



House of Commons
Committee of Public Accounts

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

Fortieth Report of Session 2006–07

*Report, together with formal minutes, oral and
written evidence*

*Ordered by the House of Commons
to be printed 27 June 2007*

The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

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The following were also Members of the Committee during the period of the enquiry:

Helen Goodman MP (*Labour, Bishop Auckland*)
Mr Sadiq Khan MP (*Labour, Tooting*)
Sarah McCarthy-Fry MP (*Labour, Portsmouth North*)
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Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Philip Jones (Committee Assistant), Emma Sawyer (Committee Assistant), Pam Morris (Secretary), Anna Browning (Secretary), and Alex Paterson (Media Officer).

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Summary

The availability of accessible, well presented data and information on NHS performance is central to the NHS reform agenda, particularly if the NHS is to achieve effective and efficient commissioning of patient services and deliver on its quality and choice agendas. In April 2005 the Department set up a new arm's length body, the Health and Social Care Information Centre (now renamed as the Information Centre), comprising the Department's Health Statistics Unit and the NHS Information Authority. The aim was to improve the collection, analysis and use of health and social care information, but it recognised that the Information Centre lacked some of the necessary skills and expertise.

The Department believed that the quickest way of acquiring these skills was a partnership with the private sector, and entered into exclusive discussions with Dr Foster Ltd, a private company with a high public profile in NHS data dissemination. There were no calls for expressions of interest to identify other possible partners. Having initiated exclusive negotiations, in July 2005 the Department passed responsibility for finalising the deal to the Information Centre.

The Department's advisors, KPMG, gave Dr Foster Ltd an indicative valuation of between £10 and 15 million. In February 2006, the Information Centre paid £12 million for a 50% share of the joint venture company, Dr Foster Intelligence. This was 33–53% higher than its financial advisors' indicative valuation of a half share, and included an acknowledged strategic premium of between £2.5 million and £4 million. The other half of the joint venture is owned by Dr Foster LLP, a holding company set up by the shareholders of Dr Foster Ltd. Neither shareholder can sell their share within the first three years without mutual consent.

On the basis of a report by the Comptroller and Auditor General,¹ we considered the reasons for establishing a joint venture without a competitive tender process; the cost of the joint venture; and the management of the joint venture's risks and benefits. We took evidence from the Department of Health and the Information Centre.

1 C&AG's Report, *Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP*, HC (2006–2007)151

Conclusions and recommendations

- 1. By failing to advertise the deal or hold a competition, the Department and Information Centre let it appear that the joint venture offered an advantage to one company at the expense of others.** The Department and Information Centre did not follow Treasury Guidance on joint ventures, nor did they comply with public sector procurement guidelines. The Department should remind its non-departmental bodies and Commercial Directorate that best practice is to advertise such opportunities appropriately, and to offer health informatics work to open competition. The Information Centre should commission the Office for Public Sector Information to check whether there is reasonable parity of access to data by health informatics companies.
- 2. Without an open competition, the Information Centre cannot demonstrate that it paid the best price for its 50% share of the joint venture, as there are no tenders or other benchmarks for comparison.** The Department and its subsidiary bodies should always consider a competitive bidding process as the best way of demonstrating value for money. In the absence of potential competitors, the Department and its subsidiary bodies should seek appropriate benchmarks. To improve transparency and accountability, the Information Centre should obtain an independent valuation of their investment in the joint venture as at March 2007 and periodically update it.
- 3. In developing the joint venture deal, the Department's Commercial Directorate did not follow established good practice in public sector procurement.** The application of business skills and experience to the management of NHS procurement can bring a number of benefits, but the Directorate needs to be aware of the need for transparency and full accountability in the use of public funds.
- 4. The cost of professional advice on the joint venture (Dr Foster Intelligence) increased from an initial estimate and contract for £284,000 to between £1.75 and £2.5 million on a £12 million investment.** The increase in costs reflected the need for additional advice and due diligence required to demonstrate that Dr Foster Ltd met the requirements of the Information Centre. The Department should remind its Commercial Directorate and subsidiary bodies of the need for good financial discipline in contracting for advice. In particular where costs increase above the agreed contract price, or there is significant expansion of work priced at hourly rates, contracts should be re-evaluated and if necessary re-tendered.
- 5. The Department and Information Centre could have reduced the need to rely so heavily on professional advice by making use of wider government experience on forming public private partnerships.** For example, the Department of Trade and Industry provide advice on state aid, and its Shareholder Executive on forming joint ventures or investing in companies. The Department should make its subsidiary bodies aware of the availability and the advantages of seeking such advice when forming relevant public private partnerships.

- 6. It is unclear what benefits the Information Centre will receive from the joint venture.** The Information Centre did not specify what services it should receive from the joint venture, nor was there any baseline valuation or key performance indicators established at the outset against which to measure benefits. Whilst some indicators have since been introduced, these do not explicitly link to the Information Centre's objectives or show the benefit of the public sector intervention to an already successful company. The Information Centre should strengthen their indicators of value of the joint venture to meeting the Information Centres' objectives, and clarify what benefits they expect.
- 7. In the first year the joint venture made a loss of £2.8 million compared with the expectation that it would make a small profit.** The Information Centre should use its position on the board of the joint venture to assess the underlying and reported financial performance of Dr Foster Intelligence, so as to challenge any potential understatement or suppression of profit during the term of the joint venture, which would diminish the Department's return on its investment.

1 Establishing a joint venture with Dr Foster Ltd

1. The Department established the Information Centre as a Special Health Authority with the statutory duty to collect, analyse and disseminate data for the NHS in the fields of health and social care. In April 2005, the Information Centre was expected to accelerate the use, analysis and distribution of health and social care information. From an early stage in the Department's conception of the Information Centre the Department believed that the Information Centre would lack the necessary commercial skills to quickly develop and market information products.² It determined that the most effective way to obtain these skills was through a commercial relationship with the private sector.

2. The idea of a partnership was conceived after a meeting in late 2004, when the Department believed that Dr Foster Ltd was the leading health informatics company.³ During this meeting the Department had been impressed with the vision for the better use of information in the NHS presented by the Chief Executive of Dr Foster Ltd.⁴

3. 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.⁵ In this case, the Department saw the joint venture with Dr Foster Ltd as a commercial opportunity to improve the use of information by creating a marketing arm for the Information Centre and bringing in the skills that its predecessor organisations lacked.⁶ The Department also believed the joint venture would boost the overall information market in the NHS, which it considers to be under-developed.⁷

4. Treasury guidance on the formation of joint ventures states that consideration should be given to whether a joint venture is the best way to meet the public sector's requirements.⁸ The Department contends that it did consider a number of options before it decided to proceed with the joint venture, as evidenced by the fact that these options were briefly outlined in the business case for the deal. Options included: investing additional money and staff for developing skills and expertise in-house; entering into contracts with private sector organisations; or 'do nothing'.⁹ The National Audit Office's review found that these alternative options were not considered in any detail and were quickly dismissed.¹⁰

2 C&AG's Report, para 1.4 & 1.8

3 C&AG's Report, Figure 1; Ev 18

4 Qq 17–18, 160; C&AG's Report, paras 1.8–1.9

5 C&AG's Report, para 1.12

6 Q 18

7 Q 85

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

9 Qq 19–20

10 C&AG's Report, para 1.19

5. The Treasury's guidance on forming joint ventures also states that the best way to ensure that the public sector demonstrates value for money is through a call to competition. In the case of this joint venture, however, there were no calls for expressions of interest to identify possible partners other than Dr Foster Ltd.¹¹ The Department's position was that it considered tendering but chose not to because the market analysis carried out by its advisor's had determined that none of the other potential partners had the skills or profile to compete with Dr Foster Ltd.¹² The Department's advisors reached this conclusion by carrying out desktop-based research and without entering into discussions with any of Dr Foster Ltd's potential competitors.¹³

6. Prior to their going ahead with the joint venture, the National Audit Office advised the Department and the Information Centre that there were risks relating to the potential breaching of State Aid legislation.¹⁴ As a result, the Department sought legal advice which suggested that State Aid rules were unlikely to have been breached because the Department had acted as a market investor for the acquisition. The Department went ahead with the joint venture on the basis of this advice.¹⁵ The market investor principle may be open to challenge, however, particularly as the Information Centre paid between 33% and 53% more for its share than the advisor's highest indicative valuation.¹⁶

7. At the outset there was an urgency to complete the deal with Dr Foster Ltd, and in negotiating the joint venture the roles and responsibilities of the Department's advisors were sometimes confused.¹⁷ The Department paid Dr Foster £50,000 to provide advice on establishing commercial relationships with the private sector, even though it had already entered into exclusive discussions with them about the terms of such an association.¹⁸ The Department also commissioned the same advisors to help define the specification and options for working with the private sector and to advise on negotiations with Dr Foster Ltd regarding the terms of the joint venture.¹⁹

11 C&AG's Report, summary para 15; 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 goods to the extent that the aid affects trade between Member States.

12 Qq 2, 22, 99, 102, 106

13 Qq 152–154, 158 and note to question 78

14 C&AG's Report, para 1.5

15 Q 48

16 Q 107; C&AG's Report, summary para 24, para 1.44 and Figure 7

17 Q 49; C&AG's Report, summary para 25

18 Qq 11–14

19 Q 49; C&AG's Report, paras 1.26, 1.32

2 The cost of the joint venture

8. In March 2005, KPMG's indicative value of Dr Foster Ltd was £10–15 million. It calculated this value using discounted cash flow models of the potential future business of Dr Foster Ltd and by comparing the company with the valuation of similar companies as there was no prevailing valuation of Dr Foster Ltd.²⁰ The value was not developed based on the assets of Dr Foster Ltd, as the company was a new service based company.²¹ This valuation suggests a half share of Dr Foster Ltd should have cost £5–7.5 million.²² However, the Information Centre paid £12 million for its 50% share of the joint venture which is to all intents and purposes Dr Foster Ltd with some extra assets provided by the Information Centre.²³ The other 50% is owned by Dr Foster LLP which is an holding company, formed after Dr Foster Ltd was split into the joint venture and Dr Foster Research Ltd. Shareholders of Dr Foster Ltd were entitled to share in Dr Foster LLP on formation of the joint venture (see **Figure 1**).

9. The value of £12 million was the price negotiated and finally agreed between the Information Centre and Dr Foster Ltd for the 50% share. In describing the deal the Department acknowledged that it paid a premium of £2.5–4 million compared to the indicative valuation it had been given by its advisors²⁴. A premium is normally paid to obtain overall control of a company, but in this case no controlling interest was obtained or sought.²⁵ The Department and the Information Centre have stated that the premium was paid because they believed it reflected the anticipated benefits to the NHS and the Information Centre of the joint venture.²⁶ The National Audit Office was, however, unable to verify the basis upon which the premium was agreed or calculated.²⁷

10. Of the £12 million contributed by the Information Centre, £7.6 million went to Dr Foster Ltd's shareholders to buy out 50% of their interest in the company and the remaining £4.4 million was put into the joint venture as working capital.²⁸ Dr Foster Ltd contributed 95% of its business to the joint venture.²⁹ The remaining 5% of Dr Foster Ltd's business was moved to a trading company which now trades as Dr Foster Research Ltd.³⁰ Dr Foster Ltd shareholders automatically became partners in the parent company, Dr Foster LLP, when the joint venture was formed.³¹

20 Qq 62, 141; C&AG's Report, para 1.21; Q 69; and note to Q 148

21 Q 94

22 Q 7

23 Qq 146–147; C&AG's Report, para 1.21

24 C&AG's Report, para 1.22; Q 107 and note to 148

25 Qq 38

26 Q 64; C&AG's Report, summary para 20

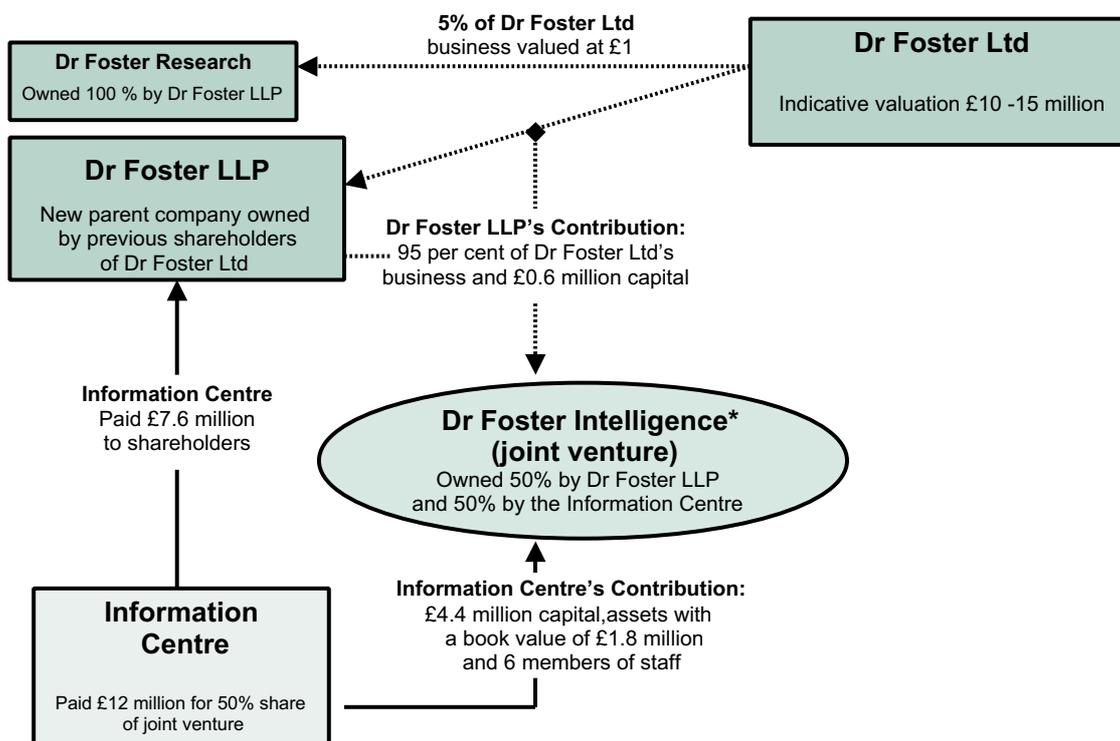
27 Q 79

28 Qq 8, 73; Ev 18

29 Q 31

30 C&AG's Report, para 1.27

31 Ev 20

Figure 1. The valuation of Dr Foster Ltd and Dr Foster Intelligence³²

* There is no baseline valuation of the joint venture other than the amount paid by the Information Centre. The Information Centre believe that on this basis the notional value of Dr Foster Intelligence is £24 million.

11. Between March 2005 and February 2006, £2.5 million was spent on legal and consultancy fees.³³ In March 2005, the Department initially contracted with KPMG to provide consultancy advice on setting up the joint venture at a contract price of £284,000. Following the establishment of the Information Centre, the Department transferred responsibility for all of the payments associated with KPMG's financial and consultancy advice and also legal advice on the joint venture to the Centre. The costs in relation to the joint venture rose significantly, reaching at least £1.7 million paid to KPMG by the conclusion of the deal: a substantial fee for a transaction of this size and relative lack of complexity. The Information Centre believes that £0.87 million was paid to KPMG for expertise and advice in relation to setting up the Information Centre, although the absence of a separate contract and invoices often failed to distinguish between this advice and for the joint venture.³⁴ The Department told us that the increased costs were incurred as a result of the completion of the deal taking longer than initially expected and because the Information Centre required a second due diligence exercise.³⁵ A further £0.8 million was spent on other legal and financial advice.³⁶

32 Qq 148, 69, 94, 186

33 Q 107

34 C&AGs Report, paras 1.26, 1.31-1.32

35 Q 67 and note to Q 78

36 C&AG's Report, Figure 6

12. In seeking advice on setting up the joint venture, neither the Department nor the Information Centre sought advice from the Shareholder Executive.³⁷ The Shareholder Executive was set up in 2003 to bring focus to shareholder issues and to improve government's ability to act as an effective shareholder. The Shareholder Executive specifically advises government on investing in private companies. Its overarching objective is to be a shareholder of business owned or part-owned by the government. It can also offer advice and expertise on corporate finance issues to help reduce the reliance on external advisors.³⁸

13. The total cost of the joint venture to the Information Centre, including advisors fees, was between £13.7 million and £16.3 million.³⁹ It is not clear what was purchased, however, or whether it represents value for money, because the lack of a tender specification makes it difficult to assess what the deal has achieved compare with what could have been achieved otherwise.⁴⁰ 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.⁴¹

14. The decision not to open up the joint venture opportunity to the wider market has also led to a number of health informatics companies questioning whether the joint venture process was fair.⁴² An internal peer review undertaken by the Office of Government Commerce in October 2005 went as far as to suggest that the development of the joint venture was to some extent carried out “under a cloak of secrecy under the guise of commercial sensitivity”.⁴³

37 Q 45

38 C&AG's Report, para 1.45

39 C&AG' Report, Figure 5

40 Qq 8, 43, 83–84

41 C&AG's Report, summary para 23

42 C&AG's Report, para 1.36

43 Q 24; C&AG's Report, para 1.35

3 The expected benefits of the joint venture

15. At the outset, the proposals for the joint venture included a service level agreement that put an obligation on the Information Centre to procure approximately £600,000 of services from the joint venture.⁴⁴ The service agreement contained performance indicators and was one of the ways the joint venture was expected to demonstrate value for money.⁴⁵ The service agreement was removed from the deal following an Information Centre review which had highlighted that the joint venture was providing services to the NHS rather than the Information Centre.⁴⁶ This review was done at the same time that the National Audit Office questioned the need to comply with EU procurement law and the legality of the service level agreement.⁴⁷

16. In writing to the Information Centre in November 2005, the National Audit Office stated that whilst the removal of the service level agreement reduced the risk of procurement law being breached, it left open the question of what was being purchased, as no services were to be delivered to the Information Centre by the joint venture.⁴⁸ 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. In addition, the Information Centre will need to procure by tender any services that the joint venture might supply. The Information Centre therefore does not receive any measurable benefits from its association with Dr Foster Intelligence, other than a share in future profits and the potential future value of the company at the end of the joint venture agreement.⁴⁹

17. The Department believes that the joint venture will deliver benefits to patients and the NHS through the better use of information in policy development, service delivery, management of NHS services and patient choice.⁵⁰ Whilst there were no explicit performance measures included at the outset, following completion of the deal the Information Centre and Dr Foster agreed some performance indicators which are reported on a monthly basis. Whilst these benefits may be measurable over time, there is no baseline against which they can be measured.⁵¹ These indicators also do not link effectively to the objectives of the Information Centre and do not demonstrate the benefits of the joint venture over and above what the company Dr Foster Ltd could have delivered without the public sector intervention.

44 C&AG's Report, para 1.37

45 Q 112

46 Q 113

47 C&AG's Report, para 1.40

48 C&AG's Report, appendix two

49 Q 114; C&AG's Report, para 1.47

50 Qq 16, 115

51 Q 116; C&AG's Report, summary para 24

18. The future value of the joint venture company is largely unpredictable, but the business case for the deal estimated that sales of the joint venture would grow by over 1000% over three years.⁵² These projections were subsequently lowered as they were considered to be ambitious. For example, the projected sales for Dr Foster Intelligence were lowered by 24% between the valuation carried out in August 2005 and the business plan produced in early 2006.⁵³ In the first year of trading it was predicted that the joint venture would make a small profit, yet audited figures show that in practice it has made a £2.8 million loss.⁵⁴

19. By entering into the joint venture the Information Centre 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”.⁵⁵ This commitment does not, however, supersede its obligation to comply at all times with procurement law. The Information Centre told us that Dr Foster Intelligence will not have any privileged access to the information it collects and stated that it has relationships with a wide range of organisations.⁵⁶ Despite this assurance there remains a real risk that the joint venture may result in a less competitive health informatics market by virtue of the fact that Dr Foster Intelligence’s close connections with the Information Centre give it an advantage.⁵⁷

20. 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. 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.⁵⁸ The Office of Government Commerce’s internal peer review of the joint venture found that the Information Centre lacked the skills to be an equal partner with Dr Foster LLP. On the basis of the findings of the peer review, the Information Centre took more time over the negotiations and put additional resources into building the Information Centre’s skills.⁵⁹

21. A joint venture normally expects the parties involved to share the risks in relation to the shareholding whilst trying to achieve their own organisational objectives.⁶⁰ Under the initial exit arrangements for the joint venture neither Dr Foster LLP nor the Information Centre can sell their share within the first three years without mutual consent.⁶¹ Any time after January 2009, however, Dr Foster LLP has a put option which requires the Information Centre to buy out its share at market value if it wishes to exit the deal and a

52 Q 65

53 Q 150 and note to Q 78

54 Note to Q 94

55 Qq 127–132

56 Qq 124–125

57 C&AG’s Report, para 1.59

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

59 Q 111

60 C&AG’s Report, para 1.12

61 Q 35

buyer cannot be found. This option is not reciprocal,⁶² so the risks are greater for the Information Centre.⁶³ The Department was content with this arrangement because it wanted to retain control in the longer term, and the joint venture represents a substantial part of Dr Foster's business but is only a fractional risk on its side.⁶⁴

62 Qq 165–167

63 Q 71

64 Q 36

Formal minutes

Wednesday 27 June 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr David Curry
Mr Ian Davidson
Mr Philip Dunne

Dr John Pugh
Mr Alan Williams
Mr Iain Wright

Draft Report

Draft Report (Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 21 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fortieth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Monday 9 July at 4.30 pm.]

Witnesses

Wednesday 28 February 2007

**Mr Hugh Taylor CBE, Permanent Secretary, Department of Health and
Professor Denise Lievesley, Chief Executive, the Information Centre**

Ev 1

List of written evidence

Department of Health

Ev 18

List of Reports from the Committee of Public Accounts 2006–07

First Report	Tsunami: Provision of support for humanitarian assistance	HC 25 (Cm 7018)
Second Report	Improving literacy and numeracy in schools (Northern Ireland)	HC 108 (Cm 7035)
Third Report	Collections Management in the National Museums and Galleries of Northern Ireland	HC 109 (Cm 7035)
Fourth Report	Gas distribution networks: Ofgem's role in their sale, restructuring and future regulation	HC 110 (Cm 7019)
Fifth Report	Postcomm and the quality of mail services	HC 111 (Cm 7018)
Sixth Report	Gaining and retaining a job: the Department for Work and Pensions support for disabled people	HC 112 (Cm 7019)
Seventh Report	Department for Work and Pensions: Using leaflets to communicate with the public about services and entitlements	HC 133 (Cm 7020)
Eighth Report	Tackling Child Obesity—First Steps	HC 157 (Cm 7020)
Ninth Report	The Paddington Health Campus Scheme	HC 244 (Cm 7076)
Tenth Report	Fines Collection	HC 245 (Cm 7020)
Eleventh Report	Supporting Small Business	HC 262 (Cm 7076)
Twelfth Report	Excess Votes 2005–06	HC 346
Thirteenth Report	Smarter Food Procurement in the Public Sector	HC 357 (Cm 7077)
Fourteenth Report	Ministry of Defence: Delivering digital tactical communications through the Bowman CIP Programme	HC 358 (Cm 7077)
Fifteenth Report	The termination of the PFI contract for the National Physical Laboratory	HC 359 (Cm 7077)
Sixteenth Report	The Provision of Out-of-Hours Care in England	HC 360 (Cm 7077)
Seventeenth Report	Financial Management of the NHS	HC 361 (Cm 7077)
Eighteenth Report	DFID: Working with Non-Governmental and other Civil Society Organisations to promote development	HC 64 (Cm 7077)
Nineteenth Report	A Foot on the Ladder: Low Cost Home Ownership Assistance	HC 134 (Cm 7077)
Twentieth Report	Department of Health: The National Programme for IT in the NHS	HC 390
Twenty-first Report	Progress in Combat Identification	HC 486 (Cm 7151)
Twenty-second Report	Tax credits	HC 487
Twenty-third Report	The office accommodation of the Department for Culture, Media and Sport and its sponsored bodies	HC 488 (Cm 7151)
Twenty-fourth Report	Ofwat: Meeting the demand for water	HC 286 (Cm 7151)
Twenty-fifth Report	Update on PFI debt refinancing and the PFI equity market	HC 158
Twenty-sixth Report	Department for Work and Pensions: Progress in tackling pensioner poverty—encouraging take-up of entitlements	HC 169
Twenty-seventh Report	Delivering successful IT-enabled business change	HC 113
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Twenty-ninth Report	Department of Health: Improving the use of temporary nursing staff in NHS acute and foundation trusts	HC 142
Thirtieth Report	The Modernisation of the West Coast Main Line	HC 189
Thirty-first Report	Central government's use of consultants	HC 309
Thirty-second Report	The right of access to open countryside	HC 91
Thirty-third Report	Assessing the value for money of OGCBuying.solutions	HC 275
Thirty-fourth Report	Recruitment and Retention in the Armed Forces	HC 43
Thirty-fifth Report	BBC outsourcing: the contract between the BBC and Siemens Business Service	HC 118
Thirty-sixth Report	Reserve Forces	HC 729

Thirty-seventh Report	Child Support Agency: Implementation of the Child Support Reforms	HC 812
Thirty-eighth Report	Sure Start Children's Centres	HC 261
Thirty-ninth Report	Preparations for the London Olympic and Paralympic Games—risk assessment and management	HC 377
Fortieth Report	Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP	HC 368

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 28 February 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Annette Brooke
Mr Ian Davidson
Mr Philip Dunne
Helen Goodman

Mr Sadiq Khan
Mr Austin Mitchell
Dr John Pugh
Mr Alan Williams
Mr Iain Wright

Sir John Bourn KCB, Comptroller and Auditor General, **Ms Karen Taylor OBE**, Director, and **Mr Andy Fisher**, Director National Audit Office, were in attendance and gave evidence.

Ms Paula Diggle, Treasury Officer of Accounts was in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

DR FOSTER INTELLIGENCE: A JOINT VENTURE BETWEEN THE INFORMATION CENTRE AND DR FOSTER LLP (HC 151)

Witnesses: **Mr Hugh Taylor CB**, Permanent Secretary, Department of Health and **Professor Denise Lievesley**, Chief Executive, the Information Centre, gave evidence.

Q1 Chairman: Good afternoon, welcome to the Committee of Public Accounts where today we are considering the Comptroller and Auditor General's Report, *Dr Foster Intelligence: a joint venture between the Information Centre and Dr Foster LLP*. We welcome Hugh Taylor, who is the Accounting Officer for the Department of Health and who we understand was involved in initiating the deal in his role as Group Director of Strategy and Business Development. We also welcome Denise Lievesley who is Chief Executive of the new Information Centre. Before we start, let me stress that no one doubts the importance of good information and data to the NHS; what we are looking at today is not the good work or otherwise of the company but whether good practice was followed in the way that this venture was set up. I will start with you if I might, Mr Taylor. Why the rush to set up this deal?

Mr Taylor: I do not think it was a rush. We wanted to pursue, as a matter of some urgency, first of all the creation of the Information Centre and to set it up in a way which enabled it to promote the improved use of information in the NHS. We formed the idea of a potential partnership, which is the subject of the Report, and pursued it as quickly and robustly as we could because we wanted it to get set up, and it was both in the interests of the Department, the Information Centre and the potential partner to move quickly.

Q2 Chairman: Why was there not a proper competitive process?

Mr Taylor: We decided not to move forward with a competitive process, largely because of the way the project started, which was as a result of discussions with Dr Foster.

Q3 Chairman: Did you get into bed with Dr Foster too quickly?

Mr Taylor: No, I do not think we did do that. I think the evaluation which we carried out—

Q4 Chairman: Then why did you not have a proper competitive process?

Mr Taylor: Because the market analysis that we carried out and the due diligence Report which we had carried out—

Q5 Chairman: How long did all that take?

Mr Taylor: From the moment we conceived the idea to the point at which we decided we had a clear runner was effectively about four months.

Q6 Chairman: In the absence of a competitive process how does the Information Centre know whether it paid a fair price or not?

Mr Taylor: We took detailed advice at every step of this, both legally and commercially. We are confident that we got good value for the purchase of the interest in the company, for the 50% interest that we took. That was on the basis of extensive commercial advice that we took within the Department of Health from our own commercial team, from our commercial advisers KPMG and, in the final stages, the Information Centre took advice from another firm to support them in interrogating the financial advisers on the issue.

Q7 Chairman: If you had all this advice how can it be good value to pay £12 million in cash for a half share which is valued at between £5 million and £7.5 million; how is that good value?

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Mr Taylor: The indicative value which is quoted in the Report of £10 million to £15 million for the company was a valuation which we carried out to support the negotiations that we were entering into with Dr Foster. It was a prudent valuation, it was carried out by KPMG who are used to making these kinds of commercial valuations; they applied a very high discount rate of 40% so it was a conservative estimate. That was for the purposes of the negotiation; it would scarcely have been in our interests in a commercial negotiation to go with anything other than a conservative estimate of potential value. The price we eventually agreed for the Dr Foster value for the company was effectively £19 million, which our advisers told us effectively was good value, taking into account the potential synergies that the joint venture was creating and the opportunities it would have.

Q8 Chairman: I will stop you there, but if you look at Figure 5 the figure given if you include advisors' fees and transfer of assets, £16.3 million was spent but it is not quite clear to me what you got for the £16.3 million that is so valuable and whether it is worth that much money.

Mr Taylor: What we effectively purchased was a half interest in the company, which in practice we eventually valued by agreement with Dr Foster as £19 million and we effectively put in—another £5 million was put in to give the business working capital. We eventually arrived at a value for the company of £24 million. We paid out a cash equivalent of £12 million for that and we thought that was a good deal. In effect what we bought with 50% of the company—£7.6 million of which went to the shareholders of Dr Foster to pay out their interest in the 50% of the company—was 50% of the products, intellectual property and skills and talent and abilities of the Dr Foster company, which was why we wanted to go into the business in the first place. That seemed to us a good deal. In addition—

Q9 Chairman: Why did you pay a strategic premium?

Mr Taylor: The phrase “strategic premium”—which I acknowledge we used and I rather regret—was a way of looking at the difference between the value of £19 million which we closed the negotiations with and the indicative valuation that we went into the negotiations with. That is essentially the difference between those two sums.

Q10 Chairman: Normally if you pay a strategic premium in the private sector you are paying that to get a brand name, but it seems to me that you were paying way over the odds, Dr Foster got the NHS brand name and you got the Dr Foster brand name. I do not think that is a fair synergy, is it?

Mr Taylor: I do not accept that as an analysis of where we were. Had our advisers said that £19 million was too high a price for the company, we obviously would not have gone ahead, they thought it was effectively a good valuation, £19 million.

Q11 Chairman: Why did you pay Dr Foster £50,000 for advice from him on establishing commercial relationships with the private sector when you had already entered into exclusive discussions with his company? Is that not a conflict of interest?

Mr Taylor: At the stage we entered into that contract we were not in commercial negotiations with the company. We were, it is true, talking to them about the possibility of some form of partnership arrangement. In effect at that stage we were benefiting from their advice or wanted to benefit from their advice in relation to the set-up of the Information Centre, in relation to its potential partnership with a private sector company and we were looking to them for support on market analysis.

Q12 Chairman: As I understand it, normally if you pay £50,000 for advice it is because you want independent advice, is it not? You do not pay £50,000 to somebody you have already entered into a commercial relationship with.

Mr Taylor: We had not at that stage entered into a commercial relationship with them, and indeed there was no guarantee on their part at that stage that they would come out of this with a commercial deal.

Q13 Chairman: But you had entered into exclusive discussions with them; nobody else was involved.

Mr Taylor: We had entered into discussions with them at that stage.

Q14 Chairman: No other company was involved.

Mr Taylor: That is true.

Q15 Chairman: You may be now in breach of EU state aid rules because you ignored the competitive process.

Mr Taylor: As you know, we took very careful legal advice on the advice of NAO and we do not believe we breached state aid rules.

Q16 Chairman: You think this was a good deal, do you?

Mr Taylor: I think it is a good deal. I am confident it will represent value for money for the taxpayer and, if I may say, I do not think there is anything in the NAO Report which suggests that it will not be, and I am confident that it is already delivering benefits for patients through the better use of information in the NHS.

Q17 Chairman: Why did you start negotiating the terms of this joint venture before the Information Centre was set up? Would it not have been better to set up the Information Centre first before you started negotiating the terms of the joint venture, so that you actually knew what you wanted?

Mr Taylor: The way that this happened was that we were in the process of establishing the Information Centre, we were in discussions within Government and with a wide range of stakeholders about setting up the Information Centre, and it was

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in the context of that wider set of discussions that I happened to meet, for the first time in my life, the Chief Executive of Dr Foster, who was Tim Kelsey, and was extremely impressed by his vision for the better use of information in the NHS, and actually he was one of the first people I met who had a real understanding and vision for what the Information Centre itself could do.

Q18 Chairman: This inquiry is not about the competence or otherwise of Dr Foster's organisation, it is an inquiry as to whether you approached this deal in a business-like manner and whether, if you had followed normal competitive processes, you would have got a better deal. As you ignored normal competitive processes it is very difficult for us to determine whether you did or you did not.

Mr Taylor: The way this happened was that both of us, having met Tim Kelsey and talked to him about where the Information Centre was going, and talked more generally about the better use of information, Sir William Wells, who is the chair of our Commercial Advisory Board, suggested to me that it might be a worthwhile thought, given the impression which he had made on us, to look at the possibility of a commercial partnership, and it is also the case that Tim Kelsey himself approached with me that possibility. What happened was that in a set of circumstances where we had been moving forward on creating the Information Centre, I saw what was, to be blunt, a commercial opportunity to give a real boost to the better use of information by creating effectively a marketing arm for the Information Centre, bringing into it the skills of communication, marketing flair and agility which, with the greatest respect, its predecessor organisations did not have.

Chairman: Thank you very much; Mr Wright.

Q19 Mr Wright: Good afternoon, Mr Taylor. Why did the Department not consider a contractual relationship, even with Dr Foster having preferred provider status, rather than rushing headlong into this joint venture arrangement?

Mr Taylor: We did look at a number of options before deciding on the joint venture route.

Q20 Mr Wright: That does not seem to be the case according to the Report.

Mr Taylor: With respect, the Report does indicate that. Let me just take one step back. At the very beginning we looked at a number of options, of which that was one, and as I think the Report makes clear the business case which the Information Centre took examined as one of the options before it whether it should proceed on the basis of contract, and it was decided on balance that that was not the best way forward but that a joint venture was.

Q21 Mr Wright: Under Chapter 22 of *Government Accounting 2000* the principles state: "Goods and services should be acquired by competition unless there are compelling reasons to the contrary.

Competition promotes economy, efficiency and effectiveness in public expenditure; competition also promotes competitiveness of suppliers, contractors and service providers." You just did not take that into account though, did you?

Mr Taylor: We did take that into account. The NAO Report properly points to the Treasury guidance on setting up a joint venture and that says, for example, "A transparent approach through an open competition will not be the best process for selecting a partner in all cases and alternative approaches can be used if they are justified." It goes on to say, "For other projects it may be more appropriate to target potential partners."

Q22 Mr Wright: Can I just stop you there, because I am conscious of the time and I have a lot to get through? I understand that there were two major providers of this service in the marketplace; why did you only focus exclusively on one at the expense of the other one?

Mr Taylor: We carried out a market analysis and we did look at alternative providers of services. Our view was that none of the other providers of services had anything like the national profile which Dr Foster had acquired or their skills in marketing and communications across the NHS. It was for that reason, as well as for the breadth of their range of products, which went wider than other companies, that we decided that in the particular circumstances of this joint venture, they were what we were looking for.

Q23 Mr Wright: Why was the Office of Government Commerce not commissioned to undertake a gateway review, but was just asked to look at an internal peer review?

Mr Taylor: We took this forward as an acquisition, not as a procurement; we took advice from the OGC and we were told we did not need to go through a gateway review, but we did have a peer review process, which was not a formal gateway review, but did provide some form of external check on the process.

Q24 Mr Wright: That concluded that the development of the joint venture—I am looking at paragraph 1.35—"...has to some extent been developed under a cloak of secrecy under the guise of commercial sensitivity". The controls regarding tendering and procurement are essentially to protect and to demonstrate effectiveness, economy and efficiency are being achieved.

Mr Taylor: It is also fair to say, as the peer review makes clear, that the peer review also suggested this was an extremely promising way forward, that there was universal agreement that it was the right way forward. I did not like the term "cloak of secrecy"; what we were engaged in was commercially confidential negotiations. I accept that given the time it was taking at that stage it was becoming clear that we ought to widen the circle and, following that Report, one of the things that

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the Information Centre did was to open up discussions with some other commercial organisations including potential competitors.

Q25 Mr Wright: In terms of the structure of the deal and going back slightly, I understand that Dr Foster was set up in 2000 by two people, one of whom was the Chief Executive, Tim Kelsey.

Mr Taylor: Yes.

Q26 Mr Wright: At the time of the deal what was his shareholding in the company?

Mr Taylor: I have not got that information with me.

Q27 Mr Wright: Is it fair to assume that of the £12 million paid for this company he was a major beneficiary as a shareholder?

Mr Taylor: The amount that was paid to Dr Foster, effectively to buy out the 50% of the interest, was £7.6 million, which was paid in two parts as one of the figures shows. He is certainly nothing like a majority shareholder, but he is the biggest as far as I am aware and of course he retains an interest in the company, he is a shareholder in 50% of this company.

Q28 Mr Wright: Do you think that is reasonable given that, as you said, you were inspired by his vision, his innovative approach to the marketplace and how that will develop, and you spoke to him before you really spoke to anybody else. Do you really think there is transparency there, or do you think there is a conflict of interest in terms of the policy standing to make a major financial beneficiary as a result of the way this scheme was organised?

Mr Taylor: I do not think there is any need to be secretive about the fact that Dr Foster was looking for an investment. If they had not come to us they would have gone somewhere else, they would have wanted to raise money in other ways. In September 2005 they were in one of these *Sunday Times* surveys and reckoned as one of the top ten fastest-growing companies.

Q29 Mr Wright: Number 9.

Mr Taylor: So they were doing extremely well. I make no apology for that, I hope the joint venture succeeds. My main aim in seeing the joint venture succeed is not about the profit, although if there is profit then the taxpayer will benefit from it and we would obviously reinvest that money, but the main reason I want to see it succeed is the reason that we did it in the first place, which is that the NHS is awash with data which it does not convert into good information, and you will have received from Dr Foster—

Q30 Chairman: We are not investigating that, we all know that you need more information. We have to narrow this inquiry down very carefully.

Mr Taylor: I am only repeating the point that the strategic point of doing this was in order to accelerate and boost that. That was our judgment of the quickest and best way to do it.

Q31 Mr Wright: Paragraph 1.27 of the Report states how Dr Foster had moved some non-NHS business into a separate trading company. In terms of the growth of the business, what was the strategic reason behind that?

Mr Taylor: That is because they had one or two contracts which are really non-NHS related, for example selling into other sectors potentially, but at the moment that is a fraction of their business, we took something like 95% of their business into the joint venture.

Q32 Mr Wright: Would it still be classed as 95% of the group?

Mr Taylor: I do not know, but as far as I know it has not grown significantly. That is not directly the concern of the joint venture.

Q33 Mr Wright: One of the major attractions of securing a joint venture with this particular company was the skills of the Chief Executive, and I understand that he was seconded. What are the secondment arrangements; is the joint venture company charged for the Chief Executive's secondment? Does the Department, and by extension the public purse, pay again, a second time, for the chief executive's time?

Mr Taylor: I am not sure that I follow your point but he is secured effectively by agreement to the joint venture for the period of three years.

Q34 Mr Wright: But is there a management fee paid to Dr Foster for his time, by the joint venture company?

Professor Lievesley: He is paid by Dr Foster Intelligence, so he is not paid twice. The fee goes across for his time in Dr Foster Intelligence.

Q35 Mr Wright: Okay. In terms of exit strategy—because one of the things in setting up a company is actually how you do extract your investment—do you think the public purse, the taxpayer, has been provided with value for money here, because it seems to me from this Report that that is certainly not the case, that all the risks have been stacked up against the Department as opposed to the private sector.

Mr Taylor: I do not think that is right; the exit arrangements are understandable and effectively what they provide for is that there is a lock-in for three years, at the end of that if one partner wants to sell to the other that is fine, against a valuation. If one partner is not prepared under those circumstances to buy it goes to market. If after going to market, at that point Dr Foster wanted out, we would be required to carry out a further evaluation and at that stage we would be required under the terms of the agreement to buy them out. I do not think that is an unreasonable outcome because what it does is secure—

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Q36 Mr Wright: Mr Taylor, why is the arrangement not reciprocal?

Mr Taylor: I do not think it can be entirely reciprocal because, to be perfectly honest, this is a very, very substantial part of the Dr Foster business and, with respect, it is a fractional risk on our side. The other point is we want to secure final control over the outcome of all this, so in a sense we were content to come to this arrangement.

Q37 Mr Wright: What arrangements have you put in place in terms of the governance of the joint venture, because it is 50/50 in terms of having control. What happens in the event of a deadlock?

Professor Lievesley: At the moment we have three representatives from the Information Centre and three from the other shareholder, so it is a 50/50 board. It would be deadlocked if there was a disagreement, but we actually deliberately negotiated that because we wanted it to be shared equally between public and private sector.

Q38 Mr Wright: What happens in the event of a strategic decision to move the company forward where there is a deadlock? Going back to the Chairman's point, you pay a strategic premium to get overall control of the company; that has not happened here.

Professor Lievesley: I do not believe that we did pay more than the value and we did not want overall control, we actually wanted it to be balanced. We discussed this at some length with both our legal advisers and our professional advisers and we decided that this was the approach that we wanted.

Q39 Mr Wright: Can I stop you, because my time is up and I just have two very brief questions. Would you do the same thing again? Would you carry out the same approach in other circumstances?

Mr Taylor: I believe that the approach was justified. I have to say 18 months of interrogation on the subject has cooled my ardour for it somewhat and perhaps there is a lesson there about discouraging civil servants from unusual moments of entrepreneurialism. Personally, I feel this was a justified course and I have no regrets about doing it.

Mr Wright: I do not share the enthusiasm, Chairman, and I think it is borderline dodgy.

Chairman: Thank you, Mr Wright. Mr Khan.

Q40 Mr Khan: Can I just follow that and say I have no problems with the use of specialist help from the private sector to do a job which clearly the Department does not appear to have the skills to do. I also have no problems with entrepreneurship, so let us get this out of the way. The Chairman, when he opened, asked you a question about whether you thought you had got into bed with Dr Foster too quickly, and your answer was no. Do you think you paid too much to get into bed with Dr Foster?

Mr Taylor: No.

Q41 Mr Khan: Do you think the procurement process could be improved a great deal if you were to do this again?

Mr Taylor: We took a very precautionary approach in terms of the care with which we used legal and financial advice. I think that was right because it was an unusual thing to do in one sense, but if your implication is should we have gone down a competitive tender route, I am not persuaded it would have come out with any form of different outcome.

Q42 Mr Khan: Do you accept the criticism about your failure to advertise the opportunity that Dr Foster had and the exclusive negotiations with "the market leader"?

Mr Taylor: I do not, because this was a commercial opportunity. We saw it as an acquisition effectively, as an investment, and we only went forward on that basis after a very, very detailed market analysis and due diligence.

Q43 Mr Khan: Do you accept the criticism that your lack of a tender specification meant that is unclear to the Committee of Public Accounts what you have achieved versus what could have been achieved otherwise?

Mr Taylor: That is a very difficult question to answer because in a sense I cannot demonstrate to you a negative. What I do believe is that we could not possibly have done more once we had set on the route of making a commercial acquisition to ensure that we got good value.

Q44 Mr Khan: You say you could not do more; can you explain then why you failed to follow Treasury guidance on joint ventures?

Mr Taylor: I do not believe we did fail to follow Treasury guidance; I feel that we—

Q45 Mr Khan: Did you contact the Shareholder Executive?

Mr Taylor: We did not contact the Shareholder Executive and—

Q46 Mr Khan: Are you surprised that the internal peer review raises very serious concerns about the probity of the single tender action?

Mr Taylor: I do not believe it does raise concerns about the probity of the single tender action.

Q47 Mr Khan: Have you seen paragraph 17, page 9?

Mr Taylor: What they identified was that concerns had been expressed to them, and indeed they were expressed to the NAO, about the legality of the action. We had taken very, very serious measures to ensure that we mitigated against any risk that this was improper or unlawful in any way at all. They were reporting a perception, that was not their conclusion and it was not mentioned in their conclusions.

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Q48 Mr Khan: Let us go to Appendix 2, which is page 30, a letter from the NAO to you, Professor. Have you satisfied yourself or indeed the NAO that you mitigated the risks outlined here prior to concluding the deal?

Professor Lievesley: This letter from the NAO was the culmination of a number of meetings that we had with them. It came specifically to inform a board meeting of the Information Centre and the Information Centre board considered every line of that letter in great detail. We satisfied ourselves with respect to state aid by taking legal advice, and our legal advice was that it would be unlikely to involve state aid because we had acted as a market investor for the acquisition.

Q49 Mr Khan: Can I come to your legal advice? One of the criticisms amongst many raised by the NAO is that the roles and responsibilities of your advisors were confused. You will see from figure 5, page 19, that you spent only £1.7 million on advisors and there is figure 6 on page 21 which sets out the sums spent on KPMG accountants, Berwin Leighton lawyers and other solicitors which comes to a whopping figure of between £1.7 million and £2.6 million. What you will see from the NAO critique is that the advice you sought prior to the establishment of the Information Centre, financial and legal advice, the same people were asked to advise and work with Dr Foster to develop the terms of the joint venture, the same people were commissioned to provide support in establishing the joint venture and the same advisors were subsequently to become advisors to the Information Centre. Would it be a surprise if members of the public and Parliamentarians and, dare I say the PAC, were to suggest that some of their advice may have been self-serving?

Professor Lievesley: From the period when I joined the Information Centre in July 2005 onwards I can reassure you that I was perfectly happy that the professional advisors and legal advisors were working on behalf of the Information Centre. They were actually helping us with two things: one was to establish the Information Centre as a robust viable organisation and the other was alongside that to establish our relationship with Dr Foster.

Q50 Mr Khan: Professor, had the advisors said to you when they were originally instructed to advise on the joint venture, "Look, we think this joint venture is ripping off the taxpayer, it is a bad deal and you should not go ahead with it", would that not have meant that they could not get the further work that I talked about?

Professor Lievesley: If they had given any indication of that nature then of course we would have taken that very seriously.

Q51 Mr Khan: Bearing in mind the size of their bill, are you surprised members of public express concern that some of their advice may have been self-serving?

Professor Lievesley: They would have, I assume, still continued to work with us in terms of the establishment of the Information Centre. The work that they were doing with us was not entirely dependent upon the joint venture and my board satisfied itself that the advice that we were getting from our legal advisors and from KPMG was in our interests. We also brought in Ernst & Young as an independent organisation to help the Information Centre board ensure that we were asking robust questions of KPMG.

Q52 Mr Khan: One of the words used to describe this arrangement was a bit "dodgy" by Mr Wright, but one of the generalisations civil servants fall into making is that private is efficient and excellent and public may not be so. Another generalisation that we fall into making is that the private sector tends to rip off the public sector when it comes to negotiating deals. Bearing in mind what we have seen here, both in terms of the valuation and the taxpayers' money paid to Dr Foster, and bearing in mind the sums paid to consultants, Mr Taylor, how do you respond to those generalisations?

Mr Taylor: It is right for the Department always to question expenditure of this kind. I do not think in relation to the nature of this deal that the expenditure was disproportionate, but clearly that is something you have to keep looking at. We were throughout this supported by my own commercial directorate, who have some expertise in these matters, and that is always going to be an issue for concern. If you look at the projected total value of this three year term, which is projected at something like £114 million in turnover, these advisors' fees represent about 1.5%.

Q53 Mr Khan: I suspect that the Chief Executive whom Mr Wright referred to probably gets paid more than José Mourinho over the period of the contract, but let me ask you this: what succession planning are you doing to ensure that when he leaves at the end of the three year period there will be somebody in place from the public sector, one of your civil servants, who can take over the job that he was doing, hopefully at a lot less remuneration?

Professor Lievesley: One of the reasons for going into this joint venture is actually to build the skills and expertise of the Information Centre and we are doing that; we are learning from working with Dr Foster Intelligence and we are affecting the company too, so it is a two-way process.

Q54 Mr Khan: You have a pool of people in the public sector from within which you will recruit to replace this person, is that right?

Professor Lievesley: There will be an option in two years time and one of the options would be for us to decide that we wanted to sell the company and that we wanted to do this work internally, but we are working with a wide range of organisations in terms of value added data services and products, not that it has to be an exclusive arrangement of the public sector. It is actually plurality of delivery.

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Mr Khan: Thank you very much, my time is up, I am afraid.

Q55 Mr Dunne: Mr Taylor, the NAO has calculated the total cost of the joint venture to the NHS as between £15.4 and £16.3 million for the 50% share. Can you tell me what the net book value of the joint venture was at the time the deal was concluded?

Mr Taylor: No, I do not have that figure.

Q56 Mr Dunne: Do you know what the revenues of the joint venture were at the time the deal was concluded?

Mr Taylor: You mean of Dr Foster?

Q57 Mr Dunne: Of the business which is now in the joint venture.

Mr Taylor: The turnover in the year in question was around £8 million, £9 million.

Q58 Mr Dunne: £8 or £9 million, you are uncertain. Do you know what the profit was at the time?

Mr Taylor: There was a small operating profit and the reason that they wanted to go to market was that they were making a small loss.

Q59 Mr Dunne: Okay, the business was loss-making, you do not know what its assets were, its turnover was somewhere in the region of a quarter of the value placed on 100% of the joint venture, is that right, so you paid four times revenues; that is the only multiple I can calculate.

Mr Taylor: What we did was take a decision on the basis of a valuation carried out by an experienced team of valuers in KPMG, which estimated the value of the business that we were inheriting as, I have said, on an indicative and conservative basis at between £10 million and £15 million.

Q60 Mr Dunne: The valuation was based on a discounted cashflow basis; did that take into account revenues generated by the NHS to Dr Foster had it been a stand-alone company?

Mr Taylor: I do not know the answer to that question.

Q61 Mr Dunne: I would suggest to you that that is an extremely important question, because if the answer is yes in effect you are paying for revenues that you are generating yourselves and therefore should not have been paying a strategic premium to purchase something that you already owned.

Mr Taylor: Of course, Dr Foster is making money and effectively the profits are coming from the NHS in the sense that it is providing added value services to the NHS; that is where its business is created. No NHS organisation is under any obligation to use it, or indeed the joint venture.

Q62 Mr Dunne: However, the revenues that it was projecting had you not done this transaction were one stream of revenues, had you done the transaction presumably an alternative stream of revenues.

Mr Taylor: We did the valuation of the company on the basis of its projected revenue. Of course, in the case of an immature company that is a difficult and necessarily subjective exercise and KPMG made that clear to us when they did that. What they did was project forward on the basis of existing business and apply a discount and, as I have indicated, it was a very high discount.

Q63 Mr Dunne: In order to make an investment decision as opposed to a decision to contract to take a service, you must have anticipated some benefit to the company from the NHS taking a shareholding in the business.

Mr Taylor: Yes.

Q64 Mr Dunne: And that benefit you could project by means of discounted cashflow and you could therefore have assumed that the relationship with the NHS, by being formalised in the joint venture, would generate an improvement in the value of the underlying business, otherwise why would you have made a decision to invest in it?

Mr Taylor: The primary reason for investment was not in order to produce a profit for the taxpayer or for the company, it was to secure better use of information. Having said that, of course, one of the reasons why after negotiation we reached effectively the indicative price of £19 million for the value that Dr Foster brought into the company and one of the factors we were taking into consideration was the synergy that would be created by its association with the Information Centre and the opportunities that we hoped would be created by the launch of the joint venture.

Q65 Mr Dunne: Could I ask Sir John a quick question? Sir John, in paragraph 1.23 you have said that you: "have not considered the future value of the joint venture company as this is largely unpredictable". Did you have access to the KPMG valuation advice?

Ms Taylor: We saw the advice that they had provided in the due diligence report and in financial reviews, not subsequent to the deal, only leading up to the deal.

Mr Dunne: The calculation of the value for money for the taxpayer is hard for us to determine when we do not understand the valuation basis on which the transaction was entered into, and it would be very helpful for the Committee, Chairman, if we could have a note of the valuation calculation undertaken by KPMG so that we can assess that against the price that was actually paid, if that would be possible.

Q66 Chairman: The answer is yes to that, is it?

Mr Taylor: In principle I can see no reason why not of course.

Q67 Mr Dunne: Thank you. Could I turn to paragraph 1.32 which looks at the advisory cost and the initial estimate from KPMG of £284,000 which turned into total advisory costs of £1.75 million from KPMG. That does seem a very

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substantial increase over their original estimate and a very substantial fee for a transaction of this size and relative lack of complexity. I know it says in here that this was a complicated transaction, but the transaction itself does not seem to me to have been that complicated. Could you comment on that, please?

Mr Taylor: It is fair to say that at the outset our expectation was that we would be able to move more quickly than in the end we did to completion of the deal, and the original estimate of the KPMG expenditure was based on that. Quite understandably, at the prompting of the Information Centre, they both supported them in their duties and we kept going back for more and more better particulars, but I do not think in the end that the sum arrived at was disproportionate for the deal. What we have done is look at comparators and it does not seem totally out of line with those.

Professor Lievesley: Could I add to that because I actually take responsibility for a lot of that increase. We did actually go through a second stage of due diligence, we wanted to make sure that this really was the right deal for the Information Centre so the board of the Information Centre asked me to get KPMG to go through another market test—

Q68 Mr Dunne: All I can say is I used to be an investment banker and I wish you were my client and I had clients like you all the time.

Professor Lievesley: Another thing I should say is that KPMG helped us considerably with the establishment of the Information Centre and some of these costs are to do with that. They were due to the fact that I did not have a senior team.

Chairman: Thank you, we will have to break for a few minutes to vote now, I am afraid; about eight minutes probably.

*The Committee suspended from
4.13 pm to 4.26 pm for a division in the House.*

Chairman: We are now quorate, and although other Members are still returning from the division we might start. I should just say that I omitted at the beginning of this hearing to say that I welcome a delegation from our sister committee, the Tanzanian Public Accounts Committee; they are over here and are very welcome. Thank you for coming. Members of the Committee, certainly myself, will be seeing them after this Committee. Mr Dunne was just finishing his line of questioning. Mr Dunne.

Q69 Mr Dunne: Thank you, Mr Chairman. Mr Taylor, you had difficulty in answering the question about the net value, and I am not surprised you had difficulty because I have looked at Table 2 and have difficulty in trying to decipher what the precise contribution from Dr Foster and from the Information Centre was. I would ask you if you would kindly submit a note to the Committee explaining exactly what the financial contribution of each party was to the joint venture in asset terms so that we can be clear about what the starting

point was¹ and, secondly, what the basis of valuation was so that we can understand that and also the advice you received from KPMG². Are you happy to do that?

Mr Taylor: I am very happy to do that.

Q70 Mr Dunne: Thank you. I have a final question which relates to a comment you made when giving evidence earlier on where, if I quote you correctly, I think you said “we want to secure final control of the outcome” and this was in the context of the one-sided put option which Dr Foster has on the Information Centre. In order to secure control you would need to have a call option, i.e. the ability for the Information Centre to require Dr Foster to sell their shares. Do you have a call option?

Mr Taylor: No, we do not.

Q71 Mr Dunne: You do not have the ability to secure control of the joint venture.

Mr Taylor: What I said—and I do not resile from it—was that the circumstances surrounding the exit arrangements we have got we think provide the opportunity for either side to move forward with quite a lot of flexibility. We accepted in the end that Dr Foster should have a put option and one of the reasons for that is that if in the end we were left with the business, that would be something that we would be willing to accept.

Q72 Chairman: When I was questioning you at the beginning you seemed to intimate to me that Dr Foster put in £19 million; is that correct?

Mr Taylor: If anything I said implied that, what I meant was effectively the negotiated value of the Dr Foster input to the business was £19 million. We started with an indicative—

Q73 Chairman: How did you arrive at that figure of £19 million?

Mr Taylor: By negotiation; that was the negotiated figure with Dr Foster, that was the agreed figure for moving ahead with the deal, together with a commitment on our part to invest, as it turned out, £4.4 million into the business as working capital.

Q74 Chairman: What did Dr Foster put in then?

Mr Taylor: They brought in with them all their existing business, effectively their health business, so they brought in all their products, all their personnel working on health products.

Q75 Chairman: Can you value that?

Mr Taylor: Eventually that was what we valued for the purposes of this as a business at £19 million.

Q76 Chairman: Can I ask the National Audit Office if they think that adds up and makes sense?

Ms Taylor: I have to admit it does not make sense to me. I can understand where the figures come from and the purely mathematical basis if you look

¹ Ev 19

² Ev 19

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at figure 2, but I have not seen the valuation of £19 million, the only valuation I saw for Dr Foster was £10-£15 million.

Mr Taylor: Can I just be clear, the valuation for the purposes of the negotiation was £10-£15 million, and that was a prudent valuation of the business. We were prepared to move forward, following negotiation, on the basis of an acceptance, but the Dr Foster view of the valuation of the business was not, I have to say, £10-£15 million, so we were in negotiation. Where we came out was at £19 million, but I have to say that it is the view of our advisors and my not professional view that were we to sell the business in three years time I am very confident that it will prove to be good value for money, but that of course is in the end a judgment you take on the best commercial advice.

Q77 Chairman: Was the National Audit Office allowed to look at the books to verify all this?

Ms Taylor: We did not. I am not sure we even pressed to look at the books of Dr Foster Ltd because we were looking at what information the Department had to take the actions and decisions it took, and as far as I am aware they did not have access to the books of Dr Foster either, but I do not know.

Q78 Chairman: Nobody in the public sector had access to them, so none of this could be verified, is that right, except on the say-so of your advisers?

Mr Taylor: We did extensive due diligence on the company and we can provide you with more information about that.³ This was in the end, of course, as it is always bound to be, a negotiation. If we had gone through a competitive tendering exercise with a view to purchasing 50% of any competitor, we would have entered into a negotiation with them, with their view of the future value of their business and our value. The effective position we reached, which is summarised in figure 2, was a total value of the business of £24 million which was effectively £5 million of working capital, £4.4 million of which was put in by the Information Centre and £19 million of which was the value in effect which we attributed to the business which Dr Foster was bringing in.

Q79 Chairman: Do I understand that the position of the National Audit Office is that you do not necessarily accept this figure of £19 million, but you think that to pay £12 million for a share worth £8.5 million is still paying over the odds; is that your view?

Ms Taylor: It is not that we do not accept £19 million because £19 million is the figure that they ended up with at the end of the negotiation. We have nothing to verify what the £19 million is.

Q80 Chairman: You simply cannot verify it.

Ms Taylor: It is not working capital and it is not assets, it is what they were judged to be worth.

Sir John Bourn: Even if the figure was £19 million and that was in the minds of the Department, they still paid £12 million for half of that so they still paid over the odds whether it was £19 million or whatever it was.

Mr Taylor: No, no, with respect, we paid £12 million to acquire a half, 50%, interest in a company which on this basis is worth £24 million. The so-called strategic premium on which so much emphasis is put in the NAO Report, and which we acknowledged as one way of looking at this, is the difference between the £19 million and the indicative value of £10-£15 million.

Sir John Bourn: But you put in the working capital, which is why it was more than £10 million.

Mr Taylor: With respect, Sir John, if I had been asked to put £4.4 million of investment into the Information Centre in order to encourage it to get serious about marketing and communicating better use of information, I doubt whether anybody would have noticed. It certainly, in relation to the Information Centre in which we invested around £14 million, would not have been regarded as that significant a sum. I should perhaps mention in this that the predecessor body, the NHS Information Authority, which we collapsed into the Information Centre, had a budget of over £200 million, and one of our frustrations at the centre was its lack of effectiveness in making a real impact on the informatics market for the NHS. In relation to those sums, an investment of £4.4 million in working capital and a joint venture company, where we were working alongside a partner which was already establishing itself as an extremely effective operator in the NHS market, seemed to me to be a good investment.

Sir John Bourn: The essential position of the National Audit Office, Chairman, as you said, is not to deny the value of the informatics provided by the company, not to deny the quality of Mr Kelsey; our basic case is you could have got it cheaper if you had really tried and we do not think the Department did really try.

Q81 Chairman: I am afraid that that might be the essence of our Report, unless in the remaining hour of the hearing you can convince us otherwise.

Mr Taylor: With respect, it is a judgment. I do not think there is any evidence in the NAO's Report that demonstrates how we might have secured better value from the deal, but can I just repeat the point that if we had competitively tendered and Dr Foster, who stood out in my view on the basis of our market analysis as the likely winner of such a competition, we would with that preferred bidder status have been getting into exactly the same negotiations with them in relation to the valuation of the company as we did following this process. I am unclear myself as to what the competitive process would have added. Could I also just point out that before we did this deal we had the NAO talking to us about the deal. They wrote to us the letter which has already been reported and, I have to say, the decision that we made to go ahead in the Department and the Information Centre board

³ Evidence received, not printed.

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made to go ahead was taken in the light of the NAO letter which appeared to us to acknowledge that in the present case, provided we could satisfy ourselves in relation to other risks they had addressed, we were going to go ahead without the competitive tendering. Had we not received the letter in the form that we did we of course would not have proceeded.

Q82 Chairman: They are using you as cover.

Mr Taylor: Can I be clear, I am not using the NAO as cover, I am merely pointing out that to place over-reliance on the potential value of a competitive tender to demonstrate value in this case is at the very best a moot point and one that I do not feel too defensive about in relation to the deal. Of course, as a matter of course we would look at competitive tendering and in the overwhelming majority of cases in the Department we would follow that process; there were very particular circumstances in this case that led us to conclude, on the basis of strong commercial and legal advice, that we were following an appropriate course.

Q83 Chairman: If there had been a competitive process we would now, presumably, have a much clearer idea whether you did get good value and this hearing would never have happened, would it?

Mr Taylor: That is possible.

Q84 Chairman: Probable.

Mr Taylor: That does not mean to say that we made a wrong judgment in this.

Chairman: No, because we do not know because there was not a competitive process which allows us to determine that fact. Mrs Goodman.

Q85 Helen Goodman: I wonder if I could draw your attention, Mr Taylor, to paragraph 1.15 on page 15 which says: “[The Department] considered that this would [i.e. setting up the joint venture] encourage more companies into the health informatics market to make the most of the existing data in the NHS to help improve services.” Could you just explain how investing in one company encourages others to join the market?

Mr Taylor: What we were looking to do was to set up a joint venture to do that; in other words, what we wanted to do was to boost the overall informatics market in the NHS, which we think is under-developed. What we wanted the joint venture to do—we wanted the Information Centre to do first and then through them the joint venture—was to create a climate in the NHS where there is greater readiness to use value added products and use the information. There is evidence, I think, of a growing interest in this area in the NHS, so we were looking if you like to seed the market, to stimulate it, and that was definitely one of the purposes of the joint venture approach.

Q86 Helen Goodman: Professor Lievesley, we see from the papers which we have been given about you that you have just been elected president of the International Statistical Institute, you are a former

president of the Royal Statistical Society. Could you tell us precisely what experience the people from Dr Foster bring to the table which you do not have?

Professor Lievesley: What they bring to the table is a really good understanding of the NHS –I came from outside the health area. They have a good understanding of how information is used in order to make a difference, both in the delivery of services and in the management of services. They also have experience in terms of how you deliver information to the general public. The skills that I bring are largely around data collection and largely around data analysis and around issues to do with data quality and the integrity of the data. They complement the terms of communication and excited delivery of information, and I am learning from them.

Q87 Helen Goodman: Good. I notice that one of the things that is made a lot of in the document is the vision and experience and so on and so forth of Mr Kelsey. I do not expect you to have this at your fingertips, but I wonder if we could have a note, please, on his previous work experience; could you send that to the Committee, please?

Mr Taylor: Yes.⁴

Q88 Helen Goodman: So that we can understand why it is that you take this view.

Mr Taylor: Can I just be clear that I formed the view largely on the basis of talking to him about the project I was engaged on at the time which was the creation of the Information Centre.

Professor Lievesley: Could I also add that it is not just one individual, it is a team across the whole of Dr Foster that has good communication skills and skills in terms of how you turn statistics into information that may be used for delivery.

Q89 Helen Goodman: That is a very good answer because that comes precisely to my next question. I had a letter, as it happened, from Mr Kelsey with a report on Dr Foster on 26 January, and in this Mr Kelsey describes himself as the chair of the executive board, whereas in this Report you were referring to the Chief Executive. Who is the Chief Executive?⁵

Professor Lievesley: The Chief Executive is Jake Arnold-Forster.

⁴ *Note by witness:* Tim Kelsey is chair of the executive board of Dr Foster Intelligence. Tim co-founded Dr Foster in 2000 to provide authoritative, independent information about local health services. A well-respected journalist and broadcaster, Tim graduated in history from Cambridge University and has worked as news editor at the Sunday Times, as foreign correspondent for the Independent and has presented award-winning documentaries for both Channel 4, and the BBC.

⁵ *Note by witness:* Jake Arnold-Forster is the Chief Executive of Dr Foster Intelligence. Jake originally joined the company as Managing Director. Until January 2003, he was Managing Director of Emap Public Sector Management, a publishing and events business which publishes the Health Service Journal.

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Q90 Helen Goodman: You are saying that he also is an important part of the team.

Professor Lievesley: He is a very important part of it.

Q91 Helen Goodman: I suppose we need to have the same sort of information about Mr Arnold-Forster's background and experience.

Professor Lievesley: There is a very strong senior team there.

Q92 Helen Goodman: Thank you. In this Report, Professor, you say—and I wonder whether you would like to confirm this at this hearing—“Traditionally the NHS has lacked information and what we might call business intelligence.” Do you think this whole episode goes to make that point?

Professor Lievesley: No, I do not believe it has. I actually believe that we have taken considerable efforts to ensure that this is in the interests of the NHS and I have worked very closely with the board of the Information Centre to satisfy ourselves of that.

Q93 Helen Goodman: If you look at page 10, diagram 2, you see this rather, to my mind anyway, unnecessarily complex structure. We are always going back to this general issue of why you did not simply have a contract and employ the organisation on an on-going basis. One thing that my colleagues have asked is whether or not we—the taxpayer—had a good deal for this investment and obviously we will not know that unless we look at the returns. Unfortunately, earlier on when I tried to get this from Companies House I saw that no accounts have yet been filed for Dr Foster Intelligence, nor for Dr Foster Research Ltd and nor for Dr Foster LLP. When do you think the Dr Foster Intelligence accounts will be filed?

Professor Lievesley: They are anticipating filing them in March; they are not yet audited.

Q94 Helen Goodman: Would you be able to send us a copy of the unaudited accounts?

Professor Lievesley: With the permission of the company we could do that, yes.⁶

Mr Taylor: We could ask.

Q95 Helen Goodman: Thank you very much. I was also rather concerned when I looked through what was available from Companies House that for Dr Foster LLP, the holding company, there is no annual return. I wonder if we could have a little more information from you than is publicly available about who the partners of Dr Foster LLP are.

Professor Lievesley: Certainly we can enquire about that, I do not have that information in my head at the moment. At the moment the LLP is separate from us; we have been working through the three

representatives of that company as the three representatives of the shareholders in Dr Foster Intelligence.⁷

Q96 Helen Goodman: Had you done the proper due diligence which you have been assuring us all afternoon you had done, I would have thought you would have that information already.

Professor Lievesley: We did have that information at the time that we did the deal.

Q97 Helen Goodman: Perhaps it would be helpful to the Committee if we could have the information as it was at the time you did the deal and as it is now. Thank you very much.⁸

Q98 Mr Mitchell: I am not quite sure why you are so cheerful. You are in the position of somebody who has gone into a second-hand car sales yard and bought a perfectly good, probably reliable car, but it is a Ford and you have paid a Bentley price and you are now explaining it to the manager. Is your good cheer a kind of bravado exercise, an expression of confidence, or can you be genuinely satisfied that you have not paid over the odds for this deal?

Mr Taylor: I have to be satisfied. I would not have been able to recommend this within the department to my ministers, to the accounting officer at the time, had I not been given assurances that it was a good deal and the same goes for Denise's board, I am sure. We both took a great deal of care to ensure that we had the best possible advice as to whether this was a good deal or not. We were advised by people whom, I think, we trusted that this was a good deal for the taxpayer and we—

Q99 Mr Mitchell: Can I just stop you there? People advised you but you did not make any inquiries of alternative bidders, did they? They did not get in touch with them and say, “What are we likely to pay? Can we get that down?”

Mr Taylor: The market analysis that we did on this and the reason we went down this route was that we could not identify another competitor, another partner who brought the range of skills that we were looking for compared with Dr Foster. Had there been—

Q100 Mr Mitchell: Do you still hold that view, that there are no alternatives, nobody else could have done this deal?

Mr Taylor: I think I hold the view that we made the right judgment in that respect. We did look at, for example, whether the Information Centre itself would be, as it were—

Q101 Mr Mitchell: That is understandable. If you want a partnership then you are looking at the private sector.

⁷ Ev 20-22

⁸ Ev 20-22

⁶ Evidence received, not printed.

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Mr Taylor: We looked at a number of other private sector companies. They did, I believe, not possess the all-round qualities that we were looking for and which we saw in Dr Foster, and that was a judgment that we made.

Q102 Mr Mitchell: Yes, but looking back at the car analogy, Dr Kelsey must be an extraordinarily good salesman. I see that he sold the idea to the present Permanent Secretary at your Department who came back and rushed this through. He never looked at any other car yards or any other possible vehicles or a rental dealer or whatever.

Mr Taylor: If that were absolutely the case then I think I would stand to be criticised but that is not what happened. First of all, it was the case that even before Tim Kelsey came to me with this idea, as I have indicated to you, we had ourselves thought that it might be that a commercial partnership with Dr Foster might be a win-win on both sides. When we looked at this we then did look very seriously, and we had, I have to say, long discussions about this within the Department, at whether there were alternatives. We did not think, to be honest, that the UK competitors of Dr Foster had anything like what we were looking for. We considered whether it would be possible to import the skills from overseas companies, and there is a developing interest from overseas companies in this market, but they did not know the NHS and anybody who was in the NHS at the time would have told you that the company making the biggest impact in the field of health informatics was Dr Foster. They had a national profile—

Q103 Mr Mitchell: But you want to encourage them all to participate more with the NHS and I do not see how you do that by going to bed with one company. You say the others really do not really know the NHS but you want to get out and get to know them and there you are sat in bed with Dr Kelsey waving to them.

Professor Lievesley: This is not an exclusive relationship and in fact we do have relationships with other companies.

Q104 Mr Mitchell: But it is very much a one-way relationship.

Professor Lievesley: No, I think it is a partnership. We are working very closely with Dr Foster Intelligence but we are also working with other companies, so it is not an exclusive relationship and that is one of the aspects of the deal I negotiated.

Q105 Mr Mitchell: Okay, let us leave it there because I still do not understand. You knew about Treasury guidelines, which were that there should be the establishment of a price by a bidding process. Why did you just ignore them?

Mr Taylor: With respect, I do not think we did ignore them. We followed what we felt was the spirit of the Treasury guidelines.

Q106 Mr Mitchell: That means ignoring them.

Mr Taylor: No, it does not mean ignoring them. We went through an options exercise. We did due diligence. We did, it is true, in this instance take the view that a competitive tender exercise was not the right way to do it, partly because of the way we got into the thing and partly because of what our market analysis showed, but I do not think it would be true to say that we did not follow Treasury guidance on this matter which, as I have said explicitly, makes provision for exceptions of this kind.

Mr Mitchell: I like the name Dr Foster because I confess that Dr Foster was the name of the doctor who brought me into the world all those years ago.

Chairman: He has a lot to answer for!

Q107 Mr Mitchell: I hesitate therefore at booting them but you did overpay. You paid £12 million, as you said, for 50%, a somewhat hypothetical valuation, and you say that is half of the hypothetical valuation. Advisers seem to think you paid 33% over the odds. You also put into it all the research you had had done, you put in the NHS assets and you demanded no return on the NHS brand, which is a marvellous brand, for which you would in the private sector make a substantial charge. You paid a strategic premium of between £2.5 million and £4 million and spent £2.5 million on professional fees. You are shoving a lot of money into this. The Dr Foster people are not putting all that much in and yet if they want out in three years you have to buy their shares back. What kind of a deal is that?

Mr Taylor: The fact of the matter is that we have paid effectively £7.6 million to the Dr Foster shareholders to buy out 50% of their interest in the company. The indicative value which KPMG gave to the company was £10-15 million. Through a process of negotiation we agreed a value of £19 million and then with an agreement we have also put working capital into the business. I was advised that that represented good value and I am confident that that will be proved to be good value, possibly after I have gone but I am confident that that will prove to be the case.

Professor Lievesley: When I came into the Information Centre one of the things that I wanted to establish was that this was indeed good value and we discussed it at great length with both the Commercial Directorate and KPMG. As I mentioned, we employed Ernst & Young to help us in the negotiations and the questioning of KPMG, and my board was satisfied that we were not paying over the odds, that this was good value for us. Indeed, just recently I have had an interest expressed from a private sector company that would like to purchase our half shares at a considerable profit.

Q108 Mr Mitchell: Sell them and then we can all go home.

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Professor Lievesley: We might consider that.

Q109 Mr Mitchell: Dr Kelsey is the man who sold the idea and scoped the deal, but he is now employed not at the Information Centre but by Dr Foster Research which took 5% of the assets related to the private sector out and is seconded to you for three years. What happens if he leaves because the value of the joint deal is going to be significantly reduced if he walks out?

Professor Lievesley: We have an arrangement that we have to have a year's notice if he is going to leave. He is committed to the future of Dr Foster Intelligence, very committed.

Q110 Mr Mitchell: You hope.

Professor Lievesley: I am convinced of that and, as I have indicated already, I do not think that we should concentrate on just one individual. Indeed, one of the things that has happened over the last year is the building up of that team at Dr Foster Intelligence and the building up of the Information Centre and our skills.

Q111 Mr Mitchell: Has the Information Centre got the skills to be an equal partner? Some seem to doubt that.

Professor Lievesley: The OGC raised that question in their peer review.

Mr Taylor: It was not the OGC. It was the peer review.

Professor Lievesley: In the peer review carried out on behalf of the OGC, sorry, they raised the issue as to whether or not we had the skills. For that reason I put more resources into building the Information Centre skills and took more time over the negotiations. That is over a year ago and I think you will see a very different Information Centre now from the one that existed then, so yes, I think we do have the skills.

Q112 Mr Mitchell: Let me ask you about the service level agreement. I see that that contained performance indicators and was to be one of the ways that the joint venture could demonstrate value for money, and yet it was dropped. Why was it dropped?

Professor Lievesley: It was my decision that we did not go ahead with the service agreement.

Q113 Mr Mitchell: Why?

Professor Lievesley: Because we had a review within the Information Centre about what it was that we wanted the joint venture to achieve and this was not about providing services to the Information Centre; this was about providing services to the NHS. It was inappropriate that we put these through. I felt very strongly that if we wanted to contract out work of that sort we needed to go to competitive tender and that we would do that at a later date when we had decided it was appropriate to do it. We have key performance indicators anyway as part of our monthly management. I am a non-executive of Dr Foster Intelligence, and they report on key performance

indicators to us as part of that management process, so the key performance indicators were not dependent upon a service level agreement.

Q114 Mr Mitchell: I see that the Information Centre is going to be an arm's length partner and it will have to go out to tender—this is at paragraph 1.47—“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”. Again, it looks like a bum deal.

Professor Lievesley: I think the benefits are to the NHS rather than the benefits being directly to the Information Centre, though we are deriving benefits in terms of learning from the skills and expertise.

Q115 Mr Mitchell: What are those benefits?

Professor Lievesley: The benefits to the NHS are in terms of getting better use of information for the development of policies, for the delivery of the services, for the management of those services, for patient choice.

Q116 Mr Mitchell: And is that measurable in any way?

Professor Lievesley: Yes, and we have key performance indicators that measure those, so we have the public benefits of the company.

Q117 Mr Davidson: I support the general idea of making better use of the information that you have but you did say at one point that you saw this as an investment. Can you clarify for me how many similar sorts of investments in different areas you have?

Mr Taylor: We have as a Department also had joint ventures with Xansa on the shared services deal and we have got a sort of similar arrangement on the LIFT (NHS Local Improvement Finance Trust) schemes with Partnerships UK (PUK).

Q118 Mr Davidson: So that is two. Just so that I have a general feel for it, there are two similar investments, are there?

Mr Taylor: Broadly speaking.

Q119 Mr Davidson: I just wanted to be clear about that. Again, I am slightly confused about the relationship here. I am not quite clear what the Information Centre actually does if Dr Foster as this joint company is actually supplying all the information to the National Health Service.

Professor Lievesley: It is not supplying all of the information. It is not an exclusive relationship, as I mentioned before.

Q120 Mr Davidson: So why to the Information Centre?

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Professor Lievesley: The Information Centre has responsibility for understanding the information needs across the NHS, for collecting information, for setting standards in terms of the quality of that information, for delivering that information, and we are part of National Statistics. We have to deliver the information according to the protocols for National Statistics.

Q121 Mr Davidson: So you collect it all?

Professor Lievesley: We collect or we work with other bodies to collect. Sometimes we sub-contract, sometimes we are the contractors, and Dr Foster Intelligence comes at the end of that process and it is actually about creating value-added services and products with the data. The data are in the public arena.

Q122 Mr Davidson: So you get all the figures in, you put them into Dr Foster and they come out at the end in a manner that makes sense?

Professor Lievesley: We deliver that information to a wide range of users, of which Dr Foster Intelligence is one. They then deliver that in exciting new ways to the front line of the NHS.

Q123 Mr Davidson: And back to yourself, presumably?

Professor Lievesley: We do not actually utilise any of the services of Dr Foster Intelligence, which is why we stopped the service level agreement with them because these are really benchmarking products for the front line.

Q124 Mr Davidson: Can I clarify in that case the question of competition? You mentioned that you had other agencies and organisations with whom you dealt. We have a section here in the Report where the other health informatics companies do seem to feel that Dr Foster have got an inside track. They say that quite repeatedly in this section of the Report. The Report here says that you said that Dr Foster Intelligence: “will not have any privileged access to data that it collects”, so presumably all of this information which is fed to Dr Foster could be fed to anybody else.

Professor Lievesley: It can, provided that they get the appropriate agreements through things like the Patient Information Advisory Group, yes.

Q125 Mr Davidson: And they in turn could market to NHS agencies their analysis of exactly the same data?

Professor Lievesley: Exactly. There is a competitive process. I should say too that I am working with a number of companies and there are other companies who have not complained that there is an exclusive relationship. There are many companies we are working with that are very happy about the plurality of this.

Q126 Mr Davidson: According to this, though, the Information Centre made a commitment as part of the joint venture agreement to promote the business of Dr Foster Intelligence. That would

indicate to me that you are actually giving them the inside track, because what else does it mean if you give it to promote the business of Dr Foster Intelligence? Presumably it means that you are treating them in a manner different from others.

Professor Lievesley: No, we do not treat them in any way differently. They do not get any favourite treatment in respect of access to data, privileged access, early access or anything of that sort. What I will do, obviously, when I am out in the NHS is that I will talk to the NHS about services and products but not exclusively about Dr Foster Intelligence.

Q127 Mr Davidson: Okay. As part of the joint venture agreement you made a commitment to: “generally use its endeavours to promote business and the interests of Dr Foster Intelligence and its subsidiary undertaking”, and also to “use Dr Foster Intelligence as the principal vehicle and channel for NHS market research and knowledge”. That is in paragraph 1.60. That does not seem to me, on reading that, to be a situation of equality between suppliers.⁹

Professor Lievesley: We do have relationships with a wide range of organisations. Some organisations might have particular expertise in respect of certain parts of the NHS and we might be working—

Q128 Mr Davidson: But you have signed up to a deal here which says to: “use Dr Foster Intelligence as the principal vehicle and channel”.

Professor Lievesley: Whenever we are determining whether or not we have services we put them out to competitive tender.

Q129 Mr Davidson: In that case you must be breaking the agreement. You cannot on the one hand be even-handed and on the other hand use Dr Foster Intelligence as the principal vehicle and channel.

Professor Lievesley: We are being even-handed.

Q130 Mr Davidson: So you are breaking the terms of the agreement then?

Professor Lievesley: I think that the terms of the agreement were really about trying to ensure that the Information Centre was going to work in co-operation with Dr Foster Intelligence in order to—

Q131 Mr Davidson: It does not say that at all. It says to: “use Dr Foster Intelligence as the principal vehicle and channel”. It does not say anything about just working with them. It says using them as the main vehicle.

Professor Lievesley: We have a non-exclusive arrangement with Dr Foster Intelligence.

Q132 Mr Davidson: Yes, but they have got to be, as the result of the deal that you signed, the principal vehicle and channel. If I were a competitor I would say, “This is a rigged market”. It is obvious. You have either signed this agreement with Dr Foster in

⁹ Ev 20

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good faith, in which case you are obliged to deal with them as your principal vehicle, or you did not, and if you did then it means that it is not an even playing field for other people. I think you can understand the circumstances if you are another company. Here is the NHS giving its brand name and its prestige to one particular company and you have got others wanting to compete in the field and you have got a commitment to deal with this company before all others. How can that be fair?

Professor Lievesley: The situation is that in practice we are working with a range of companies. We have put work out to contract where we need services. We certainly do work in co-operation as part of Dr Foster Intelligence. We need Dr Foster Intelligence to be a success, of course.

Q133 Mr Davidson: Okay. We are not going to get much further with that. Can I ask about this being a cosy relationship? It seems to me that this is a very cosy relationship that has evolved. Is there anybody in Dr Foster, either then or now, who could be considered to have had some sort of inside track to the NHS or to government by being a special adviser or anything similar?

Mr Taylor: I am not sure I understand your question.

Q134 Mr Davidson: Okay; shall I put it again then?

Mr Taylor: Could I say that it is certainly the case that members of Dr Foster before we did this deal saw it as part of their job to be well networked, to have dealings with ministers, special advisers and so on. That is certainly the case.

Q135 Mr Davidson: Yes, but were any of them special advisers?

Mr Taylor: No.

Q136 Mr Davidson: Or anything similar? Anything that could cause concern and a feeling that they had an inside track which was not available to anyone else?

Mr Taylor: I am not aware of that.

Q137 Mr Davidson: Could you maybe take that away and come back and let me know whether or not on reflection you think there is something that could cause some concern? I accept that you do not carry all this in your head.

Mr Taylor: The only reason I am hesitating slightly is that *Private Eye* carried a story which related to the move of an employee of Dr Foster into the Department of Health and that is documented. There is no particular issue about that, but I am happy to provide you with the details of it.

Q138 Mr Davidson: Can I just make it clear that I have not read *Private Eye*. It may be wrong but I think up my own questions generally.

Mr Taylor: That was the only thing that was going through my mind as you were speaking. I am confident that there is no such relationship but I

will reflect on it and come back to you if I think there is anything which I should draw to your attention.

Professor Lievesley: And I certainly am not aware of anything.

Q139 Chairman: *Private Eye* says that “there were also alarming conflicts of interest. The same government adviser, KPMG, designed the deal specification and whilst arranging the JV with Dr Foster”. Is that what you are talking about? I have got *Private Eye* in front of me.

Mr Taylor: No, I do not understand what they mean by that.

Q140 Chairman: You do not understand what they are talking about in that? Do you want to take it away with you?

Mr Taylor: It is clear that KPMG were our advisers throughout this deal, but I --- I am sorry.

Chairman: All right. You do not have to answer now but if you want to take it away I can give it to you.

Q141 Mr Bacon: Mr Taylor, you said you took advice and the KPMG advice was that the businesses was worth £10-15 million, but you also—and I am quoting from a Department of Health press release—stated that professional advice was taken throughout the planning and negotiation of the joint venture and that you followed this advice at each stage. You said something similar earlier. Am I to take it that you were advised to pay more than the KPMG valuation of £10-15 million and, if so, by whom?

Mr Taylor: We were advised by the Commercial Directorate primarily, who were my key advisers, if you like, inside the department on the deal, and I think with the support of KPMG.

Q142 Mr Bacon: “I think”, I am afraid, does not really cut it for me, Mr Taylor. What I want to know is what did your advisers in the end advise you to do? You said very clearly that you followed the advice at all stages. My question is, was the advice from your professional advisers, not from employees of the Department of Health like the Commercial Directorate, in the end to pay more than the indicative valuation of £10-15 million? Yes or no?

Mr Taylor: The advice was that £19 million represented good value.

Q143 Mr Bacon: Whose advice?

Mr Taylor: Our advisers.

Q144 Mr Bacon: No. Who gave you that advice?

Mr Taylor: KPMG.

Q145 Mr Bacon: And Ernst & Young as well?

Mr Taylor: They were not, I think, called upon.

Professor Lievesley: They were not called upon to do that.

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Q146 Mr Bacon: So KPMG in the end advised you to pay more, in other words £19 million, than their own initial valuation? Is that correct?

Mr Taylor: They felt that it was a reasonable price.

Q147 Mr Bacon: I am just looking for a yes.

Professor Lievesley: Yes.

Q148 Mr Bacon: Could you send us the advice please, the initial indicative valuation of £10–15 million and the advice that it was worth £19 million?¹⁰ That would be very helpful. The payment of £2.5 million referred to on page 10, is a deferred payment, deferred for 18 months, Professor Lievesley, from the Information Centre to Dr Foster. Is that payable in all circumstances or is it performance related?

Professor Lievesley: It is payable in all circumstances except if there were some liabilities or something that was not declared at the time. We know of no reason why that will not be paid in July.

Q149 Mr Bacon: It has got nothing to do with the performance of the business?

Professor Lievesley: It has not got to do with the performance of the business, no.

Q150 Mr Bacon: Because it was KPMG, I take it, was it, who, in paragraph 1.54, predicated the business case on sales growing by over 1,000% over three years. It says in paragraph 1.54, “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 . . . were lowered by 24% between the valuation carried out in August 2005 and . . . [the] Business Plan produced in early 2006”. The difference between those sorts of growth rates and the original 1,000% would produce a significant decline in estimated performance, would they not?

Professor Lievesley: They would.

Q151 Mr Bacon: But the £2.5 million payment is not dependent on any of that?

Professor Lievesley: It is not dependent on it.

Q152 Mr Bacon: Thank you; I just wanted to check that. The market analysis, which is referred to in paragraph 1.13b on page 15, “Workstream 2”, says that Workstream 2 is to undertake market analysis. Mr Taylor, which companies did you talk to when you were doing the market analysis?

Mr Taylor: KPMG who did, I think, the market analysis with our Commercial Directorate, I do not think did talk to other commercial companies.

Q153 Mr Bacon: That is my information as well. Why did they not talk to CHKS?

Mr Taylor: They carried out a review of what CHKS were doing.

Q154 Mr Bacon: Just desktop-based research, was it?

Mr Taylor: It was essentially, yes.

Professor Lievesley: If I could add—

Q155 Mr Bacon: In a minute. Can I ask which company, Dr Foster or CHKS, had the larger share of the NHS market at that time?

Mr Taylor: My understanding is Dr Foster.

Professor Lievesley: In England Dr Foster.

Q156 Mr Bacon: National Audit Office, would you like to comment on that because I have been told the reverse, that CHKS had a larger share of the NHS market at that time?

Ms Taylor: Certainly CHKS had a share of the market in Wales. Our understanding—and I will have to ask one of my colleagues—is that they had a margin greater in NHS in England.

Mr Fisher: In certain benchmarking products.

Q157 Mr Bacon: Right, but nonetheless, as it makes clear in paragraph 1.53, “the turnover of the two biggest specialist companies by far,”—this is presumably a global figure—“Dr Foster Ltd and CHKS, were . . . £6.8 million and £5.1 million respectively”, so they are both quite large businesses and by far the biggest players; that is right, is it not?

Mr Taylor: Yes.

Q158 Mr Bacon: But you only talked to one? You did not talk to the other? You did a market analysis, but you did not talk to the other, and you spent £2 million on advice.

Mr Taylor: Yes.

Q159 Mr Bacon: Including this market analysis, but you only talked to one company?

Mr Taylor: That is right.

Q160 Mr Bacon: Fine; I just want to be sure about that. The meeting that is referred to in paragraph 1.9 is 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”. Can you just say who in that meeting was the Group Director of Strategy and Business Development?

Mr Taylor: Me.

Q161 Mr Bacon: That is you?

Mr Taylor: Yes.

Q162 Mr Bacon: Yes, I thought so. Who was the Chair of the NHS Appointments Commission who was also Chair of the Commercial Advisory Board?

Mr Taylor: Sir William Wells.

Q163 Mr Bacon: And who was the Chief Executive of Dr Foster Ltd?

¹⁰ Evidence received, not printed.

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Mr Taylor: Tim Kelsey.

Q164 Mr Bacon: And he is the same Chief Executive referred to in paragraph 1.28, “One of the key assets of Dr Foster Ltd, its Chief Executive . . .”; this is on page 19. That again refers to Tim Kelsey?

Mr Taylor: Yes.

Q165 Mr Bacon: With regard to the put option, which was referred to in paragraph 1.55, and Mr Dunne asked about this earlier, is there a minimum price at which the put option can be put on to you? Are you obliged to pay a certain amount?

Professor Lievesley: We are obliged to pay the market value and that is independently assessed.

Q166 Mr Bacon: By whom?

Professor Lievesley: That is to be determined by us.

Q167 Mr Bacon: So you can go out to independent advisers and figure out what it is worth?

Professor Lievesley: That is right. That is exactly the situation.

Q168 Mr Bacon: My next question is about the present Chief Executive; this is Jake Arnold Forster. What is his background?

Mr Taylor: He is, I think, a journalist by background who has been with Dr Foster, I think, since pretty early on.

Q169 Mr Bacon: I have come across something here which I found on an organisation called democraticdeficit.org.uk. It says, “Googling Jake Arnold Foster returns a website document dated 23 January 1996 referring to a public hearing of the Nolan Committee study into local government where a witness of that name”—Jake Arnold Forster; it is Forster, not Foster, by the way,—“is listed as the deputy editor of the *Local Government Chronicle*. This is the same person, is it not?”

Professor Lievesley: That is the same person. He worked for EMAC before.

Q170 Mr Bacon: Yes. He was the Managing Director of EMAC Public Sector Management?

Professor Lievesley: That is right.

Q171 Mr Bacon: What is the relationship between Jake Arnold Forster, who is now Chief Executive of Dr Foster, and Josh Arnold Forster?

Professor Lievesley: I have never heard of Josh Arnold Forster.

Q172 Mr Bacon: I am looking at an answer to a parliamentary question on 21 July 2005 and lists special advisers, and there is somebody called Josh Arnold Forster who is listed as the special adviser to the Secretary of State for Defence. When I googled Josh Arnold Forster I got loads of things suggesting that Josh Arnold Forster was a journalist. I do not know if Josh Arnold Forster and Jake Arnold Forster are the same person or not. Do you?

Professor Lievesley: I have never heard of Josh Arnold Forster, so I would not be able to say if they were the same person.

Q173 Mr Bacon: Is it possible that it is the same person, Josh and Jake are after all diminutives? Is it possible that this is the same person?

Professor Lievesley: It is possible.

Q174 Mr Bacon: But you do not know that?

Professor Lievesley: No.

Q175 Mr Bacon: Who was the Secretary of State for Defence at that time?

Mr Taylor: When was this, sorry?

Q176 Mr Bacon: This was in 2005. I have a feeling it was Dr John Reid, was it not?

Mr Taylor: It may have been, yes. It probably was.

Q177 Mr Bacon: And had he not been Secretary of State for Health before that?

Mr Taylor: He was, yes.

Q178 Mr Bacon: Is it possible you could find out, since he was a government employee, this Josh Arnold Forster, if it is the same person or not, or perhaps if they are brothers?

Mr Taylor: I am sure we can find out.¹¹ What I am sure about is that Jake Arnold Forster was not a special adviser to John Reid in 2005.

Q179 Mr Bacon: Okay. It would be helpful if we could be clear about the relationship, if there is one, because it is quite an unusual name. Matt Tee was the person you were referring to earlier when you talked about the employees?

Mr Taylor: Yes.

Q180 Mr Bacon: You took him on as Acting Communications Director at the Department of Health?

Mr Taylor: Yes.

Q181 Mr Bacon: When you took him on as Acting Communications Director did he have a financial interest in Dr Foster’s?

Mr Taylor: He did, yes.

Q182 Mr Bacon: He was the Business Development Director of Dr Foster’s?

Mr Taylor: He was.

Q183 Mr Bacon: Does he still have a financial interest in Dr Foster’s?

¹¹ *Note by witness:* Jake Arnold-Forster and Josh Arnold-Forster are brothers. Only Jake Arnold-Forster had any involvement with the subject of this Report, as Chief Executive of Dr Foster intelligence. Josh Arnold-Forster has never been either a civil servant or a special adviser in the Department of Health.

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Mr Taylor: At the time we took him on he was an employee of Dr Foster, and we took him on secondment. He is now no longer an employee of Dr Foster and he has a small shareholder interest, effectively, in the company.

Q184 Mr Bacon: I would just like to ask you one final question and that is about the shareholdings. I understood you to have said to Mr Wright earlier that you were not necessarily aware of all the shareholders in Dr Foster's. Is that right?

Mr Taylor: At the time of the due diligence and the deal I was aware of a list of who the shareholders in Dr Foster were at the time, yes.

Q185 Mr Bacon: And their percentage shareholdings?

Mr Taylor: I think we did know about those.

Q186 Mr Bacon: Is it possible you could send us that information with, based upon the valuation that was done and the purchase price into the joint venture, what their percentage interest in each shareholding was worth? By this I mean in each

entity because there are several Dr Fosters, are there not? There is Dr Foster Intelligence, there is Dr Foster Ltd, there is Dr Foster Research and there is Dr Foster LLP. Is it possible that you could send this information about all of these so that it is crystal clear who owned what, when and who had what interest and when, in other words, at the time the deal was done, at the time Mr Tee joined the Department of Health on secondment and then when he was made permanent, and what it is now?¹²

Mr Taylor: Yes.

Mr Bacon: Thank you.

Chairman: I do not think anybody else has any further questions so that concludes our inquiry, Mr Taylor. I should say that this Committee has no objection to joint ventures between the public and private sectors as long as they are based on a fair and competitive and open process, and my initial conclusion is that this was glaringly lacking in this case. There was also blurring of lines between the position of Dr Foster as an adviser and as a joint venture partner. Lastly, in the absence of a competitive process it is unclear whether or not the taxpayer paid over £4 million more for this than he should have done, so I am afraid, given all we have heard this afternoon, despite your convincing and calm demeanour on a difficult wicket, that you can expect a very tough Report. Thank you very much.

¹² Ev 20

Supplementary memorandum submitted by the Department of Health

The circumstances in which the potential for a partnership with Dr Foster was developed

A number of questions related to the circumstances under which we began exclusive discussions with Dr Foster about the potential for a commercial partnership.

My initial contact with Tim Kelsey was in the context of the process of setting up the Information Centre. It is the first time I had met him. He impressed me—and Sir William Wells (Chair of the NHS Appointments Commission and of the Department's Commercial Advisory Board), was also present—with his vision for improving the use of information in the NHS, and his understanding of the potential role of the IC (Information Centre) in that context. He wanted it to succeed—recognising it as a potential competitor to Dr Foster—because he saw it has having a crucial role in raising capability and capacity in informatics across the NHS, which would, of course, benefit companies like his but also deliver improvements in services to patients. He was frustrated at the lack of corporate leadership from the NHS and the Department on this issue.

He was one of the first people I came across who 'got' the vision for the Information Centre that I, as its sponsor, with Ministers was developing.

I was, of course, aware of Dr Foster's growing reputation and of the national profile of the organisation—and Tim Kelsey, in particular—had in the NHS. Sir William Wells—who was meeting Tim Kelsey for the first time—suggested it might be worth thinking about some form of partnership with Dr Foster to capture their leadership and marketing flair. He did some early due diligence through our Commercial Directorate and suggested to me that Dr Foster was almost certainly looking for investment.

When I met Tim Kelsey in January the possibility of finding some way of engaging the particular skills of Dr Foster was already, therefore, in mind. In fact, Tim Kelsey himself mooted the possibility of a public/private sector partnership at the meeting; and it went on from there.

At that stage a possible joint venture with the Information Centre was only one of a range of options under consideration. The key question under consideration was: might there be a benefit to DH in taking some form of interest in Dr Foster, as a means of taking a more direct corporate DH/NHS leadership role in promoting the better use of information across the NHS.

A number of options were considered: straight acquisition of Dr Foster; the Department taking a stake in Dr Foster (ie some form of joint venture); the IC entering into a contract with Dr Foster for services; or an outsourcing agreement. The joint venture quickly emerged as the front-runner. However, it needed to be tested on the basis of due diligence, market analysis and business and commercial fit.

It was at that stage I sought approval from Ministers to enter into without prejudice discussions with Dr Foster about a possible commercial partnership. Neither they nor their special advisers had any role in the matter prior to this point; and I would like to state emphatically, for the avoidance of any doubt, that while I kept Ministers and, as appropriate special advisers, informed of the progress of these discussions—and; of course, sought Ministers approval for the final decision, they took no active part in the process. At no stage did I come under any pressure, direct or indirect, which might have influenced the course or outcome of the negotiations in any way. In particular, to answer directly a question put by Mr Davidson, I was involved in these negotiations throughout the process and I can confidently reassure him and the Committee that there was no question of Dr Foster having an ‘inside track’ in relation to the deal or contacts which might have improperly affected its outcome.

This was a strategic decision made to improve the way in which the NHS uses its information. The Information Authority—with a budget of over £200 million—had faded to make a sufficient impact in this area. The Information Centre was being created—but without early access to the kind of communication and marketing skills required to make an impact of the kind the Information Authority had failed to deliver.

A number of small businesses were (and are still) operating in this health informatics area. But Dr Foster stood out in terms of national profile and the range of its products. What we saw in Dr Foster was a small leadership team, with the vision, flair and marketing skills that the Information Centre needed. It was those qualities, combined with the strong product range that they had developed, which made them strong potential partners for the IC: bringing Dr Foster’s vision, flair, marketing skills and product range to bear on the utilisation and presentation of NHS Information, alongside and in tandem with the professionalism of the IC in data collection and analysis.

Having identified the potential for a commercial opportunity to acquire skills and expertise we needed, we of course recognised the need to do a full options appraisal; this included a market analysis carried out by KPMG as part of the due diligence process. Through this analysis, Dr Foster stood out as manifestly the right fit for a commercial partnership with the IC. KPMG found that, of the companies engaged in data healthcare solutions, only two were focused exclusively on clinical data benchmarking, and of these only Dr Foster provided an integrated product portfolio on nationally-based data sets. The conclusion of KPMG’s due diligence report was: “We consider Dr Foster to be the only private sector organisation capable at present of helping HSCIC to meet its key strategic requirements and objectives.”¹

The indicative valuation of Dr Foster and the pricing of the deal

As indicated in the NAO Report, KPMG were engaged by the Department to provide an indicative valuation of Dr Foster Ltd to commence the commercial negotiations over a potential deal. Their report, which is limited in scope and appropriately caveated, provided an indicative valuation of Dr Foster Ltd as a stand alone business of £10–£15 million.² The valuation took no account of any synergies that might arise as a result of the formation of the joint venture.

KPMG then supported the Department and the Information Centre in an arm’s length commercial negotiation with Dr Foster. They provided advice and scenario analyses, based on the expected future profitability of the joint venture, to support the decision making process. However, the final decision on an appropriate value for the contribution of Dr Foster’s business was a matter for the Department and the Information Centre. KPMG did not, therefore, provide formal advice that the Dr Foster contribution was “worth” £19 million (or any other amount). KPMG were party to the deliberative process, which led to the decision to reach a deal at this effective valuation. I would not have recommended the deal to Ministers had I not been confident that both our Commercial Directorate and KPMG felt this was a good outcome in value for money terms.

The outcome of the negotiations was an agreement to create Dr Foster Intelligence Ltd on the terms set out in diagram two on page 10 of the NAO Report, Mr Dunn (Question 69) asked about the financial contribution from Dr Foster and the Information Centre to the starting point of the joint venture.

Dr Foster Ltd bought out all its NHS business which went into the new company (Dr Foster Intelligence). Effectively this was valued at £19 million. This was higher than the indicative valuation of Dr Foster Ltd as a standalone business used for the purpose of the negotiations, because of the synergy that was being created by the joint venture and the opportunities it created. We regarded this as good value for the new business.

The agreement that we reached was to pay £7.8 million to the Dr Foster shareholders in two stages to give up 50% of their business. That is equivalent to 50% of the indicative valuation of the Dr Foster business.

In addition we invested £4.4 million in the working capital of the new business and Dr Foster contributed £0.6 million to the working capital of the business.

¹ Evidence received, not printed.

² Evidence received, not printed.

In short we made a cash investment of £12 million in a business valued at £24 million and gained a 50% interest in all the products, intellectual property and marketing communications capability of Dr Foster.

One of the suggestions in the NAO Report is that we might have sought advice from the Shareholder Executive on our approach to the acquisition and the negotiations. I agree that this might have been helpful; and it is perhaps in retrospect a point that might have been made by the NAO at the time they were carrying out inquiries into the process prior to a decision being reached. We have, however, subsequently taken the view of the Shareholder Executive on the approach to valuation in a case such as this.

The Shareholder Executive's view is consistent with the view we took: namely that for a private (untraded) company such as Dr Foster Ltd there is no pre-established market value and the value is generally determined as a result of an arms length agreement between a willing buyer and a willing seller. Valuers will often form a view on the standalone or intrinsic value of a private business by looking at expected future cash flows and comparable companies and transactions, where there is a benchmark. The value of the company's assets (net book value) would not be a normal valuation basis for a services business such as Dr Foster. A more common valuation basis would be expected future cash flows.

The Shareholder Executive has also confirmed that bidders will pay more than the standalone or intrinsic value of a private company, where they believe they can extract synergy benefits which would not be available to the business on a standalone basis.

This is exactly the position we arrived at. I am confident that the deal we reached was value for money; that we would have come down to exactly the same form of negotiation with Dr Foster had we tendered the opportunity for a joint venture competitively and Dr Foster had been selected as 'preferred partner'; and that the joint venture will prove profitable as well as producing the value that we are already seeing in terms of services to the NHS.

Question 127: (Mr Ian Davidson): *Equality between suppliers*

Mr Davidson raised an issue about the impact of the joint venture on market opportunities for other providers of health informatics, on which Professor Denise Lievesley felt further clarification might be helpful. The Information Centre entered into a commercial relationship with Dr Foster on the basis of the joint venture agreement referred to in paragraph 1.60 of the NAO Report. Our legal advice on clause 10.1.4 of the agreement is that the terms used—"generally use its endeavours to promote business and the interests of Dr Foster Intelligence"—indicate a wish to promote the interests of Dr Foster Intelligence, but not at the expense of the Information Centre's broader public sector obligations. Thus, the Information Centre has supervening obligations, which trump any others in the agreement. This is acknowledged by Dr Foster Intelligence. One such supervening obligation is the Information Centre's responsibility to comply at all times with procurement law, which cannot in any way favour or operate to promote "the interest of Dr Foster Intelligence" (clause 11 A).

It should also be noted that the joint venture agreement enables the Information Centre to enter into other "strategic partnership arrangements" to further the Information Centre's statutory functions (which are wide, and listed in schedule 3). As the NAO Report makes clear, the Information Centre has the right to enter into other agreements, and the joint venture agreement does not preclude it from entering into new relationships with other companies.

Question 186 (Mr Richard Bacon): *Shareholdings*

The number of shares in each entity and what that represents as a percentage of the total shares in each entity held by each shareholder or partner at all times from the first discussions in November 2004 to the present; the value of each of these shareholdings at all times from the first discussions in November 2004 to the present; and all changes in ownership of shares in each entity from the first discussions in November 2004 to the present, showing the buyer, the seller, the total consideration paid, and the date of change of ownership.

Structure

Until January 2006 when the JV commenced there was only one company. Dr Foster Ltd. Disclosed below is information about the shares in Dr Foster Ltd from November 2004 to January 2006. Following the JV deal, Dr Foster Ltd became wholly owned by Dr Foster Intelligence Ltd. Dr Foster Intelligence Ltd is in turn 50% owned by Dr Foster Holdings LLP and the Information Centre. Dr. Foster Research Ltd is wholly owned by Dr Foster Holdings Ltd.

There are no shares in an LLP; members have interests. From January 2006, individual ownership was in Dr Foster Holdings LLP.

November 2004 to January 2006—Dr Foster Ltd

The table below details the interests in Dr Foster Ltd (then the only Dr Foster company) in November 2004.

<i>Shareholder/LLP member</i>	<i>November 2004</i>		<i>January 2006</i>	
	<i>Shares</i>	<i>% of total</i>	<i>Shares</i>	<i>% of total</i>
Tim Kelsey	27,315	15.9%	30,493	12.0%
Roger Taylor	26,600	15.5%	28,611	11.2%
Herald Ventures Limited Partnership	—	0.0%	28,847	11.3%
Close Brothers Investments Ltd	22,223	13.0%	22,223	8.7%
Bamboo Investments (Isle of Man) Ltd	14,815	8.6%	14,815	5.8%
Herald Ventures Limited Partnership II	—	0.0%	12,821	5.0%
Jake Arnold-Forster	7,143	4.2%	11,913	4.7%
Roger Killen	13,300	7.8%	15,311	6.0%
Herald Ventures Limited Partnership III	—	0.0%	10,257	4.0%
Barton Street Ltd (Barchester Group)	12,438	7.3%	12,438	4.9%
Vavasseur Overseas Holdings Ltd	6,687	3.9%	6,687	2.6%
Mr John Brown	5,111	3.0%	5,111	2.0%
Close Brothers Corp Finance	—	0.0%	—	0.0%
Frank Hollendonor	3,297	1.9%	4,906	1.9%
Steven Bellamy	3,572	2.1%	3,572	1.4%
Ms Anu Vilganen	2,500	1.5%	2,500	1.0%
Nigel Medhurst	—	0.0%	1,333	0.5%
Yili Holdings Ltd	1,296	0.8%	3,307	1.3%
Mr Julian Jarman	2,500	1.5%	2,500	1.0%
Mark Butt	1,584	0.9%	5,782	2.3%
Double Eight Limited	—	0.0%	2,011	0.8%
Bittar International Inc	—	0.0%	1,408	0.6%
Nexus Structured Finance Ltd	1,862	1.1%	1,862	0.7%
Luton Investment Establishment	291	0.2%	1,297	0.5%
Lady Kate Salomon	1,185	0.7%	1,185	0.5%
NCL (Nominees) Ltd	1,112	0.6%	1,112	0.4%
Gryphon Trading SA	—	0.0%	1,006	0.4%
John Reilly	1,297	0.8%	1,297	0.5%
Mr William Salomon	1,185	0.7%	1,185	0.5%
Matt Tee	—	0.0%	1,137	0.4%
Mr Michael Cook	774	0.5%	774	0.3%
Mr Ray Pattison	774	0.5%	774	0.3%
Mr Peter Buckley	774	0.5%	774	0.3%
Mr John Randolph	741	0.4%	741	0.3%
Stewart Millman	—	0.0%	1,035	0.4%
Aeon Management Establishment	291	0.2%	1,297	0.5%
Mr Geoffrey Bowden	853	0.5%	853	0.3%
Ellen Klaus	143	0.1%	810	0.3%
Ms Adele Collins	1,000	0.6%	1,000	0.4%
Mr Jonathan Holborow	741	0.4%	741	0.3%
Mr John Horner & Barnett Waddingham	450	0.3%	450	0.2%
Mr Charles McIntyre	593	0.3%	593	0.2%
Ms Carolyn Townsend	593	0.3%	593	0.2%
Federated Trust Corporation Ltd	593	0.3%	593	0.2%
Arglen Properties Ltd	667	0.4%	667	0.3%
Mr John Horner	667	0.4%	667	0.3%
Mr Jeremy Bailey	445	0.3%	445	0.2%
Mr Egon Vorfeld	466	0.3%	466	0.2%
Mr David Charters	466	0.3%	466	0.2%
Mr Gavin Henderson	466	0.3%	466	0.2%
Mr Mark Gardiner	297	0.2%	297	0.1%
Mr Dennis Killen	278	0.2%	278	0.1%
Mr Richard Lamb	299	0.2%	298	0.1%
Forna Ltd	291	0.2%	291	0.1%
Mr Adrian Stevensen	291	0.2%	291	0.1%
Mr Derek Morgan	223	0.1%	223	0.1%
Mr Peter Apps	200	0.1%	200	0.1%
Ms Claire Read	200	0.1%	200	0.1%

<i>Shareholder/LLP member</i>	<i>November 2004</i>		<i>January 2006</i>	
	<i>Shares</i>	<i>% of total</i>	<i>Shares</i>	<i>% of total</i>
Rhidian Wynn Davies	143	0.1%	143	0.1%
Marc Farr	—	0.0%	100	0.0%
Ms Maja Dragovic	150	0.1%	150	0.1%
Ms Violeta Radovic	150	0.1%	150	0.1%
Mr Jeremy Bolt	117	0.1%	117	0.0%
Gita Mendis	—	0.0%	100	0.0%
Rob Forbes	—	0.0%	100	0.0%
Steve Middleton	—	0.0%	100	0.0%
Julia Howes	—	0.0%	67	0.0%
Melanie Wardle	—	0.0%	67	0.0%
Saba Syed	—	0.0%	67	0.0%
Dan Collins	—	0.0%	67	0.0%
Jeff Collins	—	0.0%	67	0.0%
Karin Mochan	—	0.0%	33	0.0%
Robert Palgrave	—	0.0%	33	0.0%
Diane Gould	—	0.0%	33	0.0%
Steve Littlemore	—	0.0%	33	0.0%
Ben Jones (P Dev)	—	0.0%	33	0.0%
Jacqueline Levy	—	0.0%	33	0.0%
Perry Rich	—	0.0%	33	0.0%
Alistair Johnston	—	0.0%	33	0.0%
Ben Jones (DFRL)	—	0.0%	33	0.0%
Louise Morgan	—	0.0%	33	0.0%
Total	171,449	100.0%	254,835	100.0%

Between, November 2004 and January 2006, there were no share transactions in Dr Foster Ltd and the only share issue was of 262 shares to Stewart Millman in December 2004. This was in lieu of fees as a non-executive director of Dr Foster Ltd, and the price of issue was a previously contracted £18 per share.

At the time of the JV deal there were a number of issues of shares in Dr Foster Ltd related to the exercise of options and conversion of loan notes. These all happened at the same time and are therefore shown as interests in Dr Foster Ltd as they entered into the JV after conversion of outstanding rights over shares—no shares were transferred.

Under the structure of the JV deal, a facility was created by which Dr Foster Ltd shareholders could invest their cash entitlement under the deal in more shares if an equal number wished to realise more cash (a mix and match facility). The price at which this trading facility was effected was the same price as the Information Centre invested (ie valued DFI at £24 million) and this facility was only available at the time of the deal. This impacted the ongoing interests of members of the LLP relative to each other but not the overall position.

January 2006 to March 2007—Dr Foster Holdings LLP

An LLP is not obliged to disclose its members' interests, only who are members in the annual return. Therefore, we cannot provide detail on individual members' interests without their consent. All the previous shareholders in Dr Foster Ltd (as detailed in the above table) became members of Dr Foster Holdings LLP.

Valuations

None of the entities are public companies and therefore there are no prevailing valuations. At the time of the JV deal, BDO Stoy Hayward valued the shares in Dr Foster Intelligence Ltd issued to Dr Foster Holdings LLP (ie 50% of DFI) at £12 million. This is the only valuation available.