



Pinsent Masons

THE MARCHES LOCAL ENTERPRISE PARTNERSHIP

ADVICE NOTE

INCORPORATION AS A COMPANY LIMITED BY GUARANTEE

1. INTRODUCTION

- 1.1 In the Strengthened Local Enterprise Partnerships report¹ dated July 2018 (the "**Report**") and the revised National Local Growth Assurance Framework² dated January 2019 (the "**Framework**"), the Ministry of Housing, Communities & Local Government ("**MHCLG**") set out the mandatory requirements for all Local Enterprise Partnerships ("**LEPs**") to adopt a legal personality by April 2019, but with limited guidance as to how this should be achieved.
- 1.2 In order to comply with the requirement, the Marches Local Enterprise Partnership ("**MLEP**") incorporated as a company limited by guarantee ("**CLG**") on 12 February 2019.
- 1.3 The MLEP has asked us to advise on the implications of MLEP operating as a CLG, including the potential legal and tax issues of operating as a CLG and managing the relationship with its members and particularly Shropshire Council ("**Shropshire**") as MLEP's nominated Accountable Body. Further details about the scope of this advice note are set out at section 2 below.
- 1.4 Our advice is provided solely for the purposes of advising MLEP and is subject to the matters set out herein. This advice note is confidential to MLEP and subject to legal professional privilege. It should not be relied upon by any other person or persons, and Pinsent Masons LLP does not any liability to any such persons whatsoever.

2. INSTRUCTIONS

- 2.1 Our instructions are set out in our letter of engagement dated 1 October 2019 and to summarise, we have been asked to advise on the following:
- 2.1.1 MHCLG's requirements in relation to the legal status of LEPs, including the relationship with a LEP's nominated Accountable Body, including considering and comparing the approach taken by other LEPs that have incorporated as CLGs;
- 2.1.2 a summary of how (and if) MLEP should be established and operate as a company limited by guarantee and the related implications. In particular, consideration of:
- (a) whether any changes need to be made to MLEP's existing constitutional documents;
 - (b) how MLEP should formalise its relationship with Shropshire, including the existing relationship with its s151 Officer;
 - (c) how MLEP should contract in future, both with its suppliers and with the recipients of its loan and grant awards;
 - (d) the management of MLEP's finances, including consideration of the terms on which Shropshire holds and accounts for those monies on behalf of MLEP;
 - (e) the current employment arrangements in place; and

¹ <https://www.gov.uk/government/publications/strengthened-local-enterprise-partnerships>

² <https://www.gov.uk/government/publications/national-local-growth-assurance-framework>

- (f) a high level review of the potential implications from a pensions, accounting and tax perspective.

3. EXECUTIVE SUMMARY

- 3.1 Unless MHCLG advises otherwise, MLEP must continue to operate as a CLG in order to comply with the mandatory requirements of the Framework.
- 3.2 If operating as a CLG, MLEP (amongst other things):
 - 3.2.1 must contract with third parties on its own behalf and should put in place appropriate contractual arrangements to manage effectively the rights and obligations of the parties;
 - 3.2.2 should review the contractual arrangements between Shropshire, the MLEP and grant beneficiaries in relation to the award and monitoring of grant and loan funding managed by the MLEP;
 - 3.2.3 would be a 'contracting authority' for the purpose of the Public Contract Regulations, but noting that a contract awarded by the MLEP to Shropshire for the provision of accountable body and other services would be likely to fall outside those Regulations;
 - 3.2.4 may employ its own staff or enter into formal secondment arrangements with Shropshire (and/or the other Member Authorities);
 - 3.2.5 must prepare and file its own accounts at Companies House, which should not be 'nil' accounts or dormant accounts and are likely to require auditing;
 - 3.2.6 will be liable for corporation tax;
 - 3.2.7 must register for and be subject to VAT.
- 3.3 Taking into account the administrative and financial cost of operating as a CLG and given that a substantial amount of the MLEP's business relates to the management of s31 grants, the MLEP board may wish to consider contacting MHCLG to see if, on an exceptional basis under the Framework, there is scope to retain the former structure of the MLEP operating as an informal partnership/unincorporated association, with Shropshire continuing as the Accountable Body, subject to agreeing appropriate governance mechanisms to provide MHCLG with the appropriate comfort.
- 3.4 In any event, we would **recommend** that when the MLEP has considered and determined an appropriate course of action to implement the Framework requirements fully, it contacts MHCLG to set out its proposed approach and seek confirmation that this is aligned with MHCLG's requirements. Such action will mitigate the risks of any potential non-compliance with the intentions of the Framework, as well as identifying where further clarifications may be needed from MHCLG. This will also demonstrate MLEP's commitment to embodying the highest standards of accountability and transparency in the use of public funding. MHCLG has recognised that some reforms will take time to implement, which suggests that any currently 'non-compliant' operations are not likely to attract immediate sanctions.

Our more detailed advice is set out below.

4. MHCLG REQUIREMENTS

- 4.1 The requirements set out by MHCLG in the Framework are mandatory unless stated otherwise as being non-mandatory best practice. The requirement for LEPs to adopt a separate legal personality is mandatory under the Framework. There is scope for a LEP to discuss exceptional circumstances (see para 15 of the Framework), but no further detail is provided in the Framework as to whether this might extend to maintaining the status quo of operating as an unincorporated association; we consider that this may be worth exploring in the context of the MLEP's current operations (i.e. that it is engaged almost completely with the management of s31 grants).

- 4.2 There is a precedent in that the London LEP operates through the Greater London Authority (which is also its accountable body, subject to the ultimate decision making powers of the Mayor of London) and the Framework confirms that the London LEP is **not** required to have a separate legal personality. As mentioned above, there may therefore be room to explore with MHCLG whether MLEP could follow a similar route, should it prefer not to operate as a CLG, provided that appropriate governance, accountability, transparency and contractual arrangements were in place in line with the Framework (these being the primary concerns of MHCLG that led to the separate legal entity requirement following the Public Accounts Committee report into the governance of the Greater Cambridge Greater Peterborough LEP).
- 4.3 The Framework confirms that the role of the Accountable Body and s151 officer will still play a crucial role for LEPs. However the nature of the relationship remains unclear. As a CLG, it is recommended that MLEP continue to use Shropshire to fulfil the role of the Accountable Body (i.e. to manage the section 31 funding received from the Government and other sources on behalf of the MLEP) and that this arrangement should be documented (see also comments in relation to the current MOU below). This is supported by confirmation in the Framework that funds will continue to be paid to the respective Accountable Bodies, for the benefit of LEPs.
- 4.4 The legal and contractual relationship that should exist between an accountable body and a LEP that is a separate legal entity in relation to the 'ownership' and management of s31 grants is not entirely clear. Section 31 of the Local Government Act 2003 requires that such grants are paid 'to a local authority' with such conditions as the Minister of the Crown may determine. Shropshire has determined in its own audited financial statements that it manages the grant funding as 'agent' for the MLEP. It is important that these arrangements are documented appropriately in terms of the rights and obligations of each of the parties, including in respect of payment, liability, data sharing, etc.
- 4.5 It is our view that any other income or expenditure of the MLEP (operating as a CLG) that does not relate to funding or grants received from the Government or local sponsors should be received directly by MLEP.
- 4.6 The Framework further confirms that the nominated s151 officer will continue to be responsible for overseeing the proper administration of financial affairs to ensure that statutory requirements are met in resource allocation decisions, and that the public interest is protected at all times. We note that MLEP has an existing (and good) relationship with James Walton, the existing s151 officer at Shropshire and that it is proposed that this relationship will continue. Management of monies not relating to public funds will fall outside of the statutory remit of the Accountable Body and/or s151 officer, however this would not prevent MLEP agreeing a formal mandate with Shropshire to continue to manage the MLEP's finances on its behalf, with a services contract in place to govern that arrangement.
- 4.7 The MLEP should consider the contractual basis on which grants are awarded and monitored. Our understanding is that contracts for the award of grants have previously been entered into between Shropshire and the beneficiary. Shropshire would need to continue to be a party to such contracts as the Accountable Body (and in particular to be able to enforce grant clawback). We would suggest that an appropriate contracting structure would be for there to be a contract between Shropshire and the MLEP (which can be included in the proposed SLA) whereby the MLEP authorises Shropshire to enter into the grant/loan agreements and make payments/enforce those agreements on the MLEP's behalf, acting in its capacity as agent for the MLEP. The grant/loan agreements can remain as bilateral agreements between Shropshire and the beneficiary and the MLEP would not need to be party to them, but the agreements should reference the role and rights of the MLEP; this would also satisfy the Council's need to meet its accountable body obligations in terms of having a direct contractual relationship with the grant/loan beneficiary that it can enforce. In practice, the existing template grant award letters/agreements used by Shropshire should be reviewed and amended to reflect the new relationship between Shropshire and the MLEP.

5. ESTABLISHING AND OPERATING AS A CLG

5.1 Legal Status prior to CLG

- 5.1.1 Prior to incorporation as a CLG, MLEP was an unincorporated association, with membership from the public and private sectors (we understand that the membership has been replicated in the membership of the CLG), including Shropshire, the County of Herefordshire District Council and the Borough of Telford and Wrekin (together the "**Member Authorities**"). The three Member Authorities managed the operation of the MLEP via a joint committee and under the terms of a Memorandum of Understanding (see below). We understand from the minutes of the meeting of the joint committee held on 19 March 2019 that it formerly ceased to operate on 31 March 2019.
- 5.1.2 An unincorporated association has no legal personality and therefore can't enter into contracts, hold assets, employ staff or sue or be sued. The unincorporated association would therefore usually operate according to rules governed by contractual relations between the members who form the association as to the ownership of assets and the rights and liabilities of the members. In relation to the MLEP, these arrangements were principally set out in the following documents:
- (a) Local Accountability and Assurance Framework for the MLEP published February 2017
 - (b) Memorandum of Understanding with an effective date of 1 January 2018 between the three Member Authorities and the MLEP relating to the responsibilities of Shropshire as the Accountable Body for all MLEP funding programmes ("**MOU**").
- 5.1.3 The MOU provides for Shropshire taking responsibility for (amongst other things):
- (a) acting as the Accountable Body for the administration of MLEP funding programmes;
 - (b) providing financial support and advice and legal advice to the MLEP both in respect of the funding programmes and generally;
 - (c) procure goods and services and hold assets on behalf of the MLEP;
 - (d) employing staff on behalf of the MLEP (including acting as host organisation for staff seconded from the other Member Authorities to work for the MLEP, subject to the MLEP meeting those costs.
- 5.1.4 The MOU also provides for the County of Hereford Borough Council to provide secretariat functions to the MLEP, but we understand that these services are now provided by the MLEP's own secretariat team.
- 5.1.5 Whilst the joint committee has ceased to operate, you have confirmed that MOU has not yet been terminated in accordance with its terms; we understand that no steps were taken to formally terminate the MOU as it was assumed that it would have terminated automatically when the joint committee ceased to exist. The fact that the joint committee is no longer operating is not relevant to the MOU as each of the Member Authorities is party to the MOU in their own right. Clause 4.1 of the MOU provides that the MOU continues unless terminated in accordance with its terms.
- 5.1.6 The termination provisions at clause 11 provide that the MOU will terminate on 31 March in the following year (i.e. 31 March 2019) "*following one party giving at least six months' notice in writing to the other*", or on the cessation of the MLEP. We understand that neither of these things has taken place. If the termination provisions have not been met, then the MOU arguably remains in force and our view is that this is the case. This is helpful in terms of the transitional period in which the MLEP is operating, as the obligations on Shropshire as Accountable Body and in relation to the other services that it

provides remain in place, until such time as the MOU is varied or terminated (with an SLA or similar arrangement taking its place). We would still **recommend** that the formal change of legal status of the MLEP to a CLG is documented for the purposes of the MOU should the parties wish to continue to operate under its terms, if only for a transitional period.

5.2 Incorporation as a CLG

- 5.2.1 Whilst a CLG has been established with the MLEP name and membership and has held board meetings, we understand that this company is currently dormant, holds no assets and has not entered into any contracts. In practice, the MLEP has been operating to date on the same basis that it had as an unincorporated association, and there is a question as to whether it remains, at this stage, an unincorporated association notwithstanding the creation of the CLG as we understand that the usual formalities to transfer the assets and liabilities of the MLEP have not been completed. It is our view that the MLEP continues to operate in practice as an unincorporated association.
- 5.2.2 The perfection of the transfer of the MLEP's business and assets into the CLG, can be achieved on paper by operation of law. We suggest an exchange of letters supported by a resolution of the unincorporated association and a record of the transfer being kept by each of the unincorporated association and the CLG. Any insurance should be transferred into the MLEP's name if this has not already been done. Any bespoke software licences should also be transferred to the CLG if they are in Shropshire's name and it is worth checking whether there are any warranties/guarantees on any equipment that has been purchased for use by the MLEP to see if they need to be transferred.
- 5.2.3 The benefits of incorporation include limited liability for the members, the ability to enter into contracts, own assets and employ staff, but incorporation also requires that certain formalities are met in order to comply with company law and there are taxation and VAT implications of 'stepping out' of the existing arrangements with Shropshire in particular.

5.3 Operating as a CLG

5.3.1 Contracting with Suppliers and Third Parties

- (a) We note that MLEP obtains various services from Shropshire including financial support, banking, HR, payroll and occupational health services.
- (b) As set out above, we **recommend** that formal contract(s) are entered into with Shropshire to document these arrangements if they are to continue (and in respect of banking arrangements, we **recommend** that a MLEP representative is included on bank mandates, even if Shropshire continues to manage the banking arrangements on behalf of the MLEP).
- (c) If Shropshire has entered into contracts with third party suppliers to the MLEP on the MLEP's behalf, then we **recommend** that these contracts should be novated to the MLEP or renegotiated directly between the supplier and the MLEP.
- (d) We also **recommend** that the MLEP assesses the level of /obtains its own liability insurance now that it is operating as a CLG, in particular as the MLEP is expected to contract in its own name.
- (e) We consider that the MLEP, whilst being a body corporate 'independent' of the Member Authorities, is likely to constitute a contracting authority under the Public Contract Regulations ("**PCR**") as it satisfies the three tests that determine whether an entity is a *body governed by public law*. Please see the more detailed analysis of this point in the appendix to this advice note.
- (f) There is a strong likelihood that any services contract awarded by the MLEP to Shropshire will fall within the scope of Regulation 12 of PCR as a contract

between entities within the public sector, which would mean that the contract would fall outside the requirement to run a regulated procurement procedure provided that the relevant thresholds are met, particularly in relation to whether less than 20% of the activities concerned by the co-operation are performed on the open market. Please see the more detailed analysis of this point in the appendix to this advice note.

5.3.2 Employment and Pensions

- (a) We have considered two options (in line with the Framework and taking into account current operational arrangements):
 - (i) Seconding the current staff to work within the MLEP (as you have been doing to date) and
 - (ii) Alternatively, effecting a transfer of those staff under TUPE.
- (b) We understand that all personnel within the MLEP are current Shropshire employees, and are provided through a loose 'secondment' arrangement.
- (c) We **recommend** that the secondment model is continued; this can be done in respect of both current and future secondees, although we **recommend** that you upgrade the documents and put in place a formal secondment agreement between Shropshire and the MLEP, (to apportion rights and responsibilities) as well as individual secondment letters for each relevant member of staff. Unless certain exemptions relating to the statutory obligations of Shropshire apply, the supply of secondees by Shropshire to the MLEP would be a VATable supply (see below).
- (d) If the employment contracts remain with Shropshire, with the staff being seconded to the MLEP, pension deductions are made by Shropshire and liability for pension deficits, etc, would be retained by Shropshire and not be passed on to the MLEP, unless this was agreed between the parties as part of the secondment agreement/SLA.
- (e) As an aside, we note from the cabinet meeting notes dated 18 February 2019, that Hertfordshire LEP confirmed that any staff currently employed by their Council/Accountable Body will continue to be employed in this way post incorporation. Hertfordshire LEP sought clarification on this points and MHCLG confirmed that this proposal in principle would be acceptable, subject to the requirement that the Chief Executive would report directly to Hertfordshire LEP in line with the Framework, which further supports the advice above.

Should the staff be TUPE transferred to the MLEP?

- (f) We understand that it is the intention of the MLEP to continue with the secondment arrangements referred to above. For completeness, it would be possible to transfer the employment of the 'in scope' employees, such that they became employees of the MLEP on a permanent basis, but this is not the MLEP's preferred route – it would perhaps be if it was anticipated that the current working arrangements enduring for a long time (10-15 years) without interruption. However if there is uncertainty about the future and any suggestion the MLEP may not continue or not continue in its present form, then TUPE would not be in the organisation's best interests. That is because once employees had transferred in under TUPE, those employees would be the responsibility of the LEP in the event that (for instance) redundancies had to be made. These members of staff are likely to have costly redundancy rights deriving from their council service and these liabilities would pass to the MLEP under TUPE.

- (g) We understand the employees concerned are LGPS members. You would not be legally obliged to continue with this, as TUPE does not operate to protect pension rights. However it is likely that you would come under fairly intense pressure (from unions representing the employees and perhaps political pressure also) to match the pension provision and perhaps seek Admitted Body status so that you could continue LGPS. Alternatively, failure to offer continued LGPS access / Admitted Body status might mean that individuals raise a formal objection to their TUPE transfer and do not then join the organisation.
- (h) Should you receive employees under TUPE, the benefit to the organisation is that the employees are fully under the LEP's control - perhaps giving more certainty (and subject to TUPE) more power to change working arrangements and ultimately terms and conditions. The ability to flex terms and conditions is restricted in the immediate aftermath of a transfer.
- (i) Whichever option you go for, if the model of operating through the CLG is continued, with a CLG being a legal entity in its own right it would be possible to hire new staff to fill any vacant posts that arise to be directly employed by the MLEP on whatever terms and conditions you choose (or you can continue with the secondment arrangements). These terms and conditions need not align in any way to Shropshire terms and conditions and could be drafted on a much more flexible and commercial basis. In terms of these positions, while responsibility for any future redundancies would sit with the MLEP, the relevant terms need not be onerous (as it would undoubtedly be for council staff arriving via TUPE). If redundancy is a particular worry you can control this risk by hiring people on fixed term contracts to carry out specific and time limited projects.

5.3.3 Tax considerations

- (a) In summary, an independent body corporate, including a CLG which carries on the business of the MLEP will be liable for corporation tax on any profits it makes from such activities. The profits should be computed on standard principles, but if there is any difference between the amount paid to any of the Member Authorities (being mainly Shropshire) for e.g. administration services and the market price for those services, it is possible the price could be adjusted by transfer pricing rules. In practice that would only be a problem where the MLEP was overcharged for services provided by the Member Authorities or undercharges for services provided to them. In this case as there are three Member Authorities it is likely that a separate company would not be found to be controlled by the Member Authorities so that specific transfer pricing rules will not apply.
- (b) A separate company carrying on the business of the MLEP would be a separate entity from its members for VAT and likely be considered to be in business for VAT purposes, to the extent it needs to make charges to third parties or recharge costs to its members. It will therefore likely need to register for VAT as a separate entity. As a commercial entity, it will not be able to benefit from the local authority's entitlement to recover VAT attributable to non business activity under s33 VATA 1994, which is likely to mean it will be less VAT efficient than previous practice where one or other of the Member Authorities could act as 'lead partner' for the MLEP activity and continue to benefit from s33. This position is set out in HMRC's internal manual at VATGPB6200.
- (c) We **recommend** that further consideration is given to the tax and VAT treatment of proposed cross charging arrangements to members and to the source of funding.

5.3.4 Accounting and Banking Considerations

- (a) The Framework clearly requires all LEPs to publish their accounts and financial information for transparency. In addition to this, the Companies Act 2006

requires that all registered companies prepare and file accounts at Companies House on an annual basis. There is currently disparity between the way grant funding and operations costs/income is reflected in LEP company accounts. None of the LEPs that have incorporated as a result of the new requirements of the Framework have yet submitted accounts for the most recent accounting period. Some LEPs that have been operating as limited companies for some time have continued to submit dormant accounts at Companies House (e.g. Dorset, Greater Lincolnshire, Heart of South West and Humber); others file full accounts, accounting for both grant funding and operational income and expenditure; others file accounts reporting operational income only, but reflect the management of grant income by the Accountable Body in the notes to the accounts.

- (b) A company is only considered dormant if it has had no 'significant accounting transactions' during the accounting period. As it is apparent that MLEP is/will be actively trading then it would not be able to file dormant company accounts.
- (c) A small company can prepare and submit accounts according to special provisions in the Companies Act 2006 and the relevant regulations. This means that they can choose to disclose less information than medium-sized and large companies. To qualify as a small company, a company must meet at least **two** of the following criteria:
 - (i) annual turnover must be not more than £10.2 million
 - (ii) the balance sheet total (i.e. total assets) must be not more than £5.1 million
 - (iii) the average number of employees must be not more than 50.
- (d) A company will also qualify for an audit exemption if it meets at least two of the criteria set out above, and therefore small company financial statements do not need to be verified by an external auditor.
- (e) Further information in relation to the requirements of company accounts can be found at the following link: <https://www.gov.uk/government/publications/life-of-a-company-annual-requirements/life-of-a-company-part-1-accounts>
- (f) We understand that there is limited guidance available in relation to the accounting treatment that should be applied by LEPs in relation to grant funding that is held by the relevant Accountable Body. It is apparent from the various accounts that are available from Companies House for LEPs that have been set up as companies limited by guarantee that there are differences in the accounting treatment in this regard. As an example, The Greater Birmingham and Solihull LEP recognise the grant funding in their accounts, while the Coventry and Warwickshire LEP do not recognise the funds that are held by their accountable body on their behalf. We note that the financial statements of both these entities have been audited.
- (g) We have reviewed the audited financial statements of Shropshire: <https://shropshire.gov.uk/media/13109/statement-of-accounts-201819.pdf>) and note that at page 45 it is stated in relation to the MLEP that "*The Council has concluded that the role of the accountable body is to be deemed as an agent, and therefore the net grant held should not be accounted within the Council's accounts.*" On this basis, and noting that interest accruing in the MLEP nominated bank accounts is applied to the operational costs of MLEP and not for the benefit of Shropshire, we consider that it is likely that MLEP should follow the example of The Greater Birmingham and Solihull LEP and recognise the grant funding in its own financial statements

- (h) We note that GBS LEP has very recently updated its accounts for accounting periods prior to 2018 as it had previously filed dormant accounts; the revised accounts state that *“The changes made to these financial statements are to provide clear line of sight as to how monies have flowed between the Company and Birmingham City Council, as the Accountable Body for the funds, as well as the internal expenses incurred by the Company in discharging its duties.”* This reinforces our view above that the MLEP should follow the GBS LEP's approach.
- (i) his has an impact on the accounts and audit exemptions referred to above. Based on the Statement of Accounts for MLEP 2018/19³ published on MLEP's website, we consider that if MLEP were to recognise the grant funding held on its behalf by Shropshire in its financial statements, then it would not meet the qualifying criteria of a small company and would therefore also not qualify for an audit exemption on the basis of the total income of £17.8m for 2018/19 shown on page 2 and total assets in excess of £15m shown on page 7).
- (j) We **recommend** that the MLEP engage the services of an auditor to advise further in relation to the accounting and auditing requirements should the MLEP continue to operate as a CLG.
- (k) In terms of **banking arrangements**, Shropshire will need to maintain the bank account for the Section 31 grants (capital and revenue) on the MLEP's behalf given its obligations as Accountable Body. The SLA or similar agreement between the MLEP and Shropshire should set out in clear terms how those funds will be managed on your behalf. For the MLEP's other financial and banking arrangements, the MLEP Board and management team should consider the practicalities in terms of making payments and deposits for day to day operations, including petty cash, etc and whether it would be more practical to maintain your own bank account for these purposes – and if not whether Shropshire is willing to offer a general banking service in this way where it is not under a statutory obligation to account for those funds to government.

5.3.5 Property

We understand that the MLEP occupies separate premises from Shropshire under the terms of a licence entered into between the licensor and Shropshire, a copy of which has been provided to us. the licence is a personal licence and can't be assigned by the licensee and our advice is therefore that the MLEP should enter into a new licence direct with the licensor. and you are checking the lease as to who the tenant is on the lease.

Pinsent Masons LLP
4 December 2019

³ https://www.marcheslep.org.uk/download/statement_of_accounts/LEP-Statement-of-Accounts-2018-19.pdf

APPENDIX 1

STATUS OF THE MLEP AS A CONTRACTING AUTHORITY UNDER PUBLIC PROCUREMENT LAW

1. INTRODUCTION

- 1.1 We are instructed to advise on whether the MLEP would constitute a "contracting authority" for the purposes of the Public Contracts Regulations 2015 ("**PCR**"), or whether it is exempt from the PCR by virtue of not being a contracting authority.
- 1.2 We are also instructed to consider whether any services contract between MLEP and Shropshire can be entered into without the requirement to run a regulated procurement procedure.
- 1.3 We have considered the MLEP's Accountability and Assurance Framework which includes various governance documents as well as the MLEP's Articles of Association.

2. EXECUTIVE SUMMARY

- 2.1 On the basis of the information made available to us, we consider that the MLEP is likely to constitute a contracting authority under the PCR as it satisfies the three tests that determine whether an entity is a *body governed by public law*.
- 2.2 In particular, we are of the view that the MLEP is meeting needs in the general interest as its main activities are to promote the local economy of the Marches region. We also consider that the MLEP does not have an industrial or commercial character as it does not act in the same manner as a standard economic operator.
- 2.3 Having reviewed the most recent financial accounts, it is likely that that the MLEP is majority financed by other contracting authorities as funding granted by the State constitutes a majority of its income. There are also arguments to suggest that the MLEP is subject to the management supervision of other contracting authorities, particularly given the role of Shropshire Council as the accountable body.
- 2.4 If the LEP falls under the definition of a contracting authority, as we expect, it will be required to run regulated tender procedures in line with the PCR whenever it awards public contracts above the relevant financial threshold.
- 2.5 The Assurance Framework confirms that the board (the "**LEP Board**") is the MLEP's ultimate decision-making authority. The LEP Board is responsible for taking all decisions and ensuring decisions meet with Government public finance and accountability requirements, and for setting strategic direction for the MLEP .
- 2.6 The LEP Board should have up to fifteen members and provides the strategic lead for the MLEP, setting the overall strategy for growth including making recommendations on: the development of the Strategic Economic Plan (SEP) priorities; oversight, endorsement and prioritisation of strategic projects; the allocation of budget; and monitoring expenditure and output performance for the SEP Growth Programme.
- 2.7 The LEP Board is required to meet twice a month in accordance with a timetable of identified dates and/or at such a time and place as the Board may from time to time determine. No business will be transacted at a meeting of the LEP Board unless at least seven members of the LEP Board are present, at least five of whom must be Private Sector members. All decisions made by the LEP Board will be made with a consensus approach. Should a consensus not be reached, a vote will be taken. Any decisions put to the vote shall be decided by a majority of the members present and voting at that meeting. In the event of a tie in votes, the Chair of the meeting will have the casting vote.
- 2.8 There is a strong likelihood that any services contract awarded by the MLEP to Shropshire will fall within the scope of Regulation 12 of PCR as a contract between entities within the public sector,

which would mean that the contract would fall outside the requirement to run a regulated procurement procedure provided that the relevant thresholds are met.

3. **LEGISLATIVE FRAMEWORK**

3.1 It is appropriate to consider public procurement law when a contracting authority is involved in securing works, supplies or services. As such, a contracting authority is required to carry out competitive tender procedures for above threshold public works, supplies and services contracts unless a specific exemption applies.

3.2 The definition of a 'contracting authority' is provided at Regulation 2 of the PCR:

"means the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law, and includes central government authorities, but does not include Her Majesty in her private capacity."

3.3 On the basis that the MLEP is neither considered a State, nor regional or local authority, it will be necessary to determine whether the MLEP is a *body governed by public law*.

3.4 Bodies governed by public law are defined as bodies that have **all the** following characteristics:-

3.4.1 they are established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; (the Specific Purpose Test)

3.4.2 they have legal personality; (the Incorporation Test) and

3.4.3 they have **any of** the following characteristics:- (the Control Test)

(a) they are financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law;

(b) they are subject to management supervision by those authorities or bodies; or

(c) they have an administration, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law.

3.5 In order to fall under the definition of a body governed by public law, and therefore a contracting authority, it will be necessary to consider the characteristics set out above in turn.

4. **THE SPECIFIC PURPOSE TEST**

4.1 **Meeting needs in the general interest**

4.2 The concept of needs in the general interest is distinct from the question of whether an organisation has industrial or commercial character. For example, an entity's activities could clearly constitute 'needs in the general interest', however if the entity also possesses industrial or commercial character, it will fail this limb of the test (and therefore the entity would not meet the definition of a *body governed by public law*).

4.3 Case law indicates that "needs" are likely to be considered "in the general interest" where they have some connection with the public interest and, as such, are usually provided for by state-run services or at least are provided under state control.

4.4 Article 2.1 of the MLEP's Articles of Association states the following:

2.1. The objects for which the Company is established (Objects) are:

2.1.1. to stimulate economic growth, productivity, employment, community development, job creation, inward investment, training and development, and commerce in the LEP Area; and

2.1.2. to promote the LEP Area positively at regional, national, European and international levels on matters affecting its economic development.

4.5 We consider that this limb of the Specific Purpose Test will be satisfied as the MLEP has been established to stimulate and promote the local economy in a positive manner. These activities reflect the services that would usually be carried out by the State for the wider public.

4.6 **Not having an industrial or commercial character**

4.7 When assessing whether an entity possesses an 'industrial or commercial character', the courts would consider whether the entity carries out the activity on a truly commercial basis. This would encompass an analysis of the characteristics of the marketplace in which it operates, and the nature of the entity itself broken down as follows:

4.7.1 **is the activity carried out in competition with other undertakings?** This would involve consideration of whether the entity is in a position which forces it to compete in a more commercial manner. More particularly, is there a possibility that the entity would have a national preference in respect of choosing suppliers? The rationale here is that a truly 'commercial' undertaking would not favour suppliers based within the same EU Member State;

4.7.2 **does the entity operate in normal market conditions, aim to make a profit and bears the risks of its activity?** The ECJ has, however, held that an entity which is not profit-making, but covers its own losses, does not necessarily constitute a body governed by public law. The relevance is whether the entity truly bears the risks of its own activity. Even if no legal mechanism exists for a public authority to cover the entity's losses, it is enough to demonstrate that a public body may 'rescue' the entity, rather than allowing it to fail;

4.7.3 **does the entity receive public finance for the activity in question?** The courts would consider this relevant as this demonstrates that the entity is not then competing on a level playing field with other undertakings.

4.8 Given the nature of the objects contained within the Articles of Association (mentioned above at 4.4), we consider that the MLEP does not act in the same manner as a standard economic operator as its priority is to maximise the economic interests of the region that it represents rather than generating profit for itself. We also understand that the MLEP receives a significant amount of public funding therefore it is unlikely that it can be said to be competing on a level playing field with other undertakings.

5. **THE INCORPORATION TEST**

5.1 The MLEP was incorporated as a private company limited by guarantee on 12 February 2019 and will therefore satisfy the Incorporation Test as it has separate legal personality.

5.2 On the basis that the first two parts of the test are satisfied, it is clear that the issue will then turn on whether any of the elements of the Control Test are also satisfied.

6. **THE CONTROL TEST**

6.1 **Financed by another contracting authority**

6.2 This element involves consideration of whether the entity is dependent on a contracting authority for financing its general activities. The term 'for the most part' is a reference to more than 50% of the funding deriving from a contracting authority. However, not all financing from the authority should be included within this calculation - only finance that has the effect of creating or reinforcing a relationship of dependency. Contracts freely negotiated in consideration of the receipt of services or supplies do not count towards this figure.

6.3 When coming to a conclusion on financing, the MLEP would need to look at all its income (including that from commercial activity) during a budgetary year. Whether the MLEP satisfies this

particular element of the control test is determined at the start of each budgetary year. Any public contracts concluded by the MLEP during the budgetary year in which it has been found to have satisfied this element of the control test would be covered by the PCR and would require a regulated tender process to be carried out.

- 6.4 Having considered the MLEP's sources of funding in their most recent Statement of Accounts for the financial year 2018/19, we are of the view that a majority of the MLEP's funding derives from contracting authorities. A pie chart showing the total funding and income available in 2018/19 can be found at Schedule 1 Appendix 2.
- 6.5 The two largest sources of funding for the LEP in the 2018/19 financial year is the Marches Investment Fund - Capital (£7,829,837 constituting 44.00% of the overall funding) as well as the Growth Deal Fund (£6,764,273 constituting 38.02% of the overall funding).
- 6.6 Our understanding is that the Marches Investment Fund was awarded by the Government from the Growing Places Fund to be used as a Revolving Loan Scheme. The aim of the fund is to provide capital loan funding for stalled housing and business premises projects that, following the injection of capital funding, will be able to start quickly and unlock economic growth.
- 6.7 As far as the Growth Deal Fund is concerned, we understand that the MLEP secured this funding from the Government's Local Growth Fund to support growth in the three urban centres of Hereford, Shrewsbury and Telford, through investment in critical transport and infrastructure improvements.
- 6.8 These sources of funding derive from State resources i.e. Central Government, and when combined, clearly exceed the 50% threshold mentioned above. We therefore consider that there is a strong chance that the MLEP will be seen as dependent on contracting authorities for financing its general activities. On the basis that this limb of the Control Test is satisfied, the MLEP will fall under the definition of a *body governed by public law* and will be caught by the PCR.
- 6.9 **Supervised by another contracting authority**
- 6.10 In order to satisfy this limb of the Control Test, it is necessary to consider whether the controls to which the MLEP is subject render them dependent on a public authority in such a way that the latter can influence their decisions in relation to public contracts⁴.
- 6.11 In general, a power to intervene in the management decisions of an entity is likely to constitute management supervision. However, this is not necessarily conclusive. If a contracting authority has supervisory powers, is able to take action over management decisions, powers to wind up the company, suspend management and appoint an administrator, such factors will be sufficient to demonstrate 'supervision'.
- 6.12 The Assurance Framework confirms at 2.2 that the LEP Board has agreed to consult the three local authorities of Herefordshire Council, Shropshire Council and Telford and Wrekin Council on a number of strategic issues such as reports/proposals that set, monitor and review objectives and priorities for economic investment across the Marches region, as well as reports/proposals that make recommendations to establish allocation of revenue and capital spend that is under the control of the MLEP . The obligation to consult is not in itself likely to be considered as management supervision unless those entities are then able to veto strategic decisions of the MLEP Board.
- 6.13 Section 2.5 of the Assurance Framework confirms that actions and decisions taken by the MLEP Board are also subject to scrutiny by the three local authority scrutiny committees of Herefordshire Council, Shropshire Council and Telford and Wrekin Council. The MLEP has agreed with the three local authorities that it will attend their relevant scrutiny panels twice a year from Autumn 2019. The MLEP will be asked to report each September/October on progress in delivering outputs and targets in the first 6 months of that year and highlight future developments for the MLEP . It will also be asked to report each April/May on progress in delivering its previous years' annual delivery plan and report on development plans and investments for the following year as outlined in its delivery

⁴ See Case C-237/99, *Commission v France* [2001] ECR I – 939, para 48

plan as approved by the LEP Board each Spring. Provided that the attendance at these scrutiny committees does not involve the local authorities influencing the decisions made by the MLEP, it is unlikely that this will satisfy this element of the Control Test.

- 6.14 All of England's 38 Local Enterprise Partnerships are required to have an accountable body. The accountable body for the MLEP is Shropshire Council and it is the Director of Finance, Governance and Assurance (known as a S151 Officer) at Shropshire who has responsibility for ensuring that a local assurance framework is in place and that decisions are made in accordance with this local assurance framework.
- 6.15 As the accountable body for the MLEP, Shropshire Council will:
- 6.15.1 hold the devolved major scheme funding and make payments in accordance with the recommendations made by the LEP Board;
 - 6.15.2 account for these funds in such a way that they are separately identifiable from the accountable body's own funds and provide financial statements to the LEP Board as required; each year a statement of accounts will be uploaded onto the MLEP website;
 - 6.15.3 record the decisions of the MLEP in approving schemes (for example if subjected to legal challenge); and
 - 6.15.4 supply protocol and guidance in relation to transparency and audit for the MLEP to adhere to.
- 6.16 The Section 151 Officer provides oversight relating to the administration of financial affairs within the MLEP throughout the year. In addition to providing an assurance statement as part of the Annual Performance Review, by 28 February each year, the Section 151 Officer must submit a letter to the Department's Accounting Officer. This letter outlines:
- 6.16.1 Details of the checks that the S151 Officer (or deputies) has taken to assure themselves that the MLEP has in place the processes that ensure proper administration of financial affairs in the MLEP;
 - 6.16.2 A statement outlining whether, having considered all the relevant information, the Section 151 Officer believes the financial affairs of the MLEP are being properly administered (including consistently with this Framework and the MLEP's Local Assurance Framework); and
 - 6.16.3 If not, information about the main concerns and recommendations about the arrangements which need to be implemented to get the MLEP to be properly administered.
- 6.17 The MLEP is also required to agree an internal audit plan for the year with the accountable body. This includes a risk-based audit plan of MLEP activity which provides assurance to the MLEP's Performance, Risk and Monitoring Committee, the LEP Board and Section 151 Officer. When signed off these audit reports are published on the transparency page of the MLEP website.
- 6.18 The Scheme of Delegation at Appendix 11 of the Assurance Framework seeks to record where authority rests within the MLEP for financial decision making⁵. This specifically sets out two areas in which the S151 Officer is responsible for making certain decisions:
- 6.18.1 On behalf of the LEP Board the S151 Officer will develop and sign off all funding decisions relating to funds allocated to the MLEP, e.g. grant funding agreements with partners allocated Growth Deal Funds and Marches Investment Fund loan agreements.
 - 6.18.2 Programme manage movement of BEIS and MHCLG funds to meet annual spend targets in the light of project performance data provided by the MLEP Secretariat and in response

⁵ The Assurance Framework states that the Scheme of Delegation was last updated on 25 March 2019

to recommendations of the MLEP Director and LEP Board and submission of claims and monitoring data in accordance with government requirements.

6.19 The CJEU stated in the *Commission v France* case that "since the rules of management are very detailed, the mere supervision of compliance with them may in itself lead to significant influence being conferred on the public authorities"⁶. We would argue that Shropshire's role as accountable body results in them having various powers of supervision over the MLEP, particularly in relation to the manner in which the MLEP exercises its spending decisions and internal audit procedures. It is not explicitly clear from the Assurance Framework whether the accountable body has powers to force the MLEP to make particular strategic, organisational or financial decisions, however based on the information available to us, we consider that there is a good chance that the MLEP will satisfy the second element of the Control Test.

6.20 **Appointed by another contracting authority**

6.21 The third element of the Control Test will be satisfied if more than half of the LEP Board's members are appointed by another contracting authority.

6.22 Appendix 2 of the Assurance Framework states that the LEP Board should have 11 Private Sector members, one Voluntary and Community Sector Member and three Council leaders representing the three administrative authorities within the partnership (Shropshire, Herefordshire and Telford & Wrekin).

6.23 As of October 2019, the LEP Board comprises of 14 members⁷ of which three are local authority leaders; these are Cllr David Hitchiner (Leader of Herefordshire Council), Cllr Peter Nutting (Leader of Shropshire Council), and Shaun Davies (Leader of Telford and Wrekin Council). A full list of the members of the LEP Board as of October 2019 can be found at Schedule 1 Appendix 3.

6.24 As far as appointments to the LEP Board are concerned, this will depend on the relevant portfolio of the Board members and is determined as follows:

6.24.1 The three Council Leaders are determined by the three administrative authorities.

6.24.2 The Chairs of the three Area Business Boards will be elected by their own Business Board Membership in accordance with their constitution/Terms of Reference. They can serve on the LEP Board for a maximum of six years.

6.24.3 The Chair of the Enterprise Zone will be elected by the Board of the Enterprise Zone in accordance with their constitution/terms of Reference. He or she can serve on the LEP Board for a maximum of six years.

6.24.4 The remaining members of the LEP Board will be recruited by an open recruitment procedure which will include adverts in the local press and on the websites of the MLEP and the three administrative authorities. The decision to recruit a new member to the LEP Board will be made by a Board Member Appointments Panel which will comprise of at least three existing Board Members plus the Chair and it will meet in the February of each year.

6.25 At present, it does not appear that this element of the Control Test will be satisfied as the only members of the LEP Board which are appointed by other contracting authorities are the three council leaders. Given that the LEP Board consists of 15 members in total, the three members appointed by contracting authorities will not meet the majority threshold required by this limb of the Control Test.

7. **CONCLUSION**

7.1 In conclusion, we are of the view that the MLEP will satisfy the Specific Purpose Test and the Incorporation Test. As far as the Control Test is concerned, it is likely that the MLEP satisfies two of

⁶ No.5, para 52

⁷ We understand that there is one current vacancy for Higher Education.

the three elements as a majority of its income derives from the State and it is subject to the supervision of Shropshire as accountable body. Given that the elements of the Control Test are not cumulative, this will be sufficient to satisfy the third test.

7.2 On the basis that the MLEP meets the three tests set out above, we consider that it will fall within the definition of a *body governed by public law* under the PCR and will therefore constitute a contracting authority. As a result, the MLEP will be required to carry out regulated tender procedures for the award of public contracts above the relevant financial threshold.

8. **REGULATION 12 PCR: PUBLIC CONTRACTS BETWEEN ENTITIES WITHIN THE PUBLIC SECTOR**

8.1 There is a strong likelihood that any services contract awarded by the MLEP to Shropshire, including for the provision of accountable body services, will fall within the scope of Regulation 12 (relevant extracts below), subject to considering the nature of the contract in further detail once the services to be provided have been determined by the MLEP, particularly in relation to whether less than 20% of the activities concerned by the co-operation are performed on the open market. We would be happy to carry out a full analysis of this in due course.

8.2 *Contracts which establish or implement co-operation between contracting authorities*

- (7) A contract concluded exclusively between two or more contracting authorities falls outside the scope of this Part where all of the following conditions are fulfilled:
- (a) the contract establishes or implements a co-operation between the participating contracting authorities with the aim of ensuring that public services they have to perform are provided with a view to achieving objectives they have in common;
 - (b) the implementation of that co-operation is governed solely by considerations relating to the public interest; and
 - (c) the participating contracting authorities perform on the open market less than 20% of the activities concerned by the co-operation.

8.3 *Determination of percentages*

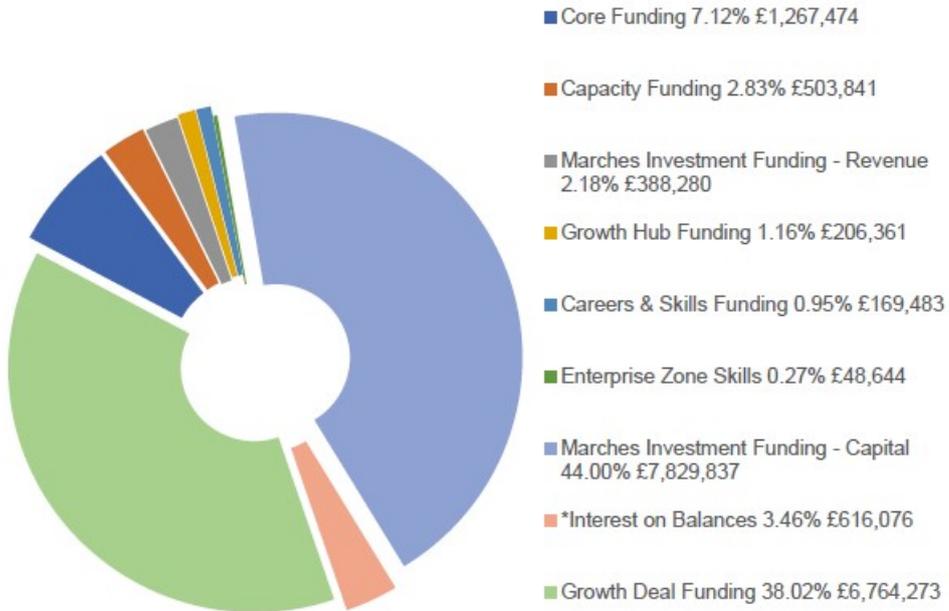
- (8) For the determination of the percentage of activities referred to in paragraphs (1)(b), (4)(b) and (7)(c), the average total turnover, or an appropriate alternative activity-based measure such as costs incurred by the relevant legal person or contracting authority with respect to services, supplies and works for the 3 years preceding the contract award shall be taken into consideration.
- (9) Where, because of—
- (a) the date on which the relevant legal person or contracting authority was created or commenced activities, or
 - (b) a reorganisation of its activities,
- the turnover, or alternative activity-based measure such as costs, are either not available for the preceding 3 years or no longer relevant, it shall be sufficient to show that the measurement of activity is credible, particularly by means of business projections.

8.4 The relevant procurement thresholds can be found [here](#) although please note that the sterling equivalent of these thresholds will be slightly increased from 1 January 2020.

APPENDIX 2

STATEMENT OF ACCOUNTS - FUNDING AND EXPENDITURE FOR 2018/19

The total funding and income available in 2018/19 is £17,794,269. The funding received from the various sources is detailed in the chart below.



* Interest on balances relates to balance from previous years £497,881 plus 2018/19 Interest £118,195 = £616,076

APPENDIX 3

COMPOSITION OF THE LEP BOARD - OCTOBER 2019

Sector	Name	Job Title and Organisation
Private Sector Chair	Mandy Thorn MBE	Managing Director, Marches Care Ltd
3 Area Business Board Chairs	Frank Myers MBE	Chair of Herefordshire Business Board
	Paul Bennett	Chair of Shropshire Business Board
	Paul Hinkins	Chair of Telford Business Board and Deputy Chair of LEP Board
Enterprise Zone	Andrew Manning Cox	Chair of Hereford Enterprise Zone
Food & Drink/Agri Tech	Dr David Llewellyn	Vice-Chancellor, Harper Adams University
Community & Voluntary Sector	Sonia Roberts	Charity Manager, Landau
Financial/Professional Services	Paul Kalinauckas	Chief Executive, BCRS Business Loans Ltd
16-18 Skills & Workforce Development	James Staniforth	Principal and CEO, Shrewsbury Colleges Group & Chair of Skills Advisory Panel
Construction	Ruth Shepherd	Founding Director, Results Communications Ltd
Manufacturing	Sara Williams	Marketing Manager, Protolabs
3 Local Authority Leaders	Cllr David Hitchiner (Alternate - Cllr Trish Marsh)	Leader of Herefordshire Council
	Cllr Peter Nutting (Alternate - Cllr Steve Charmley)	Leader of Shropshire Council
	Cllr Shaun Davies (Alternate - Cllr Lee Carter)	Leader of Telford and Wrekin Council