APPENDIX 3

Your reference:
Our reference: BJLW/2007856-0127-0
Document number: bjlw192lbjlw.doc

Direct line: +44(0)121 456 8226
Direct fax: +44(0)121 456 8481
johann.wylly@mills-reeve.com

MILLS & REEVE

Mr A Chaudry
London Borough of Barking & Dagenham
DX 8511
BARKING

24 July 2003

Also sent by DX

Dear Assaf

Advice relating to NHS LIFT
Strategic Partnering Agreement

Thank you for letting us have further instructions with regard to this matter, and for forwarding the Strategic Partnering Agreement (SPA) to me as discussed. You have requested advice on two separate but related points as follows:

1. The Council requires specific advice on the basis of an analysis of the risks inherent in entering the SPA at Level 3, as opposed to Level 2. In fact, the Council is contemplating entry at Level 3 at this point. As a matter of fact, the client Social Services Department is not proposing to hold shares in the LIFT Company at this stage (there is no obligation for it to do so anyway, but it is recognised that this may be an option in the future); nor will they be entering into any LeasePlus Agreement.

2. Further, the client Department has concerns regarding any conflict of interest which may arise from a Chief Officer sitting on the Strategic Partnering Board (SPB) and advice is requested on this aspect of the proposal.

I have discussed this with Sheila Waddington who is a Partner specialising in the Health Sector with extensive experience of advising on LIFT arrangements, and she has also contributed to the advice given below.

Before dealing with your specific points, it is important for the Council to understand the basis of the SPA in the LIFT scheme of things. The SPA establishes the SPB which is the 'body' through which the parties to the LIFT Agreement secure the delivery of the LIFT CO services and establish a mechanism for partnering with LIFTCO at a strategic level.

It is a non-statutory Board which has no functions delegated to it by any of its members but which is designed to guarantee LIFTCO exclusivity in the delivery of primary care facilities throughout the term of the LIFT Contract. It also provides a high degree of control in respect of the running of the entire Project. The exclusivity granted to LIFTCO includes that in

respect of all the construction work in respect of primary care facilities in the area of benefit of the PCTs for the life of the Agreement. The SPB could not control the Council's own procurement of facilities or services, but if it sits as a member of the SPB, the Council would have a say in how, and to what extent, social care premises are provided in the local area through the vehicle of the LIFT arrangements.

1 Entry in SPB at Level 3

In order to advise the Council as to the risks of entry of the SPB at Level 3 we would need to know more about the Council's strategic plans for its own development of social care premises and how it could benefit in the long term from the arrangements proposed in the SPA via the SPB.

Is the Council ready at this stage to enter at Level 3? Level 3 means that the Council would be a contracting authority for the purposes of future social care development in the area of benefit. It signs up to the SPA *but does not grant* the exclusivity provided for in the SPA. The requirements of entering at Level 3 do mean a high level of commitment from the Council, involving representation on the SPB and the contractual obligations within the SPA. But what benefits are obtained?

It is essential that the Council first considers whether it is ready to give this level of commitment. It will require a clear understanding on the part of the client Department of their aims and objectives of joining the Project – what do they want from it? Once this has been established, each obligation contained in the SPA would need to be considered and perhaps negotiated with the other parties, depending on the obligations the Council wishes to adopt. This would entail a meeting with the relevant client Department(s) to discuss the Project in detail. It would be counter-productive at this stage to examine each element of the SPA in any detail, without fuller instructions as to what the Council actually wants to achieve, when the Council seems uncertain of what it wishes to gain from this Project.

From the information given, I can only ascertain that the Social Services Department has been involved in parts of the negotiations, and, for entrance at Level 3 to be viable, there would need to be a greater involvement from other Departments within the Council, including potentially property, estates, and economic development . In our view, there does not appear to be sufficient time to carry out these collateral arrangements with other Council Departments to promote entry by the Council as corporate body into the Project at Level 3 and to commit to the obligations of the SPA. The portfolio holder of the Cabinet for Well-being arrangements would have to be involved in taking this further.

2. Chief Officer representation on the SPB

There may well be a number of difficulties with a Chief Officer (such as Dave Woods who, it is understood, is a Housing Chief Officer and it is not clear why he would be involved) having membership of, and representation on, the SPB. There are associated benefits of discounted procurement which may cause a conflict of interest, depending on the capacity which the Officer may have within the Council vis-à-vis procurement. To advise in further detail, it is necessary to understand the basis of his capacity, whether it be an advisory role, or a deeper responsibility, or whether he has delegated authority to deal comprehensively with procurement on behalf of the Council in areas such as development policy or promotion of social care and well being projects. The Council may have a policy on procurement, and this could help to identify any potential conflicts.

To understand the issues which could arise the Council would need to compare the terms of reference of the SPB with the existing Cabinet structure and scheme of officer delegation within the Council to ensure that there was no *cross cutting* of existing Council

arrangements. These issues frequently arise in non-statutory Board arrangements and issues of accountability would have to be fully investigated, including any Standing Order interface issues.

In our view, the Council should consider if there are any greater advantages of entering at Level 3 rather than at Level 2, at this point. As far as we can see, Level 2 is likely to offer the best solution for the Council at this stage. Entering at Level 2 would allow the Council to be involved to a sufficient degree in the control of the procurement process in the local area, and it would not mean that they would have to be involved as a member of the SPB. It would have the freedom to sign up to the SPA in the future, if it deems it appropriate to do so, once it has decided on its aims and objectives, allowed sufficient time to involve all the relevant Departments, considered the obligations of the SPA in detail, and assessed the degree of conflict which may arise from membership of the Board.

In conclusion, if the Council decides that the benefits of entering at Level 3 will satisfy its aims and objectives, and that it can devote sufficient resources to the preparation of entrance at this Level, then we suggest that a meeting is convened so that the necessary detailed instructions can be given. Otherwise, we advise that entrance at Level 2 would be a far safer option at the present time, as it enables more time for the Council to give consideration to the whole Project as a corporate body. It does not rule out a greater commitment in the future, and ultimately will not mean that the Council loses any great degree of control within the Project at the end of the day.

Please do not hesitate to contact me in the first instance, or Sheila Waddington, if you would like to discuss anything further.

Yours sincerely

Johann Wylly

This page is intentionally left blank

Your reference: AC
Our reference: BJLW/2007856-0127-0
Document number: bjlw186lbjlw.doc

Direct line: +44(0)121 456 8226
Direct fax: +44(0)121 456 8481
johann.wylly@mills-reeve.com

MILLS & REEVE

Mr A Chaudry
Property Lawyer
Property & Contract Law
London Borough of Barking & Dagenham
DX 8511
BARKING

21 July 2003

Dear Assaf

Advice relating to NHS LIFT

Wesley Hall and I are pleased to let you have our broad advice in connection with what appear to be the risks which may arise from the Council entering into the various LIFT Agreements at level 3, at the present time. At this early stage, and in the time allowed, it is only possible to let you have a general overview of the risks associated with entering into an arrangement of this nature. Once matters become clearer, and the Council is certain of a) its shareholding and b) what its final commitment to the Project will be, we can then provide you with more detailed advice in terms of the Shareholders' Agreement and due diligence regarding the Company formation. What is important to note at this stage, is that the obligations of the LeasePlus Agreement are very different to those contained in any ordinary Lease, and we have included a very broad indication of the main features. We recommend that once the detail of the Project becomes clearer (if the Council decides to formally commit to the Project), then a specialist Property lawyer should look at the obligations contained in the LeasePlus Agreement in greater detail, so that the Council's various interests are accorded such protection as is deemed appropriate.

Primarily, we have considered the obligations imposed by Level 3. The Council will enter into various Agreements, in which it is named as a Contracting Authority. It 'signs up' to the Strategic Partnering Agreement (SPA) as a core statutory body or "Participant". The SPA is a separate document to the Shareholders' Agreement, but is also integral to the documentation as it will impact upon the other Agreements (we have not yet had sight of the SPA). The Shareholders' Agreement requires the Council to become a Shareholder in the LIFT Company (LIFTCO). The Council will also enter into the LeasePlus Agreement as a Participant of the LIFT Company who is the Landlord, but at the same time, receive the Services and Accommodation provided, as a Tenant. The Council will therefore have an interest in the Lease as both Landlord and Tenant which may, to some extent, balance the obligations and benefits of the Lease. We have looked at each aspect of the Project and their implications under separate headings below.

1 Local Government Implications

As you know, Local Authorities are able to form or participate in Companies, including joint venture companies, pursuant to the Local Government Act 2000, provided that they are satisfied that the formation of, or participation in, a particular company is likely to achieve the promotion or improvement of the economic, social or environmental well being of the area. The Council is likely to be able to satisfy this requirement as the purpose of participating in the LIFT Company is to enable joined-up service delivery for the benefit of end users and cost efficiency, and it is hoped that this outcome will be the improvement of the Primary Care premises in the area.

The LIFT Company is a Company limited by share capital. It is necessary to consider whether the company will be a Controlled, Influenced, Regulated or Minority Interest company under the terms of the Local Government and Housing Act 1989, and the Local Authorities (Companies) Order 1995. If a Local Authority holds more than half the shares or the voting rights in a company, then it is classified as Controlled by the Authority. All Controlled companies are also defined as Regulated companies which means that they are subject to the terms of the Companies Order. We do not think, on the face of it, that the Council will hold a controlling share of the company and therefore will not be a Controlled company.

If a Local Authority's interest is less than 20%, the company is automatically classified as Minority Interest and therefore in the Private Sector. It is accordingly not defined as Regulated and not subject to the Companies Order. Companies where the Local Authority interest is between 20% and 50% are defined as Influenced, if certain other tests are met. Those tests are that either:

1. there is a business relationship between the Authority and the company accounting for over 50% of the company's turnover; or

2. the company is located on land obtained from the Authority at less than best price.

We are not able to ascertain at the present time, from the information provided, whether the Council's interest is less than 20% or more than 20%. Perhaps you will be able to confirm this at a later date, when you are clear what the total interest will be.

Influenced companies are then subdivided into two categories :

- Where the Local Authority has no effective control, the company is Private Sector Influenced and not Regulated (ie not subject to the Companies Order).

- Where there is effective control, the company is Public Sector Influenced and Regulated (ie subject to the Companies Order).

As mentioned, it is not possible to ascertain at this stage, the extent of effective control (if any) which the Council will have within the Company. Generally, effective control can potentially be exercised in various ways, such as holding rights to appoint or dismiss the majority of Directors, controlling pricing, investment or borrowing, or managing the company's business or operations, and so on. If the Council has some control, the Company may be Public Sector Influenced (ie Regulated) and subject to the Companies Order.

If this is the case, the LIFT Company would be a Company subject to Local Authority Influence, as described in Section 69 of the Local Government and Housing Act 1989. It would need to comply with the rules thereunder, and the Local Authorities (Companies) Order 1995, the provisions of which will also apply. The main rules arising out of the above

legislation (for Regulated Companies) relate to clear identification of the Company; payment to Directors; disqualification; publication of political material; and provision of information (including information to the Council's Auditors).

For Minority Interest and Unregulated Influence Companies, there are rules regarding disqualification of Councillors; access to information; and confidentiality.

Further advice on the above could be provided at a later stage, once we have details of the Council's total shareholding.

2 Company Law Implications

As the company is a "body corporate" ie a legal person distinct from its Shareholders and Directors, it is liable for its own debt, and may sue and be sued. The liability of the Shareholders of the company is limited, however, to the value of the shares and the Shareholders' Agreement provides for payment for the shares to be made immediately upon execution of the Agreement. This means that there will be no liability for the company's debts in the event of liquidation, as the shares will be fully paid up.

We have not yet had sight of the LIFT Company's Memorandum of Association, which should contain details of the Company's authorised share capital and how it is divided into shares of a specified nominal value. This would give details of the Council's total shareholding. Perhaps you may wish to let us have this in due course.

There are circumstances in which a Director may become personally liable for the actions of the Company. Section 213 of the Insolvency Act 1986 provides that any person who is knowingly a party to fraudulent trading by a company whose business is being carried on with intent to defraud creditors or other persons, may be liable to pay the debts of the Company. This liability arises only if the Company is being wound up (although criminal liabilities may be imposed even if the Company is not being wound up). Personal liability may also arise on the part of the Directors in cases of wrongful trading, if the Company is being wound up.

The Shareholders' Agreement is structured to allow the LIFT Company's management to manage the business with all the necessary commercial freedoms, whilst providing some protection to all of the Shareholders about the activities of the company. The Shareholder Consent matters at Clause 10 and the Share Transfer provisions at Clause 15 reflect these safeguards, as Shareholders Consent matters include the market testing of a supply chain (including an Associate of the Private Sector Partners), and the Share Transfer provisions lock the initial Shareholders in for a defined period, give "pre-emption rights" to Partnerships for Health and local stakeholders over each others' Shareholdings, and ensure the suitability of any successor Private Sector Partners. The Shareholders' Agreement may not be time limited, and it can survive the expiry of the Strategic Partnering Agreement, for example where Leases are still operational. GPs may also become Shareholders where this is appropriate to local circumstances.

The main risks which may arise out of the Shareholders' Agreement are as follows:

- The Council will hold B shares according to Schedule 2 of the Shareholders Agreement and therefore, the shareholders holding a majority of the B shares are entitled to nominate and appoint one Director. Shareholders are not entitled to purchase any further shares in the Company. If the Board decides that the Company requires further funding, the Board must consult with the other Shareholders about how such additional funding should be obtained. This effectively gives the parties a right to veto over the

issue of shares or further Loan Stock (or however the Board decides to acquire further funding), but it would, of course, be subject to the relative power of the Shareholders within the Company and the voting rights of the Directors.

- It should be remembered that a Shareholders' Agreement is a contract. Each party provides consideration by agreeing to abide by the terms of the Agreement. It follows from this that if the Agreement is broken, the other parties can claim damages. The Agreement can also be enforced by an injunction which requires a Shareholder who is a party to it not to vote in a way contrary to the terms of the Agreement. It may also be enforced by a positive injunction requiring a Shareholder who is a party to it to vote in accordance with its provisions.

- Liability may also arise if the Director appointed by the Council is removed from office.

3 Strategic Partnering Agreements

A Strategic Partnering Agreement (SPA) will also be created (besides the Shareholders' Agreement) which will involve the Strategic Partnering Board. The SPB is a forum which will agree the local health and social care communities needs for local services and facilities to be provided by the LIFT Company (LIFTCO). The SPA is for 20 years and the Council will be a Participant in this Agreement. The SPA should establish the LIFTCO as the partner for the provision of new services and facilities. The LIFTCO should provides the Partnering Services in a way which provides Value For Money for the Strategic Partnering Board. However, this will not mean that the Council will have to grant the exclusivity provided for in the SPA. The grant of exclusivity is only intended to apply to Primary Care and integrated Primary and Social Care facilities within the locality, and explicitly does not apply to the requirements of owner/occupier GPs, acute NHS services, or to other Local Authority services (although Local Authorities can request the LIFT Company to provide such services under Level 4).

4 LeasePlus Agreement

We are not clear at this stage how the Council will occupy the Premises to be provided for local social and health care, but we have assumed that the Council will in some way occupy the Premises at some stage, perhaps through the provision of social care via its Social Services Department. As the Lift Company is expected to enter into a LeasePlus Agreement as Owner with the occupants of the accommodation, the Council is therefore likely to be both part of the Company, and also the Landlord and the Tenant of the accommodation.

However, there are risks for both the Tenants and the Landlord (the LIFT Company), arising out of the LeasePlus Agreement. The general implications highlighted below does not purport to be an exhaustive list of risks for the Council as both Tenant, Landlord and Shareholder within the LIFT Company. We suggest that you seek further specialist advice on the detailed aspects of the LeasePlus Agreement later.

The LIFT Company as landlord takes on the responsibility for the repair, maintenance and insurance of the Premises throughout the term. The most significant aspects of the LeasePlus Agreement in terms of risk, are that if the accommodation is not available for use, the Tenant (eg individual GPs, dentists, pharmacists or PCT, Local Authority or voluntary sector occupants), is, in principle, not required to pay for it (subject to the detailed provisions of the LeasePlus Agreement). If the required standards are not met, but the failure does not prevent the facility being useable, then the Tenant will have a right to remedy the failure at LIFTCO's expense (once defined response and rectification times have passed). These are the main features of the LeasePlus Agreement.