

# Forest Holidays Governance Review – Key Findings and Proposals for Discussion

8 February 2019

This Review has been undertaken by means of a 'desktop' review of key documentation supplemented by interviews with Defra, the Forestry Commission, Forest Enterprise and Forest Holidays personnel. We have been not been able to independently assure any of the information or opinions therein nor has it been practicable to revisit and triangulate interviews and we may not have had sight of all key documents. This Document is only intended for distribution to the following:

- 1) The Board of the Forestry Commission
- 2) The Board of Forest Enterprise
- 3) Defra Permanent Secretary and Steering Group Members
- 4) Defra Ministers.

This Document is not to be disclosed beyond those listed without the consent of UKGI.

# Contents

- 1. Introduction
- 2. Conclusions and Recommendations
  - 2.I Part1 of ToR - Governance Options and Recommendations for Defra and FC in relation to FH  
Summary Table of Recommendations
  - 2.II Part2 of ToR - Advantages and disadvantages of FC Shareholding in FH

## Appendix A: Structure and Decision Making Process

- A1. Forestry Commission Structure
- A2. Forest Holidays Structure
- A3. Understanding of Decision Making Process
- A4. Detailed Findings and Recommendations
- A5. EMGN4a Site Selection Process Schematic

## Appendix B: Additional Documents

- B1. Forestry Commission Governance from April 2019
- B2. Eversheds Proposed Forest Holidays Ownership Structure
- B3. Terms of Reference

# 1. Introduction

# 1. Introduction

## 1.1 Background and context of review

A review was undertaken by the Government Internal Audit Agency (**GIAA**) in September 2018 of decision-making by the Forestry Commission (**FC**) in relation to its commercial investments. This followed a request for approval of a commercial transaction (Project Bluebell) relating to Forest Holidays (**FH**), a joint venture between FC, (as a minority shareholder) private equity investors and FH's managers. This request was declined by Ministers in July 2018.

One of the recommendations of the GIAA (recommendation 8), which was accepted by Ministers, was that an independent governance review be undertaken by UK Government Investments (**UKGI**) led by Defra group Commercial of decision-making in relation to FH by FC and Forest Enterprise (**FE**). This review is the output of that action.

## 1.2 Areas covered by the review

The terms of reference for this review and detailed scope are included as Appendix B3 but in summary:

- The review will consider two elements:
  - I. Governance (the mechanisms, processes and relations by which corporations are controlled and directed) review of the FC's decision-making in regards to its relationship with FH. The review will focus on the effectiveness and appropriateness of the current Governance arrangements for commercial decision making within FC and FEE in relation to FH and the link to Defra Ministers; and
  - II. The strategic and practical benefits derived from FC's shareholding in FH and whether there would be any advantages or disadvantages to maintaining or dispensing of its shares.

Action I. is covered by section 2 of this review at pages 6 to 14 and Action II. is covered by section 3 at pages 16 to 19. A detailed analysis of the current decision making process together with the detail of our findings and recommendations can be seen in Appendix A .

- The review takes into account GIAA's findings and recommendations (in so far as they are relevant to governance), but does not revisit the detailed background to and issues arising from the transactions addressed by the GIAA in their report, or opine on the validity or otherwise of any purported delegations of authority.

**2.1 Conclusions and Recommendations:  
Part 1 of ToR - Governance Options and Recommendations  
for Defra and FC  
Summary Table of Recommendations**

## 2.1 Governance Options and Recommendations for Defra and FC

Set out below are four potential options for the future relationship and governance between Defra and FC in relation to FC's interest in FH. We have provided, in addition to a short, tabulated description of the options, and a summary of the issues, benefits and challenges of each option.

The options cover maintaining the status quo, control exercise largely by Defra, control exercise largely by FC and a hybrid option which provides an element of control for Defra but only intended to be exercised where FC/ FH have moved outside an agreed policy framework. *Our strong recommendation would be for this hybrid option*, which exploits the expertise that resides largely in FC, it is likely to be the most efficient and the option most likely to secure the continued support and investment of FH's capital providers; it does however provide some measure of control for Defra.

While a well-articulated and clearly understood governance framework is an important component it would be desirable for this to be underpinned by greater transparency and communication between Defra and FC/ FH both as regards Defra's policy in so far as it affects FH's business and greater communication from FH as regards its strategic objectives, the execution of its business model and the impact of FH's business on the PFE.

# 2.1 Governance Options and Recommendations for Defra and FC

## Summary of Options

Option 1 - Current arrangement	Option 2 – Defra/ SoS control	Option 3 – Delegated authority	Option 4 – hybrid model with integrated approval process - RECOMMENDED
Lack of clarity over authority for making decisions in relation to FH sites	Defra/ SoS effectively responsible for all key decisions/consents in relation to FH sites	Authority delegated to FC by SoS for all FH site related decisions	Authority delegated to FC by SoS, but with right of veto, but only in clearly defined circumstances
Lack of clarity over Defra policy in relation to site development by FH	Criteria for key decisions/consents would need to be established	Would clearly need to be appropriate governance and accountability as highlighted in the 2012 review by the Bishop of Liverpool	If a (pre-agreed) site approval process has been followed, SoS should be prepared to confirm at the appropriate stage (eg agreement for lease, prior to planning) that a site lease will be granted
		Likely to require primary or secondary legislation to ensure delegation of authority	Would require greater transparency and communication between Defra, FC and FH
SoS has de facto control of all freehold related decisions	SoS has control of all freehold related decisions and can ensure close alignment with Defra policy and any other considerations of which they are aware	Defra's involvement would be minimised and SoS ultimately not responsible for FH related decisions whether VFM or otherwise	SoS retains control over certain key decisions, albeit that control is required to be exercised in a consistent and predictable manner
	Less likelihood of conflicts of interest between FC income generation/protection of the PFE	Possible conflict between FC income generation/protection of the PFE (depending on governance and accountability arrangements)	Transparency over an agreed upon (sic) process and right of veto will minimise potential scope for conflict
Uncertainty as to outcomes leading potentially to: (1) wasted effort and costs by FC/FH on site appraisal, and/or (2) deferment of investment decisions by FH/ Capital providers (3) FH business model becoming unsustainable/FH no longer viable	Uncertainty as to potential outcomes, unless consistency in decision-making against a clear policy framework. In the absence of this potential adverse consequences as in option 1 in relation to site appraisal, deferment of investment decisions and sustainability of FH business model	Outcomes likely to be more predictable and more conducive to investment by FH/capital providers However unlikely to be an attractive option for Defra given current sensitivities relation to the economic exploitation of PFA and the requirement for amending legislation.	Providing control is exercised in a consistent and predictable manner (and seen to be), this should reduce the scope for uncertain outcomes in the approval process, improving investor confidence and propensity to appraise and invest in new sites. Likely to improve the longer-term prospects of FH
Potential deferment of/delay in other site related decisions	Inefficiency and potential delay in decision-making, with duplication of effort between Defra and FC	Should improve the efficiency and speed of decision-making	Should improve the efficiency and speed of decision-making
	Appears to contradict policy of delegating responsibility to FC where the principal body of expertise resides, and which has its own accountable officers		Broadly consistent with the policy of delegating responsibility to FC as a non-ministerial government bond
	Would require Defra to increase its own resources to deal with a wide(r) variety of land -related decisions, (depending clearly on the extent of decisions to be referred to Defra)		
Reduced FC income stream as a result of fewer site leases entered into by FH	Reduced FC income stream as a result of fewer site leases entered into by FH	Likely to increase future income streams for FC as leaseholder both in terms of renegotiation of existing arrangements as well as new site lease arrangements	Likely to increase future income streams for FC as leaseholder both in terms of renegotiation of existing arrangements as well as new site lease arrangements

## 2.1 Governance Options and recommendations for Defra and FC.

We set out below in more detail the four possible approaches outlined above and our views on the likely consequences of pursuing each course of action and our recommended approach.

### 2.1.1 Continuing with the current model

- Our review identified differing views on Defra policy and the implementation of it in relation to commercial exploitation of the Public Forest Estate (PFE) leading to uncertainty and impacting upon outcomes. In particular, if a veto can be exercised in relation to transactions by the SoS without clear guidelines there is potential for FH's operating model to be undermined and to create uncertainty for investors and for investment decisions to be delayed to the detriment of trading performance and future funding.
- We understand that FH typically incurs circa £1m in securing planning permission for proposed sites which have been approved by FC for development. Without clarity in respect of the grant of leases, this significantly increases the risk for FH and the propensity for it not to undertake feasibility assessments for developing new sites. In the absence of changes to the governance framework and approval processes, it is therefore questionable whether the current model is sustainable and the failure of FH would likely mean that the PFE would revert to the SoS as landlord with potentially adverse implications from an operational and PR perspective.
- Both FC and FH have expressed their concerns about recent decisions and the uncertainty that they have created in the model. Apart from the uncertainties over the veto it does not appear that the EMGN4a (Estate Management Guidance Note) process (see Annex A3 and A5) has been endorsed by Defra and there is no indication of how FC balances its various policy objectives, particularly in relation to commercial development. As such FH finds itself in a position where it could incur the costs of moving a proposed site through planning permission only to find that the site is vetoed at a later stage by Ministers. Both organisations have expressed their desire that Defra and the SoS clearly outline their policy and proposed process in relation to FH to ensure that all stakeholders are aware of the parameters in which they operate going forward.
- It would seem that continuing on the basis of the current model is unsustainable and we would caution against the SoS seeking to retain a right to review all FC/FH processes. Indeed, without certainty, an improved approach to Governance, a clear policy steer and an understanding of the interests and requirements of all of the stakeholders involved there is a real possibility that the current majority investor will either refrain from investing further funds to enable the growth of the business, or will seek to withdraw its investment altogether. *Without a change in approach there is therefore a real possibility that the FH business could fail.*



## 2.1 Governance Options and Recommendations for Defra and FC

### 2.1.2 SoS and Defra have explicit control over all key decision making processes

- This option would make it clear that a Defra right of veto exists over all key decisions in relation to FH but that some comfort could be drawn from the fact that there would also be oversight from Defra throughout the process both in relation to site selection and corporate decisions. This position would be clearly outlined in a Defra policy statement setting out how these powers would be exercised.
- In this option, Defra will remain responsible for all key decisions; it would, however, be necessary to determine what these “key decisions” are in relation to FH. Decisions in relation to Landlord and Tenant obligations, for example, are likely to be numerous and varied and it would therefore be appropriate to consider whether Defra would wish to be responsible for all of these decisions and if not, where the line is drawn and what the governance around the determination looks like. For example it could be set in terms of only the grant of certain types of lease and for a particular term certain.
- Retaining control over all key decisions within Defra could also have the following implications:
  - Currently commercial functions, including the process of determining site selection, sit within FC and Defra would therefore need to provide that resource itself;
  - the decision making process is likely to be cumbersome with SoS being faced with a significant increase in submissions for FH authorisations, with a consequent increase in the time commitment of Defra staff and potential delays in decision making - all of which is likely to be commercially detrimental to FH;
  - without clarification on what the SoS is likely to approve (or not) it will be difficult for FH to operate effectively and will create uncertainty. This is likely to have an adverse impact on FH’s investors and their propensity to invest further; and
  - this approach would appear to contradict the purpose of FC as a Non-Ministerial Government Department and the policy of delegating responsibility for the PFE to FC and could create an unwelcome precedent for other development projects undertaken by FC.
- In pursuing this approach there is the real possibility that the FH model will be unsustainable on the basis that decisions relating to future site developments are outside of its control. Investors in particular are likely to find this uncertainty unattractive, looking to withdraw their support and creating a financially uncertain future for the Company. We would not, therefore, advocate pursuing this approach.

## 2.1 Options and Recommendations for Defra and FC

### 2.1.3 Delegated authority

- In this option, authority would be completely delegated to FC by the SoS in relation to the PFE for the purposes of granting leases to FH by entering into a formal delegation of authority. Indeed, the Bishop of Liverpool in the *Independent Panel on Forestry: Final Report* of 4 July 2012 explored this idea with the suggestion of creating a Charter for the PFE which would specify the public benefit mission and statutory duties to be delivered by a group of Trustees or Guardians accountable to Parliament overseeing a PFE management organisation evolved from FE.
- *We recognise, however, that this idea may be unattractive to Defra given the current sensitivities in relation to the PFE and the possible need for primary or secondary legislation. Therefore pursuing a model which delegates the SoS's authority on an unfettered basis is perhaps unrealistic at this time.*

### 2.1.4 Hybrid Model with integrated approval process - RECOMMENDED

- With this approach, we envisage the SoS retaining the ultimate veto over the site approval process, but with the ability to use the veto only at a relatively early stage to ensure that FH have confidence to proceed through the planning process. This approach could also incorporate an enhanced role for Defra Group Commercial.
- For example, the process for granting new leases could operate in the following way:
  - Defra agrees a process along the lines of the existing EMGN4a (or indeed endorses the existing process in full without modification) for selecting sites suitable for development by FH on the PFE, in line with Defra policy;
  - The process is clear and transparent, is shared with FH as a readily available public document and is expressed in a refreshed Defra policy statement;
  - Once a site has cleared the EMGN4a process it is reviewed and approved by the future Forestry England Board (or Forestry England Chief Executive, if FC choose to delegate approval authority in certain circumstances) and FH's views are sought on whether the site is suitable based on their own criteria;
  - Assuming that both the Forestry England Board and FH wish to take the site forward, a determination will be made as to whether the site should be referred to the current Defra Investment Sub-Committee (**Investment Committee**). We would suggest that new site leases which are of material significance should be reviewed by the Investment Committee, acting as a gateway for a further decision by the SoS;
  - Defra and FC may wish to agree exactly what should be determined as being of "material significance" when it comes to site approvals, however, we would make the following suggestions in determining a site to be of material significance which should therefore be referred to the Investment Committee.

## 2.1 Options and Recommendations for Defra and FC

1. By reference to the existing Investment Committee ToR - for example, if the grant of the new lease is considered to be novel, repercussive or contentious; however, if the agreed process has been followed properly, these risks would be deemed to have been addressed and/ or
  2. Whether the proposed lease term exceeds a certain term, with leases which exceed this term being referred to the Investment Committee; and/or
  3. Whether the notional value of the lease based on the present value of future rents (discounted at a pre agreed discount rate) over the proposed lease term, exceeds a certain amount.
- The proposal for the new site lease would then be considered by the Investment Committee and a determination will be made as to whether the site is suitable based on VfM considerations and Defra Policy (which should be a given assuming that the site has been through the EGMN4a process);
  - If approved by the Investment Committee then a submission would be made to the SoS for approval, subject to planning (and any other conditions which may be relevant). If the above process has been robustly followed, in line with Defra policy, then there should be no reason for the SoS to withhold consent;
  - If the SoS is happy with the site selection then FC enters into an Agreement to Lease, a legally binding document which commits the SoS to enter into a lease with FH (in an agreed form) subject to certain conditions (e.g. Planning approval is obtained). Once FH have satisfied the conditions within the Agreement to Lease, the SoS would grant the lease;
  - The above process could also be followed for all materially significant changes to existing leases based on the above considerations, but again, this should be the subject of future discussions and agreement between Defra and the FC;
  - Decisions in relation to all other site approvals (i.e. for leases below the “materially significant” criteria considered above) and in relation to the management of existing leases should be made wholly by FC or the future Forestry England Board, pursuant to existing powers within the Countryside Act 1968. We do not feel that Defra or the SoS should be involved in these decisions as the expertise and resource currently sits within FC and management of the PFE is one of the key activities of FC.
- In relation to Corporate Decisions we would note the following:
    - The Regulatory Reform (Forestry) Order 2006 already contains restrictions in relation to Joint Ventures (including FH) whereby FC must seek authorisation from HMT before making investments or providing loans. We do not therefore feel that the process needs to change in this regard, albeit that FC should take time to understand the limitations on what they may do by reference to the Order as previously suggested by the GIAA report;
    - There are clear Financial Delegations in place between Defra and FC as outlined in the Financial Delegation letter sent by the Defra Permanent Secretary (as Primary Accounting Officer) in March 2017 – for example, Ian Gambles, as Agency Accounting Officer for FC has authorisation to sign off on expenditure up to £10 million;

## 2.1 Governance Options and Recommendations for Defra and FC

- FC is subject to the requirements in MPM and therefore the organisation, and Ian Gambles as the Agency Accounting Officer must ensure that all transactions which are Novel, Repercussive or Contentious are referred to HMT;
- The decisions where FC has a right to consent as shareholder are set out in the December 2017 Investment Agreement (Schedule 7, part 4) between FH, FC and its investors and appear to be comprehensive for a minority shareholder. It cannot be obliged for example to put in new capital but would be diluted if it chose not to do so. Again, it should be agreed between FC and Defra whether there should be a de minimis level below which the decision would remain with FC;
- Notwithstanding the above, if there are particular corporate and commercial decisions which are not already covered by the above assurance processes and which Defra has determined, as a matter of policy, should always be referred to Defra by FC (perhaps by reference to the consents required under the Investment Agreement) then these should be clearly spelt out by Defra and could follow the above process of reference to the Investment Committee as envisaged for new site leases of material significance.
- We note that the proposed Project Bluebell transaction offered the opportunity to re-set market rents, update the Framework Document so that it is more fit for purpose and crucially, remove the Evans Group from the overall FH structure. It is unfortunate that this transaction did not proceed as we consider that the removal of the Evans Group from the structure is essential to the future success and growth of the business and we would therefore endorse any future attempts of Defra, FC and FH to revisit a variant of this transaction.
- We feel that this option would deliver the most effective governance model for Defra and FC in relation to FH whilst ensuring certainty to enable the FH business to grow.

***Note that the above options and recommendations are specifically aimed at Forestry Commission England but may have equal application to the Devolved Administrations. We comment below on the implications of the new structure set out in B.2 for the exercise of the shareholding in FH.***

### 2.5 Table of Recommendations

- Outlined in the following two slides is a table of recommendations for actions which we feel would enhance the governance of FC's relationship with FH.
- Whilst we have not had the opportunity to consider the relationship which the Devolved Administrations share with FH in relation to the Commercial Decision Making process we feel that a number of recommendations outlined below would be equally applicable to those administrations to the extent that they feel it is relevant.

## 2.1 Summary Table of Recommendations

Issue	Action	Output	Priority
<b>Ambiguity in Relationships, Powers and Delegation of Authority</b>			
No Framework Document to articulate and formalise relationship and respective responsibilities of Defra and FC in relation to FH	Defra and FC to agree and finalise a Framework Document to govern the relationship in relation to FH to clarify, for example, authority levels for approval of transactions, address conflicts of interest and manage expectations, governance and referrals for defined transactions and any material changes to policy.	New Framework Document	HIGH
Lack of clarity, understanding and agreement between Defra and FC on the extent to which the SoS has delegated powers to grant leases and other dispositions of the PFE to FC in relation to FH.	As per recommendations of GIAA, seek external legal advice to determine the current position.	Legal opinion provided by external Lawyers	HIGH
Lack of clarity and understanding on the extent to which the SoS wishes to be consulted or make decisions in future regarding site leases and other dispositions of the PFE in relation to FH. Determination and articulation of appetite for delegation of authority.	SoS to clarify extent to which Ministers should be involved in future decisions on site leases (and the grant of other rights) at the earliest opportunity. Defra needs to 1) determine exactly what authority has or has not been delegated to FC; 2) Determine it's appetite for future corporate decisions in relation to FH; 3) clearly articulate this to FC; and 4) ensure that a robust assurance structure is in place with clear line of sight on delegation and responsibility.	Statement from SoS Clarification of Delegations of Authority	HIGH
Absence of Defra Policy in relation to FH (nb: findings in GIAA report that ". . . Defra has not (so far) clearly defined its own expectations [in relation to FH]")	Defra and Ministers to clearly define Policy position in relation to FH which is clearly communicated to all primary stakeholders including FH and its investors.	Policy Statement	HIGH
<b>Internal Governance within FC and FH</b>			
Departure of Forest Enterprise CEO in December 2018. Disproportionate decision making power rests with FE CEO	Replacement of CEO with sufficient expertise and commercial acumen to manage relationship with FH. Consider CEO's decision making powers to incorporate future Forestry England Board.	Appointment of new CEO Revised delegation of authority to FE CEO	HIGH
Current internal structure within FC is overly complex. Lack of Defra representation on Forest Enterprise (Forestry England) Board.	Endorse the proposed restructure of FC and, in particular, the creation and constitution of the new Forestry England Board to include enhanced representation from Forestry England executives and NEDs with Commercial and/or Forestry related experience relevant to the activities of FH and FC. Additionally, either appoint a nominated Defra NED to represent Defra's interests or, appoint a Defra observer to ensure that Defra are sighted on all key decisions.	Finalise proposed restructure Appoint Defra NED/Observer with requisite skillset	MEDIUM
Limited oversight of activities of FH by the FC ARAC	FC to ensure that the ARAC proposed in the revised structure has strong representation from the FE Board, has appropriate commercial skills, allocates sufficient time (including dedicated meetings and/or sections of meetings) to FE business, and is specifically tasked in its terms of reference with monitoring the FH shareholding and site leases.	Agree and embed structured format of ARAC approach to FH	MEDIUM

## 2.1 Summary Table of Recommendations

<i>Issue</i>	<i>Action</i>	<i>Output</i>	<i>Priority</i>
<b>Implementation Issues</b>			
FC oversight of site approval process	Use April 2019 restructure post devolution to tighten up process. Going forward all decisions to progress a site to offer/option stage with FH should be approved by the new Forestry England Board (which would include FC and Defra representation) once the site has been approved through the EMGN4a approval process.	Restatement of Governance and role of new Forestry England Board in process.	<b>HIGH</b>
Intervention of Ministers at late stage in the process creates uncertainty and can lead to wasted costs to FH if such decisions are made after the planning process has been successfully navigated.	Once Forestry England Board have approved site selection (see above) a submission should be made to the SoS to approve the site before offering the site to FH for further work. If the SoS approves the site at this stage, they would consider entering into an Agreement to Lease to give FH certainty of outcome in the event that they are successful in obtaining planning consent. NB: Not applicable if the SoS decides to delegate authority to FC in this regard.	Statement of process to provide for SoS sign off on all new site leases once the EMGN4a process has been completed to the satisfaction of the Forestry England Board	<b>HIGH</b>
Lack of understanding of current site selection process by Defra	The EMGN4a process used by Forest Enterprise appears to be sound. It would be desirable for Defra to review the process in some detail and either endorse the EMGN4a process in its current form or suggest and agree amendments with FC as well as an agreed process for updating it for e.g. changes in policy. We suggest this includes escalation procedures for difficult or sensitive issues and is supported by appropriate representation on the new Forestry England Board.	Defra endorse MGN4a process in refreshed Policy	<b>HIGH</b>
Defra have lack of visibility on site selection shortlist.	Forest Enterprise have identified a shortlist of sites which may be suitable for approval based on Forest Enterprise criteria and known criteria of FH. FC should share the criteria and decision-making process adopted in drawing up the shortlist with Defra. Defra to refine the list further as required.	FC share shortlist and criteria with Defra	<b>MEDIUM</b>
Limited early stage stakeholder engagement. Limited understanding of assessment process	FC and Forestry England to assist FH in identification of key stakeholders and a communication protocol should be agreed for engagement with stakeholders including a clear announcement of the criteria imposed for the site selection process and benefits to be gained for the PFE and local community from the development of the site in question.	Agreed protocol between FC and FH for identification and engagement with key stakeholders. Criteria for site selection process to be published by FH	<b>HIGH</b>

## **2.2 Part 2 of ToR: Advantages and Disadvantages of FC Shareholding in FH**

## 2.2 Advantages and Disadvantages of FC Shareholding in FH

### 2.2.1 Disadvantages of retaining the shareholding - Potential for Conflicts of Interest

- Concerns have been raised by Defra that FC is potentially conflicted in its roles as shareholder, landlord and in its 'policy' role in relation to its wider obligations as regards the Forest.
- In relation to the shareholder/leaseholder v policy potential conflict:
  - This potential conflict applies to all FC's commercial activities - it has, since its inception, had to manage this potential conflict between generating income while preserving the forest for the public benefit;
  - There is a robust approval process for individual sites under MGN4a which is focused on a wide range of criteria of which economic benefit to FC is not a principal consideration;
  - A Defra nominee sits on the English National Committee which is sighted in the process and approves contentious sites;
  - The FC Commissioners are independently appointed not least to support the FC's purpose, namely the protection of the Forest. FC has limited influence over commercial negotiations given its (minority) shareholding - without Phoenix's investment FH would not be able to invest and develop sites the proposed terms of which are, however, likely to be influenced by Phoenix's investment objectives; and
  - FC's shareholding is not held directly in the FH trading entities, it is held at a Canopy Holdco level, higher up the corporate structure, and is therefore more strategic than prescriptive in the day to day running of FH (see Appendix A2).
- In relation to FC's potential shareholder/leaseholder conflict although FH may seek to keep lease payments as low as possible its interests are aligned with FC as Landlord in:
  - that both are seeking to maximise the success of the selected sites as well as increase access to the Forest
  - Both should recognise the need for site lease rents to be on a market basis, as far as possible if they are to be approved (and indeed many FH site leases are not presently at market rates and the amendments proposed in Bluebell sought to address this issue). However, FH have told us that they see the relationship as a collaboration and recognise the need to ensure they meet FC requirements in order to ensure a pipeline of future site leases.



## 2.2 Advantages and Disadvantages of FC Shareholding in FH cont.

### 2.2.2 Benefits and Advantages of retaining the shareholding

- On balance, although we do not consider that Government should displace private sector investment, we consider that FC should retain its shareholding in FH for the following reasons, which may be summarised in terms of enhanced governance and a stronger commercial relationship with FH. Specifically:
  - The Investment Agreement provides for FC to appoint a NED to the Board of Canopy Holdco, ensuring that FC has visibility on all significant decisions which the majority investors seek to make in respect of FH;
  - We understand that the majority investor, Phoenix, was insistent that FC retained a shareholding in FH at the time of the 2017 refinance to ensure that (1) they remained a stakeholder and (2) to represent their view, and the view of FH that FC's interaction with FH and its investors was a collaboration;
  - The shareholding ensures that FC is appropriately represented in relation to decisions made in relation to FH and affords them the rights afforded to all minority shareholders under law. The 2017 restructuring negotiations enabled FC to retain enhanced voting rights of 20%; and
  - It is acknowledged that retaining the shareholding requires the shareholding to be monitored and that FC provides consents where required and administrative support for these activities. However, on balance, we feel that the benefits outweigh these requirements and we are not aware of any other compelling reasons why the shares should be sold at this stage given their strategic benefit.

### Value Considerations

- In arriving at this conclusion we have looked essentially at the strategic arguments rather than from a value perspective. We note that at the time of the 2017 restructuring FC's shareholding was valued in the Investment Agreement at £11m. However we could not be sure of that value today and we consider that value will be maximised when the issues above have been addressed.

### 2.2.2 Other Considerations - Interactions with Forest Holidays

- **Defra**
  - From discussions we have had with both Defra and FH it would appear that Defra have had only limited contact directly with FH. This is understandable given that FH is a private limited company rather than a Government Company and that it operates at arm's length, but this does present problems. It would appear that at present Defra has only a limited understanding of FH's strategic objectives and the investment objectives of FH when assessing sites; we think it would be helpful if the FH team were to explain more fully its approach to site development and maintenance as well as the benefit they consider they bring to the surrounding forest. Engagement at a senior level with FH (and arguably its principal investor) would, in our view assist Defra's understanding of FH's business and its key commercial objectives. This would help Defra in understanding the benefits of the relationship and in managing the messaging to the wider public in terms of what FH does, and how it supports Defra policy or not.

## 2.2 Advantages and Disadvantages of FC Shareholding in FH cont.

- As outlined above, Defra policy particularly as regards commercial exploitation of the Forest, is unclear and/or is not well understood by FH or FC. This is also clearly very important as regards FH's investors, as a consistent application of that policy is likely to inform future investment (or otherwise), investors strategy in relation to their investment and the likelihood of future investors being willing to invest in FH;
- To be successful, the relationship and interaction between Defra and FH would benefit from regular communication and greater transparency. It appears to us that FE and FH have, to date, enjoyed a collaborative relationship and we feel that there would be benefits to be gained from greater involvement by Defra in this relationship.
- **Post Devolution Shareholding Structure**
  - We have been provided with a copy of the revised structure for the FC shareholding in FH which will come into effect on 1 April 2019 (a copy of which is attached at Appendix B2). We have not undertaken a detailed review of the revised structure and its operation as this is outside of the scope of this review however we understand that FC have taken external legal advice from Eversheds in this regard. It would appear to us from the proposed structure that decision making on consent matters will move from solely within FC to include the other administrations;
  - We understand that the mechanism for effecting the restructure is in place as between the Devolved Administrations and that it does not require the consent of FH's other shareholders under the Investment Agreement (and as such, there is no scope to seek re-negotiation of FC's position and required consents under the Investment Agreement as part of the exercise);
  - We understand that the FC have set up a Forestry Commission Governance Group. This executive group, chaired by Ian Gambles and with representation from FC England, FC Scotland and Natural Resources Wales, was established to promote three-country co-ordination over Forest Holidays matters;
  - The Governance Group held meetings in 2017 and 2018 to manage the interests of the three administrations during the refinancing of Forest Holidays under Project Canopy, and most recently these meetings have focused on the Framework Agreement negotiations and devolution of the shareholding; and
  - Whilst the structure appears complex to us and potentially could make the management of FC's investment in FH more complicated with scope for confusion in how the investment is to be managed we would endorse the use of the Governance Group going forward to ensure a smooth transition and ongoing communication and co-operation between the devolved administrations. It is, however, clearly important that FC and Defra consider and fully understand how the revised structure will work in practice.

## 2.2 Advantages and Disadvantages of FC Shareholding in FH cont.

### Summary of Advantages and Disadvantages of retaining FH Shareholding

Advantages of Retaining Shareholding	Disadvantages of Retaining Shareholding
<ul style="list-style-type: none"> <li>The Investment Agreement provides for FC to appoint a NED to the Board of Canopy Holdco, ensuring that FC has visibility on all significant decisions which the majority investors seek to make in respect of FH. This gives FC (and Defra) a crucial seat at the table in terms of being sighted on key decisions which may affect the PFE which they would not have without the shareholding.</li> </ul>	<ul style="list-style-type: none"> <li>Potential FC conflict of interest in respect of its Shareholder, Landlord and Policy roles in generating income while preserving the forest for the public benefit and acting as landlord in managing the PFE</li> </ul>
<ul style="list-style-type: none"> <li>The majority investor, Phoenix, was insistent that FC retained a shareholding in FH at the time of the 2017 refinance to ensure that (1) they remained a stakeholder and (2) to represent their view, and the view of FH that FC's interaction with FH and its investors was one of collaboration</li> </ul>	<ul style="list-style-type: none"> <li>FC has limited influence over commercial negotiations given its (minority) shareholding and is unable to prevent its shareholding being further diluted without investing further funds.</li> </ul>
<ul style="list-style-type: none"> <li>The shareholding ensures that FC is appropriately represented in relation to decisions made in relation to FH and affords them the rights afforded to all minority shareholders under law. The 2017 restructuring negotiations enabled FC to retain enhanced voting rights of 20%</li> </ul>	<ul style="list-style-type: none"> <li>FC's shareholding is not held directly in the FH trading entities, it is held at a Canopy Holdco level, higher up the corporate structure, and is therefore more strategic with little direct influence over FH (although this may change following the restructure required following devolution in April 2019)</li> </ul>
<ul style="list-style-type: none"> <li>The Investment Agreement details several actions which require FC consent (effectively a veto and appear to be quite comprehensive for a minority shareholder (including, for example, any material change to the nature of the business of the FH Group))</li> </ul>	<ul style="list-style-type: none"> <li>Resourcing required within FC to manage shareholding and accompanying consents under the Investment Agreement</li> </ul>
<ul style="list-style-type: none"> <li>At the time of the 2017 restructuring FC's shareholding was valued in the Investment Agreement at £11m and continues to represent a value to FC (albeit that we are unable to quantify what this may be)</li> </ul>	<ul style="list-style-type: none"> <li>The current shareholding structure will be revised post devolution in April 2019 meaning that FC (and therefore Defra's) influence will be diluted given that consents, treatment of shareholding etc. will need consensus between the three administrations. The revised structure will add an additional layer of complexity as a result</li> </ul>
<ul style="list-style-type: none"> <li>Should FH continue to grow as projected then there is the prospect of a financial return to FC in the form of dividend returns</li> </ul>	<ul style="list-style-type: none"> <li>Shareholding presently offers no financial benefit in the way of dividends</li> <li>Government policy moving away from investments in private limited companies</li> </ul>

## Appendices

### **Appendix A Structure and Decision Making Process**

- A1. The Forestry Commission Structure
- A2. Current Forest Holidays Structure
- A3. Understanding of Decision Making Process
- A4. Detailed Findings and Recommendations
- A5. EMGN4a Site Selection Process Schematic

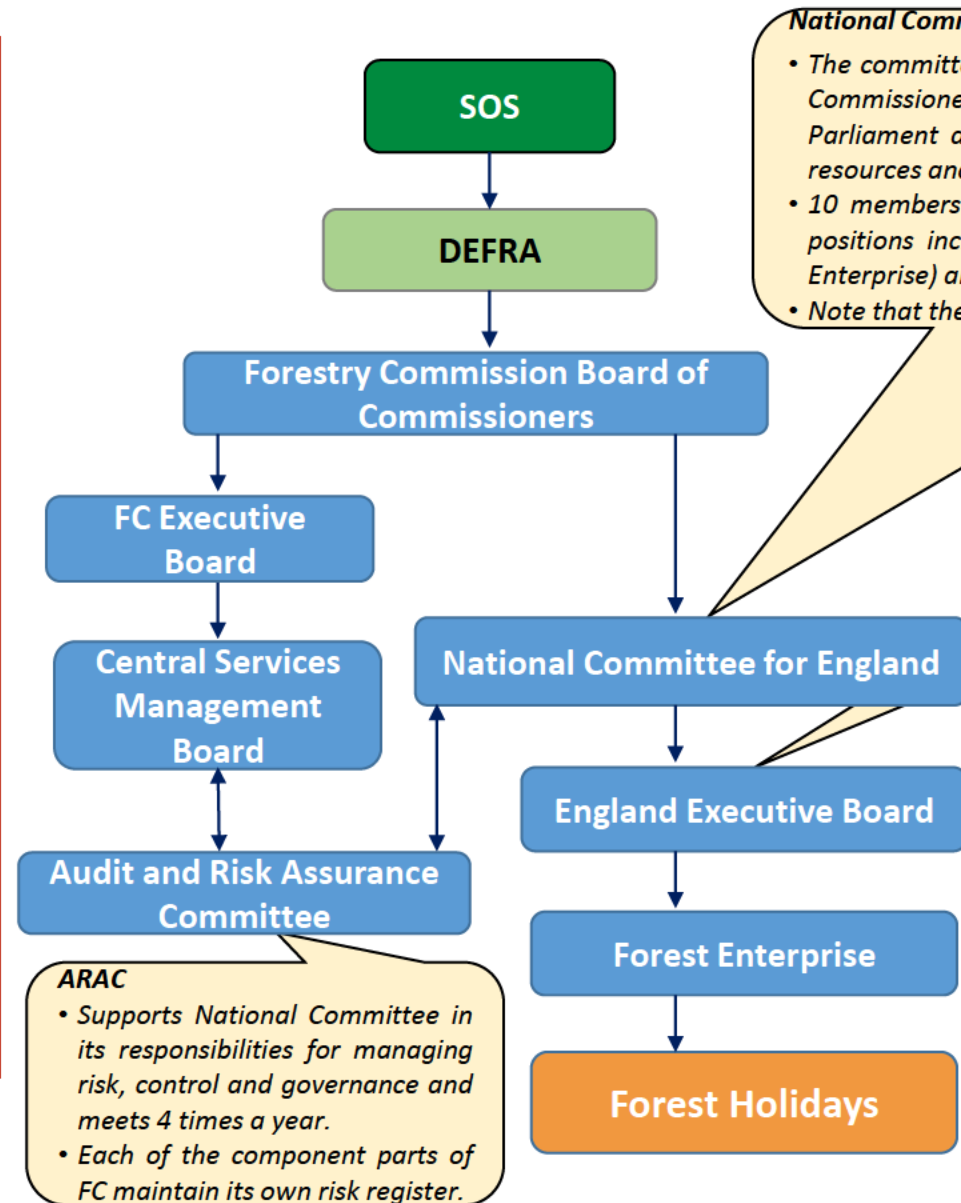
### **Appendix B Additional Documents**

- B1. Proposed Forestry Commission Structure
- B2. Proposed Forest Holidays Ownership Structure
- B3. Terms of Reference

# A1. The Current Forestry Commission Structure

## The Forestry Commission (FC)

- The FC is a non-ministerial government department created by Royal Charter in 1920.
- The Forestry Acts of 1967 and 1979 (the "Acts") set out the framework in which the FC operates and the FC is headed by a board of Commissioners who derive their powers from the Acts.
- The purpose of the FC is to protect, improve and expand England's woodlands and increase their value for people, nature and the economy.
- Responsibility for managing the Forest is devolved to the Commissioners who are separately accountable to the SoS.
- There are currently 7 Forestry Commissioners with 2 Executive positions and 5 NED positions.
- Ian Gambles an Executive Commissioner and the FC Director for England, having been appointed in 2013, is the Senior Executive within FC and the Additional Accounting Officer. Sir Harry Studholme is the Chairman of the FC having occupied the role since 2013.
- Defra is responsible for forestry policy in Great Britain.
- From 1 April 2019 formal responsibility for Scotland's forests will transfer from the FC to the Scottish Government resulting in significant changes to the FC structure including the departure of 3 commissioners.



**National Committee for England**

- The committee is appointed under the 1967 Act to undertake any functions of the Commissioners that they may delegate and is responsible for working with Parliament and Defra, giving strategic direction to the FC's activities, allocating resources and setting targets for Forest Enterprise.
- 10 members including 5 NEDs (with Sir Harry Studholme as Chair), 4 Executive positions including Ian Gambles and Simon Hodgson (Chief Executive of Forest Enterprise) and Shirley Trundle, Defra Director of Environment and Rural Affairs.
- Note that the Committee will cease to exist after the 1 April 2019 restructure.

**England Executive Board**

- Established to manage the business of FC within the policy framework set by ministers and the National Committee and is supported by two sub-committees – the Forest Enterprise England Strategy Board and the Forest Services Management Board.
- Note that the England Executive Board will cease to exist after the 1 April 2019 restructure.

**ARAC**

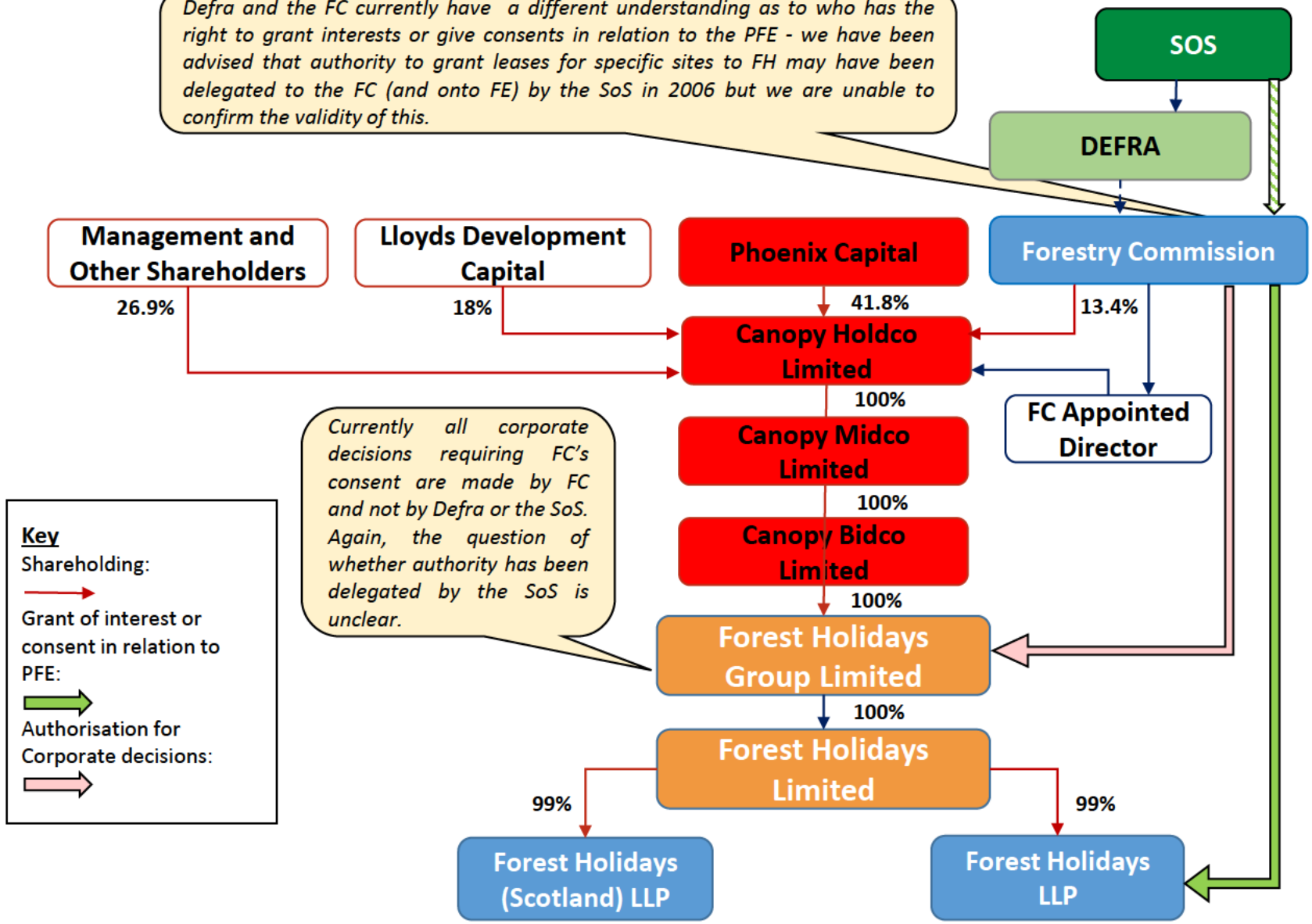
- Supports National Committee in its responsibilities for managing risk, control and governance and meets 4 times a year.
- Each of the component parts of FC maintain its own risk register.

**Forest Enterprise (FE)**

- Executive Agency sponsored by the FC, responsible for managing England's Forest Estate on behalf of the FC.
- Majority of FE's income is from the sale of timber, leisure and tourism services – its remit also includes maximising the broader commercial potential of the land.
- Managed by the FE Strategy Board, the Chief Executive (Simon Hodgson up to 30/11/18 and Ian Gambles in an acting capacity thereafter) and executive team manage day to day operations and performance of FE.
- Chief Executive is the Agency AO and attends the FC ARAC.
- Responsible for managing FC's 13.3% share in Forest Holidays and agreeing the future development and lease of sites to FH.

# A2. Current Forest Holidays Ownership Structure

Defra and the FC currently have a different understanding as to who has the right to grant interests or give consents in relation to the PFE - we have been advised that authority to grant leases for specific sites to FH may have been delegated to the FC (and onto FE) by the SoS in 2006 but we are unable to confirm the validity of this.



**Key**  
 Shareholding: Grant of interest or consent in relation to PFE: Authorisation for Corporate decisions:

Currently all corporate decisions requiring FC's consent are made by FC and not by Defra or the SoS. Again, the question of whether authority has been delegated by the SoS is unclear.

**Current Forest Holidays Structure**

- The diagram represents the current structure and interactions between FC and FH as at today's date.
- Forest Holidays was originally set up as a Joint Venture in May 2006 between the FC and the Camping and Caravan Club Limited with FC holding a 49% shareholding interest.
- FC's shareholding interest in FH was diluted following a refinance in September 2012 which saw the shareholding reduce to 19% following an investment from Lloyds Development Capital.
- Following an investment by Phoenix in December 2017, FC's shareholding has been further diluted to 13.4%, albeit FC have retained voting rights of 20% and the right to appoint a director to Canopy Holdco Limited.
- The relationship between the Shareholders is governed by an Investment Agreement entered into on 18 December 2017.
- The Investment Agreement includes drag along rights for future investments and the ability for FC's shareholding to be further diluted in the event that they choose not to participate in future funding rounds.
- A Framework Agreement dated 21 September 2012 governs the relationship between FC and FH and the granting of leasehold interests and consents on the PFE.
- Phoenix invested in December 2017 with the aim of securing a capital return from the growth of the FH business. This is clearly dependent upon new sites being secured and developed.
- FC has sought to secure a financial return from commercial activities on the PFE to assist in addressing its structural operating deficit but we have seen no articulation of Defra policy in this regard.

## A3. Understanding of Decision Making Process

The successful operation of FH as a business is dependent on the identification, scoping, leasing and development of sites on the PFE in the UK. This requires ongoing interaction between FC, FE and FH and the making of timely decisions. It is important that a distinction is made in the decisions which are made by FC and FE in relation to the identification and leasing of sites to FH, and those decisions which are corporate in nature and determine the structural relationship between FC, FH and its investors. Our understanding of the current decision making process is that there is a very different approach to site decisions and corporate decisions and the understanding of how decisions should be made in relation to both varies between stakeholder groups.

In addition, as a result of the responsibility for Scotland's forests devolving to the Scottish Government from 1 April 2019, the organisational arrangements will need to be restructured, both internally within FC (see proposed structure at Appendix B1) and also as regards FH (see proposed structure at Appendix B2). We outline our understanding of the effect of these proposed changes on the decision making process below.

### A3.1 Current Land and site decisions

#### ▪ *Context*

- Since the inception of FH in 2006 FC has operated on the basis that the decision making process for the granting of new leases on the PFE rests with FC and FC alone. This is based on their understanding that the authority to make this decision was delegated to them through an Authorisation Certificate entered into in 2006 by the then SoS nominating levels of delegated authority to FC to grant leases to FH, albeit restricted to certain sites, which supplemented the powers delegated to the FC by the Countryside Act of 1968.
- In practice, any authority delegated to FC has been further delegated by the Commissioners to the Chief Executive of FE for the granting of leases on the PFE to FH in almost all circumstances (considered further below).
- Defra's position is that the right to grant leases (and other interests) and consents to use the PFE remains with the SoS at all times.
- Whilst we have seen copies of both documents we make no comment on the validity of the documents themselves or whether the basis for the assumption which FC has made is correct. We note however that Defra and FC have differing views as to the nature of the arrangements in place and therefore the legal and operational arrangements need to be clarified.

## A3. Understanding of Decision Making Process cont.

### ■ *Estate Management Guidance Note 4a (EMGN4a)*

- FC's process for approving sites and the granting of leases in relation thereto is enshrined within the FC's EMGN4a Assessment Report. The document contains comprehensive guidance for the process involved in developing new FH sites on the PFE. It represents an internal consultation process culminating in the completion of an "Assessment Report" which is submitted to the FE Executive Team for sign off and is effectively the "gateway" for sites which are deemed suitable for development by FH.
- Before specific sites reach the EMGN4a process they are scoped for suitability internally by FE. This process is led by the Commercial Development Manager for FE who has drawn up a shortlist of sites deemed suitable to FC based on criteria consistent with FC policy and which is intended to embrace all relevant Defra policies (e.g. there is a presumption against development of sites in or near ancient woodland).
- This "National scoping exercise" has been undertaken over the last few years and additionally takes into consideration the requirements of FH. This has been assisted by FH resourcing a part time role within FE to assist with the FH perspective.
- As part of this exercise it would appear that a number of sites have initially been dismissed as unsuitable by FE as they do not meet the FC policy requirements (and therefore do not accord with Defra policy).
- It would also appear that the process of site selection/feasibility analysis is a collaborative effort between FE and FH; FE are aware of FH's overall strategy and the areas where FH would ideally wish to develop new sites. Equally, FH appear to be aware of the principles that FE will apply in determining whether a particular area would be suitable. This is important since site assessment and approval is a potentially costly exercise for FH (in excess of £1m) as well as for FE. A clear understanding of each parties' objectives and constraints is therefore important.
- Once a site has been identified FH are invited to attend a site visit hosted by the FE district team to determine whether, at this initial stage, they wish to take their interest further.
- The process moves onto completion of EMGN4a wherein the suitability of the chosen site is screened by reference to specified Site Assessment Criteria. We do not propose to recreate the EMGN4a in full (a schematic of the process can be seen at Appendix A4), however we would flag the following key points:
  - The FE Forest Management Director (**FMD**) and the Forest Services (the arm of FC responsible for delivery of Defra policy) Area Director (**AD**) liaise, undertake site visits, complete the prescribed "sequential test" and complete the Assessment Report (annex D to EMGN4a);
  - The FE Forest Management Director will consult with FH and determine whether to contact the local planning authority (e.g. to submit a pre-application notice), particularly where the proposal may have a significant local planning policy dimension such as economic development;
  - FE FMD and the Forest Services AD will liaise with Forest Holidays to produce a communications handling report which will include lines to take with the media and a statement of the FC's position;
  - Once completed, the EMGN4a Assessment Report is submitted to the FE Executive Team via the FE Commercial Development Manager.
- Upon receipt of the completed Assessment Report the FE Chief Executive (**FECE**) will, pursuant to the powers delegated to him by the FC, determine whether or not to give notice to FH confirming that the site is acceptable and offering them the opportunity to move to the next stage of the process.



## A3. Understanding of Decision Making Process cont.

- In the event that the FE FMD and Forest Services AD are unable to agree on the content to be included on the completed EMGN4a form then the proposal will be referred to the National Committee for England for determination (the English National Committee is briefed on all sites subject to the assessment process). Similarly the National Committee for England may be required to make the determination for a number of more contentious matters, for example, where the proposed site is high profile, there are value concerns or political sensitivity.
- In the event that the FE CE or the National Committee for England make the determination that the site in question is not suitable for development by FH then this will be notified to FH and no further action may be taken in respect of the site.
- Note that the Forestry Commissioners are not involved in the decision making process albeit that they are present on the National Committee board who, as well as making determinations on site approvals which have been escalated to them, are regularly updated on the site approval process by the FE CE. Further they are aware of the pipeline of sites as a result of routine updates; there is also regular dialogue between FC and FE as sites move through the assessment process. DEFRA is also aware of progress with the assessment process by virtue of the DEFRA director responsible for Forestry being a member of the National Committee.
- It is not apparent to us that the ARAC is involved in the site approval process outside of issues which have been escalated to it by the National Committee.
- **Development of proposal**
  - Once they have received notification from FC that a site has been approved for development FH will make their own internal decision as to whether they wish to proceed.
  - Pursuant to the Framework Agreement Document of September 2012 (**FWD**) the site to be developed can be placed onto the “Exclusivity List” giving FH exclusivity to enter into an Option or New Site Lease for up to five years from the date of entry onto the list (albeit that the MGN4a process must be completed and approval granted before the Option can be actioned).
  - The Option Agreement provides them with the option to enter into a New Site Lease on proforma terms as set out in the FWD within three years of entering into the Option Agreement. However, we understand from FE that in practice the Option Agreement has not been entered into by FH to date as the provisions within the FWD are perceived to be overly cumbersome.
  - FH will need to make an application for planning permission to the local authority to develop the site in question which must take into account any site based issues identified in the EMGN4a Assessment Report along with any issues which arose in any pre-application discussions with the local planning authority.
  - Assuming that FH obtain planning permission, there is an expectation on the part of FH that they may enter into a New Site Lease based on the terms of the proforma lease set out in the FWD and to develop the site in full.

## A3. Understanding of Decision Making Process cont.

### ■ **Other Considerations**

- Pursuant to s.23 of the Countryside Act 1968, FE is responsible for discharging all Landlord obligations under site leases as well as monitoring the Tenants' obligations. It is understood that authority to deal with such matters is provided for under s23 Countryside Act 1968, since FH's business is classed as recreational development. Each lease is the responsibility of the Area Land Agent for a particular Forest District, with any required escalation being made to the FE Commercial Development Manager or the FE Head of Estates.
- We understand that whilst there are only limited Tenant obligations outstanding due to the relative age of the sites, this is likely to become more relevant as the stock ages, or investment by the Tenant declines as a result of which the Landlord will need to manage maintenance obligations proactively.
- We understand that the FC is responsible for discharging all landlord obligations and Defra would not appear to be involved in any decisions in relation thereto.
- It would appear that FC and Defra have adopted a different approach for approval of non-forestry developments within the PFE as the FC clearly does not have authority to deal with these developments on Defra's behalf (a recent example being the exploratory drilling for fossil fuels on the PFE). To address the issue FC have seconded Land Agents to Defra who act as seconded Land Management Officers for Defra ensuring that the approval is made within Defra. Individuals within both Defra and FC have expressed their views that this system is not ideal but note that it works well enough in practice.
- The above outlines the process for approval of development of new sites in England. Given the forthcoming devolution of responsibility for approval of new sites in Scotland to the Scottish Government (see further below) we have not sought to understand the approval process for Scottish sites in detail although we assume that this is presently the same as for English sites.

### **A3.2 Current Corporate Decisions**

- Currently, FC's understanding of its responsibility for day to day corporate and commercial decisions which it makes in relation to FH generally mirrors that for site approvals and entry into leases i.e. in their view, the authority to make Corporate decisions rests with FC and has been delegated to the FE Executive. It would appear that the FC Board of Commissioners rely on their interpretation of the Countryside Act 1968 and the Regulatory Reform (Forestry) Order 2006 (which was passed to enable FC to enter into joint ventures and attract private capital). It is understood that consents required under the FWD and Investment Agreement and shareholder/relationship matters (which take a significant amount of time) are dealt with on a national basis by FE's Commercial Development Manager.
- More significant corporate decisions, such as those in relation to the 2012 and 2017 restructure and refinancing's appear to have been escalated to FC's Executive Board for sign off, with the FC Board of Commissioners being sighted for information purposes (although we have not been able to identify as stated process for this). Defra do not appear to have been fully sighted on this matter; the degree of Ministerial oversight is considered in some detail in the GIAA report and we do not therefore propose to reiterate those findings here.

## A3. Understanding of Decision Making Process cont.

- We note that the reduction of FC's shareholding in FH from 49% at inception to the 2017 Canopy restructure of 13.4% has resulted in a significant dilution in FC's rights and ability to influence significant corporate decisions with FH. The relationship is now governed by the December 2017 Investment Agreement which includes a number of drag along rights and the right for FC's shareholding to be diluted further in the event that FC does not contribute in future funding rounds. The Investment Agreement does, however, give FC enhanced voting rights of 20% along with the ability to appoint an NED to the Board of Canopy Holdco Limited (the Phoenix Investment vehicle incorporated as the Topco for the acquisition of the FH group) which they have done in the appointment of Peter Nixon, who had been a senior land manager with the National Trust; his appointment was made by the Chairman of the FC. We understand Peter provides a report on Board Meetings to the FC Board and meets and presents to the Board on an annual basis with his remit being to ensure that FC's position is protected. It is unclear, however, how this board position translates to meaningful influence in the running of FH from FC's point of view given the remoteness of Canopy Holdco Limited from the FH Group Limited, in the FH Group structure.
- We understand that a formal "FC Governance Group" was set up following the 2012 refinancing with representation from FC England, FC Scotland and Natural Resources Wales, to promote three-country co-ordination over FH matters.
- The Governance Group held meetings to manage the interests of the three countries during the 2017 refinancing of FH under Project Canopy, and more recently meetings have focused on the FWD (re)negotiations and devolution of the shareholding as agreed actions from Project Canopy.
- During the refinancing, the Governance Group sought to provide for devolution in the drafting of documentation, and following legal advice several options for the proposed structure were considered vis a vis the relationship between FC England, the devolved FC Scotland entity and FH. We understand that a revised LLP structure has been chosen which will come into effect with FH on 1 April 2019. A copy of the structure can be seen at Appendix B3 .
- Separately, as a direct result of devolution, the internal structure of FC will change. The Board of FC, Defra and Defra Ministers have agreed a revised strategy detailed in the February 2018 paper "The future Forestry Commission". The restructure will result in a more streamlined approach, largely as a result of the removal of the National Committee for England, with a new Forestry England Board reporting directly to the Forestry Commissioners. Forestry England will be the new name for Forest Enterprise and will be directly responsible for FH. A copy of the simplified structure can be seen at Appendix B2 of this review.
- We note that FC and FE have both been and are due to be subject to fairly significant personnel changes. As a result of the devolution of responsibility to Scotland, a number of Commissioners will step down and require replacement. In addition, the CE of Forest Enterprise, Simon Hodgson, who has occupied the role since 2013 and was key to the relationship with FH, stepped down on 30 November 2018 with his role being taken over by an Executive Officer for the FC, Ian Gambles, on a temporary basis.
- We note that FC's decision to seek authority from Defra to enter into the Project Bluebell transaction in 2018 is at odds with FC's view that authority had already been delegated to FC pursuant to the 2006 RRO. We understand from FC that authority was sought because the proposed transaction had become contentious, as a result of the proposed development at Mortimer Forest having coming under external scrutiny.

## A4. Detailed Findings and recommendations

### 3.1 Ambiguity in Relationships and Powers

#### ***Relationships and lack of clear lines of sight***

- It would appear that the relationship between Defra and FC in relation to FH has historically been conducted on the basis of generally good relationships but with an informal understanding regarding respective roles.
- Attempts have in the past been made to put in place a framework document to articulate and formalise the relationship and respective responsibilities of Defra and FC in relation to FH, but these have yet to be concluded. Clearly such a document would help to clarify the position as regards (for example) authority levels for approval of transactions, dealing with possible conflicts, managing expectations as regards consultation in relation to potential transactions, particularly where these are likely to be contentious issues or additional expertise may be required and also any material changes to policy.
- In addition there is perceived to be a potential conflict between the FC's interest in maximising the total return from its interest in FH to support the funding of its continued operations and the FC's remit to maximise public benefit from the Forest. This is considered further in s.4 below.

#### ***Powers to grant leases and other dispositions of Forestry Land and delegation of authority***

- Probably as result of this good relationship FC appears to have operated as if it had delegated authority to make all material decisions in relation to FH (as regards site selection and grant of leases in relation thereto) as well as the majority of commercial and corporate decisions concerning the FH shareholding. However, central to the issues which have raised concern over the last 18 months is the question of whether, and to what extent, the SoS has delegated authority to make decisions in respect of FH without further recourse to Defra or its Ministers whether in respect of FC's shareholding in FH or other commercial transactions in relation to sites leased or proposed to be leased to FH.
- Our discussions have indicated that there is clearly a difference of view between Defra and the FC as to what the correct legal position is. The position has further been confused by past practice which may not reflect the actual legal position.
- This issue has been considered in the GIAA report and recommendations have been made that external legal advice be sought to determine the correct legal position. We fully support this recommendation. In our view, it is difficult for FC to make decisions in relation to FH without clarity as to their powers, what authority has been delegated to FC in relation to FH and what decisions are required to be referred to Ministers.

## A4. Detailed Findings and recommendations

- This analysis would enable FC and Defra to determine the current position but it will not provide an answer on the degree to which the SoS wishes to be consulted or make decisions regarding site leases (and the grant of other rights) and therefore, irrespective of the outcome of the legal review, it would be desirable for the SoS to clarify the extent to which Ministers wish to be involved in future decisions on site leases (and the grant of other rights) and to provide clarity at the earliest opportunity.
- The outcome of that determination is likely to have a direct impact on FH's investors propensity to invest further funds. Discussions with FH suggest that in addition to clarifying the extent to which the SoS wishes to be involved in such decisions (a) it would be desirable if there is greater transparency concerning Defra's policy in relation to the commercial exploitation of the forest in so far as it is relevant to FH and (b) that providing compliance with this policy and agreed criteria for site approval are met, new site leases (or other rights) will always be granted. Without this certainty there is a risk that external capital will not be available to enable FH to invest and develop. We outline our suggestions for levels of engagement and the perceived consequences in section 4 below.
- Once the level of engagement is determined the nature and level of delegated authority should be documented in a way that is transparent and clear to all parties involved, including FH.

### **Powers in relation to corporate transactions**

- As with the decision making process for site leases there appears to be some ambiguity as to the extent to which authority has been delegated to the FC by the SoS in relation to corporate transactions. There would, however, appear to be a clearer line of sight on this issue in light of the 2006 RRO making it clear where Treasury authority is required for certain decisions – for example, the provision of loans.
- In practice day to day corporate decisions are being made by FE without recourse to Defra. Our discussions indicate that Defra require an enhanced role in this regard and to that end it would appear that Defra needs to 1) determine exactly what authority has or has not been delegated to FC; 2) Determine it's appetite for future corporate decisions in relation to FH; 3) clearly articulate this to FC; and 4) ensure that a robust assurance structure is in place with clear line of sight on delegation and responsibility.

# A4. Detailed Findings and recommendations

## 3.2 Relationship with Defra Policy

- It would appear that there is some ambiguity around Defra's policy objectives as regards commercial exploitation of the PFE including the development of FH's business and it is also unclear whether the overarching policy has changed since 2006. The Explanatory Statement to the 2006 RRO by the FC, prepared on behalf of the SOS shortly prior to FH's formation states:

*"The broad reason behind the changes proposed [to the existing Forestry legislation] is the Government's policy of securing maximum public benefit from Forestry. This includes maximising the opportunities for the public to enjoy forests, and generally using forests to secure social and economic benefits as well as encouraging involvement from stakeholders at a local level. The proposals are also driven by the Government's Public Private Partnerships Initiative ("PPP"), which encourages public sector bodies to take advantage of commercial opportunities and private sector funding, and the wider markets initiative, aimed at greater exploitation of public resources."*

- If Defra's policy remains broadly in accordance with this policy statement it is perhaps understandable that FC has continued to operate its relationship with FH on an arm's length basis from Government, consistent with its status as a Non Ministerial Governmental Department (a point which we note was not disputed by Defra in the GIAA report).
- The GIAA report additionally states that "We also consider that Defra has not (so far) clearly defined its own expectations" in relation to FH. We would echo this view and in our opinion it is essential that this position is clarified by Defra and its Ministers. Once Defra's policy in relation to FH has been clarified, it could clearly be desirable for the successful operation of FH that it is clearly communicated to all primary stakeholders including FH and its investors.

## 3.3 Governance within FC/FE - complexity of current structure with insufficiently broad range of expertise

- The current structure of FC (see Appendix A1) appears overly complex. Responsibility for the relationship with FH appears to have been delegated (at least internally) to the CEO of FE with the FC Board of Commissioners structurally separated from the decision making process by two additional and separate boards in the England Executive Board and National Committee for England.
- Responsibility for FH within FE appears to fall to a small number of key individuals, namely the CEO, the Commercial Development Manager and the Estates Manager. There is therefore a question of whether there is sufficient expertise within FE to manage the relationship with FH and whether adequate plans are in place for succession. The departure of the CEO Simon Hodgson in November 2018 is of concern in terms of engagement and the ongoing relationship with FH. We note that steps are in place to replace the CEO and this exercise should be a matter of priority and it is essential that someone with sufficient expertise and commercial acumen is appointed to the role given the interaction with FH. Once appointed, the new CEO should take time to ensure that the relationship and future direction of the FH relationship with FC and Defra is fully understood.

## A4. Detailed Findings and recommendations

- We are also concerned that a disproportionate amount of the decision making process rests in the hands of the FE CEO and would recommend that going forward, this is reviewed and that more decisions are taken by the new Forestry England Board as a whole.
- We note the revised structure which FC has proposed from 1 April 2019. In our view, this would be a beneficial change and the simplified structure should result in greater clarity as regards roles, responsibility and Governance. In particular, we agree with the proposed structure of the new Forestry England Board and the increase in executive positions alongside the existing Commissioners should enhance the range of expertise and strengthen governance at Board level. We also support the proposal to appoint independent Non Executive Director/s with commercial skills and experience relevant to the business of FH as this would give enable Defra to be sighted on all key issues at an early stage. The director appointed should have suitable commercial experience and/or experience in working with the FC if possible.
- The decision making process vis a vis FC and FH is detailed at Appendix A3 below and we note that at present Defra have a board role on the National Committee but that it is currently envisaged that a similar role will not be offered to Defra on the Board of Forestry England with their Board position instead being on the Forest Services Board. We would suggest that this is given further consideration by both Defra and FC with one option being to give Defra observer rights on the Forestry England Board to ensure that there is some form of direct visibility of FH activities. Alternatively, Defra could appoint an independent NED to the Forestry England Board which could also address the concerns noted below regarding possible conflicts of interest and help to facilitate appropriate expertise (e.g. from Defra) being made available.
- We note that the “FC Future Forest Commission” proposal suggests that there will be “close and continuing collaboration” between FE, Forest Services (FS) and Forest Research (FR) as a result of reporting into the FC Executive Board which we agree would be desirable.
- The FC ARAC role in the current structure and its interaction with FE is, in our view, insufficient. The ARAC does not have direct line of sight of the activities of FE (and therefore FH) and relies on reporting through the National Committee and risk registers prepared by FE. We note that, at present, the role of ARAC in the proposed revised structure is yet to be determined but that current thinking is that the ARAC will span FE, FS and FR with each reporting into the ARAC. While we recognise the challenges of resourcing multiple ARACs in a relatively small organisation, FC may wish to take steps to ensure that the new ARAC has strong representation from the FE Board and appropriate commercial skills, allocates sufficient time (including dedicated meetings and/or sections of meetings) to FE business, and is specifically tasked in its terms of reference with monitoring the FH shareholding and site leases.

### 3.4 Specific Process/Implementation Issues

#### ▪ **Process of granting non-forestry leases**

- We note the current process for approval of non-forestry related developments on the PFE and the concerns that have been expressed. However, without amendments to the current statutory framework (which seems unlikely given the currently pressures on the legislature) there appears to be little alternative but to continue with the current arrangements.

## A4. Detailed Findings and recommendations

### ■ **FC visibility of Site Approval Process**

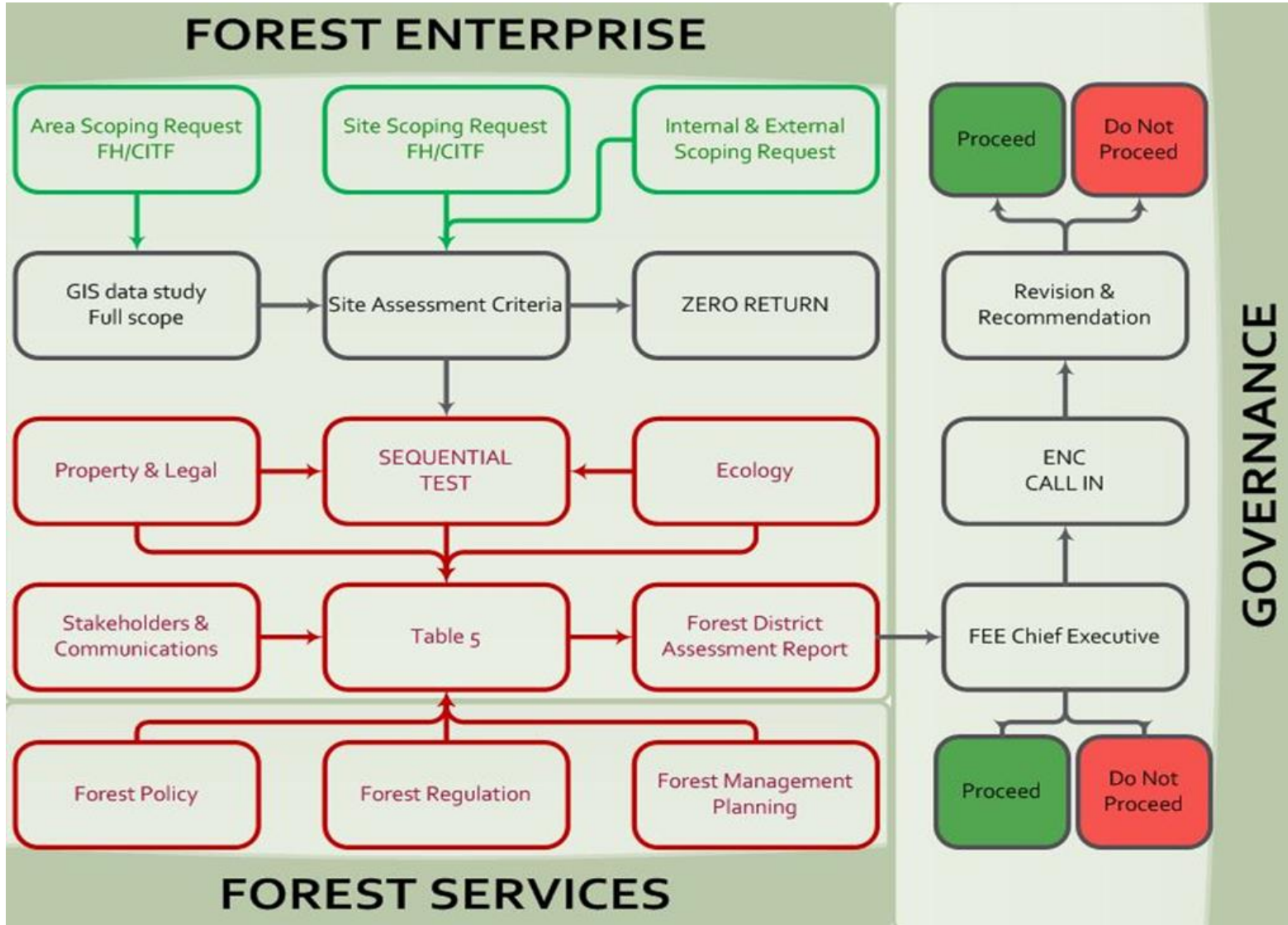
- Responsibility for approving sites which are offered to FH as suitable for further consideration and the opportunity to enter into an Option Agreement currently rests almost exclusively with the CEO of FE (authority having been formally delegated to him by the FC National Committee), albeit in certain circumstances (as noted in Appendix A3 below) the FC National Committee may be engaged where FE and FS cannot agree on site selection as part of the EMGN4a process or the selection is in some way contentious. The FC is sighted by the membership of certain Commissioners on the National Committee board which, as well as making determinations on site approvals which have been escalated to it, is regularly updated on the site approval process by the FE CEO. There is also regular dialogue between FC and FE as sites move through the assessment process. Defra is also aware of progress with the assessment process by virtue of the Defra [deputy] director responsible for Forestry being a member of the National Committee.
- The restructure post devolution in April 2019 should provide FC with the opportunity to tighten up this process and we would suggest that going forward all decisions to progress a site to offer/option stage with FH should be approved by the new Forestry England Board (which will include FC representation in the form of five FC Commissioners), but only once the site has been through the EMGN4a approval process.
- We have reviewed the EMGN4a process and discussed it in some detail with the FE CEO and FE Commercial Development Manager. In our view the process is a comprehensive, robust and sound one which has been designed to take into account the views and policies of both FC and FH and crucially, the selection criteria are based on published existing Defra policies and a schematic of the process can be seen at Appendix B4. However, we have seen no evidence of Defra involvement or input on the formation of the EMGN4a process. In our view, it would be sensible for Defra to review the process in some detail and either endorse the EMGN4a process in its current form or suggest amendments and then agree with FC. We suggest this includes escalation procedures for difficult or sensitive issues and is supported by appropriate representation on the new Forestry England Board. We would also suggest that provided the process has been followed in full an agreement for lease for, or option over, a particular site which is deemed suitable under the process can automatically be entered into by FC without further recourse to the SoS, other than to execute the lease in agreed form (unless this power is also to be delegated).
- We note that the majority of the PFE has been reviewed by the FE Commercial Development Manager and FE Head of Estates with a view to drawing up a long list of those sites which are deemed suitable to FE based on their own criteria and the known criteria of FH. We suggest that FC should consider sharing this list with Defra for a joint FC/Defra working group to refine this list further before any other sites are offered to FH for further consideration.

### ■ **Stakeholder Engagement**

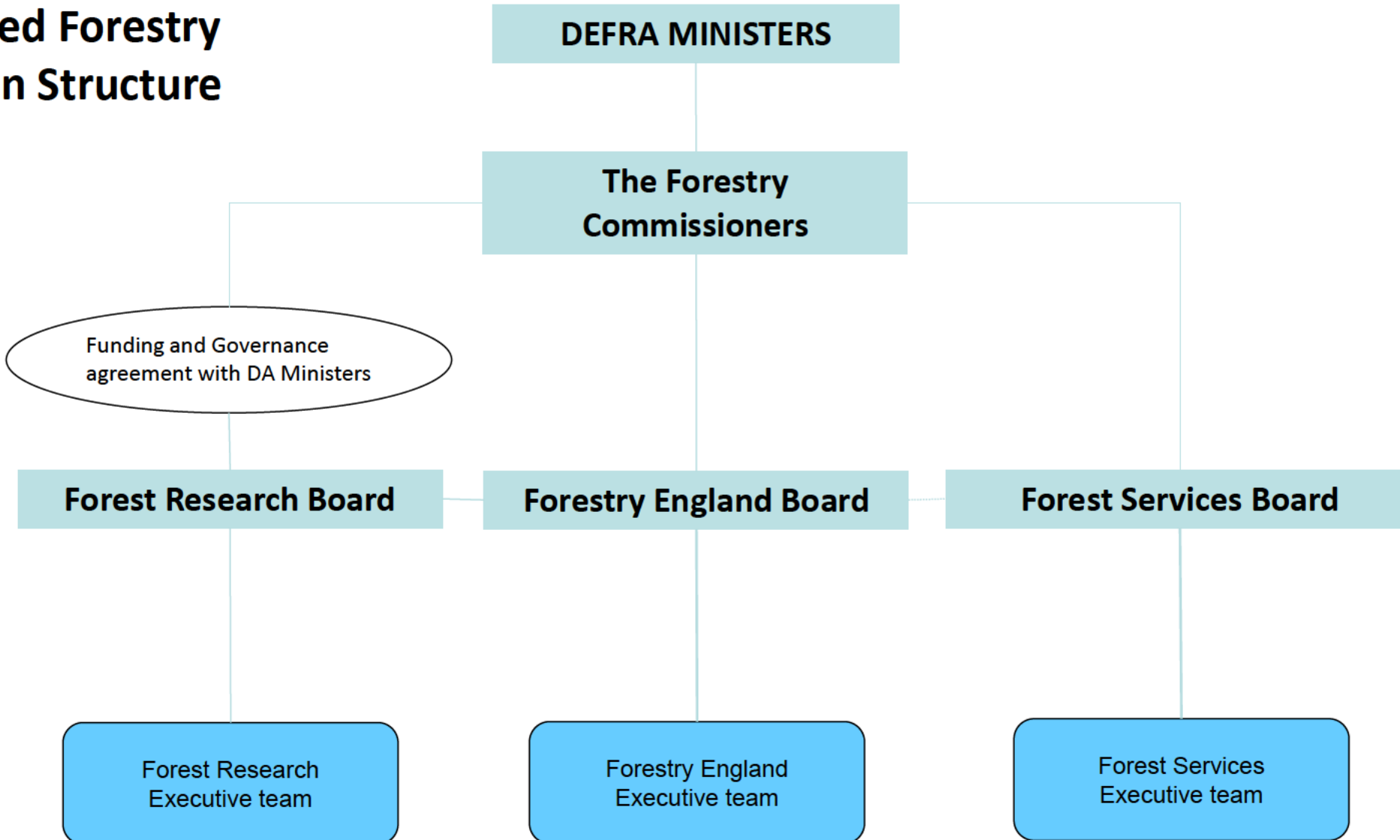
- In the last 12 months' FH has decided to withdraw from the proposed developments at Mortimer Forest and Fineshade Wood largely due to opposition in the local community supported by their constituency MP. Stakeholder management is clearly important at the local level and it is possible that the situations with Mortimer Forest and Fineshade Wood could have been avoided had a broader stakeholder group been identified by FE (e.g. including the constituency MP) and engaged with as part of the EMGN4a process; this would have led to earlier identification of potential opposition ensuring that the sites weren't offered to FH with the resultant adverse publicity and upheaval. We think though it would be beneficial if this process were to be publicised, to provide comfort that there is a robust assessment process with takes into account issues of local interest.



# A5. EMGN4a Site Selection Process Schematic

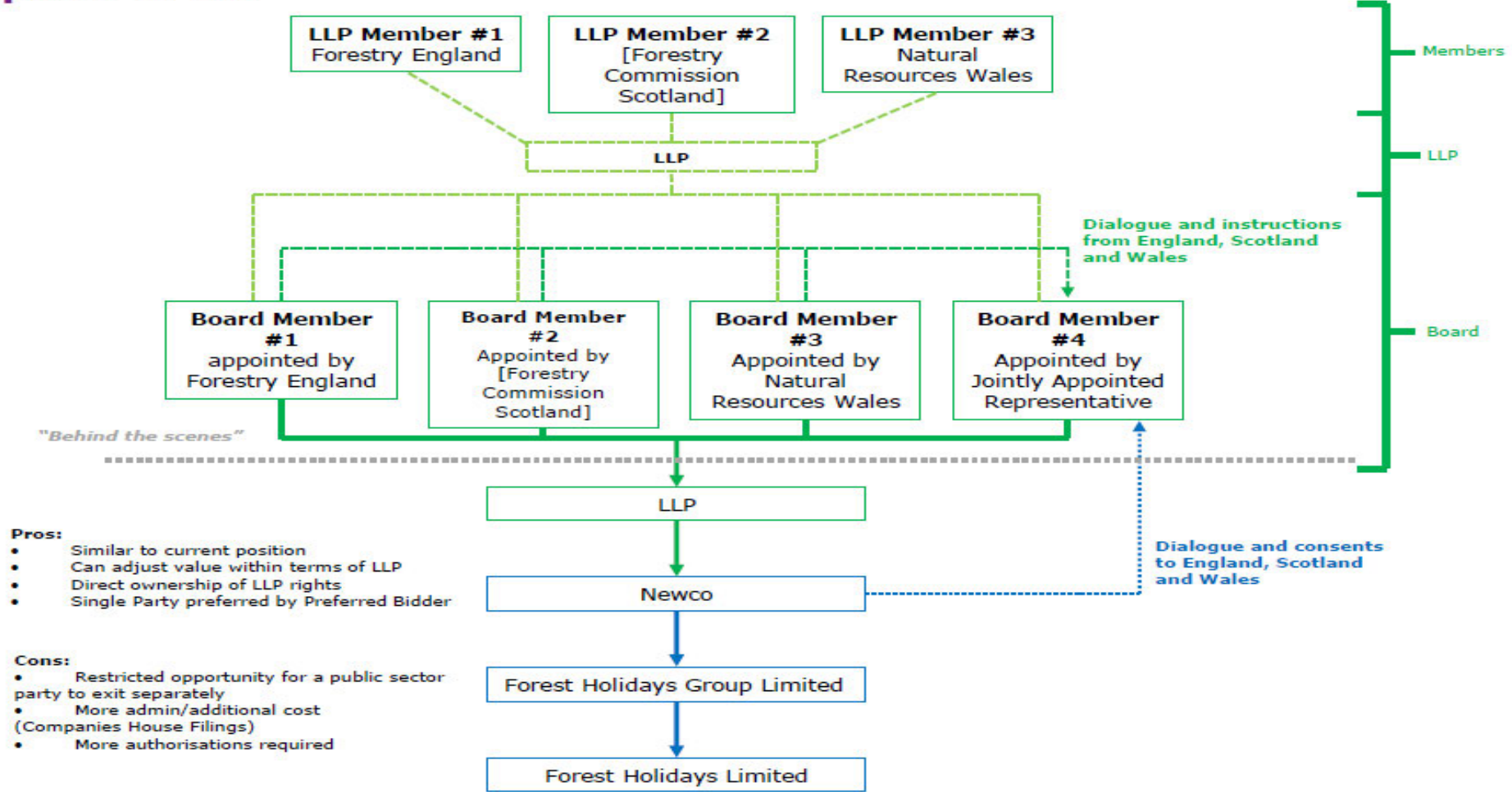


## B1. Proposed Forestry Commission Structure



# B2. Proposed Forest Holidays Ownership Structure

## Option 3: LLP



- Pros:**
- Similar to current position
  - Can adjust value within terms of LLP
  - Direct ownership of LLP rights
  - Single Party preferred by Preferred Bidder
- Cons:**
- Restricted opportunity for a public sector party to exit separately
  - More admin/additional cost (Companies House Filings)
  - More authorisations required

## B3. Terms of Reference

### Decision making for the Forestry Commission's commercial investments

#### Terms of Reference for Governance Review – Action 8

##### Introduction

**Forestry Commission (FC) request for approval for a commercial transaction relating to Forest Holidays (FH), a Joint Venture organisation of which FC is a minority partner was recently declined. Ministers have decided to launch a review of the Governance of FH commercial decision making (using UK Government Investments (UKGI) to ensure that this is robust and independent).**

##### Dependencies / Interactions

**In the light of advice from auditors the review will be focussed on governance of FH by FC and Forest Enterprise England (FEE). There are a number of potential interactions between the individual recommendations and, additionally with Ministerial steers on policy priorities. Commercial, Policy, Finance and Governance teams will be engaged to ensure effective alignment of activities. A steering group, chaired by Sonia Phippard the DG for Environment, Rural and Marine, will oversee delivery of all audit recommendations.**

## B3. Terms of Reference Cont.

### Scope and limitations of this review

The review will consider two elements:

- 1) Governance (the mechanisms, processes and relations by which [corporations](#) are controlled and directed) review of the FC's decision-making in regards to its relationship with FH.

The review will focus on the effectiveness and appropriateness of the current Governance arrangements for commercial decision making within FC and FEE in relation to FH and the link to Defra Ministers and include consideration of:

- Process for FC and FE to determine whether they and FH are taking the right commercial decisions, for the right reasons having regard in particular to Defra objectives.
  - Roles and responsibilities – including the role of the Board(s) and checks and balances on the executive in the decision making process
  - Delegations of authority
  - Controls, accountability and oversight
  - Reporting lines and escalation
  - Forums for decision making,
  - Engagement with stakeholders and their advice
  - Information provision and relevance
  - Communication of decisions
  - Commitment, approach to risk, its management and appetite
- 1) The strategic and practical benefits derived from FC's shareholding in FH and whether there would be any advantages or disadvantages to maintaining or dispensing of its shares. The review would focus on:
    - whether any benefit gained from the shareholding could be derived from other agreements or controls; and
    - the interaction between Defra's Shareholder interest and the SoS's interest in the land from which the FH sites operate and whether these two interests are divisible

## B3. Terms of Reference Cont.

### Approach

Engage UKGI to review current arrangements including the roles and capabilities of FC and, FEE, in the commercial decision making process.

Establish steering / oversight group and reporting arrangements

#### **For part (i) – Governance arrangements**

- Obtain relevant information on Governance arrangements in relation to decision making including shareholding arrangements.
- Determine the 'as is' position for Governance of all revenue streams from Forest Holidays to FE and FC and how policy objectives are aligned with and fit into the current arrangements.
- Review of current Governance arrangements for decision making compared with best practice, and alignment with Defra objectives. Consider issues and opportunities within current Governance arrangements including current and potential levers for influencing decision making.
- Draft recommendations to be made for amending current commercial decision making process in relation to governance arrangements, to ensure robust governance and decision making where appropriate
- Consideration by Steering Group and proposals to be made to FC and Ministers

#### **For part (ii) FH Shareholding Governance benefits**

- Determine as is position of FC and FE in relation to Forest Holidays shareholding and responsibilities, taking on board recent findings by GIAA including
- FE's FH shareholding and whether it is a necessary part of the relationship and commercial arrangements.
- Review and consider benefit of Shareholding alongside SoS control over the land on which FH sites operate and the commercial implications which result from FH's dependency on the land.

## B3. Terms of Reference Cont.

### Responsibilities

#### Action:

UKGI - Mark Batten / Jon Ingram

DGC - [REDACTED]

Defra Policy - [REDACTED]

Defra Legal – [REDACTED]

Defra Finance – Martyn Joy (TBC)

#### Support:

Einav Ben-Yehuda, Group Commercial Director (action owner)

Tim Martin, UKGI

[REDACTED]

Ian Gambles, Director, FC (England)

Simon Hodgson, Chief Executive, Forest Enterprise England Shirley

Trundle, Director, Wildlife, International, Climate and Forestry Nathan

Paget, GIAA

Bruce McKendrick (Forest Holidays) - TBC

### Key Deliverables

For (i) Governance:

- Report on 'as is position for Governance of decision making process;
- Review of issues and opportunities for improvement in Governance of decision making process; and
- recommendations for the future governance of decision making process

[For (ii) Shareholding:

- Report on 'as is position for shareholding
- Review of issues and opportunities for improvement in Governance;

Owner

Target Date

UKGI

14/12/18

UKGI

14/12/18

## B3. Terms of Reference Cont.

Recommendation(s)	Action agreed
8 In view of the scope for uncertainty and disagreement we observed, over the level of oversight which the parties may or may not consider appropriate, we <b>recommend (8)</b> that a governance review of FC be undertaken, which should consider (i) its relationships with Defra, Forest Enterprise England and Forest Holidays and (ii) whether FC should retain its interest in Forest Holidays. It is proposed that this review be led by Defra group Commercial and conducted by UK Government Investments.	Recommendation accepted. We agree with the necessity of a governance review of the Forestry Commission's decision-making in regards to its relationship with Forest Holidays. The review will focus on the effectiveness and appropriateness of the current governance arrangements within FC, Forest Enterprise England and Forest Holidays. We also accept the commission to review FCs current shareholding interest in FH.  Target date: 30/11/18 Owner - Einav Ben-Yehuda