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NEWS ANALYSIS: Healthy outcomes?

22/07/2012

The financial condition of the South London Healthcare NHS Trust has attracted considerable media and public attention. The secretary of state has informed the trust he is thinking about using his powers to appoint a trust special administrator to run the trust under the unsustainable NHS provider regime. Moodys responded by placing its A2 rating on the £138.5 million indexed-linked bonds issued by United Healthcare (Bromley), a PFI project company that has a long-term concession with the trust, on review for downgrade. Investors in PFI schemes will be questioning what trust administration would mean for them, and whether their investment is at risk.

Whilst that is significant, as it is the first time that the secretary of state has threatened to use these powers, hospital closures are a long way off. The UKs last Labour government established the unsustainable provider regime. It allows the secretary of state if he considers it appropriate in the interests of the health service to appoint a special administrator to manage the trust in place of existing management. Following a 30-day consultation period, the administrator is required to provide the secretary of state with a report recommending what action should be taken. Following that report, the secretary of state is required to decide what action to take in relation to the trust. In the meantime, the administrator runs the trust.

What is striking is the breadth of the power that the secretary of state enjoys the regime can be instigated where he believes it to be in the interests of the health service to do so. It does not just cover insolvent trusts. Reports suggest that Barking, Havering and Redbridge NHS Trust could also be put into administration for failings in service delivery. But while the Secretary of State has the statutory power to dissolve a trust, that is not an inevitable outcome.

But the option of trust dissolution is on the table. What does that mean for a PFI deal? To answer that question we have to revisit one of the key legal hurdles that the early NHS PFI deals had to overcome; the lack of a clear insolvency regime for NHS trusts. The issue was finally resolved through primary legislation the National Health Service (Residual Liabilities) Act 1996, an act that provided that whilst the decision to wind up a trust remains discretionary, if a NHS Trust ceases to exist, the secretary of

state would have to ensure that its liabilities (including PFI commitments) were dealt with. The Residual Liabilities Act (as it is commonly known) has now been consolidated in the NHS Act 2006.

So it has been clear from the outset that NHS trusts PFI liabilities are effectively underwritten by central government. If the Secretary of State decides to dissolve a trust, the interests of the investors in the PFI scheme should be safeguarded. That was a value judgement taken at the time to facilitate the involvement of private finance at an acceptable price.

It remains to be seen what the secretary of state might do in relation to the South London Trust. He may wish to engage the private sector in the management of the trust, as has happened with the Hinchingbrooke Health Care NHS Trust, although that is unlikely to be politically palatable. Or he could simply introduce a new NHS management team. But the most likely outcome is that the Trusts hospital buildings, people and supply chain (including any PFI contracts) will be transferred to a financially sound foundation trust assuming there are any takers. A cynic might draw from that the outcome the conclusion that it would help meet the target of converting all NHS trusts to foundation trust status by 2014.

But the issue of financially challenged trusts has been on the agenda for some time and the fact that the secretary of state is now willing to take decisive action is a good thing. An orderly administration seems more attractive than the alternative.

There is one legal risk that all investors in NHS PFI projects bear; the lack of clarity surrounding the trust insolvency regime. Whilst the Residual Liabilities Act clarifies what happens if a trust ceases to exist, the secretary of state retains discretion to dissolve a trust, but there is no statutory compulsion on him to do so. In theory, at least, the government could stand by whilst a trust struggled to honour its PFI commitments.

This issue was recognised in the comfort letters that the then Secretary of State issued in relation to the early hospital deals. Those letters provided that the proposition that the Secretary of State would stand by and do nothing in circumstances where an NHS Trust was unable to meet its obligations is untenable given his statutory responsibilities: the key word being untenable. Investors took great comfort from that political (if not legally binding) comfort. Whilst more recent deals do not have the benefit of that comfort letter, that statement still holds true through other statements of government policy.

The PFI market initially struggled with foundation trusts, as they do not benefit from the protection of the Residual Liabilities Act and other legislation (known as the protective legislation). However, the solution arguably puts investors in a better position. Since 2003, a deed of safeguard has been issued on all NHS PFI transactions. The deed of safeguard applies where the trust ceases to be protected by the protective legislation; in other words on conversion to foundation trust status. The deed of safeguard effectively provides for a secretary of state guarantee if the foundation trust becomes insolvent or commits an event of default. Despite the initial investor concerns, central support for the PFI obligations of foundation trusts is arguably stronger compared to NHS trusts.

So, despite the headlines, my view is that the PFI industry should not be spooked by the trust administration regime. Whilst the uncertainty that administration causes is unsettling, PFI deals for NHS facilities have been structured to safeguard the interests of investors.

If failing trusts are unable to improve their condition, the secretary of state seems willing to take action. But PFI is likely to come under intense scrutiny and criticism. Whether or not PFI obligations are the root cause of the financial difficulties facing trusts remains to be seen. But the PFI is not to blame for trusts no longer requiring facilities, the blame lies in the failures in estate planning that led to the PFI procurement.