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

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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.

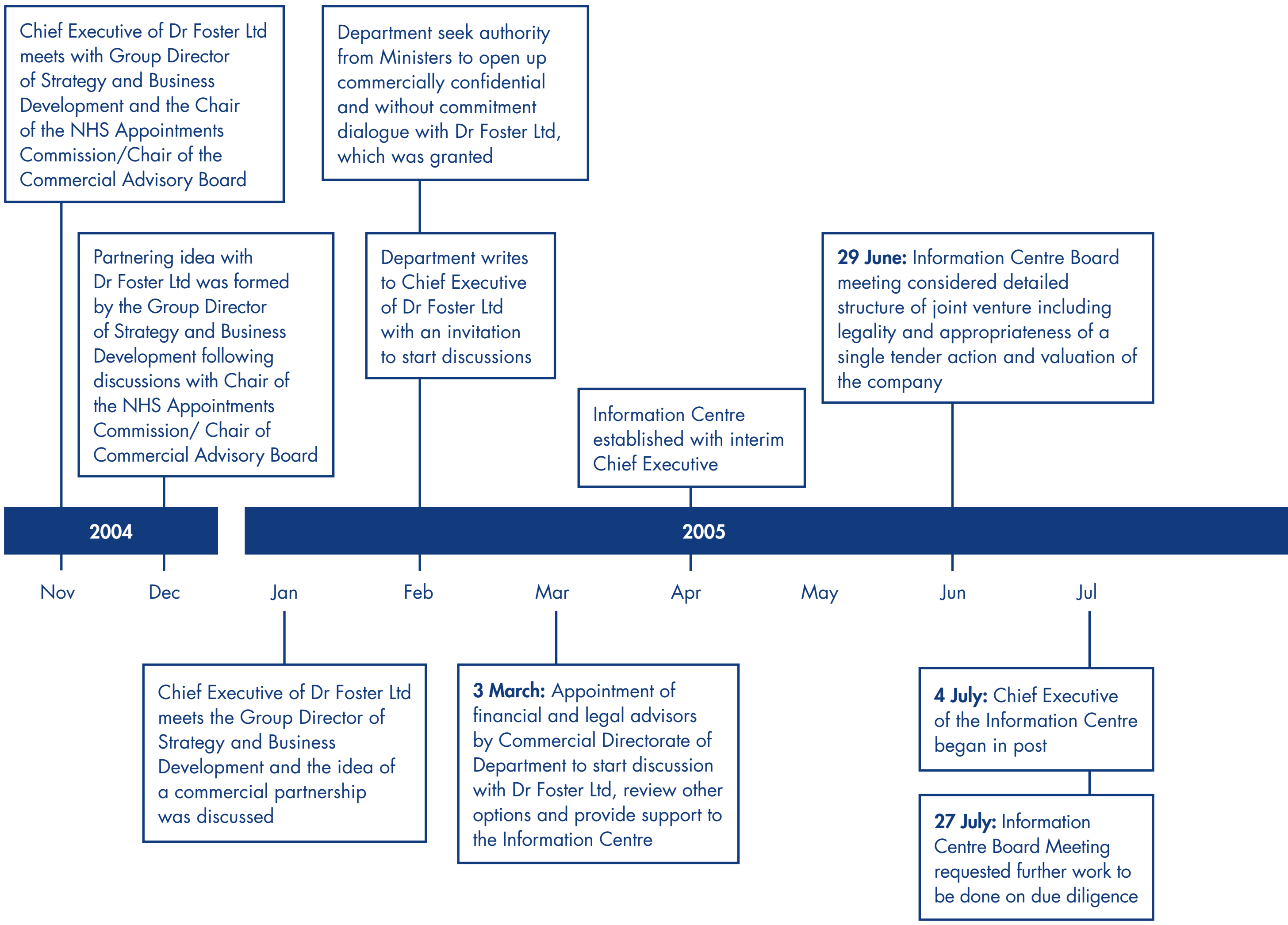
7 Our review focused on the negotiations, the terms of the joint venture, and whether the amount paid for the joint venture was value for money for the public sector. It does not form any view on the value for money for Dr Foster Intelligence's private shareholders or on the conduct of Dr Foster Ltd. 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).

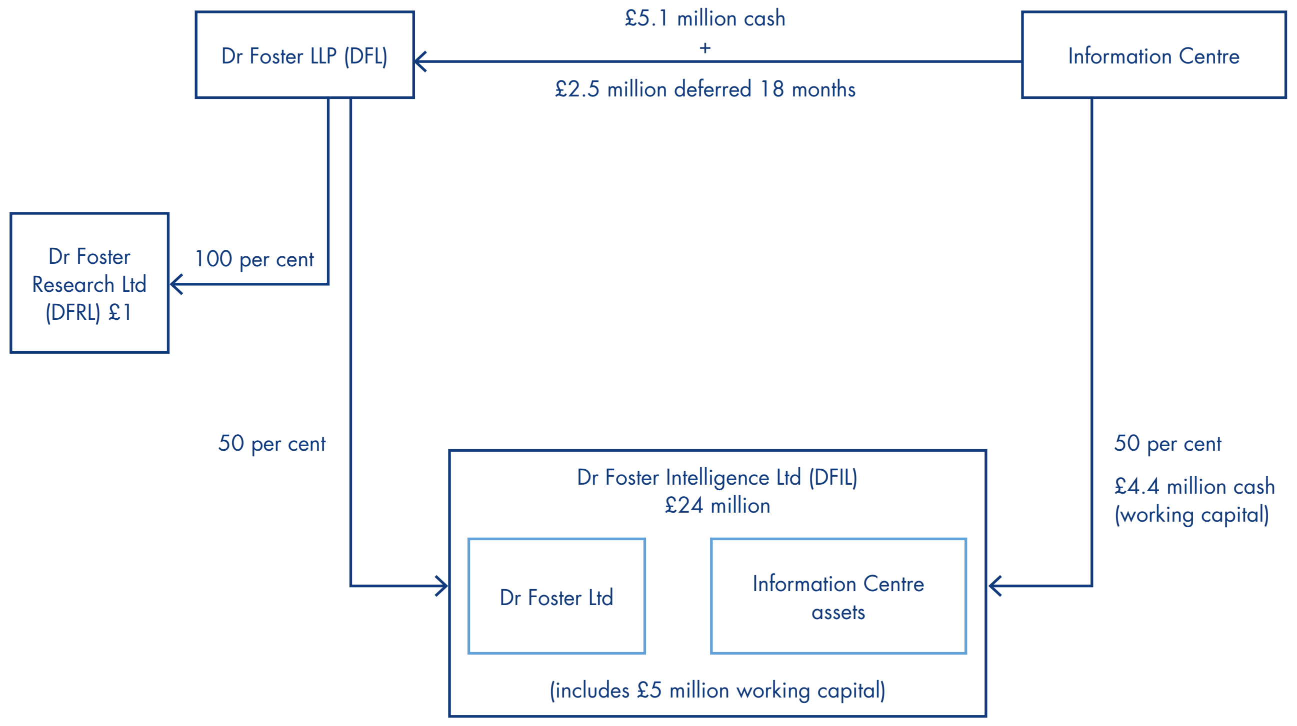
21 As part of its contribution, Dr Foster Ltd transferred all of its existing NHS business including information products and intellectual property to the joint venture company. Dr Foster Ltd moved a small amount of its private business comprising of contracts with the private sector to a new company 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.