

# Governance, Risk and Best Value Committee

10am, Thursday, 21 May 2015

## Lothian Buses Shareholder Agreement

Item number 7.2  
Report number  
Executive/routine  
Wards

### Executive summary

---

At its meeting on 29 January 2015 the Governance, Risk and Best Value Committee requested a report providing some detail on the Council's shareholder agreement with Lothian Buses Limited and that company's dividend policy.

The Council, through its wholly-owned subsidiary Transport for Edinburgh Limited, is the majority shareholder of Lothian Buses Limited, holding 91% of the shares. The remaining shares are held by East Lothian, Midlothian and West Lothian Councils.

The Council has Shareholder Agreements in place with both Lothian Buses Limited and Transport for Edinburgh Limited. These agreements govern the relationship between the Council and these arms-length subsidiary companies, and ensure the Council has the required governance, financial and shareholder controls. The Agreements are of a confidential nature, but this report contains a high level summary of the controls and protections which the Council has in place in respect of its relationship with these two companies, including around the payment of dividends.

### Links

---

Coalition pledges  
Council outcomes  
Single Outcome Agreement

## Lothian Buses Shareholder Agreement

### Recommendations

---

- 1.1 It is recommended that the Committee:
  - 1.1.1 notes the content of this report; and
  - 1.1.2 discharges the action to report to Committee regarding the Lothian Buses Limited shareholder agreement and the company's dividend policy.

### Background

---

- 2.1 At its meeting on 29 January 2015 the Governance, Risk and Best Value Committee requested a report on some detail on the Council's shareholder agreement with Lothian Buses Limited ("LB") and the company's dividend policy.

### Main report

---

- 3.1 The City of Edinburgh Council, through its wholly owned subsidiary company Transport for Edinburgh Limited ("TFE"), is the majority shareholder of LB, TFE holding 91% of the shares in LB. The remaining 9% are held in aggregate by Midlothian, East Lothian and West Lothian Councils.
- 3.2 The Council entered into Shareholder Agreements with both of TFE and LB in October 2013 to govern this arrangement. The Agreements contain information that is of a confidential nature, and the full terms of these agreements cannot be disclosed.
- 3.3 LB's principal activity is to operate over 650 buses and open top tours carrying about 115 million passengers in 2013.
- 3.4 In the early part of 2012, as part of a Council-wide review of governance, the Director of Corporate Governance undertook a review of the governance of Council companies. Following extensive consultation with elected members, a report was submitted to full Council on 13 December 2012, where it was agreed that the Council needed to be more rigorous in the implementation and use of its monitoring rights in relation to LB. The Director of Corporate Governance was instructed to put in place the new shareholder agreement and governance arrangements approved by Council at that December 2012 meeting.

- 3.5 In implementation of that earlier review of Council companies, on 27 June 2013 and 22 August 2013, full Council approved reports which proposed a revised corporate and governance structure for the group of companies charged with fulfilling the Council's vision for integrated transport in Edinburgh. Included in Appendix 1 to this report is a summary of the group structure.
- 3.6 The above-mentioned reports in June and August 2013 emphasised the critical requirement for an appropriate level of shareholder control being in place for these companies, the reasons including for good governance, management of financial risk and to safeguard the Council's investment in integrated transport.
- 3.7 As referred to in the 22 August 2013 report, prior to the full Council meeting in August 2013 a data room was set up to provide elected members with access to a full suite of the contractual documentation it was proposed the Council enter into, as well as the full business models for each of the relevant companies, the financial, tax, legal and insurance reports which had been prepared for the Council and a risk summary as also referred to in that August report.
- 3.8 Subsequently to the 22 August 2013 decision, the revised corporate and governance arrangements were effected on 28 October 2013. Certain arrangements in respect of TFE were of a interim nature pending the commencement of passenger services on the Edinburgh Tram on 31 May 2014, at which point those aspects were also effected in a finalised manner in accordance with the Council approvals. As such, the first full financial year these revised governance arrangements applied to LB was the financial year commencing 1 January 2014.

### **Shareholder Agreements**

- 3.9 All companies are required to have a set of Articles of Association, which regulate some of the more procedural mechanics of that company, and how it operates, including the arrangements around the holding of annual general meetings. These Articles of Association are public documents, registered at Companies House.
- 3.10 Given the nature of the Articles of Association, if a shareholder wishes to have specific controls around how a company conducts its business, then a separate agreement may also be put in place between the shareholder and the company, what is often called a Shareholder Agreement. Such Shareholder Agreements are private. The purpose of such agreements for arms-length commercial operations, such as LB, is not to regulate all aspects of the running of the company, just those key aspects of most importance to the shareholder, since the company must be allowed certain freedoms to conduct its business. In addition, a shareholder should also be able to rely upon the professional judgement of the company's board of directors. Directors owe, by law, certain fiduciary duties to the company to act in its best interests.

- 3.11 It should also be noted that for LB the terms of the Transport Act 1985 provide certain obligations, and some restrictions, around how a local authority must exercise its control over LB. This means that the Council is under a duty to ensure the board of LB has no more than seven members who are not full time employees of the company, and not less than three members who are full-time employees of the company and hold sufficient positions of responsibility. In addition, no paid director or employee of LB may be an elected member of the Council, and nor may any unpaid director of LB who is also an elected member of the Council vote at Council meetings in respect of matters relating to the activities of LB. These controls do not apply to TFE.
- 3.12 Summaries of the main terms of the Shareholder Agreements were appended to the report to full Council of 22 August 2013, and these are replicated in Appendix 2 of this report, updated slightly to reflect the terms entered into.
- 3.13 As referred to above, the purpose of the Shareholder Agreements is to provide the Council with the controls and protections it requires over the operations of TFE and LB, and which are not needed over all aspects of the companies' operations. As such, it is for the boards of TFE and LB to run the companies as they best see fit, and they only need to report back to the Council as stipulated in the Shareholder Agreements, or otherwise required by law (for example the holding of the annual general meeting). Where the approval of the Council is required to any business of TFE or LB then this is a decision to be approved by the Council in the normal way, ie approved by a meeting of full Council or the appropriate Committee, or else by officers in accordance with the Council's own governance process.
- 3.14 Under the Shareholder Agreement, LB is required to produce quarterly management accounts, audited accounts, an annual budget and a three year business plan. The annual budget is produced by the board of LB in consultation with the Council and the business plan requires approval by the Council.
- 3.15 LB is developing a new business plan which will be reported to the Transport and Environment Committee for approval.
- 3.16 LB has produced audited accounts for 2014 and these will be reported to the Finance and Resources Committee prior to consideration at the LB Annual General Meeting, which Annual General Meeting is to be held on 25 June 2015.
- 3.17 LB consulted the Council on its draft 2015 budget and a response was provided to LB, prepared by the Acting Director of Services of Communities in consultation with the Convener and Vice Convener of the Transport and Environment Committee.

## **Dividends**

- 3.18 The Shareholder Agreements include provision for dividend policy, as referred to in Appendix 2 to this report. In summary, LB and its subsidiaries pay a cash dividend in each financial year subject to the reasonable cash flow requirements of LB and its subsidiaries. Payment of such a dividend shall be made only to the extent that there is cash in LB and/or subsidiaries. The declaration and payment of any dividends by those companies shall be the decision of the relevant board of directors.
- 3.19 The history of recent total dividend payments to all shareholders is as follows:
- |      |   |
|------|---|
| 2014 | £5.5m (the Council's share of this was £5,005,000). |
| 2013 | £3.3m (the Council's share of this was £3,003,000). |
| 2012 | £3.3m (the Council's share of this was £3,003,000). |
- 3.20 The dividend is distributed to shareholders proportionately relative to their shareholding in LB.

## **Measures of success**

---

- 4.1 The Council and TFE work closely with LB to ensure that Edinburgh benefits from a high quality and profitable integrated public transport system which assists the Council to achieve its objectives and outcomes as set out in the Local Transport Strategy 2014-19.

## **Financial impact**

---

- 5.1 There are no direct financial impacts arising from this report.

## **Risk, policy, compliance and governance impact**

---

- 6.1 The Shareholder Agreements for LB and TFE secure an appropriate level of shareholder control for the Council, and ensure there is good governance, management of financial risk and a safeguard for the Council's investment in integrated transport in Edinburgh, all as reported elsewhere in this report.

## **Equalities impact**

---

- 7.1 There are no equality impacts arising from this report however the principal operation undertaken by LB contributes greatly towards a high quality, accessible and well integrated public transport system available to all groups.

## Sustainability impact

---

- 8.1 The principle operation undertaken by LB contributes greatly towards a high quality, accessible and well integrated public transport system. This reduces dependency on car travel, reduces congestions and emissions.

## Consultation and engagement

---

- 9.1 None.

## Background reading/external references

---

Local Transport Strategy 2014-19

[http://www.edinburgh.gov.uk/download/downloads/id/3525/local\\_transport\\_strategy](http://www.edinburgh.gov.uk/download/downloads/id/3525/local_transport_strategy)

Report to City of Edinburgh Council 13 December 2012

[http://www.edinburgh.gov.uk/download/meetings/id/37567/item\\_no\\_83\\_-\\_council\\_companies](http://www.edinburgh.gov.uk/download/meetings/id/37567/item_no_83_-_council_companies)

Report to City of Edinburgh Council 22 August 2013

[Item No 8.4 - Edinburgh Tram - Preparing for Operations – Reports, 1.77 MB](#)

Report to City of Edinburgh Council 27 June 2013

[Item No 8.2 - Edinburgh Tram - Preparing for Operations – Reports, 658.33 KB](#)

## John Bury

Acting Director of Services for Communities

Contact: David Lyon, Acting Head of Transport

E-mail: [david.lyon@edinburgh.gov.uk](mailto:david.lyon@edinburgh.gov.uk) | Tel: 0131 529 7047

## Links

---

**Coalition pledges**

**Council outcomes**

**Single Outcome**

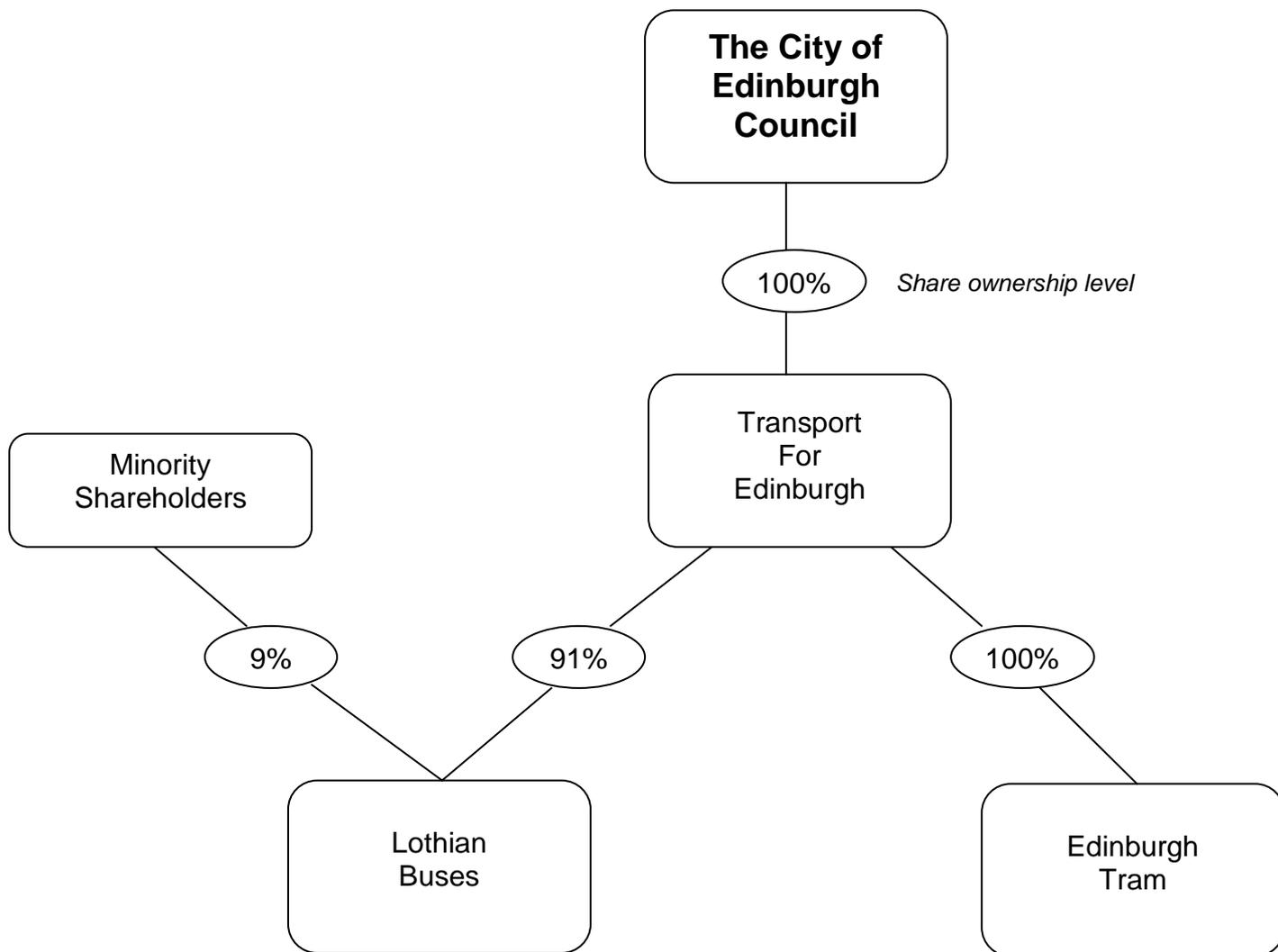
**Agreement**

**Appendices**

Appendix 1 – Group Structure Chart

Appendix 2 – Shareholder Agreements Summary

**APPENDIX 1**  
**Group Structure Chart**



## APPENDIX 2 Shareholder Agreements Summary

### 1. INTRODUCTION

1.1 This is a high-level summary of the shareholder agreements in relation to:

- (a) Transport for Edinburgh Limited ("**TFE**") entered into between the Council and TFE ("**TFE SHA**"); and
- (b) Lothian Buses Limited ("**LB**") entered into between the Council, TFE and LB ("**LB SHA**"),

(together the TFE SHA and the LB SHA, the "**Shareholder Agreements**").

1.2 This is not intended to be a comprehensive summary of the Shareholder Agreements, only a summary to the extent relevant for the purposes of the foregoing report. In addition, it should be noted that the provisions of the Shareholder Agreements are supplemented by the articles of association of the relevant company.

### 2. TFE SHA

2.1 **Business:** the business of TFE is, amongst other things, to act as a holding company for the Council to hold the Council's shareholding in LB and Edinburgh Trams Limited ("**ETL**") and to provide certain strategic and support functions (on arms' length terms) to its subsidiaries.

2.2 **Governance:** the board will comprise eleven directors. For so long as the Council holds 75 per cent or more of the share capital of TFE it shall be entitled to appoint and remove any and all directors of TFE. The Council will be entitled to appoint the chairman of the board (who shall not have a casting vote). Quorum for meetings of directors shall be three directors (of whom, one must be a non-executive Director being an elected council member). Save for certain reserved matters requiring the prior consent of the Council (see further paragraph 2.5 below) material decisions relating to TFE and ETL shall be taken by the board. The board shall constitute a remuneration committee and audit committee.

2.3 **Board Observer:** for so long as the Council holds 75 per cent or more of the share capital of TFE it shall be entitled to appoint an observer to TFE and ETL. The observer shall be entitled to receive the information sent to the boards of TFE and ETL and shall be entitled to attend and speak at (but not vote) at meetings of those boards and duly constituted committees. The current observer is the Acting Director of Services for Communities

- 2.4 **Financial:** TFE is required to produce quarterly management accounts, audited accounts, an annual budget and a three year business plan. The annual budget will be produced by the board of TFE in consultation with the Council and the business plan requires approval by the Council.
- 2.5 **Consent Matters:** the prior written consent of the Council is required before TFE and ETL can effect or propose certain reserved matters. The reserved matters include issuing/allotting new shares in TFE/ETL; passing a resolution to wind up TFE/ETL; amalgamating or merging with another business other than non-strategic acquisitions; making any material change in the nature or organisation of the business or the territory in which the business operates or discontinue or cease to operate all or a material part of the business; and appointing/removing any director or auditor of TFE/ETL.
- 2.6 The TFE SHA incorporates an accelerated procedure for obtaining consent to such reserved matters from the Council where waiting for the next Council meeting or Council committee meeting would lead to a material adverse effect on the trading of TFE (or relevant subsidiary). Such procedure permits for approval or rejection of any reserved matter to be given following consultation of the reserved matter with the Council's Convenor of Transport by the Chief Executive or Director of Corporate Governance of the Council.
- 2.7 **Dividend Policy:** it is the intention that TFE and its subsidiaries distribute by way of cash dividend all profits available for distribution subject to reasonable cash flow requirements for the following year.
- 2.8 **Confidentiality:** the TFE SHA contains confidentiality provisions which are usual for an agreement of this type. In addition the TFE SHA permits the passing of information by the Observer and Councillor Directors to officials and members of the Council provided that where the information is deemed "Commercially Sensitive" (disclosure of such outside TFE is reasonably likely to be materially detrimental to the business) the flow of and access to that commercially sensitive information may be restricted. The provisions relating to commercially sensitive information apply equally to information to be given directly to the Council under the TFE SHA.
- 2.9 **Assignment:** The Council may assign the benefits and burden of the agreement to any party to whom it transfers shares in TFE. TFE shall not be entitled to such assignment.
- 2.10 **Governing law:** governed by the laws of Scotland and the Scottish Courts will have exclusive jurisdiction to hear any disputes.
3. **LB SHA**
- 3.1 **Parties:** Note that the minority Council shareholders are not a party to the LB SHA, nor is there any requirement for them to be.

- 3.2 **Business:** the business of LB is, amongst other things, to operate bus networks in Edinburgh and the Lothians as part of an integrated network of public transport service in harmony with other modes of transport owned or operated by any affiliate of LB and to provide certain support services to its affiliates (on arms' length terms or at cost).
- 3.3 **TFE Covenants:** TFE covenants with LB, amongst other things, to co-operate and use reasonable endeavours to promote and develop the business and procure, to the extent it is able, that LB conducts its business in accordance with the annual budget and business plan.
- 3.4 **Governance:** the board shall at all times reflect the requirements of the Transport Act 1985. The Council will be entitled to appoint the chairman of the board (who shall have a casting vote). Quorum for meetings of directors shall be three directors (of whom, one must be a Council appointed director). Save for certain reserved matters requiring the prior consent of the Council (see further paragraph 3.7 below) material decisions relating to LB shall be taken by the board. The board shall constitute a remuneration committee, audit committee and nominations committee.
- 3.5 **Board Observer:** for so long as the Council holds 75 per cent or more of the share capital of TFE and TFE hold 75 per cent or more of the share capital of LB, the Council shall be entitled to appoint an observer to LB. The observer shall be entitled to receive the information sent to the board of LB and shall be entitled to attend and speak at (but not vote) at meetings of those boards and duly constituted committees. The current observer is a senior manager in the Council's Transport Division.
- 3.6 **Financial:** LB is required to produce quarterly management accounts, audited accounts, an annual budget and a three year business plan. The annual budget will be produced by the board of LB in consultation with the Council and the business plan requires approval by the Council.
- 3.7 **Consent Matters:** the prior written consent of the Council is required before LB or any of its subsidiaries can effect or propose certain reserved matters. The reserved matters include issuing/allotting new shares in LB and its subsidiaries; passing a resolution to wind up LB and its subsidiaries; amalgamating or merging with another business other than non-strategic acquisitions; making any material change in the nature or organisation of the business or the territory in which the business operates or discontinue or cease to operate all or a material part of the business; and appointing/removing any director (save a director appointed as an employee representative) or auditor of LB and its subsidiaries.

- 3.8 Pending the Council consenting (or withholding consent) to LB or a LB subsidiary running a route outside Edinburgh and the Lothians (a "**Permitted Route**"), LB (or a subsidiary) shall be allowed to run a Permitted Route, provided that:
- (a) the commencement is in response to a competitor (which operates in an area neighbouring Edinburgh and the Lothians) making an aggressive competitive move in or into Edinburgh and the Lothians which would otherwise cause a material competitive disadvantage to LB (or relevant subsidiary) if LB (or relevant subsidiary) did not respond immediately to such move (an "**Aggressive Move**");
  - (b) the route is run from within Edinburgh and the Lothians into an area bordering Edinburgh and the Lothians;
  - (c) LB notifies the Council in writing promptly following such Aggressive Move, such notification to include details of the proposed response of LB (or relevant subsidiary); and
  - (d) LB seeks the the Council's consent as soon as reasonably practicable under the reserved matters regime to the establishment of a Permitted Route (notwithstanding that such commencement of such Permitted Route may already have taken place under the provisions described above).
- 3.9 The Council consent shall not be required in relation to the acquisition of shares in an undertaking or the business of an undertaking where:
- (a) the business of the company being acquired or the business being acquired is the provision of a bus service on a route in Edinburgh and the Lothians;
  - (b) the Company would have otherwise been able to provide such a service provided by the company being acquired or the business being acquired without the consent of the Council under the reserved matters provisions of the LB SHA;
  - (c) the total consideration and any other payments in connection with the acquisition payable to the seller or other third party (including deferred payments, earn out payments, repayment of debt or incurrence of liability on behalf of the acquired entity and/or seller but excluding costs and expenses of professional advisers) in relation to the acquisition is less than £250,000; and
  - (d) LB either consults with the Council or notifies the Council in writing, in each case prior to any such acquisition.

- 3.10 The LB SHA incorporates an accelerated procedure for obtaining consent to such reserved matters from the Council where waiting for the next Council meeting or Council committee meeting would lead to a material adverse effect on LB. Such procedure permits for approval or rejection of any reserved matter to be given following consultation of the reserved matter with the Council's Convenor of Transport by the Chief Executive or Director of Corporate Governance of the Council.
- 3.11 **Dividend Policy:** it is the intention that LB and its subsidiaries distribute by way of cash dividend all profits available for distribution subject to reasonable cash flow requirements for the following year.
- 3.12 **Confidentiality:** the LB SHA contains confidentiality provisions which are usual for an agreement of this type. In addition the LB SHA permits the passing of information by the Observer to officials and members of the Council provided that where the information is deemed "Commercially Sensitive" (disclosure of such outside LB is reasonably likely to be materially detrimental to the business) the flow of and access to that commercially sensitive information may be restricted. The provisions relating to commercially sensitive information apply equally to information to be given directly to the Council.
- 3.13 **Assignment:** No assignment is permitted without the consent of the other parties to the LB SHA.
- 3.14 **Governing law:** governed by the laws of Scotland and the Scottish Courts will have exclusive jurisdiction to hear any disputes.