National Audit Office

Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 151 Session 2006-2007 | 6 February 2007

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John Bourn
Comptroller and Auditor General
National Audit Office

2 February 2007

The National Audit Office study team consisted of:

Andy Fisher, Will Palmer and Duncan Butler-Wheelhouse, under the direction of Karen Taylor

This report can be found on the National Audit Office web site at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Email: enquiries@nao.gsi.gov.uk

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SUMMARY

1 Good quality data and information are essential for any organisation to be able to manage its performance effectively. Healthcare providers, staff and patients need reliable and accessible information to make informed decisions and choices; and good use of data is fundamental to achieving a safe and patient-led NHS. The Department of Health (the Department) and NHS trusts have traditionally collected information and data in order to manage performance and improve the delivery of healthcare services. The Department acknowledges, however, that in the past it and the NHS have not always made full or effective use of the data and information that they routinely collect.

2 The Health and Social Care Information Centre (now renamed as the Information Centre) was established in April 2005 as an NHS Special Health Authority responsible for the collection and dissemination of data in the NHS **(see Figure 1 on pages 6 and 7)**. The Department set up the Information Centre following its Arm's Length Body Review, largely by merging parts of the former NHS Information Authority and the Department's Health Statistics Unit. The Department's aim was to rationalise and co-ordinate information collection across the healthcare system in England and to analyse and distribute facts and figures. This aim was designed to help all health and social care organisations use information intelligently and improve how they run their business.

3 During the establishment of the Information Centre, the Department recognised that the Information Centre lacked expertise in publishing, marketing and in producing relevant information products and services that would encourage strategic level and senior NHS staff to make more intelligent use of information. At the beginning of 2005, before the Information Centre had been established, the Department identified the possibility of a partnership between the Information Centre and Dr Foster Ltd, a private company already successful in data dissemination.[1] By working with the private sector the Department believed it would open the market for other private companies to become involved in providing information services to the NHS. The Department also believed it needed to improve the use of information quickly so as to support its reform agenda and considered that a commercial partnership with Dr Foster Ltd was the best option for achieving this goal.

4 Between March and July 2005, the Department's Commercial Directorate, advised by KPMG LLP, brokered the key commercial and financial terms of a joint venture agreement with Dr Foster Ltd. In July 2005, the Information Centre took over negotiations to finalise the joint venture and, in February 2006, the Secretary of State for Health announced the formation of the joint venture company – Dr Foster Intelligence (see chronology of the deal at Figure 1 and Appendix 1). The joint venture is half owned by the Information Centre and half owned by Dr Foster LLP, a holding company set up by the shareholders of Dr Foster Ltd.

5 In October 2005, we received a letter from an anonymous whistleblower who expressed concern about the legality of the joint venture. We investigated the allegations and the details of the proposed deal through interviews and examination of relevant documents. In November 2005 we wrote to the Information Centre, copied to the Department, highlighting concerns about the decision not to tender or advertise the proposal and the lack of evidence as to the value for money of the joint venture (Appendix 2). We stated that "the best way of reducing risk and demonstrating value for money is through a competitive process. Given where you are, we would recommend that this approach is considered in approaching the market in the future. As far as this current deal is concerned, we would encourage you to ensure that there is more openness and transparency; and that your board have the opportunity to fully consider any risks, and steps taken to mitigate these risks, before entering into any agreement to form the joint venture." We did not receive a reply to this letter. However, the letter was discussed at the Information Centre's November Board meeting where the Board concluded that it had taken all reasonable steps to mitigate the risks.

6 Following the Secretary of State's announcement of the finalisation of the joint venture in February 2006, we decided to conduct a value for money study to evaluate the rationale for and terms of the joint venture (at the time of signing the deal), and identify any lessons for future joint ventures.

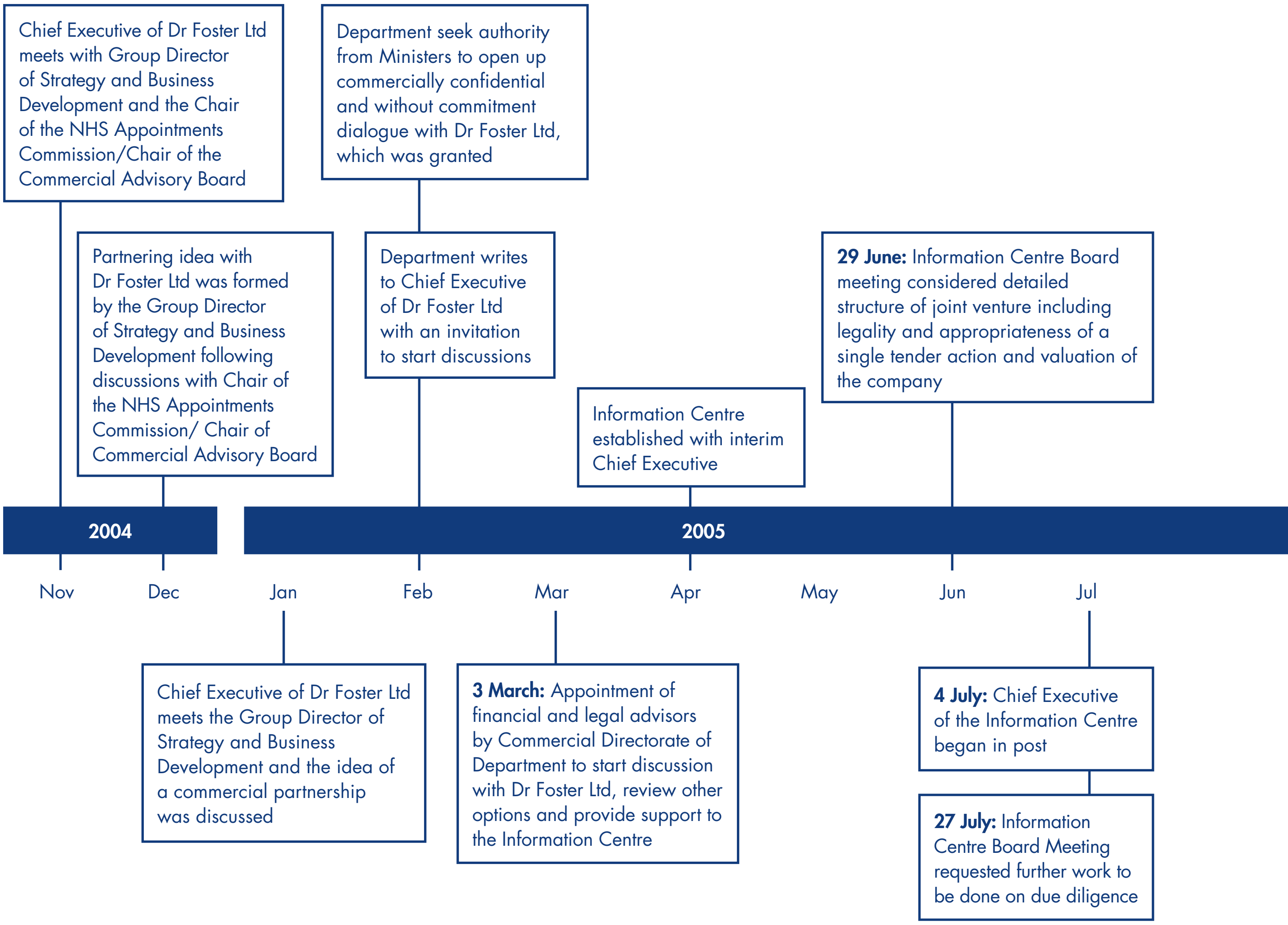
7 Our review focused on the negotiations, the terms of the joint venture, and whether the amount paid for the joint venture was value for money for the public sector. It does not form any view on the value for money for Dr Foster Intelligence's private shareholders or on the conduct of Dr Foster Ltd. Nor does it speculate on the future value for money of the joint venture, where only time will tell. We also do not comment on the quality of the advice given by advisors, but do comment on how the Department and Information Centre used this advice. Our work comprised reviews of all available documents underpinning the deal and interviews with principals and some key stakeholders (the scope of the report is set out in paragraph 1.7 and the methodology detailed in Appendix 3).

Key findings

8 The Department's Group Director of Strategy and Business Development (the Departmental sponsor of the Information Centre) saw a partnership with Dr Foster Ltd as a unique commercial opportunity to support the establishment of the Information Centre. Some form of commercial partnership was seen as a way to achieve the Department's aims of improving the use of data quickly. The Department considered that exploring this commercial opportunity was justified on the basis that Dr Foster Ltd was the clear market leader in this field, with an established national profile and was seeking investment to support its growth.

9 In February 2005, the Department started to discuss the formation of a commercial partnership with the Chief Executive of Dr Foster Ltd. The Department has stated that analysis from its Commercial Directorate suggested that no tender exercise was needed. The Group Director of Strategy and Business Development gained approval from Ministers to open up a commercially confidential and without prejudice dialogue with Dr Foster Ltd. The Department told us that it was conscious at the outset of the need to manage the risks of such a proposal and to consider alternative options. Throughout the process of developing and negotiating the deal, the Department and the Information Centre took and acted upon advice from its legal and financial advisors.

1 Chronology of the deal (see Appendix 1 for a more detailed chronology)



Source: National Audit Office

2005

Aug

Internal peer review process initiated

Heads of Terms approved and signed off

Business case finalised

Sep

Information Centre Board Meeting – further work was requested by the board to be done before sign off

Oct

31 October: Legal Due Diligence report completed

Nov

Further internal analysis performed against the issues raised at the September and October Boards

Following receipt of correspondence the National Audit Office reviewed the deal and wrote to the Information Centre and the Department of Health highlighting the risks of entering into joint venture

Service Agreement removed: it had originally been intended to have a service agreement between the Information Centre and joint venture. The service agreement was dropped as it was no longer needed.

This meant that the Information Centre would be required to go to tender where appropriate for the works that would have been outsourced to the joint venture via the service agreement.

24 November: Information Centre Board Meeting – the Board granted Chief Executive delegated authority to approve the Joint Venture Transaction in principle

30 November: Lord Warner writes to Secretary of State for Health requesting approval

30 November: Group Director of Strategy and Business Development recommends transaction approval to Lord Warner

Key legal documents completed

Dec

Department of Health approval granted by the Department of Health's Capital Investment Unit

Secretary of State for Health grants income generating powers, and agrees joint venture

2006

Jan

Dr Foster Intelligence created as a legal entity

Feb

13 February: Dr Foster Intelligence launched by Secretary of State

10 In March 2005, the Department commissioned KPMG LLP to: carry out initial due diligence on Dr Foster Ltd and develop a business plan for the proposed joint venture; undertake a market analysis and produce a strategic options paper; and prepare an outline business plan for the Information Centre. In March 2005 the Department also contracted with Dr Foster Ltd for consultancy services to the value of £50,000, to provide advice in connection with the establishment and role of the Information Centre, and associated strategic advice connected with the possible relationship to be developed between the Information Centre and the private sector.

11 The Department, considering the findings from KPMG's due diligence work, believed that Dr Foster Ltd met their specification and was the clear market leader in terms of its profile. The Department told us that they had considered tendering but the market analyses by its Commercial Directorate and KPMG confirmed to the Department's satisfaction that this was not likely to be worthwhile. In June 2005, the Information Centre Board considered the detailed structure of a possible joint venture, together with the appropriateness of taking forward negotiations with a single prospective partner.

12 Following the appointment of the new Information Centre's Chief Executive in July 2005, the Department handed formal responsibility for the joint venture over to the Information Centre. At this stage the Information Centre asked its advisers (Berwin Leighton Paisner LLP) for further advice on the governance of the joint venture. It also requested that KPMG LLP give advice on how the joint venture would assist in the achievement of the Information Centre's objectives, and to give further consideration to other options. The consideration of options was undertaken concurrently with KPMG's further due diligence and with the Information Centre's negotiations with Dr Foster Ltd to agree non-legally binding Heads of Terms for the joint venture.

13 The two other options (in-house and outsource) were included in the Information Centre's business case for the joint venture produced in August 2005, and dismissed. No discussions were held with other health informatics companies to determine their interest or ability to deliver the aims of the joint venture. The finalisation of the Business Case in August 2005, and the completion of legal due diligence by end-October 2005, provided the basis for the key legal documents to be completed in November 2005, and the creation of the Dr Foster Intelligence joint venture in January 2006. Throughout these processes, the Board's objectives were to enable the Information Centre to deliver on key aspects of its strategy, to benefit from an innovative public-private partnership, and through this to make more rapid progress in the development and use of health informatics products in the NHS than would be achieved otherwise.

14 HM Treasury guidance on joint ventures[2] suggests, amongst other best practice principles, that exploring alternatives and generating a business case should usually precede a decision about whether a joint venture is the best option to meet an organisation's requirements. The guidance also suggests that the best way to obtain and demonstrate that best value will be delivered is to run a competition to select a joint venture partner. In particular, competition is likely to be the best, and in some cases the only way to test the market and establish a justifiable price for the public sector's contribution to a joint venture. Competition also reduces the chances of a challenge under the State Aid rules although this cannot be guaranteed.

15 In this case it was the emergence of an opportunity to form a commercial partnership with a company that the Department saw as a clear market leader in its field in the NHS that prompted consideration of a possible joint venture. The development of a business case and the consideration of alternatives to a joint venture were therefore then taken forward in the context of preliminary discussions with one potential partner, Dr Foster Ltd. Because the due diligence confirmed to the Department's and the Information Centre's satisfaction that the joint venture was the best option, and that Dr Foster Ltd was the most appropriate partner, there were no calls for expressions of interest to identify other possible partners.

16 The Department and Information Centre stated that they acted throughout on the basis of the advice given by its Commercial Directorate and paid advisors. The Department concluded that in order to realise the benefits from the joint venture no competitive tender procedure was required. Our research has shown that there were companies providing similar services to Dr Foster Ltd already working in the UK, and in other European countries. However, on the basis of the market analysis it had commissioned, the Department believed that Dr Foster Ltd clearly represented the best possible prospect for a joint venture partner for the Information Centre in the UK or in Europe, given the benefits it was seeking to attain.

17 In October 2005, the Department commissioned the Office of Government Commerce to undertake an internal peer review of the joint venture (this was not a Gateway Review[3]). The review concluded that there was widespread support for Dr Foster's management products and acceptance that a joint venture was a way of making a rapid change in the delivery and use of health information. It also concluded that a joint venture proposal had the clear potential to stimulate the development of a significant market for health informatics and make possible the potential improvements in the cost reduction, efficiency and choice in the NHS. However, it highlighted potential concerns about the process, including stakeholders' concerns about the probity of a single tender action, which would need to be addressed.

18 The Information Centre paid £12 million in cash for a 50 per cent share of the joint venture **(see Figure 2 overleaf)**. Assets in the form of information products were made available by the Information Centre to the joint venture. These assets have been listed on the Information Centre's books with a value of £1.8 million. In negotiating the deal, however, the Information Centre's financial advisors afforded the assets a nil value based on their assessment of the saleability of these products on transfer.

19 The Information Centre also spent over £2.5 million in consultancy and legal fees throughout the formation of the joint venture, and in supporting the Information Centre in business planning. The Information Centre states that £875,000 of the £2.5 million related to consultancy advice for setting up the Information Centre. However, when we audited this particular expenditure we found that much of the consultancy activity was inextricably tied up with either setting up the joint venture or considering alternatives to the joint venture.

20 Before the deal was negotiated Dr Foster Ltd was given an indicative valuation by the Department's financial advisors at £10 to £15 million based on assumptions on the future growth of its business. The Department have acknowledged that the £12 million paid for the 50 per cent share included a strategic premium of £2.5–£4 million. This strategic premium was paid because the Department and Information Centre believed that it reflected the anticipated benefits to the NHS and the Information Centre of the joint venture. Of the £12 million paid, £7.6 million was paid directly to Dr Foster LLP (made up primarily of shareholders of Dr Foster Ltd). The remaining £4.4 million is being used by the joint venture company as working capital (see Figure 2).

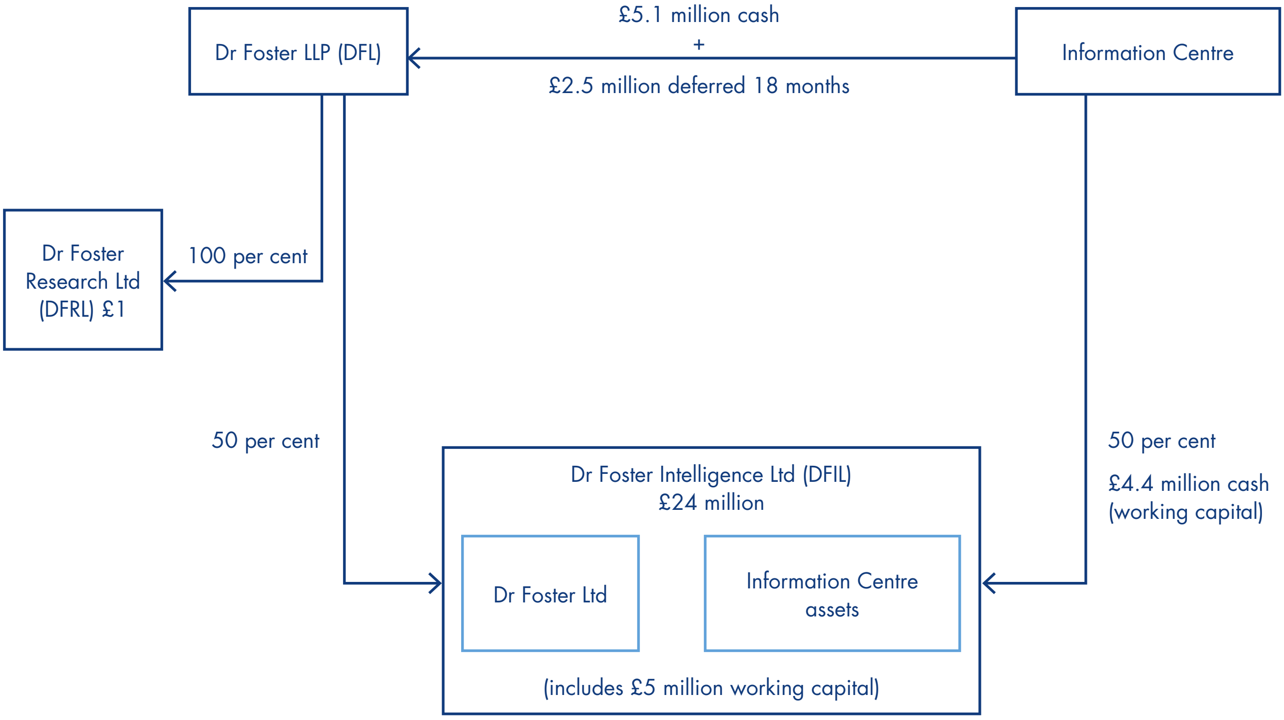
21 As part of its contribution, Dr Foster Ltd transferred all of its existing NHS business including information products and intellectual property to the joint venture company. Dr Foster Ltd moved a small amount of its private business comprising of contracts with the private sector to a new company Dr Foster Research Ltd. The key asset was the then Chief Executive of Dr Foster Ltd who is seconded from Dr Foster Research Ltd to Dr Foster Intelligence for the three years of the joint venture. Dr Foster Ltd also provided its senior management team to the joint venture together with the related network of contacts and marketing expertise.

22 In October 2005, before the deal was completed two companies wrote to the Information Centre expressing concerns about the joint venture, following an article in the Guardian newspaper. They were concerned that they had not been given the opportunity to show that they could have delivered the requirements of the joint venture, and that they had not been contacted as part of the due diligence or internal peer review processes. Since its launch the joint venture has created further concerns amongst other health informatics companies that there is no longer a level playing field and that there is a disincentive for them to bid for future NHS work. The Information Centre has put in place policies and procedures to demonstrate fairness, including processes to ensure that there is no privileged access to data for the joint venture, but competitors continue to have concerns.

Overall conclusions

23 It is government policy to encourage departments to use private sector resource by way of outsourcing public private partnerships and joint ventures when there is a good case for doing so on value for money grounds. We believe that in this case the Department might well have obtained better value for money if they had advertised the opportunity of the joint venture more widely. By not going out to tender or advertising the opportunity to the market, the Department and the Information Centre entered into a transaction that carries the risk of legal challenge. Regardless of legality, it is good practice to hold a competitive process. Without a competitive process the Information Centre has no fair comparisons or benchmarks to demonstrate that the joint venture with Dr Foster Ltd was the best structure to meet its needs, or that it represents good value for money.

2 Summary of the joint venture



Dr Foster Ltd

Contribution

- Entire business and assets of DFL excluding two contracts that go to DFRL

Cash received

- £7.6 million cash received from Information Centre to be used primarily for share consolidation

Assets

- 50 per cent of DFIL = £12 million
- DFIL Loan Note = £2.5 million in 18 months
- 50 per cent of DFL current assets = £300,000
- DFRL with nominal value £1

Cash to existing shareholders

- Maximum of £5.1 million dependent on mix and match take up

Key people – Chief Executive of Dr Foster Ltd

- Employed by DFRL and seconded to DFL. Secondment requires DFL's prior consent to terminate
- CEO needs to give 12 months notice to terminate
- DFRL is required for CEO to enter into confidentiality provisions and restrictive covenants with DFL
- Except for gross misconduct etc. DFL is required to give 12 months' written notice to terminate

Information Centre

Contribution

- Intellectual Property licences for some products

Cash outlay

- £7.6 million total cash payment to Dr Foster Ltd as follows:
  - £5.1 million at deal completion (representing £4.5 million cash, £0.3 million net assets adjustment and £0.3 million options cash) and £2.5 million after 18 months
  - £4.4 million equity invested into DFIL (at deal completion) to fund working capital requirements

Assets

- 50 per cent of DFIL = £12 million
- 50 per cent of DFL current assets = £300,000

Source: Department of Health

24 Although the Department believes that it acted as a market investor in negotiating a realistic price, we calculate that the Information Centre paid between 33 and 53 per cent more than the advisor's highest indicative valuation based solely on the acknowledged strategic premium of between £2.5 and £4 million. As the joint venture does not deliver any direct or measurable services to the Information Centre, it is an investment in a private company for which the Information Centre paid a strategic premium without gaining a controlling interest. The only measurable benefit is a 50 per cent share of any future profits. Whilst the Information Centre maintains that there will be other benefits, which may be measurable over time, no baseline exists for January 2006 against which the quantum of these benefits can be measured.

25 Our review found that throughout the deal there was an urgency to complete the deal with Dr Foster Ltd and, in negotiating the joint venture, the roles and accountabilities of the Department and Information Centre were sometimes confused. There was also a potential for conflict in the role given to advisors; the same advisors were asked to help define the specification for working with the private sector, consider the options of working with the private sector at the same time as starting dialogue with Dr Foster Ltd on forming a joint venture. We are concerned by the Department's decision to pay Dr Foster Ltd for advice on the informatics market, at a time when they had already entered into discussions about the possibility of some form of commercial partnership.

26 We consider that there is a real risk that this joint venture may result in a less competitive health informatics market, certainly over the three years of the agreement. Whilst the Information Centre has now taken steps to try to ensure there is equal and fair access to data and that future procurement of services is subject to competition, other providers consider that Dr Foster Intelligence has "first mover advantage" and are not convinced therefore that there can be a level playing field.

27 Had the Department or Information Centre put the opportunity out to tender there would have been a clearer measure as to its value for money. The choice of partner would have been more readily defensible and furthermore, the Information Centre could have: contracted services directly from their choice of partner; been an active partner rather than arm's length investor; and there would be a reduced perception that the joint venture is uncompetitive as others would have had an equal opportunity to demonstrate whether they could meet the requirements of the Department and Information Centre. Given the above, we believe that the rewards are not equal to the risks.

The Department's response to the National Audit Office's conclusions

The Department and the Information Centre contend that they sought appropriate legal and professional advice in planning and negotiating the joint venture, that they followed this advice throughout, and that any legal challenge would fail. It is also the Department and the Information Centre's view that the joint venture was not primarily about financial gain, but rather was designed to harness private sector dynamism, efficiency and effectiveness to public sector expertise and ethics, in the health informatics field.

The Information Centre has maintained throughout the National Audit Office's investigation that the Board's focus was on the following objectives:

- to help the Information Centre deliver on key aspects of its strategy – including greater customer focus and improved accessibility, coverage and use of information in the health and social care sector to support better commissioning, choice, quality and efficiency;
- to take advantage of the most up to date techniques for presenting and marketing information in ways which engaged and met the needs of managers, clinicians, patients and the public;
- to benefit from an exciting and innovative public-private partnership which would over time make a real difference as well as generating savings and efficiencies in the NHS through better distribution of information and the wider adoption of performance management tools and information;
- to exploit Dr Foster's existing range of products, skill-set and contacts together with their understanding of the information market and their ability to develop commercial products; and
- to deliver against market drivers and to make more rapid progress than either the Information Centre or Dr Foster could achieve separately or through less formal collaboration.

The Department and Information Centre further contend that the Information Centre is able to contract services directly from its choice of partner, and that the Information Centre has, throughout its existence: taken careful steps to seek to ensure that there is equal and fair access to data; that Dr Foster Intelligence has no "first mover advantage"; and that all procurement of services beyond the minimum value threshold are subject to competition. Additionally, the Department and Information Centre believe that as the joint venture has been in existence for less than a year it is too early to measure the benefits and judge value for money.

The Department and the Information Centre stand by their view that Dr Foster Ltd was the right strategic choice as a partner for the Joint Venture, based on the market analysis and due diligence that was carried out before and during the negotiations, and on the subsequent performance of the Joint Venture. They fully acknowledge the case for a systematic approach to competitive tendering in such exercises and the need to follow best practice. However, they are not persuaded that a competitive exercise to select a partner would have produced a different outcome in this instance, given the benefits that they were seeking to derive from the Joint Venture.

The Department's response to the National Audit Office's conclusions *continued*

They remain of the view that the price negotiated to establish Dr Foster Intelligence was a reasonable one, based on the commercial advice they received, and the fact that the vendors were ceding control of their company. It was never the intention of the negotiations to gain a controlling interest in Dr Foster Intelligence; but through the shareholder agreement and its presence on the Board, the Information Centre is in a position to ensure that the Company, with its vital role in the information business, meets the needs of the health and social care system. The joint venture was designed from the outset to be an equal partnership, bringing together public and private sector expertise and values.

Recommendations

28 Bringing together the best of the public and private sector to deliver public services has clear potential benefits and it is likely that similar partnerships will be considered in the future. Whilst the Dr Foster Intelligence joint venture is an attempt by the Department of Health to provide an innovative approach to meeting the information needs of the Department and the wider NHS, there are sensible steps in the development of all public-private partnerships that should be taken at the outset. Fundamentally there should be an overriding principle of openness, transparency and fairness. The following recommendations are aimed at ensuring best practice for the future.

29 The Department, as for all Government Departments, should:

- Require that all public-private partnerships are advertised appropriately within the European Union. Even when EU procurement directives do not apply, good practice indicates that there should be an application of these directives in principle and spirit.
- Maintain a competitive bidding process as far as possible or, in the absence of appropriate competitors, ensuring adequate benchmarks exist to measure value for money.
- When undertaking similar deals and joint ventures it should follow Treasury guidance and consider taking advice from the Government's Shareholder Executive and Department of Trade and Industry's State Aid Branch.
- Clarify to their Arm's Length Bodies the financial and corporate governance processes that should be followed when considering entering into joint ventures, and monitor their compliance.

30 The Information Centre should:

- Expedite the further deployment of policies to ensure that fair and equitable access to data can be demonstrated at all times. This policy should continue to be subject to independent scrutiny which should include representatives from bodies that represent the private sector industries.
- Where possible the Information Centre should ensure that all future services are competitively procured.
- If procurement processes show that there is unwillingness for companies to bid for work when placed out to tender, the Information Centre should ensure that it consults with appropriate competitors to understand the reasons why and, if appropriate, takes steps to ensure a level playing field.
- Recognise that demonstrating the value of the investment will be important for the Information Centre and, therefore, the need to re-evaluate its investment and the joint venture's performance on an annual basis.

PART ONE

The fairness and value for money of the joint venture

1.1 The use of good quality information has always been important to the provision of safe and effective healthcare, but is becoming increasingly vital to help achieve the NHS reform agenda. For policies such as Payment by Results, Commissioning a Patient Led NHS, Practice Based Commissioning, and Choice to be successful there is a need for informed decision-making by patients as well as NHS managers and clinicians. Informed decision-making requires timely and reliable information. In the past the NHS has been good at collecting information but poor at interpreting and using this information. One of the reasons that information has not been effectively used is that it has not been packaged in a way that enables the NHS and the public to understand and use the information presented to them.

1.2 Over the last few years an increasing number of private sector companies have entered the health informatics market. Health informatics is the practical application of information to help inform the management and delivery of health services. These companies take NHS data or information, then analyse and repackage it (in a form known as information products) in a way that makes it easier for patients, managers and clinicians to understand. An information product commonly uses data collected from the NHS which is then analysed and presented in a form that is more easy to use and interpret. In some cases, sophisticated algorithms or programmes can be used to analyse data and make predictions of future performance. Whilst NHS trusts often have in-house information capability these external products can add significant value.

1.3 Dr Foster Ltd is perhaps the most high profile health informatics company to have emerged over the last five years. Whilst other private companies providing data products and information to the NHS have a lower public profile, at least one, CHKS, had similar revenue derived from the NHS market at the time of the development of the joint venture. There are also other public sector organisations involved in health informatics including shared information services such as the NHS funded Public Health Observatories and the Information Centre. The Department also collects much data in its performance management role of the NHS through the Information Centre.

1.4 The Information Centre is a Special Health Authority with a statutory duty to collect, analyse and disseminate data for the NHS in the fields of health and social care. The Information Centre was set up in April 2005 as a result of the Department of Health's Arm's Length Bodies Review. It comprised, in essence, parts of the former NHS Information Authority and parts of the Department of Health Statistics Division. When it was launched, the Information Centre was expected to accelerate the use, analysis and distribution of health and social care information (sometimes referred to as informatics). The objectives of the Information Centre are to:

- reduce the burden on front-line services in the collection of data; and
- stimulate the reform of health and social care informatics to enable the NHS and care organisations to improve efficiency and effectiveness.

1.5 In October 2005, we investigated allegations from a whistleblower about the Department's plans to endorse a joint venture between the Information Centre and Dr Foster Ltd. We spoke to the Chief Executive of the Information Centre and the Department's Group Director of Strategy and Business Development in November 2005 to outline our concerns. We highlighted that there were risks relating to EU Procurement Laws and State Aid legislation. We also stated that it was difficult to determine the value for money of the transaction because of the absence of a competitive tender process. The Information Centre then sought further legal advice and took some steps to mitigate the risks.

1.6 Following further discussion we wrote to the Information Centre (Appendix 2). We stated that "the best way of reducing risk and demonstrating value for money is through a competitive process. Given where you are, we would recommend that this approach is considered in approaching the market in the future. As far as this current deal is concerned, we would encourage you to ensure that there is more openness and transparency; and that your board have the opportunity to fully consider any risks, and steps taken to mitigate these risks, before entering into any agreement to form the joint venture." We did not receive a reply to this letter. However, the letter was discussed at the Information Centre's November Board meeting where the Board concluded that it had taken all reasonable steps to mitigate the risks.

1.7 The Information Centre's participation in the joint venture was approved by the Secretary of State for Health in December 2005, and the new joint venture company Dr Foster Intelligence was launched on 13 February 2006 (see detailed chronology Appendix 1). Fifty per cent of the new company, Dr Foster Intelligence, is now owned by the Information Centre and 50 per cent by private shareholders (Dr Foster LLP)[4] (see Figure 2). Given our concerns about the way the joint venture had been negotiated, whether the issues we had raised had been mitigated and the implications for future public/private partnerships, we decided to examine the transaction, including evaluating the joint venture against Treasury Guidance, in order to identify lessons for future initiatives. This report examines the fairness and value for money of the joint venture, in particular:

- the decision to enter into a joint venture (paragraphs 1.8–1.15);
- setting up the joint venture (paragraphs 1.16–1.19);
- the cost of the Information Centre's share of the joint venture (1.20–1.28);
- cost of the legal and consultancy advice associated with the joint venture (paragraphs 1.29–1.33);
- the procurement process and implications (paragraphs 1.34–1.45);
- the risks and rewards of the joint venture (paragraphs 1.46–1.56); and
- perceptions of other health informatics companies (paragraphs 1.57–1.62).

The decision to enter into a joint venture

1.8 The Department believed that the Information Centre, which comprised of the former Information Authority and the Health Statistics Division, had the skills and expertise to discharge their core statutory duties in relation to data collection and standards, but they lacked the necessary commercial skills quickly in terms of developing and marketing information products. From an early stage in the establishment of the Information Centre, the Department decided that the most effective way to obtain these skills was through a commercial relationship with the private sector.

1.9 The Department's idea of developing a commercial relationship arose after a meeting in November 2004 between the Chief Executive of Dr Foster Ltd, the Group Director of Strategy and Business Development and the Chair of the NHS Appointments Commission who is also Chair of the Department's Commercial Advisory Board. During these discussions the Chief Executive of Dr Foster Ltd, impressed the Department with his vision for and knowledge and understanding of the health informatics market.

1.10 Subsequently, and on the basis of advice from the Department's Commercial Directorate, in January 2005 the Group Director of Strategy and Business Development considered how the Department could capitalise on the drive, capability and marketing flair of Dr Foster Ltd. At the time, Dr Foster Ltd wanted to increase its capacity and the Department wanted to improve the use of data in the NHS so the concept of a commercial partnership was deemed appropriate by the Department.

1.11 The Department considered that Dr Foster Ltd had already established itself as clear market leader in the NHS in marketing NHS data, and in February 2005 the Department sought and obtained ministerial approval to start commercially confidential, without-commitment dialogue with Dr Foster Ltd. The Department has told us that there was a need to 'seize the moment' as improving informatics was critical to achieving the NHS reform agenda and therefore needed to be done quickly. Advice from the Department's Commercial and Financial Directorates identified that no tender exercise was needed as the likely relationship would be a direct purchase of assets or shares.

1.12 The use of joint ventures in both the public and private sectors is increasing. Organisations see joint ventures as a way to bring together skills and resources to achieve objectives they might not have been able to achieve alone. A joint venture allows individual bodies to share the risks and rewards in trying to achieve their own organisational objectives, which may differ. A joint venture can involve various models from simple contractual arrangements to the formation of joint venture companies as new legal entities. Joint ventures can also have disadvantages, particularly when there is no majority shareholder, as the shareholders' objectives may diverge over time making the joint venture difficult to manage.

1.13 The Department was conscious from the outset of the need to identify and manage the risks associated with carrying out the joint venture and a requirement to consider alternative options formally. In early March 2005, the Department commissioned KPMG to look at partnerships with the private sector. This phase of the work was expected to cost £284,000. Specifically there were three workstreams identified in the specification for KPMG:

- **a** Workstream 1 – work with Dr Foster Ltd's management, the Department and Information Centre to undertake due diligence on Dr Foster Ltd and develop a business plan for the proposed joint venture;
- **b** Workstream 2 – undertake market analysis and produce a strategic options paper to provide advice to the Department and Information Centre. Work with the Dr Foster Ltd's management and Departmental legal advisors to develop options as to the structure of the joint venture; and
- **c** Workstream 3 – work with the Department's legal advisors to ensure that all options under consideration can be undertaken and that the timescale and approval routes have been identified.

1.14 As part of the evaluation work in March 2005 the Department entered into a separate £50,000 contract with Dr Foster Ltd to "provide consulting services in connection with the establishment and role of the Information Centre and development of a business plan and associated strategic advice connected with the possible relationship to be developed between the Information Centre and the private sector". This piece of work was commissioned after initial discussions on partnership working had already begun, using a call off contract with the Department for providing market research services.

1.15 Following receipt of the initial due diligence report by KPMG, completed in draft in April 2005, the Department were convinced that setting up a joint venture would boost the development and use of information in the health and social care system. It considered that this would, in turn, encourage more companies into the health informatics market to make the most of the existing data in the NHS to help improve services. **Figure 3 overleaf** shows the relationships of the key players in developing the joint venture and Appendix 1 shows the chronology of events in developing the joint venture.

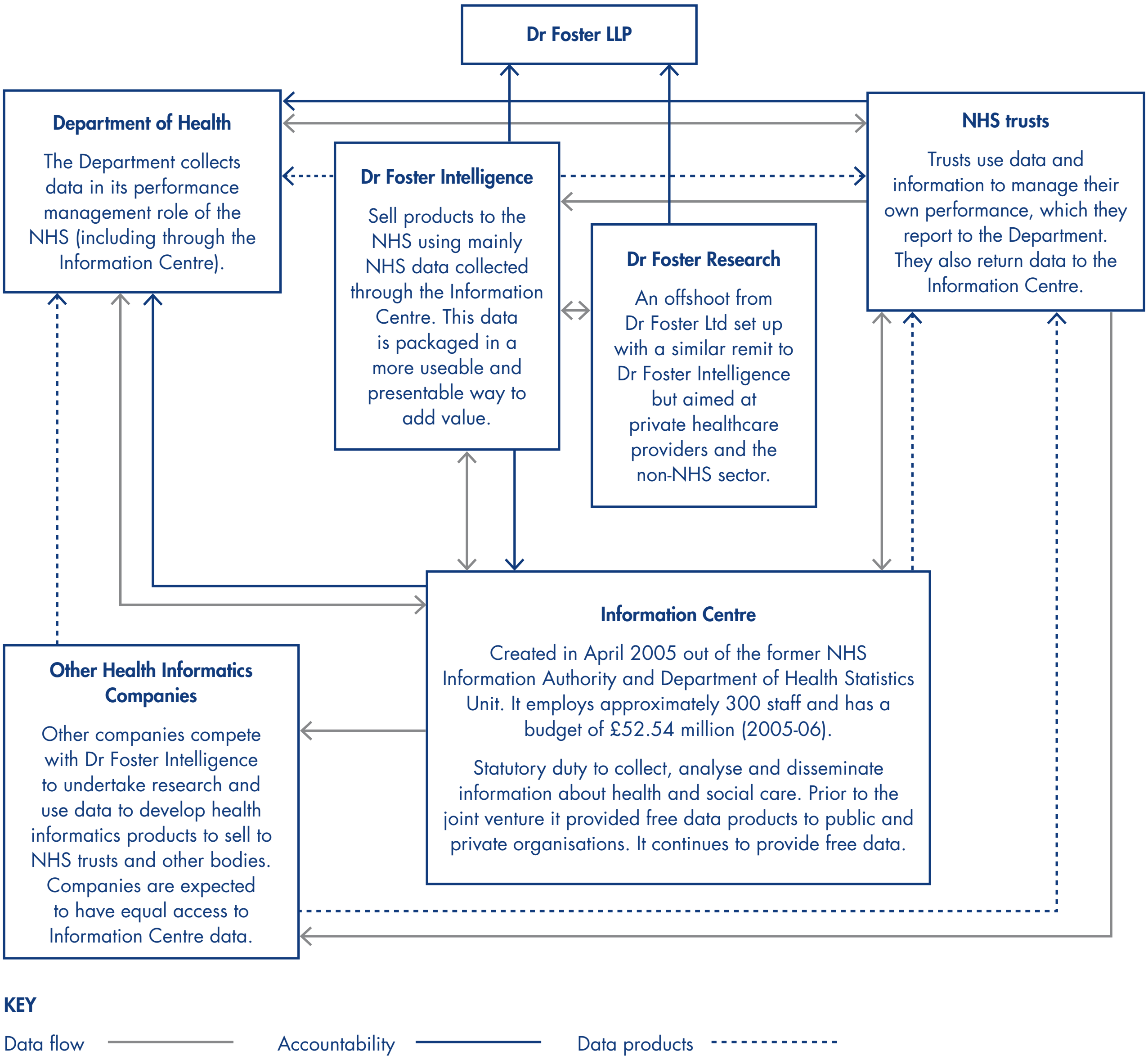
Setting up the joint venture

1.16 Treasury guidance on the formation of joint ventures outlines the important issues that public sector bodies will need to address when forming joint venture companies. The guidance concentrates on the issues associated with the creation of joint venture companies by the public sector in partnership with the private sector. It was produced with the Government's Wider Markets Initiative in mind but is valid for most public-private joint ventures. The guidance outlines the typical key steps and considerations for forming a joint venture **(see Figure 4 on page 17)**. This includes considering firstly whether a joint venture is the best way to meet the public sector's requirements. It then also suggests that the best way to ensure that the public sector demonstrates value for money is through a call to competition.

1.17 Initially the deal for the joint venture included a service level agreement and therefore procurement issues needed to be considered. Legal advice was sought by the Department from Berwin Leighton Paisner LLP (solicitors) on the proposed approach to procurement. In June 2005, the Department and its advisors, presented their findings to the Information Centre's Board. This included the initial options analysis as alternative considerations to the joint venture.

1.18 Following the appointment of the Chief Executive in July 2005, the Department handed formal responsibility for the joint venture over to the Information Centre. At this point the Information Centre's Board took further advice from advisors Berwin Leighton Paisner LLP on the governance and from KPMG LLP as to how the joint venture would help the Information Centre achieve its objectives. The advisors also considered other options to the joint venture at this stage. The terms of the joint venture were then further negotiated by the Information Centre with an expectation that the transaction would be completed in November 2005. These further negotiations did not include the key commercial terms such as price and exit arrangements which were concluded through negotiations between the Department's Commercial Directorate and Dr Foster Ltd.

3 The main roles, responsibilities and accountabilities in Health Informatics



Source: National Audit Office

1.19 In August 2005 the Department formalised its business case for the deal. The business case assessed the joint venture against the following options:

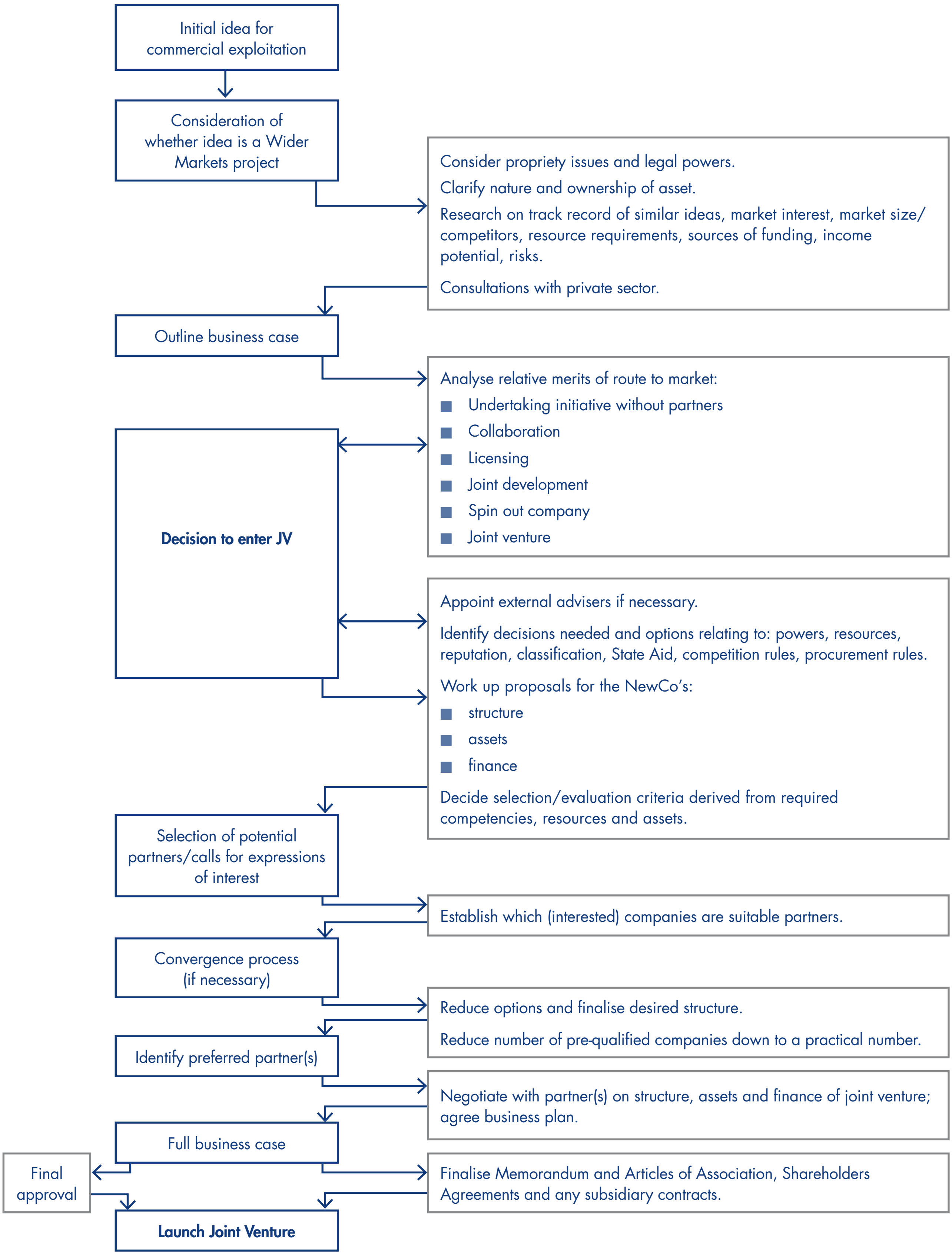
Option A Investing additional money and staff into developing skills and expertise, products and services in-house;

Option B Entering into contracts with private sector organisations through a combination of outsourcing and procurement of expertise; and

Option C Investing no additional money and staff – effectively this is the "do minimum" option.

The business case concluded that Option C was unlikely to succeed within an acceptable timeframe, including in the context of the NHS reform agenda, as the Information Centre was unlikely to achieve its objectives without investment in required skills. Both Options A and B were considered in detail but not in as much detail as the joint venture with Dr Foster Ltd and were dismissed. The business case was completed after the due diligence and non-legally binding Heads of Term for the joint venture had been completed. At a later date the Heads of Term were renegotiated but a new business case was not produced.

4 Treasury Guidance on typical key steps for setting up a joint venture company



Source: HM Treasury guidance

The cost of the Information Centre's share of the joint venture

1.20 The consideration paid by the Information Centre for Dr Foster Ltd's contribution to the joint venture was determined on an arm's length basis, in commercial negotiations between the Department and Dr Foster Ltd. The Department told us that it negotiated the consideration as a normal market investor would, basing its valuation on independent advice, from KPMG, as to the indicative valuation of the assets and business being contributed by Dr Foster Ltd, and on its assessment of the value to the Department of their investment. Essentially, the Department saw the joint venture arrangement as an investment in a private company in the informatics market where the main measurable financial benefit at the time was a 50 per cent share of any profit. The Department expected that the joint venture would lead to other companies getting involved in health informatics with the end result being better use of health information.

1.21 The advisors indicative value of Dr Foster Ltd was between £10–£15 million in March 2005 using discounted cash flow models based on extrapolations from the previous performance of the company, and by comparison with similar companies. This suggests that the value of a 50 per cent share of Dr Foster Ltd should have been around £5–£7.5 million. Dr Foster Ltd contributed most (95 per cent) of its business to the joint venture. Following negotiations, the Information Centre agreed to pay £12 million for a 50 per cent share of the joint venture. The £12 million contributed by the Information Centre was split between £4.422 million working capital into the joint venture and £7.578 million to Dr Foster LLP shareholders (see Figure 2 in the Executive Summary).

1.22 The Information Centre paid an acknowledged strategic premium of between £2.5–£4 million. A strategic premium is commonly paid to obtain a controlling interest in a company; in this case no controlling interest was obtained nor wanted. The Department have said the strategic premium that the Information Centre paid recognises the value that the joint venture brings above the value of the standalone company, Dr Foster Ltd. The strategic premium can be calculated based on the expected value of the new joint venture company, taking into account the £4.4 million injection of capital into the joint venture and the net asset adjustment.

1.23 As the price was negotiated at an arm's length basis and in the absence of a competitive process with market tension, it is difficult to judge if this represents a market value for a seller who was willing to sell a half share in return for investment to grow the company. It is not known if the value brought by the Information Centre, including the NHS brand, has been reflected in the form of a lower negotiated price. We have not considered the future value of the joint venture company as this is largely unpredictable, although to some extent the future value formed part of the valuation by KPMG.

1.24 As part of the transaction, certain assets of the Information Centre, which at the time of the deal had a book value of £1.8 million, were also made available to the new joint venture company. The assets were given a zero value when transferred although a number of the information products were in use at the time of the transfer and some continued to be used until they were migrated to existing or new products of Dr Foster Intelligence. The Department and Information Centre state that these assets were given a zero value by their advisors KPMG LLP as the assets had no net earning potential for the Information Centre.

1.25 The Information Centre has made clear that it does not agree with the NAO's view that this £1.8m is a consequence of the joint venture; rather, it is the Information Centre's professional view that this value would have been written off irrespective of whether the joint venture deal had proceeded or not. The Department and the Information Centre contends that the £1.8m should not be included when calculating the costs of the joint venture.

1.26 The Information Centre spent £2.5 million on legal and consultancy advice in developing the joint venture, and setting up the Information Centre. The Information Centre contends that £855,000 of the money paid to KPMG was associated with costs for setting up the Information Centre which included business planning. However, they could not provide an explicit breakdown of these costs between the work done for the joint venture and work in advising on setting up the Information Centre, as some pieces of work are inextricably linked. We therefore calculate that the total cost to the taxpayer of a 50 per cent share is between £15.4 million and £16.3 million **(Figure 5)**.

5 Costs of the joint venture to the NHS

Details	Total cost to the NHS of the joint venture
Cash payment	**£12 million** (£2.5 million of which is deferred until 2007)
Payment to advisors	**£1.7 million** (A further £874,000 was paid to an advisor for work done on both the joint venture and setting up the Information Centre although there is no explicit breakdown of these costs)
Contribution of fixed assets	**Zero value** given at transfer to the joint venture (The assets were given a book value of £1.8 million in the Information Centre's accounts)
Total	**£13.7 million** (£16.3 million including the book value of transferred assets and additional payments to advisors)

Source: National Audit Office

1.27 In forming the joint venture, the Board of Dr Foster Ltd proposed a new structure to accommodate the joint venture. The proposal was to move Dr Foster Ltd's NHS business to a holding company Dr Foster LLP and move some non-NHS business to a trading company. This non-NHS business was based around two contracts that represented just over five per cent of the turnover of Dr Foster Ltd. This trading company, which was valued by financial advisors BDO Stoy Hayward at £1 when the deal was completed, now trades as Dr Foster Research Ltd. The remit of Dr Foster Research Ltd is to generate comparative analysis of private healthcare and non-NHS business to patients and citizens both directly and through a variety of private sector channels.

1.28 One of the key assets of Dr Foster Ltd, its Chief Executive, is now an employee of Dr Foster Research Ltd, who have seconded him on a full-time basis to Dr Foster Intelligence for the three years of the joint venture. The terms of the agreement of the joint venture mean that Dr Foster Research Ltd will be able to use its association with Dr Foster Intelligence to develop its business, including the exploitation of intellectual property of which the joint venture will receive agreed royalty payments.

Cost of the legal and consultancy advice associated with the joint venture

1.29 The Department had largely completed the negotiations on the key commercial terms (in particular the total consideration payable) for the joint venture by the time that the Chief Executive of the Information Centre started in post. On taking up the post the Board and Chief Executive were diligent in seeking further legal and financial advice. The Information Centre worked hard to ensure that they were happy with the deal before agreeing to form the joint venture.

1.30 The nature of the deal changed in the course of these negotiations. In particular, the Information Centre decided to remove a non-compete clause so that it would not be restricted to working exclusively with the joint venture. There were also changes to the scope of the joint venture which meant a service agreement was no longer required, and a shift from the original asset purchase to a share acquisition transaction. The result of this re-negotiation and diligence was that the deal took a lot longer than expected to complete, with commensurate increases in the cost of advisors' fees.

1.31 In 2005-06, the Department and the Information Centre spent £2.5 million on legal and consultancy fees (although the Department passed all of the costs to the Information Centre). This represents up to 20 per cent of the cost of the joint venture to the Information Centre. Over £1.75 million of advice was spent with the main financial and consultancy advisors – all of which was procured based on an initial agreement that was signed by the Department, using the Office of Government Commerce's S-CAT framework agreement.

1.32 Initially, the consultancy advice on setting up the joint venture work was estimated by KPMG to cost no more than £284,000; however, as the length of time to complete the transaction extended, these costs rose to £1.75 million. As discussed (paragraph 1.26) previously the Information Centre have stated that some of this time was spent on advising the Department in setting up the Information Centre and helping with the business planning process; however, this is not clearly documented and is inextricably linked with the joint venture or alternatives to the joint venture.

1.33 The legal advice provided by Berwin Leighton Paisner LLP cost £623,000 and represents just over 2,100 hours of legal work. This appears to be relatively high for a transaction of this size but may demonstrate the complexity of forming a joint venture of this scale **(Figure 6)**. The Department also paid £50,000 to Dr Foster Ltd for providing consultancy services in connection with the establishment and role of the Information Centre (paragraph 1.14 refers).

The procurement process and implications

1.34 In October 2005, the Department commissioned the Office of Government Commerce to undertake an internal peer review of the joint venture (which was not a gateway Review). The review concluded that there was widespread support for Dr Foster's management products and acceptance that a joint venture was a way of making a rapid change in the delivery and use of health information. It also concluded that the joint venture had the clear potential to stimulate the development of a significant market for health informatics and make possible the potential improvements in the cost reduction, efficiency and choice in the NHS. It did also highlight potential concerns about the process, including stakeholders' concerns about the probity of a single tender action, which would need to be addressed. The list of stakeholders interviewed was limited primarily to those involved with the deal.

1.35 The peer review also noted that "up to now project and programme management activities across the development of the joint venture have not been systematic or routine. Project and programme management disciplines have not been applied and governance arrangements have not followed best practice." It also described the development of the joint venture "…has to some extent, been developed under a cloak of secrecy under the guise of commercial sensitivity". The Department told us that this is normal for such acquisitions of parts of a private company to ensure commercial confidentiality.

1.36 Normal public sector procurement practice suggests that joint ventures or other public-private partnerships should be advertised for expressions of interest. However, Treasury guidance on joint ventures recognises that there may be commercial sensitivities in setting up joint ventures but there are ways that you can still approach the market and consider alternatives. We consider that, given the lack of a competitive tender exercise or discussion with the wider market, it is difficult to demonstrate that the joint venture with Dr Foster Ltd was the best way to achieve the aims of the Information Centre. We consider that as the Department did not open up the joint venture opportunity to the wider market, it has left itself open to suggestions from competitors that the process was unfair.

1.37 From March through to early November 2005, the negotiations of the joint venture included a service level agreement that would put an obligation on the Information Centre to procure approximately £600,000 of services from the joint venture. Whilst Public Services Contracts Regulations 1993 (SI1993/3228) would suggest that the Information Centre would need to go out to tender if it was to procure goods or services over the value of £129,000 or €200,000[5], legal advice from Berwin Leighton Paisner LLP noted that whilst there was a presumption under the regulations for an open call for competition there are exceptions when only one supplier can meet a requirement for the services required.

1.38 The Department and the Information Centre sought extensive legal advice from Berwin Leighton Paisner LLP which confirmed that whilst there were risks of challenge under European Procurement laws, the Department and Information Centre had mitigated these risks by undertaking due diligence which showed that only Dr Foster Ltd could meet the Department's requirements.

1.39 The Department commissioned KPMG LLP to look at the market as part of its initial due diligence, which concluded that only Dr Foster Ltd could meet the Department's stated requirements. This supported the Department's decision to commence without-commitment negotiations with Dr Foster Ltd. However, in the first stage of due diligence KPMG LLP was not instructed to look at European providers not already working in the UK, based on the preconception that only UK companies could meet the requirement to "have a detailed knowledge of the NHS". In November 2005, the Information Centre asked KPMG to carry out further due diligence on European companies and a more detailed examination of a competitor of Dr Foster Ltd, CHKS. This due diligence was done based only on information available publicly. KPMG identified that there were companies in Europe that could potentially meet the Information Centre's requirements as could CHKS.

6 External advisors costs and benchmarking

Advisors	Cost £	Comparator with other deals
KPMG LLP *(consultancy)*	895,376 – 1,750,499[1]	Dr Foster Intelligence – advice cost 20 per cent of the value of the deal.
Berwin Leighton Paisner LLP *(legal)*	623,125	
Ernst & Young LLP *(consultancy)*	70,953	
Dr Foster Ltd *(advice and consultancy)*	50,000	The "Radio-communications Agency's joint venture with CMG" cost five per cent in advisors fees against the total value of the deal.[2]
Wragge & Co *(legal)*	59,199	
Total	1,698,653 – 2,553,776	

Source: National Audit Office

NOTES

1 The Information Centre contend that £855,123 was spent on advice and support to senior management while establishing the joint venture.

2 National Audit Office report – *Radiocommunications Agency's joint venture with CMG* published December 2000.

1.40 At the same time of our initial investigation in late October 2005 the joint venture still contained a service level agreement. The service agreement contained performance indicators and was one of the ways the joint venture was expected to demonstrate value for money. In November 2005, the Information Centre removed the service agreement from the negotiations. In conducting our initial investigation into the deal, we raised concerns that the approach was at risk of being open to legal challenge without a tendering exercise being undertaken for either a) forming a joint venture or b) having a service agreement. The Information Centre told us that the service agreement was removed following the findings from an Information Centre workshop which found that the services were not, on balance, needed. In formally writing to the Information Centre (Appendix 2) we acknowledged that "the risk that procurement law is being breached is now reduced because the service agreement element is removed. However removal of the element does bring into question what is being purchased".

1.41 The Information Centre's legal advice following this amendment to the transaction structure concluded that the purchase of the shares does not constitute a "service", "supply" or "works" within the EU procurement rules, and as such, the call to competition prescribed by such laws did not apply. The legal advice did, however, note that notwithstanding the lack of a call for competition, the Information Centre as a contracting authority must ensure that the selection of the joint venture partner was undertaken in a manner which respected EU treaty principle of transparency, equality of treatment, proportionality and mutual recognition. This EU principle established in the case of *TelAustria*[6] suggests that to achieve this would normally entail advertising the opportunity broadly. There was no such advertisement.

1.42 Article 87 (1) of the EC Treaty contains a general prohibition on aid granted by a Member State which distorts competition by favouring certain undertakings or the production of certain goods to the extent that the aid affects trade between Member States see **Figure 7 overleaf.**

7 The conditions that need to be considered when judging whether there is a risk of State Aid

Article 87 (1) of the EC Treaty	The situation as regards the joint venture
"Aid": the joint venture has to be shown to provide an economic advantage to a particular company, which it would not have received in the ordinary course of business ("gratuitous benefit").	The National Audit Office's opinion is that the capital investment to one company with a strategic premium provides an economic advantage/financial support. The Information Centre and Department contend that throughout they acted in the same way as a market investor.
"Granted by a Member State or through State resources": the joint venture has to amount to a burden on state resources, for example in the form of a direct transfer of state funds.	The joint venture meets this criterion as the purchase of the shares was funded directly by the Department through the Information Centre.
"Favouring certain undertakings": the joint venture must benefit a particular company or companies (to the exclusion of others) or a particular industry sector (the so-called "selectivity criterion").	The investment and ongoing relationship with the Information Centre will directly benefit just Dr Foster Intelligence and therefore meets this criterion.
"Which distorts or threatens to distort competition": the joint venture must have at least a potentially distortive effect on competition that puts the competitors of the beneficiary of the aid at a competitive disadvantage.	The size of the investment and the "NHS branding" of Dr Foster Intelligence has given it first mover advantage and a number of health informatics organisations and representative organisations that have contacted the National Audit Office believe it is affecting their business.
"Affecting trade between Member States": the joint venture must have at least a potential effect on trade between Member States. This criterion can generally be satisfied if it can be shown that the beneficiary operates in a market in which there is trade between Member States.	There are existing companies in Europe which operate in the health informatics field and this joint venture has singled out one company in the UK for investment. Indeed the Information Centre's November Due Diligence identified companies that may have wished to enter the UK market.

Source: National Audit Office

1.43 Department of Trade and Industry (DTI) guidance on State Aid in joint ventures identifies that there is risk of bringing into play State Aid even when there is an equal level of input and reward, as there can be "difficulty in proving how a given undertaking has not received a State Aid by virtue of the public sector intervention in the first place"[7]. The DTI and Treasury guidance also suggests that competitively tendering the joint venture may help deflect concerns about State Aid but this is not guaranteed.

1.44 The advice of the Information Centre's lawyers has been that the transaction would appear unlikely to involve State Aid on the basis that the Information Centre acted in the same way as a market investor. The Department went ahead with the joint venture based on this advice. Only the European Commission or European Court of Justice can determine if the deal behind the joint venture includes an element of State Aid. The National Audit Office's legal advice suggests that the market investor principle may be open to challenge.

1.45 The Department of Trade and Industry and a number of other state funded bodies provide advice on joint ventures and other procurement exercises where State Aid or other EU procurement laws may be an issue. Appendix 4 details a number of frequently asked questions about State Aid. Another body also exists which advises specifically on investing in private companies – the Shareholder Executive's overarching objective is to be an effective shareholder of business owned or part-owned by the Government. They can also offer advice and expertise on corporate finance issues to help reduce the reliance on external advisors. Neither the Department nor the Information Centre sought advice from these Government bodies on the Dr Foster Intelligence joint venture.

The risks and rewards of the joint venture

1.46 According to Treasury guidance, joint venture companies are usually established because the parties have complementary objectives: each has a contribution to make to the delivery of a successful business or venture, which they would be unable to achieve independently at lower cost or risk. For a joint venture to work effectively there needs to be some kind of contribution from both sides; greater than just an investment of working capital. The internal peer review notes that the Information Centre, as of November 2005 did not have the skills, resource and strategy to fulfil its role as an equal partner.

1.47 In deciding not to tender and in the absence of a clear definition at the outset of what the Information Centre would receive for its investment, the Information Centre is restricted to being simply an arm's length partner or investor and has to go out to tender to procure any services that the joint venture might supply. The Information Centre will also need to ensure that they act in a way that does not appear to favour the joint venture. The Information Centre therefore does not receive any measurable benefits from its association with a private company, other than a share in future profits.

1.48 If there had been a tender process for the joint venture all competitors in the health informatics market would have had the opportunity to bid to be the private sector partner. Additionally, the company that was chosen would be able to show that it best met the needs of the Information Centre and there would be an opportunity to benchmark the bids in order to demonstrate value for the money available. With a tender process for the joint venture, explicit service agreements with measurable benefits could have been included as part of the deal and the Information Centre may have been able to maximise the likely benefits of the joint venture.

1.49 The stated purpose of the joint venture is to deliver, to health and social care organisations in England, a range of healthcare informatics products and services more quickly and to a higher quality than would be possible without the joint venture. The joint venture aims to accelerate reform of healthcare information in the public sector to enable NHS organisations to improve delivery of primary and secondary clinical care. Specifically, it was expected to do this by increasing the number of information products and services and therefore improving distribution of information. Increasing the use of health and social care informatics products was in turn expected to heighten the commercial attractiveness of the health and social care informatics market to other private-sector organisations.

1.50 The Information Centre also anticipates that the joint venture will complement one of its statutory duties, to disseminate information. Whilst the aims of the joint venture are appropriate it is difficult for the Information Centre to be able to show how the joint venture company, as it has been set up, will directly help achieve this goal more effectively than Dr Foster Ltd or any other company could have delivered on their own. Given the removal of the service agreement between the joint venture company and the Information Centre, there are no measurable services expected from the joint venture.

1.51 The Information Centre initially stated that the service agreement would provide one of the ways to demonstrate that the joint venture was value for money. In the absence of any direct services the Information Centre cannot explain what it will directly gain from the joint venture apart from a share of the profits. The Information Centre hopes that indirectly the joint venture will stimulate other health informatics companies to provide products to the NHS. It is not clear, however, how the joint venture will achieve this if the joint venture is only an investment in a private company. The Information Centre is now in the process of developing some new performance indicators for the joint venture. The Department and Information Centre also contend there are other benefits **(see Figure 8)**.

8 The perceived benefits of the joint venture

The Department and the Information Centre believe that this arrangement was not about monetary gain. There was a perception that predecessor organisations to the Information Centre had produced some good work but had not made a real impact on the service. The Information Centre was created to add value and deliver high quality, timely and relevant information across the health and care system. The joint venture was seen as an opportunity to develop rapidly the skills needed to create customer-focused data services and products and to understand the information market.

A key issue for the Department throughout the process of establishment of the Information Centre and then taking forward the joint venture was to stimulate and boost the development and use of informatics in the health and care system – to support better commissioning, choice, quality and efficiency. The joint venture was seen as a chance to bring together the public sector ethos with private sector energy and dynamism. A further key driver was the fact that the Information Centre was still going through a major transition with the move of service delivery to Leeds and associated recruitment of new staff and would not be able to deliver the required changes alone.

The Information Centre has reported that it is learning a lot from the Dr Foster Intelligence approach to communication, working relationships with suppliers and users and ability to translate information into a user-friendly format. Equally Dr Foster Intelligence is learning from the Information Centre's strong commitment to integrity of information and links to NHS and social care at the front-line.

Source: Information Centre

1.52 Making money was not one of the stated objectives of the Information Centre or the Department in creating this joint venture. However, the primary measurable benefits of the joint venture are an annual share of the profits and future realisation from any growth in value of the company. The Information Centre expects that the joint venture will make a small profit in its first year of trading and may become more profitable in future years. As with all businesses, there remains a possibility that the company will lose money and the value of the Investment Centre's investment could diminish. The Information Centre think that this is very unlikely. Prior to the joint venture Dr Foster Ltd declared profits of £0.4 million in 2004 and a loss of £0.1 million in 2003.

1.53 In 2005, KPMG LLP's due diligence report valued the health informatics market as being worth up to £325 million, based on the anticipated spends of a sample of NHS organisations. In 2004, the turnover of the two biggest specialist companies by far, Dr Foster Ltd and CHKS, were only £6.8 million and £5.1 million respectively. On this basis we believe that a prudent estimate of the current annual spend on the health informatics market would be no more than £20 million per annum.[8] Indeed, the Office of National Statistics has recently estimated that the whole public sector informatics market is worth around half a billion pounds.

1.54 The business case for the joint venture suggested that the joint venture would recover 85 per cent of its costs through income by 2008. This was predicated on the sales of the joint venture growing by over 1000 per cent over three years. The Department's advisors estimated the value of the sales that the joint venture might achieve by using projections of future financial performance. These projections of financial performance have since been lowered, as following the formation of the joint venture, the estimates were considered to be ambitious. For example, the projected sales for Dr Foster Intelligence in the year 2006 were lowered by 24 per cent between the valuation carried out in August 2005 and Dr Foster Intelligence's Business Plan produced in early 2006. Dr Foster Intelligence has also projected that its accumulative profits yield is now expected to be 50 per cent lower than presented in the business case. We have not attempted to estimate the residual value of the company at the end of the three years as this value cannot be accurately forecast.

1.55 One example of a risk that is greater for the Information Centre than for Dr Foster LLP arises from the exit arrangements for the joint venture. The agreement with Dr Foster Intelligence differentiates between the Dr Foster Holdings' shareholders and the Information Centre as a shareholder. Neither shareholder can sell their share within the first three years without mutual consent. Anytime after January 2009, however, should Dr Foster LLP shareholders wish to sell their share they can, with a put option obligation on the Information Centre if no buyer is found. This obligation is not reciprocal. The Department have said that they wanted this put option so that it could retain long term control.

1.56 Another example of a risk is the terms agreed for a "cash call" to shareholders. There is an optional cash call of up to £2.5 million from both shareholders if the Joint Venture Board decides there is a need for a further cash injection. In the event that Dr Foster Holdings LLP does not contribute their £2.5 million the Information Centre can provide this on loan or equity terms if it wishes. As before, this option is not reciprocal. This risk has disappeared as Dr Foster Intelligence has confirmed in writing that no cash call will be required.

Perceptions of other health informatics companies

1.57 The Information Centre has put in place measures to reduce the risk of market distortion arising from the joint venture. In December 2006 its Board agreed new policies and procedures to ensure fair tendering for services and equal access to data supplied by the Information Centre. It has also stated that Dr Foster Intelligence will not be the only health informatics company with whom it partners and have begun discussion with other companies to explore partnership working to demonstrate that this is not an exclusive relationship.

1.58 One example of working with others is a partnership agreement which was signed in late November 2006 with Newchurch. Unlike the joint venture, the partnership involves no cash payment from either party. The Information Centre has also pointed out that it has developed a number of other links and working relationships and will continue to do so – including with Public Health Observatories, the Healthcare Commission and the NHS Institute.

1.59 The Information Centre has told us that Dr Foster Intelligence will not have any privileged access to data that it collects. However, we consider that Dr Foster Intelligence, through its close connections with the Information Centre, is likely to have first mover advantage. A number of companies and organisations in health informatics that the National Audit Office has spoken to believe that, as a result of the joint venture, the health informatics market is not a level playing field. There is also a further potential tension as the Information Centre made a commitment, as part of the joint venture agreement, to promote the business of Dr Foster Intelligence. The Information Centre has emphasised that it needs Dr Foster Intelligence to succeed on a level playing field and will not permit privileged access to its data for any commercial or non-commercial partner.

1.60 We consider that the Information Centre has entered into an agreement with potentially conflicting commitments to act fairly. The Information Centre, by entering into the joint venture agreement, has made a commitment to "generally use its endeavours to promote business and the interests of Dr Foster Intelligence and its subsidiary undertaking" and to "use Dr Foster Intelligence as the principal vehicle and channel for NHS market research and knowledge"[9]. The agreement does, however, recognise that the Information Centre has the right to enter into other agreements and comply with applicable laws and regulations and does not preclude them from entering into new relationships with other companies. The agreement also acknowledges that the Information Centre should not be obliged to act in a manner inconsistent with its wider statutory objectives.

1.61 There is also a tension relating to the Information Centre's objective to stimulate the health informatics market, as this could pose a competitive threat to the joint venture. However, the Information Centre believe the market is large enough for this not to be a significant risk in practice.

1.62 Since the announcement of the joint venture, two main competitors of Dr Foster Intelligence and two representative groups have contacted us to say that they believe that the joint venture creates an unfair market in health informatics. These companies and representatives believe that the new company carries the badge of the NHS and therefore is more likely to be chosen by buyers of services e.g. health trusts and GPs because of this reason. Competitors believe that they too should have been given the opportunity to demonstrate that they could have met the 'requirement' and are not confident that there is fair access to NHS data. They also believe that the 'first mover' advantage held by Dr Foster Intelligence will deter them and other companies from investing in health informatics.

APPENDIX ONE

Chronology of the joint venture

Date	Event
22 November 2004	Chief Executive of Dr Foster Ltd has discussions with the Group Director of Strategy and Business Development (sponsor of the Information Centre) from the Department of Health and the Chair of the NHS Appointments Commission/Chair of Commercial Advisory Board.
December 2004	The idea to partner with Dr Foster Ltd was formed by the Group Director of Strategy and Business Development based on discussions with the Chair of NHS Appointments Commission.
11 January 2005	Group Director of Business Strategy has lunch with Chief Executive of Dr Foster Ltd.
9–10 February 2005	Department seek authority from Ministers to open up commercially confidential and without prejudice dialogue with Dr Foster Ltd, which was granted.
15 February 2005	Chief Executive of Dr Foster Ltd scopes ideas of partnership.
3 March 2005	Appointment of advisors by the Department's Commercial Directorate.
7 March 2005	Chair of Information Centre, Chief Executive of Dr Foster Ltd, Group Director of Strategy and Business Development, and Temporary Chief Executive of Information Centre visit Paris to meet the new Chief Executive of the Information Centre to discuss the idea.
1 April 2005	Information Centre formally established.
29 June 2005	Information Centre Board Meeting considered detailed structure of joint venture including appropriateness of a single tender action and valuation of the company Dr Foster Ltd. The deal included a 50 per cent share in the joint venture for £12 million and a service level agreement worth £660,000 to the joint venture company.
4 July 2005	Chief Executive of the Information Centre starts in post.
July 2005	Negotiation and approval activities performed between Information Centre and Dr Foster Ltd with assistance from advisors.
27 July 2005	Information Centre Board meeting. ■ Authority to sign off Heads of Terms on behalf of the Board granted. ■ Formal advice on how Information Centre statutory functions would be affected requested. ■ Updated Due Diligence report from KPMG and legal Due Diligence from Berwin Leighton Paisner (BLP) requested. ■ Formal advice based on Due Diligence report as to whether single tender action is justifiable requested. ■ Commercial Directorate Indemnity required. ■ Asset valuation discussions.
August 2005	Heads of Terms approved and signed off.
August 2005	■ Due to tax considerations, Dr Foster Ltd proposed a new structure behind the formation of the joint venture. ■ Advisors requested to perform analysis into the proposed new joint venture structure and perform additional due diligence against it.

Date	**Event**
19–23 August 2005	Letter of advice from BLP on single tender action received by the Information Centre.
	■ This was subsequently reviewed 11 November 2005.
	BLP Paper on deal structure complete KPMG Due Diligence Report complete.
25 August 2005	Information Centre August Board meeting.
	■ The Information Centre Board meeting scheduled for 25 August was cancelled due to the issues arising regarding the structure of the joint venture company.
	■ The following documents were produced for presentation to the Information Centre Board. These documents were subsequently presented to the Information Centre September Board.
	■ Business Case finalised.
	■ Information Centre exit strategy finalised.
	■ Business Plan finalised.
	■ Due Diligence Report (KPMG and BLP).
	■ Single tender action opinion document.
	■ Report from BLP examining the joint venture's impact against the Information Centre statutory functions.
	■ Report from BLP examining the Heads of Terms document.
August 2005	Internal Peer Review process initiated.
August – October 2005	Progression of Dr Foster Ltd Due Diligence request upon the Information Centre.
September 2005	**Information Centre Board meeting.**
	September Board main items:
	■ Exit Scenarios section within the Business Case requires to be extended to incorporate additional information regarding the Information Centre ability to exit from the joint venture.
	■ Joint venture governance structure to be clarified further, leading to the Information Centre Board raising the following concerns:
	▪ Impact against the timescales in concluding the transaction.
	▪ Requirement for further due diligence work and its associated cost.
	▪ Further clarification upon the single tender action required.
	▪ Should the Information Centre seek Treasury advice to assist in concluding the transaction?
7 October 2005	National Audit Office initiate initial investigation following the receipt of a letter from an anonymous whistleblower.
18 October 2005	Independent Peer Review completed.
	■ Chief Executive of the Information Centre met Group Director of Strategy and Business Development to discuss the Independent Peer Review report, timing and managing Dr Foster Ltd expectations.
20 October 2005	Independent Peer Review Report received by Chief Executive of Information Centre.
27 October 2005	Information Centre Board meeting.
	■ Delegated authority not granted to the Chief Executive to form the joint venture transaction.
October 2005	Creation of internal Information Centre work streams.
	■ In order to address the issues raised at the Information Centre September and October Boards, clarify the scope of the products and services the Information Centre was to contribute and seek to gain transaction approval by the Information Centre Board at its meeting on the 24 November, the following internal Information Centre work streams were created:
	▪ Content and scope of products to be contributed.
	▪ Staffing/infrastructure/transition planning activities.
	▪ Communications, branding, stakeholder engagement.

Date	Event
October 2005	Internal Information Centre managing the joint venture workshop. ■ Information Centre perform further analysis against products and services it is to contribute to the joint venture. ■ All applicable service level agreements and key performance indicators associated with a contribution defined. ■ Intellectual property rights discussion performed.
31 October 2005	BLP Due Diligence report completed.
November 2005	Further internal analysis performed against the issues raised at the September and October Boards. ■ Paper produced summarising progress made on all key issues. The paper address all issues raised by the Board and included an explicit recommendation from the Executive Directors regarding the Board's approval of the joint venture transaction. ■ Joint venture corporate governance. ■ Single tender action. ■ Information Centre contribution into the Information Centre. ■ Joint venture branding and naming. ■ Performance indicators for Information Centre performance management of the joint venture.
November 2005	Non-Compete Issues. ■ Agreement with Dr Foster Ltd that the Information Centre can enter into other joint ventures and strategic partnerships with other bodies in the future. This fact was incorporated into the legal documents (Subscription and joint venture Agreement). ■ Agreed that the non-compete agreement between Information Centre and Dr Foster Intelligence applies to the scope of the joint venture in terms of initial contributions at signing of agreement. Exit Strategy and Scenarios. ■ Required analysis performed in clarifying potential exit strategies and scenarios. ■ Key financial indicators requiring monitoring identified. ■ Additional advice sought from KPMG in analysing a number of potential exit scenarios and their impact against the Information Centre. DH Indemnity. ■ Information Centre received letter from Chief Information Officer detailing the Department of Health's willingness to provide the Information Centre with the indemnity sought from the Information Centre Board members.
November 2005	Key Legal Documents. ■ The following key legal documents were complete: a Subscription and joint venture Agreement. b Disclosure Letter from Dr Foster LLP to the Information Centre. c Tax Deed to be entered into by Dr Foster LLP in favour of the Information Centre. d Articles of Association of Dr Foster Intelligence Limited. e Agreement for the transfer of non-NHS business from Dr Foster Ltd to Dr Foster Research Ltd. f Offer document in relation to the offer by Dr Foster Intelligence Ltd to acquire the entire issued share capital of Dr Foster Ltd. g Loan notes of nominal value £2,500,000 to be issued by Dr Foster Intelligence Limited to Dr Foster Holdings LLP. h Promissory note for £2,500,000 to be issued by the Information Centre to Dr Foster Intelligence Ltd.
November 2005	Lord Warner writes to Secretary of State for Health requesting approval.

Date	Event
11 November 2005	Amended KPMG Due Diligence Report completed. ■ Addendum to the KPMG Due Diligence Report dated 23 August.
11 November 2005	Updated letter of advice from BLP on single tender action received by the Information Centre. ■ This report provided an additional review of the advice provided by BLP on the single tender action, as documented in their report to the Information Centre 19 August 2005.
17 November 2005	National Audit Office met Group Director of Strategy and Business Development, Department of Health and Chief Executive of Information Centre to discuss issues that we had raised in our communications. At this meeting we were told that the services agreement had been removed. It had originally been intended to have a service agreement between the Information Centre and joint venture. Information Centre report that it was dropped by mutual agreement on the basis that it was no longer needed due to the amended joint venture structure.
23 November 2005	Chief Executive of the Information Centre and advisors from KPMG and BLP met with the National Audit Office (NAO) to discuss the NAO analysis of the joint venture transaction. Following the meeting the NAO wrote formally to the Information Centre to outline concerns that we have raised.
24 November 2005	**Information Centre Board Meeting.** November Board main items: ■ The Information Centre Board granted Chief Executive delegated authority to approve the joint venture transaction in principle.
30 November 2005	Group Director of Strategy and Business Development recommends transaction approval to Lord Warner.
30 November 2005	Lord Warner requests transaction approval from the Department Capital Investment Business Unit.
December 2005	Capital Investment Branch grant transaction approval. Secretary of State for Health grants transaction approval (including statutory power to generate income). Department of Health approval granted.
6 January 2006	Internal Information Centre managing the joint venture workshop. ■ Information Centre perform further analysis against products and services it is to contribute to the joint venture. ■ All applicable service level agreements and key performance indicators clarified further. ■ Information governance issues clarified further.
January 2006	Dr Foster Intelligence created as a legal entity.
13 February 2006	Dr Foster Intelligence launched.

APPENDIX TWO

Letter sent to the Information Centre and Department of Health by the National Audit Office before the joint venture deal was signed

NAO
National Audit Office

Helping the nation spend wisely

GTN 421
Switchboard +44(0)1253 333432
Facsimile +44(0)1253 333771

Direct Line +44 (0)20 7798 7000
Email karen.taylor@nao.gsi.gov.uk
Room A571
Reference GF1613/05
Date 23 November 2005

Professor Denise Lievesley
Chief Executive
Health and Social Care Information
Centre
1 Trevelyan Square
Boar Lane
Leeds
West Yorkshire
LS1 6AE

PROPOSED JOINT VENTURE WITH DR FOSTER LTD.

Dear Professor Lievesley,

Following our very useful meeting this morning, where we discussed the proposed joint venture with Dr Foster, we promised that we would outline our current view on the proposed deal. We were grateful to you for explaining how you intend to mitigate the risks that have been identified; for the purposes of your board we would like to reiterate our concerns that we have in respect of the deal. Whilst we can see that you have taken action to mitigate many of the risks, we would like to draw attention to some residual risks that your board should consider.

Whether there is a case that the deal might be considered as state aid?
As outlined in our discussion today we have assessed the deal based on the documents that the Information Centre has supplied to us and there remains a question as to whether by entering into the joint venture the centre is providing state aid to Dr Foster. Our question is based on the acknowledged "strategic premium" that will be paid in return for 50 per cent of the business. We understand the reason for this payment is classified as "goodwill" and the value of "synergy" however, in our view, there is no evidence for judging the rationale for this and whether this could constitute state aid.

We would also raise concern whether the true value of the HSCIC assets is known and whether there is the possibility that these may have been undervalued when negotiating the deal. Again this becomes important in the determination of whether state aid is being applied.

DTI guidance on state aid in joint ventures identifies that there is risk of bringing into play state aid even when there is an equal level of input and reward as there can be "difficulty in proving how a given undertaking has not received a state aid by virtue of the public sector intervention in the first place". It would be prudent to further explore the risks and potential liabilities if the deal could be interpreted as state aid.

Legality in respect of procurement
We acknowledge that the risk that procurement law is being breached is now reduced because the service agreement element is removed. However removal of this element does bring into question what is being purchased.

157-197 Buckingham Palace Road, Victoria, London SW1W 9SP 020 7798 7000 www.nao.org.uk

Income Generation Powers

We note your response as regards the powers afforded to the Information Centre to generate income, and that this is a matter for consideration by the Secretary of State. However we believe there is some confusion in the non-legally binding heads of term, which states that one of the purposes of the joint venture is "helping HSCIC in its strategic and statutory objectives to improve the use of health informatics across the health and social care market in England with the objective of commercial profitability" and later states one of the critical success factors of the joint venture will be "to contribute to the successful delivery of certain HSCIC statutory requirements". It would be helpful to address this confusion.

Value for Money Issues

If the joint venture is not intended to help deliver some statutory functions of the HSCIC, and you now state that there will be no service agreement, it is unclear what benefits the HSCIC will gain that it could not purchase through competitive tendering. You state that one benefit is that the joint venture will help stimulate the use of health informatics within the health and social care system. Other companies are already doing this and it remains unclear to us how the joint venture expands upon what already exists in the market place and what the HSCIC and Dr Foster can deliver independently.

We have discussed the value of Dr Foster and the assets of HSCIC being important in judging whether the deal constitutes state aid. Not withstanding the market valuation by KPMG, the lack of competitive tendering makes it difficult for us to judge whether this deal is good value for money. Our previous studies on procurement and public-private partnerships have shown that single tender actions can make it difficult to demonstrate value for money.

We believe that the best way of reducing risk and demonstrating value for money is through a competitive process. Given where you are, we would recommend that this approach is considered in approaching the market in the future. As far as this current deal is concerned, we would encourage you to ensure that there is more openness and transparency; and that your board have the opportunity to fully consider any risks, and steps taken to mitigate these risks, before entering into any agreement to form the joint venture.

If you would like to discuss these concerns further please do not hesitate to contact me.
I have copied this letter to Hugh Taylor at the Department of Health.

Yours sincerely

Karen Taylor
Director of Health VFM

APPENDIX THREE Methodology

1 The fieldwork for this study concentrated on the review of documentation for the joint venture deal and development of the deal, held by the Department and the Information Centre. There was some documentation that we failed to obtain in reviewing this deal, in particular documents that related to initiation of the deal. We also took our own legal advice on the formation of the joint venture and the relevant European laws that could be applicable.

2 We spoke to the following organisations or individuals, to whom we are grateful for their time and cooperation:

- Department of Health
- Information Centre
- Dr Foster Intelligence
- Healthcare Commission
- Audit Commission
- Locus Association
- NHS Appointments Commission
- CHKS Ltd
- Newchurch Ltd
- Bidetime Ltd
- London Health Observatory
- National Association of Public Health Observatories

3 The study aimed to answer the question "Does the investment in a 50 per cent share in a private company offer benefits to the public and was the transaction conducted fairly?"

With two main sub questions:

i) Was the deal constructed fairly?

ii) Does the joint venture offer good value for money?

APPENDIX FOUR

Department of Trade and Industry – frequently asked questions on State Aid

Q. PPPs (Public Private Partnerships /Joint Ventures) Is there State Aid where the public sector gets back something of the same value as that which the private partner or beneficiary gains?

There still could be State Aid. The difficulty is in proving how a given undertaking has not received a State Aid by virtue of the public sector intervention in the first place. This can most often be circumvented by going to open tender in choosing private partners for a project where benefits will be shared between the public and the private participants. Technically, because you go to open tender in selecting the private partners you get around the "distortion of competition" criterion of Article 87(1) in that all interested parties had a chance to bid for it.

Q. How do Public Private Joint Ventures steer clear from State Aid concerns? How can one ensure that JVs/PPPs do not raise State Aid problems?

This is by no means easy, and such initiatives should be cleared with State Aid Branch. By market testing and placing OJEC (Official Journal of the European Community) notices you are certainly heading along the right lines.

Source: Department of Trade and Industry, State Aid Branch, Frequently Asked Questions, January 2005

ENDNOTES

1 Dr Foster Ltd was launched in January 2001 with the publication of the Good Hospital Guide in the Sunday Times. This was followed by a series of guides, on the internet and in local and national newspapers, about the availability and standards of local health services along with reports and guides on specialist services, such as diabetes and breast cancer. Dr Foster Ltd quickly acquired high national profile and in 2003 was identified in the Guardian as "one of the 100 most 'influential' organisations in the public sector"(Appendix 5).

2 HM Treasury Guidance prepared by Partnerships UK, December 2001. A Guidance Note for Public Sector Bodies forming Joint Venture Companies with the Private Sector.

3 Gateway Reviews are carried out by the Office of Government Commerce for Government projects. The OGC Gateway Process examines programmes and projects at critical stages in their life-cycle to provide assurance that they can progress successfully to the next stage.

4 LLP is a limited liability partnership which means the partner or investor's liability is limited to the amount he/she has invested in the company.

5 Directive 92/50.

6 Teleaustria Case C-324/98.

7 Department of Trade and Industry, State Aid Branch Guidance, Frequently Asked Questions January 2005.

8 Electronic Publishing Services Ltd, David Worlock EPS Insights, 16 February 2006.

9 Subscription and Joint Venture Agreement, December 2005.

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