- 4.4 An overview of directors currently appointed to each company in which the Council has a shareholding interest is attached at [Appendix A](#) whilst an overview of the relevant stipulations, in company constitutional documents, with regards to the composition of and appointment to each board of directors is outlined below. A company's articles of association, and any shareholder agreement, play a part in how directors are to be appointed in practical terms, i.e. describing who and how they are appointed:

Company	Stipulations
Opportunity Sutton	<p><b>Model articles</b> for private companies limited by shares - no specific reference to composition.</p> <p><b>Quorum: 2</b></p> <ul style="list-style-type: none"> <li>• Currently appointed: 3.</li> </ul> <p><b>Shareholder agreement reserved matter(s):</b></p> <ul style="list-style-type: none"> <li>• Appointment to the post of director.</li> <li>• Dismissal of director.</li> </ul>
Sutton Living	<p><b>Bespoke articles:</b></p> <ul style="list-style-type: none"> <li>• (20) Unless otherwise determined by ordinary resolution, the number of directors is not subject to any maximum and the minimum number is two.</li> <li>• (21) .... the holder or holders of a majority in nominal value of the issued ordinary shares in the capital of the company [<i>Opportunity Sutton Ltd</i>] may at any time... appoint any person to be a director... or remove any director from office.</li> </ul> <p><b>Quorum: 2</b></p> <ul style="list-style-type: none"> <li>• Currently appointed: 2.</li> </ul> <p><b>Shareholder agreement reserved matter(s):</b></p> <ul style="list-style-type: none"> <li>• (3.2) The Directors may appoint a managing director on such terms as they may think fit who shall be responsible for the day to day management of the Business... The Directors may also remove such managing director and appoint a replacement... providing that no appointment to the post of managing director ... shall be made without Shareholder Consent.</li> <li>• Dismissal of director.</li> </ul>
SDEN	<p><b>Bespoke articles:</b></p> <ul style="list-style-type: none"> <li>• (19) Unless otherwise determined by ordinary resolution, the number of directors is not subject to any maximum and the minimum number is three.</li> <li>• (21) .... the holder or holders of a majority in nominal value of the issued ordinary shares in the capital of the company [<i>Opportunity Sutton Ltd</i>] may at any time... appoint any person to be a director... or remove any director from office.</li> </ul>

	<p><b>Quorum:</b> 3</p> <ul style="list-style-type: none"> <li>• Currently appointed: 3.</li> </ul> <p><b>Shareholder agreement reserved matter(s):</b></p> <ul style="list-style-type: none"> <li>• (3.2) The Directors may appoint a managing director on such terms as they may think fit who shall be responsible for the day to day management of the Business... The Directors may also remove such managing director and appoint a replacement... providing that no appointment to the post of managing director ... shall be made without Shareholder Consent.</li> <li>• Dismissal of director.</li> </ul>
Encompass LATC	<p><b>Model articles</b> for private companies limited by shares - no specific reference to composition.</p> <p><b>Quorum:</b> 4 if an executive director is appointed, comprising 2 council directors, one independent director and the executive director.</p> <ul style="list-style-type: none"> <li>• Currently appointed: 6.</li> </ul> <p><b>Shareholder agreement reserved matter(s):</b></p> <ul style="list-style-type: none"> <li>• (5.2) The parties shall agree on the appointment of the Independent Director but, subject to clause 5.6, the Council shall have the right to remove the Independent Director.</li> <li>• (5.3) There shall be a minimum of 3 directors on the board, made up of 2 council directors and 1 independent director. In the event that the board is made up of 6 directors, 3 shall be council directors, 2 shall be independent directors and 1 shall be an executive director.</li> <li>• (5.4) The post of chairman shall be held by a council director....</li> <li>• (5.5) The Council may appoint a Director, and remove a Director,</li> <li>• (5.6) The Council shall consult with Encompass prior to any removal of an Independent Director</li> <li>• Schedule: (19) Appointing or dismissing any director.</li> </ul>
Cognus	<p><b>Bespoke articles:</b></p> <ul style="list-style-type: none"> <li>• (17.1) Unless otherwise determined by the directors from time to time, there shall be a minimum of seven directors.</li> </ul>

	<ul style="list-style-type: none"> <li>• (17.2) The A Shareholder [<i>The Council</i>] shall appoint a minimum of four directors by notice in writing to the company signed by the A Shareholder Representative.</li> <li>• (17.3) A majority of the B Shareholders may appoint up to 2 directors, by notice in writing to the company signed on behalf of all the B shareholders...</li> <li>• (17.4) The directors shall appoint one executive director to the role of managing director.</li> </ul> <p><b>Quorum: 2</b></p> <ul style="list-style-type: none"> <li>• Currently appointed: 6.</li> </ul> <p><b>Shareholder agreement reserved matter(s):</b></p> <ul style="list-style-type: none"> <li>• Dismiss a director</li> <li>• Appoint or dismiss the chairman and setting the terms of such appointment</li> <li>• Enter any contract of employment with a Director other than the Managing Director</li> </ul>
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4.5 Taking into account each company’s constitutional requirements and level of commercial activity, the review will explore whether there would be benefit in appointing independent non-executive directors to the companies and in particular, to the two subsidiaries of Opportunity Sutton Ltd: Sutton Living and SDEN. Independent NEDs would contribute expertise and knowledge to these specialist areas - entirely new strands of development activity for the Council in house-building on a commercial basis and energy supply.

4.6 Another benefit would be increased resilience in terms of quorum: in both subsidiaries, the number of appointed directors is equal to quorum, meaning all must be able to participate in a decision reserved to the board of directors. In that regard, the review will also consider whether there may be benefit in proposing relevant amendments to a company’s constitutional documents.

*Board Evaluation*

4.7 A shortlist of questions to be sent to each board of directors for response is attached at Appendix B. These questions are taken from sample board evaluations and are designed to assess the current composition of the board for its effectiveness from the shareholder perspective.

*Independence*

4.8 All directors, of course, have a duty to exercise independent judgement though it is recognised that they may be inclined to have a particular view. The UK Corporate Governance Code

recommends the board identifies each NED it considers to be independent in its annual report. This is a matter for the board's judgement but the board would need to give explanation under certain circumstances, including where:

- They have been an employee within the last five years.
- They have a material business relationship with the company.
- They receive, or have received, additional remuneration other than a director's fee.
- They have close family ties with the company's advisers, directors or senior employees.
- They have cross-directorships with other directors.
- They represent a significant shareholder.

In addition, circumstances may change after appointment and independence should be kept under review.

#### *Induction*

4.9 On the part of the company, under the Code of Practice, (4.10) "*governance arrangements will seek to ensure that there is sufficient induction, training and other materials in place so that:*

- *their legal duties;*
- *stewardship of assets;*
- *the provisions of the governing documents;*
- *the external environment; and*
- *the total structure of the organisations and the venture*

*are appropriately understood by ... the directors of the companies.*" Therefore the review should also seek reassurance from the companies that adequate induction processes are in place for company directors.

#### *Recommendations*

4.10 Evidence from the review will be assessed from the shareholder perspective to determine whether a recommendation must be made in respect of the appointment of further non-executive directors in any company in which the council has an interest. Any such recommendation will be as considered best to meet the requirements of the company and to protect the shareholder interest.

## **5. Options Considered**

5.1 The Sutton Shareholdings Board has resolved to conduct a review of independent non-executive directors appointed to the companies at its September 2018 meeting. It is suggested in section 4 that to carry out this review, it will also be necessary to consider the

general composition of the company boards in order to put the role and contribution of independent NEDs into context.

- 5.2 The responses received from the companies as part of the review will be used to present opportunities for appointment, if deemed necessary and appropriate, at a future meeting of the Sutton Shareholdings Board.

**6. Impacts and Implications**

Financial

- 6.1 The review will have no direct costs to the Council above officer time. There will be a small cost to the companies of having additional independent NEDs. However, this should be considered against the additional benefits to be gained through widening the experience and independent expertise available to the companies.

Legal

- 6.2 With regards to the review of NEDs mentioned in paragraphs 2.5 and 4.2, if a company falls under Regulation 12(1) Public Contracts Regulations (commonly referred to as the Teckal Exemption), then regard must be had to the impact on the Council’s reliance on the Teckal Exemption with regards the control test when appointing Independent NEDS. Such an appointment may affect the composition of the board and impact on the Council exercising a control over the company which is similar to that which it exercises over its own departments.
- 6.3 The number of council NEDS appointed to a board which enables this level of control is an important piece of evidence for satisfying Regulation 12(1). Before a decision is made with regards to appointing Independent NEDs, regard must be had to the wording of the articles of association about the composition of the board, what has been put in place in the articles in relation to compliance with Teckal, how such an appointment would affect this, whether the composition of the board in relation to Council NEDs will need to be amended in order to preserve the reliance on the Teckal exemption and whether the articles of association will require amendment.

**7. Appendices and Background Documents**

Appendix letter	Title
A	Overview: Directors currently appointed to companies in which the council has a shareholding interest.
B	Questions: Abbreviated Board Evaluation

<b>Background documents</b>
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Company Articles of Association and Shareholder Agreements
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<b>Audit Trail</b>		
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Version	Final	Date: 16 April 2019
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<b>Consultation with other officers</b>		
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Finance	Yes	Joseph Stockwell
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Legal	Yes	Fabiola Hickson
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Other Officers:	Yes	Simon Latham Amanda Cherrington Kieran Holliday
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Equality Impact Assessment required?	No	N/A
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