Special administration in the NHS: resuscitating health services in financial flat-line

Devi Shah
Mayer Brown International, London
dshah@mayerbrown.com

Nichola Padget
Mayer Brown International, London
npadget@mayerbrown.com

The UK Government has appointed a special administrator over the South London Healthcare NHS Trust (SLHT), for the first time, in an attempt to sort out the trust's financial woes. The unprecedented appointment comes at a time when the financial stability of the NHS is already under scrutiny due to cutbacks introduced as part of the UK Government's austerity measures. Mayer Brown International considers what the appointment means for SLHT and, more generally, for the wider National Health Service.

Andrew Lansley, the Secretary of State for Health, has appointed a trust special administrator in respect of South London Healthcare NHS Trust (SLHT). The appointment, which was ordered on 12 July 2012 and took effect on 16 July 2012, is the first of its kind and could be a big step towards a major restructuring of this sector.

When the prospect of this appointment was first announced in June, it prompted an outbreak of commentary and opinion across the UK press speculating on the cause of SLHT's financial struggles and predicting widespread financial difficulties across the National Health Service ('the NHS').

Reports of financial difficulties in the NHS are not new. In September last year, Andrew Lansley predicted that 22 NHS trusts were facing financial ruin due to debts incurred under high-cost private finance initiatives (PFI). The revelation was met with a degree of scepticism at that time given that 17 of the 22 NHS trusts were rated by the Department of Health as performing financially. Five, prophetically including the SLHT, were under-performing or under review.

The special administration process

As matters currently stand, the appointment has been effected under the National Health Service Act 2006 ('2006 Act'), as amended by the Health Act 2009 ('2009 Act'). The process of appointing trust special administrators, known as the regime for unsustainable NHS providers ('the Regime'), is to be reformed when the relevant provisions of the Health and Social Care Act 2012 ('2012 Act') come into force.

Under the 2009 Act, the Secretary of State can order the appointment of a trust special administrator over a NHS trust or NHS foundation trust (the providers of healthcare services in the UK), if he considers it appropriate in the interests of the health service. A very similar process also applies in respect of Primary Care Trusts (the commissioners of healthcare services in the UK), in which the Secretary of State can direct the trust to appoint a trust special administrator to exercise the trust's functions on its behalf.

The Regime can be used not only in respect of financially unsustainable organisations, but also for trusts which are unsustainable on clinical and/or performance grounds. The Regime is designed to put in place a structure for quick decision-making as to the future of failing trusts and to take the management role out of the hands of the incumbents.

On 5 July 2012, the Department of Health published its *Statutory Guidance for Trust Special Administrators appointed to NHS trusts*. The guidance was undoubtedly published as a direct result of the, then anticipated, appointment, as none had existed beforehand. The guidance clarifies when and how the Regime is to be used, stating that it should be applied only in 'exceptional circumstances' and as the 'very last step in dealing with poorly performing NHS providers'.

The guidance sets out five essential principles which apply to all trust special administrations:

- patients' interests must always come first;
- state-owned providers are part of a wider NHS system meaning that their assets will be protected;
- the Secretary of State is ultimately always accountable to Parliament for what happens to local NHS services;
- the Regime should take into account the need to engage staff in the process; and
- the Regime must be credible, workable and critically it must ensure rapid decision-making.

In addition to the five essential principles, a trust special administrator's key objective is to ensure NHS providers deliver 'high-quality services to patients that are clinically and financially sustainable for the long term'. The focus of the Regime is, therefore, on the continued provision of healthcare services and not, in its current form at least, the protection of creditors.

The appointment of a trust special administrator must take effect within five working days of the order. Upon the appointment taking effect, the trust special administrator immediately assumes the functions of the board for the duration of the appointment. The trust's chairman and its non-executive directors are suspended pending the outcome of the appointment; so too are the executive directors but only in respect of their board functions. The executive directors' employment continues notwithstanding their suspension from the board on the basis that their roles are considered necessary to ensure the ongoing provision of services.

Neither the 2006 Act nor the 2009 Act provides any restrictions as to the qualifications that a trust special administrator must have. Importantly, the Regime does not import any provisions from the Insolvency Act 1986 which sets out the administration regime applying generally to companies. According to the statutory guidance, the Secretary of State's decision as to who should be appointed will be based upon the recommendations of the NHS Chief Executive.

In the case of SLHT, the Secretary of State has appointed Matthew Kershaw. Mr Kershaw's background is in clinical management; he is not an insolvency practitioner. He has worked in the NHS since 1993, in senior leadership roles in various trusts and in national policy development and implementation for the Department of Health, most recently working as the national director for provider delivery. Given the nature of the five essential principles and the key objective, it seems likely that any future appointments will be given to persons who also have a clinical management experience rather than the insolvency expertise which is required for administrators of companies.

In terms of the key stages that will follow Mr Kershaw's appointment, the Regime has a clear and prescriptive list of steps which must be put into action. The trust special administrator must publish a draft report within 45 working days of appointment providing recommendations on how to provide services in a sustainable way. When preparing the draft report, the trust special administrator must consult with the Strategic Health Authority (the bodies which manage healthcare services in the UK) and, if the Secretary of State so directs, other NHS bodies to whom the trust provides healthcare services in accordance with the 2006 Act. The draft report is published and laid before Parliament.

Within five working days of publication of the draft report, a second consultation must commence lasting 30 working days. A consultation plan must be included in the draft report explaining how people will be able to respond to the report and setting out when the consultation will begin and end.

During this second consultation procedure, the trust special administrator must seek written responses and arrange at least one meeting with each of the following: the staff of the trust and staff representatives; the Strategic Health Authority; and, if directed to, any commissioner of services. The trust special administrator must also publish at least two notices seeking responses from the public, and providing the date, time and venue for a public meeting. A summary of all responses received as part of the second consultation process must be summarised as part of the trust special administrator's final report in order to ensure transparency.

A final report must be provided within 15 working days of the end of the second consultation period. Up until the date on which the final report is submitted to Parliament, all the time periods may be extended by permission of the Secretary of State but only if it is unreasonable for the trust special administrator to complete its duties in the prescribed timeframes. The power to extend has already been exercised in respect of SLHT. The Department for Health has announced that Mr Kershaw's draft report is not due until 29 October 2012, some 75 working days after his appointment takes effect. His final report is due on 8 January 2013.

The 2006 Act does not impose any limitations on the potential recommendations in the final report, nor does it require the Secretary of State to accept the trust special administrator's recommendations. The statutory guidance says that the possible outcomes of the Regime are:

- the rescue of the NHS trust;
- the acquisition by or merger with another NHS trust or NHS foundation trust; or
- the dissolution and transfer of service and staff to another NHS trust or NHS foundation trust.

In relation to the latter option, as a matter of law,

it is not in fact a strict requirement under the 2006 Act that a trust's staff, property and liabilities must be transferred to other NHS bodies upon dissolution, so it remains to be seen how the Secretary of State will choose to exercise his powers.

The Secretary of State has 20 working days from receipt of the final report to decide what action to take. The 2006 Act does not permit the extension of the 20 day period. As such, assuming no further extensions are permitted to the timeframe currently in place for the production of the final report in the SLHT trust special administration, the Secretary of State's final decision is due on 4 February 2013.

If the Secretary of State decides not to dissolve the trust, he must make an order specifying when the suspension of the chairman and directors will come to an end so that they can resume control of the trust; that need not happen immediately. The 2006 Act allows the trust special administrator's appointment to continue beyond the publication of the final report, to assist with the implementation of the Secretary of State's final decision.

Reform on the horizon

When the 2012 Act comes into force, the regulator ('Monitor'), not the Secretary of State, will have the power to appoint administrators. The trust special administrator regime introduced by the 2009 Act is retained with some modifications and health special administrators are introduced for companies providing essential, but as yet undefined, NHS services.

The Monitor will only be able to appoint a trust special administrator if the trust is, or is likely to become, unable to pay its debts. Further regulations are required in respect of the grounds on which a health special administrator may be appointed. The 2012 Act states that those regulations may provide that such an appointment may only be made if it is just and equitable to wind up the provider in the public interest.

Under the 2012 Act, the objective of trust special administrators is unchanged. The objective of the newly created health special administrators is to secure the continuation of the provision of services and, in common with administrators appointed over ordinary trading companies, to try and rescue or sell the trust as a going concern. Provided it is consistent with that objective, the health special administrator must also protect the interests of the trust's creditors.

A trust special administrator will be appointed by order of the Monitor in the same way that the Secretary of State exercises its function under the 2006 Act. A health special administrator will be appointed by application to court and, crucially, must be an insolvency practitioner. The 2012 Act states that further regulations may apply parts of the Insolvency Act 1986 to the health special administration regime. There is no further guidance as to exactly how, and in what circumstances, the Insolvency Act 1986 may be applied.

Wider consequences

In a speech last September, Andrew Lansley said that he 'would not flinch' from taking action if trusts are failing financially, so is this likely to be an isolated incident? To try and answer that question, it is first necessary to understand how SLHT has found itself in its current position.

SLHT has had a long history of financial issues. It was formed on 1 April 2009 by the merger of three NHS hospital trusts. At the time of the merger, those trusts had a combined deficit of £21.3m; by the end of the year 2010–11, that had risen to £41m. Last year, SLHT's deficit increased further to £65m, equating to a loss of £1.3m a week, based on a turnover of £424m.

Since 2006–07, SLHT (and its predecessor trusts) have received bailouts totalling £356m. £79.2m of that was paid out last year; it was the largest single bailout in 2011–12. According to the National Audit Office's report *Securing the Future Financial Sustainability of the NHS*, SLHT has not managed to repay any of its bailout money. It is not alone in that respect. Of £1bn public dividend capital paid out by the Department of Health since 2006–07, only £160m has been repaid.

In addition to government bailouts, Strategic Health Authorities and Primary Care Trusts have provided further financial support to NHS trusts and NHS foundation trusts. The National Audit Office estimates that £161m of such financial support was paid in 2011–12, meaning that the financial support paid to those trusts hit £414m last year.

Of 377 NHS bodies across England and Wales, 34 were in deficit in 2011–12; three Primary Care Trusts, ten NHS trusts and 21 NHS foundation trusts. It is estimated that a further 22 trusts would have reported deficits had they not received direct financial support, either in the form of government bailouts or funding from another NHS body. The NHS's Annual Report for 2011–12 reveals that 14 of the reported deficits represented more than 0.5 per cent of turnover, which is the point at which the deficit is categorised by the NHS as material.

That is not to say that all NHS trusts are in financial difficulty. The National Audit Office reports that there was a £2.1bn surplus in the NHS for 2011–12. However, there is a significant gulf between those who have, and those who have not.

SLHT's financial struggles have been widely attributed to its liabilities under two PFI schemes. SLHT paid out 14 per cent of its income, or £61m a year, to service its PFI contracts in 2011–12. It is rumoured in various press reports that payments equal to ten to 20 per cent of turnover are not unusual amongst other trusts. It is unlikely that PFI costs are the sole cause of the NHS's financial problems. Of the 22 trusts identified by the Secretary of State as having significant PFI liabilities, the National Audit Office concludes that only six are not viable without financial assistance. Other issues causing financial problems for trusts include historic debt, cuts in budgets and an imbalance between capacity and demand.

As a part of the government's austerity measures, the NHS is expected to produce savings of £20bn by 2015. All of this suggests that, whilst SLHT is the first NHS trust placed into trust special administration, it may not be the last.

About the authors
Devi Shah is a partner and joint head of Mayer Brown International's restructuring, bankruptcy and insolvency group. Nichola Padget is a senior associate in the group.

An introduction to the fundamental principles governing cross-border insolvency in an English law context*

Morgan Bowen
Nabarro, London
m.bowen@nabarro.com

The English law of cross-border insolvency is complex and multifaceted involving consideration of a number of different, competing sources of law. This article summarises these competing sources and attempts to understand them through the prism of the competing doctrinal positions of universalism and territorialism.

Competing doctrinal positions in international insolvency

Whilst there are similar fundamental principles underlying the respective insolvency laws of many countries,[1] insolvency, being an area of law underpinned by a great number of public policy considerations – more so than many other areas of law, is also an area in which considerable substantive differences can be seen between the laws of different countries.[2]

The differences have so far proved too great to enable the creation of a harmonised insolvency law system. Instead, doctrinal argument has centred around two different camps – the universalists and the territorialists. The universalists assert that the country with which the debtor entity has its closest connection should determine the insolvency law governing that entity in relation to all its assets and liabilities wherever they are situated in the world even if they are situated in countries the insolvency law of which, if applied, would produce completely different consequences. The territorialists assert that the country in which an insolvency proceeding is opened should limit the effects of that proceeding to that country and should not seek to apply its insolvency law to assets and creditors situated abroad.

The universalists typically defend universalism on the ground that it is most consistent with the principle of collectivity as it ensures that creditors, no matter where they are situated, are accorded equal treatment. Territorialists would counter that universalism is unfair on foreign creditors in that it may defeat their legitimate expectations where they have agreed with the