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Governance of wholly owned companies - where to start?

When advising on and helping set up trading companies, it is governance that frequently causes a measure of uncertainty - there is no one size fits all solution.

20 August 2020

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We frequently advise on, and help to set up, trading companies of one kind or another. The initial focus is around structure, powers, state aid, procurement, and governance. It is the last of these that frequently causes a measure of uncertainty – there is no one size fits all solution.

Assuming a typical wholly owned company owned by a local authority, and being a teckal company (or possibly not), what are the key governance considerations and how do these make their way into the corporate documents?

The first and obvious point is that the company is itself a corporate entity and will (ordinarily at least) have a board of directors, appointed by the council and made up of officers, members, or non-executive external appointees. Meanwhile, the Council is the shareholder and will hold shares (or a share). The council’s liability is limited, the company’s liability is not.

The company may have been formed adopting model articles of association and may also be subject to a shareholder’s agreement. The company may also have borrowed money from the council (as debt rather than equity) and may be reliant on the council for working capital and revenue. Alternatively, it may be a pure trading company, less reliant (if at all) on the council and paying dividends annually out of profit.

So how should governance be structured and how much difference will it make if the company is at one or the other end of this spectrum?

The starting point is that under Article 4 in the Model Articles the shareholder(s) have blanket ability to instruct the directors of the company not to undertake a course of action. So, whilst management of the company is vested in the board of directors, the shareholder has this backstop and blanket power. But this is not a particularly helpful place to leave things.

The conventional method for dealing with that is to adopt “reserved matters”, a list of things that the board (and therefore company) cannot do without getting shareholder consent. These tend to be standard and cover things like changing the nature of the business, setting up subsidiaries, borrowing money, giving guarantees, winding up, and so on. Big ticket items in other words.

Often these reserved matters are set out in the Articles or a shareholder agreement. In that sense they are set in stone and relatively inflexible (at least in the sense that any modification will require the Articles or shareholder agreement to be formally amended).

An alternative approach is to adopt a “delegations’ matrix”. The immediate benefit of this approach is to take the overall scheme of delegation out of the Articles or Shareholder Agreement and instead to adopt a stand-alone document which may be varied from time to time by simple agreement and resolution (the Council always having final say).

To achieve that, the Articles might say:

> a. Subject to any provision of these Articles to the contrary, the directors are responsible for the management of the company’s business, for which purpose they may exercise all the powers of the company.

b. Any matters which require the consent of the controlling shareholder pursuant to **the delegation matrix** from time to time shall not be carried out without the prior written consent of the controlling shareholder and each of the directors shall use their respective rights and powers to procure, so far as they are each able, that no such matter is carried out unless the required consent has been given. No amendment or variation **to the delegation matrix** which would reduce or limit those matters which require the consent of the controlling shareholder shall be approved by the company without the prior written consent of the controlling shareholder.

The Articles would usually go on to provide for the council to be able to direct the board not to take a course of action (i.e. a blanket right of veto) and would also enable the board of directors to delegate to individual directors, committees and so on.

The matrix itself will normally distinguish between

- Reserved matters – those things which sit with the Shareholder;
- Board matters – those things that sit with the Board;
- Managing Director and other director matters – those things that they may deal with outside of the Board (individually or via Committees);

In certain cases, these may overlap – meaning that a matter may be actioned on the approval of, for example, one director and the Managing Director (jointly).

The delegations may also be framed so that they refer to the approved "business plan". This would be presented, for example, so that certain matters may be authorised and actioned by the Board, notwithstanding that this might be a "reserved matter". Equally the matrix may authorise the Managing Director or a manager to act where the matter is contemplated by the current business plan (or a sub-set of that plan, e.g. an operating plan or budget).

This approach (referring to the business plan) has the benefit of enabling the controlling council to review and approve a business plan, usually annually) and then for matters within that plan to be left for the board of the company (and managers) to implement. This may include matters which would otherwise be reserved matters (e.g. borrowing money, setting up a subsidiary, going into a new area of business, transaction above a value that would ordinarily require shareholder consent.

As a general point of principle, a greater degree of delegation by the shareholder to the company will normally apply where the company is a "pure" trading company rather than a teckal company but that is by no means a rule. The degree of delegation will also depend on the size of the business, the make-up of the Board, the extent to which the company may be indebted to the council or reliant on public sector loans or grant – for example.

This business plan approval does not need to be annual and there might equally be reference to a strategic document that is only updated on an ad hoc basis (essentially at the instigation of the Council as shareholder). Provided the Board (or company managers) are acting within that document, the reserved matter consent requirement is disapplied.

In this type of arrangement there will always be a tendency to ponder whether something is or is not "in the Business Plan" and this can be resolved (to an extent) by using terminology such as "contemplated by" rather than "expressly authorised by". The former is more elastic, whereas the latter may be too restrictive; the choice is for the company and shareholder to settle.

To avoid the inevitable concern that a shareholder may have where adopting the most elastic approach, we have usually made a blanket proviso in the delegations' matrix, along these lines: *"The Board, and its Directors, shall in all cases consider whether a matter for decision may require reference to [the Council], notwithstanding the delegations below. This may be due to the reputational or other potential impacts on [the Council] as shareholder."*

Ultimately it will be for a council to weigh up the degree of autonomy it is comfortable giving to the company and its board. In parallel it will consider how to exercise its shareholder function, including (as is often the case) via a special "shareholder board". Members of that board as well as the directors of the company will benefit from training and support – to understand their respective roles and duties (not least in the case of the directors, under various statutes, e.g. Companies Act 2006, Insolvency Act 1986).

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