DAC BEACHCROFT

Regulating NHS provider-owned companies – our response to NHS Improvement

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We previously updated clients concerning NHS Improvement's ("NHSI") consultation regarding NHS provider-owned subsidiaries. NHSI's latest proposals would require both NHS Foundation Trusts and NHS Trusts to seek approval from NHSI prior to establishing subsidiaries (regardless of their size) or making any material changes to existing subsidiaries. NHSI posed a number of questions on these proposals in their consultation for providers and interested parties to respond to.

Read our response to this consultation below:

1. Do you agree that all subsidiary proposals should be reported to NHS Improvement regardless of value? Yes/No

Having reviewed the proposals, we do not consider it appropriate for all subsidiaries to be reported to NHSI regardless of value. Furthermore, we do not consider the current proposals to be consistent with NHSI 2020 Objectives. In particular, we refer to Objective 16 which seeks to "focus on high value interactions with providers, minimising any low value or disproportionate regulatory burden".

We have advised a number NHS Trusts and Foundation Trusts on the incorporation of wholly and partly-owned subsidiaries for a range of purposes, including to establish integrated care, as well as the provision of services, such as pathology, pharmacy, primary care and estate management. While we accept some transactions of this nature may be novel or complex, the vast majority are relevantly straightforward commercial transactions in line with the respective function of the NHS Trust or Foundation Trust.

Furthermore, it is our view that establishing a regulatory framework where all subsidiary proposals are reportable to NHSI creates an onerous regulatory burden on both Trusts and NHSI. It is important that a balance is struck between the autonomy of Trusts and the requirement for regulatory oversight. Foundation Trusts, in particular, have a statutory right to create, or participate in, corporate bodies and such powers should not be unduly fettered. Similarly, NHS Trusts already require Secretary of State approval for subsidiary arrangements to confirm they are income generating.

The proposals, as set out in the Consultation, are likely to increase pressure on resources, time and professional support for the Trusts involved, as well as NHSI. We understand NHSI's concerns regarding tax avoidance structures (a matter ultimately reserved for HMRC) and the fact that business cases are required to stand regardless of any consequential VAT savings is of course essential. Notwithstanding this, we also understand that it is essential that subsidiaries are structured in an efficient way to provide the relevant services and therefore specialist support and advice will always be required. Organisations in the private sector would always seek independent financial advice regarding a proposed structure prior to building a business case, it is an essential part of managing risk.

At its best, regulatory oversight should ensure that Trusts are offered guidance and support, and held to account so that they are well-governed and therefore services are of high quality, risks are managed, providers are financially secure, and of course, arrangements are in line with respective statutory functions. The autonomy of Foundation Trusts should not be unduly compromised.

All regulatory oversight should be proportionate to the aims to be achieved and in accordance with best regulatory practice also be transparent from the outset. As currently proposed, much of the proposed regime will be finalised during the first year of operation, after which it will be reviewed. This is likely to have a negative effect on innovation, with many Trusts potentially holding off on their projects as a result.

The consultation also does not seem to consider collaborations between Trusts and Teckal compliant subsidiaries. Such companies are essential in the NHS landscape to make savings and efficiencies for the benefit of patients. Trusts should instead be clearly guided on the governance requirements for such collaborations rather than having a further approval stage.

We would also note that external investment is likely to be stifled if additional regulatory burdens are imposed for subsidiary companies. It is widely accepted that engaging with the NHS to foster innovation is difficult (see for example the

Accelerated Access Review and other related policies). The approach being proposed here would add to those difficulties, and has the potential to stifle the subsidiaries working in a nimble and agile way. Start-ups, typically take a number of years to become established and profit generating and sometimes fail. Subsidiaries should be given the latitude to take time to

generate profit, and to fail.

It is our overall view that the majority of subsidiary arrangements should not fall into the review process given the current legislative framework. NHSI's role should be to provide clear guidance to facilitate the set-up of subsidiaries with clear commercial drivers. Clear guidance is key, particular around governance practicalities to ensure successful subsidiary operation. If clearer guidance was available, this may have avoided some of the negative press around certain subsidiaries and the assumptions that are made about them being a "back door to privatisation" and bad news for employees.

We would propose that Trusts (and in particular FTs) are empowered to self-report proposals that are 'material' or 'significant'. We do not agree that there is a need for NHSI to take that decision. Where proposals would be material or significant, then NHSI would be involved, in line with the existing Transactions Guidance.

2. What criteria or threshold do you think should make the creation of a subsidiary a 'reportable' transaction?

We would propose that material or significant transactions would be reportable. If NHSI require absolute assurance that any tax savings are only incidental to the primary purpose of every new subsidiary, we consider it would be proportionate for NHSI to direct Trusts to explicitly confirm the same at the board meetings where the subsidiary proposals are approved. We consider this to be within the powers of NHSI given that this would relate to ensuring that subsidiaries are used in accordance with the functions of the Trust.

Additionally, NHSI could link its oversight into the Single Oversight Framework ("SOF") and seek to regulate arrangements where a particular Trust is within SOF segment 3 or 4 as part of its mandated support.

3. Do you agree that a 'material change' to a subsidiary should also be reported as a transaction? Yes/No. If you do not agree, why not?

No.

"Material changes" should not be reportable as a matter of course, such changes should only be reportable where it would be proportionate to do so, or where a Trust requires additional support from NHSI. Instances where it may be considered proportionate are where such changes in themselves would amount to material or significant transactions (or would change the whole transaction from being one that is below threshold, to one that is above threshold), or where the subsidiary's parent is within SOF segment 3 or 4.

In respect of any material change to existing subsidiaries, like any subsidiary in the private sector, the subsidiary would have to obtain the consent of its parent/shareholder and it seems excessive to the have to also have such changes approved by NHSI, adding an unnecessary hurdle which could prevent growth and the exploitation of commercial opportunities.

Changes to corporate bodies may be required to reflect changes in law, best practice or governance arrangements as well as changes to reflect current requirements e.g. the Teckal exemption. Requiring Trusts to engage with NHSI may result in a loss of efficiency as it will increase the timescales in which changes are approved in accordance with internal governance requirements and implemented. In our experience clients carefully consider all changes to their subsidiaries and ensure they have clear governance arrangements throughout their group structure to manage and mitigate risks associated with the same.

4. How do you think a 'material change' should be defined?

As per above, we do not consider that material changes should be reported as a transaction.

The Consultation states that the proposals will also apply to "material" changes to existing subsidiaries, however, no indicative definition has been provided. NHSI has stated that this will be defined "*following consultation feedback and initial reviews.*" We consider this to be problematic from a transparency point of view given that, assuming the proposals are implemented as drafted and therefore contained in the next version of the Transactions Guidance, providers are unable to comment on proposed approaches, for example, will "material" be linked to financial thresholds or will there be indicative examples of what may be considered a "material" change? This could result in all providers needing to incur additional costs to determine whether the change is reportable, which may in turn result in further losses due to the requirement to report and progress through the review process. Again, this is likely to be a turn off to potential external investment.

We recommend that NHSI provides some indicative definitions prior to implementing the proposals for comment from Trusts and interested parties so that an initial definition is clear from the outset, acknowledging that this may change as the review process becomes more established.

5. Do you agree that a panel review is an appropriate way to determine whether a proposal for a subsidiary should be classified as 'material' or 'significant' and reviewed accordingly? Yes/No

No

5.1. If you agree that a panel review is appropriate, what risk factors should the panel consider to determine whether the proposal is 'material' or 'significant'?

N/A

5.2. If you do not agree, what do you consider is the appropriate way to determine this classification, e.g. set criteria?

We would propose that Trusts (and particularly FTs) be empowered to determine this classification.

6. Do you agree with the proposed make-up of the panel? Yes/No. If you do not agree, who should be included on the panel?

No. Where panels are used they should be selected on a case-by-case basis to represent the expertise and experience required for the particular transaction.

7. What risk factors should the board certification cover?

Risk factors should be addressed as they are currently i.e. in accordance with internal governance arrangements. We consider that the following should be covered as part of any board certification process:

- the business case can clearly articulate how the subsidiary will create genuine value for the Trust. This would be consistent with using such structures in accordance with Trust functions;
- the business case stands in the absence of any VAT savings. Again, this this consistent with Trust functions;
- the Trust can clearly articulate how the subsidiary will be established, managed and monitored, including a considered exit strategy and appropriate governance arrangements;
- appropriate licences will be obtained for the purposes of the subsidiary, including the requirement for an NHS provider licence, where relevant;
- confirmation specialist advice and regulatory support has been sought. In our experience with the ISAP, it has been a requirement for commissioners to confirm they have received professional advice (legal and financial) and we would recommend this is a clear requirement.

Ultimately, however, it is for an individual Trust board to decide that risks have been mitigated or can be effectively managed and so any board certification should not require lengthy reports because this will seek to further increase costs to trusts in terms of advice and resource.

Authors

Hamza Drabu
London - Walbrook
+44 (0)20 7894 6411
hdrabu@dacbeachcroft.com

Alistair Robertson
London - Walbrook
+44 (0)20 7894 6020
arobertson@dacbeachcroft.com

Anne Crofts
London - Walbrook
+44 (0)20 7894 6531
acrofts@dacbeachcroft.com

Louise Watson-Jones
Newcastle
+44 (0)191 404 4093
lwatsonjones@dacbeachcroft.com

Anne-Marie Gregory
Bristol
+44(0)117 918 2324
amgregory@dacbeachcroft.com

DAC BEACHCROFT