RR/App 04/2021
(Agenda item: 23)

Appendix to Engagement Policy

Significant Transactions

The Trust's Constitution does not currently contain any descriptions of the term 'significant transaction' for the purposes of section 51A of the 2006 Act (Significant Transactions). The Trust has therefore relied upon the regulators published determination of what classifies as a significant transaction. Both the Board of Directors and Council of Governors agreed to describe more clearly as part of the approved Engagement Policy, what is to be deemed a significant transaction and how both boards would deal with such. The following policy appendix resets understanding of what is a significant transaction within regulation and expands to include on page 6 a wider definition to be adopted by the Trust.

What are "significant transactions"?

NHS foundation trusts are permitted to decide themselves what constitutes a "significant transaction" and may choose to set out the definition(s) in the trust's constitution. Alternatively, with the agreement of the governors, trusts may choose not to give a definition, but this would need to be stated in the constitution. Examples of a definition in NHSI's Transaction guidance are often relied upon by Foundation Trusts and include a certain percentage of the trust's annual turnover or assets. Trusts can choose to define what constitutes a "significant transaction" in non-monetary terms.

This guidance document determines the **statutory transactions** for which regulatory provision is made for executive, non-executive and governor involvement and provides information about the legal aspects of the following transactions:

- merger – section 56
- acquisition – section 56A
- three-way merger or acquisition
- dissolution of an NHS trust and transfer of assets – schedule 4
- dissolution of a foundation trust – section 57A
- commercial transfer – ordinary legal powers.

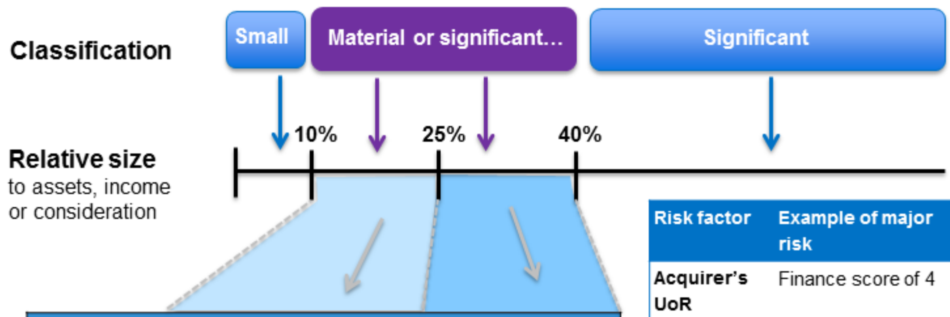
NHS Improvement has a statutory role to grant these transactions if the legal requirements are met. Significant transactions would generally be captured in all of the above where they each trigger the asset/income/capital thresholds.

Trusts undertaking transactions must satisfy NHSI's review requirements before entering into any legally binding commitments with the scope extending to cover three types of transaction. These are:

- **Material transactions:** require board certification to be submitted to and agreed with NHSI.
- **Significant transactions:** require detailed review which will result in a transaction risk rating. Foundation trusts should only proceed with transactions that are risk rated green or amber.
- **Statutory transactions:** there are specific requirements for each transaction highlighted above.

The Figure below shows NHSI's approach to classifying transactions, to help governors understand likely outcomes and the detailed and regulatory procedures necessary to be adopted. This policy covers each of the above transactions and sets out to determine a process of governor engagement and involvement accordingly, additionally capturing a process to provide assurances to governors concerning ‘other’ transactions as defined by this policy.

Relative size, SOF segmentation and additional risk factors determine classification and level of review



…depending on additional risk factors present		
Material if:	No risk factors or one **other** risk	No risk factors
Significant if:	One or more **major** risk or two or more **other** risks	One or more **major** risk or **other** risk

Classification	Reportable to NHS Improvement	Review
Small	No	No review
Material	Yes	Review of certification submission
Significant	Yes	Detailed transaction review
Statutory	Yes	Level of review per above

Risk factor	Example of major risk	Example of other risk
Acquirer’s UoR	Finance score of 4	Finance score of 3
Acquirer’s quality	CQC rating of ‘requires improvement’	CQC rating of ‘requires improvement’ for well-led
Leverage	Capital servicing capacity of enlarged trust is <1.75	Capital servicing capacity of enlarged trust is <2.5
Experience of services	A significant change in scope of activity of acquirer	A minor change in scope of activity of acquirer
Target quality	CQC rating of ‘inadequate’	CQC rating of ‘requires improvement’
Target ‘s SOF rating	Segment 4	Segment 3

Roles and responsibilities

The decision to transact (concerning relevant transactions) is an important decision for the trust. Executive directors, NEDs and governors need to work together to successfully execute a relevant transaction. This section of the Engagement Policy discusses respective roles and how they fit together in the context of statutory transactions where governor approval is needed and sources the guidance in NHSI’s Transaction guide and supporting appendices.

Roles

Executive directors are responsible for making transaction proposals, plans and strategies for the future of the trust. They will work with governors on relevant transactions by providing them with sufficient information on a proposed transaction. They will explain to governors why they believe the transaction is necessary and provide reasons to support that view.

NEDs constructively challenge the executives to justify their recommendations on all transactions relevant for Board approval, deal with the risks involved and seek assurance that the executive directors’ decisions are the right ones. NEDs are individually and collectively held to account by governors for the performance of the board.

Governors have a statutory role in approving applications for statutory transactions – that is, mergers, acquisitions, dissolutions and separations involving a foundation trust. This role is discharged in the context of the general governor role under schedule 7 of the NHS Act 2006, which is to hold the NEDs to account, both individually and collectively, for the performance of the board of directors, and to represent the interests of the foundation trust's members and the public. Therefore, in deciding whether to approve a transaction, governors are deciding whether the board of directors has:

- been thorough and comprehensive in reaching its decision to transact;
- considered and when relevant obtained the interests of foundation trust members and the public as part of the decision-making process.

The Board will help governors with their decision by providing appropriate information and they have a wider duty to ensure that the governors are equipped with the skills and knowledge they need to fulfil their role.

The decision to proceed with a transaction is ultimately determined by the board of directors. It has the power under the foundation trust's constitution to exercise all the powers of the foundation trust. Provided appropriate assurance is obtained on the two points above, governors should not unreasonably withhold their approval for the transaction to go ahead.

Engagement

It is recognised good practice for the board to engage early with the governors about statutory transaction plans. From the outset directors will involve governors to ensure engagement about the transaction to include as relevant to the transaction:

- early identification of an impending investment/disinvestment to include updates as Board and regulatory requirements and approvals arise;
- the content and timing of subsequent information to be provided to governors and any training needs;
- how, when necessary, the views of members will be sought and stakeholders kept informed;
- how governors can get involved with the future governance model if for example, a new constitution is required following acquisition for the post-transaction foundation trust in the event of an acquisition or a merger transaction.

Governor approval

There are no legal requirements about when governor **approval** needs to be sought for material, statutory or significant transactions. However, NHS Improvement recommends that it happens towards the very end of the process: after a Trust has received a Trust's transaction risk rating and after the board has decided to proceed with the transaction. By this time the governors will have sufficient information about NHS Improvement's view of the transaction risk and can be satisfied that the board has completed a comprehensive process of transaction planning and assurance.

Approval is usually given at a meeting of the council of governors by way of a vote. Voting procedures (including any rules on the chair's vote, casting votes or abstentions) are set out in the trust's constitution. For a statutory transaction application to proceed, more than half of all members of the council **in post** need to approve it. For a significant transaction application to proceed, more than half of the members of the full council of governors of the trust **voting** must approve it.

General considerations

Governors have a general duty to represent the interests of members and the public and this includes representing their views in relation to potential:

- significant transactions;
- mergers;
- acquisitions;
- separations and dissolutions of the trust; and
- increases to non-NHS income.

Governors should therefore interact regularly with the members of the trust and the public to ensure they understand their views, and to make sure that they clearly communicate to them information on trust performance and planning. However, governors should take care to disclose only those matters which the trust considers non-confidential**.**

Taking decisions on significant transactions, mergers, acquisitions, separations and dissolutions

In NHSI's guidance for governors on statutory duties, Governors are tasked with approving significant transactions - mergers, acquisitions, separations and dissolutions proposed for the foundation trust by the directors. The guidance covers:

- the legal requirements;
- significant transactions;
- mergers, acquisitions, separations and dissolutions;
- what governors are asked to take decisions on;
- how they might take such decisions in practice;
- how the board of directors should support governors in their duty;
- how to inform stakeholders; and
- what happens to the council of governors after a merger or acquisition.

What are the legal requirements?

Under the 2012 Act:

- *More than half of the members of the full council of governors of the trust voting* need to approve the trust entering into any significant transaction, as specified in the trust's constitution. This means more than half of the governors who are in attendance at the meeting and who vote at that meeting.
- *More than half the members of the full council of governors* must approve any application by the trust to merge with or acquire another trust, separate the trust into two or more new NHS foundation trusts or to be dissolved. This means more than half of the total number of governors, not just half the number that attends the meeting at which the decision is taken. If the other party to the proposed transaction is also an NHS foundation trust, more than half the governors of that foundation trust must also approve the transaction.

What are governors asked to take a decision on?

The 2006 Act, as amended, states that the trust's constitution must provide for all the powers of the corporation to be exercisable by the board of directors on its behalf. This means that it must be the decision of the board of directors as to whether a transaction should proceed.

Governors must obtain sufficient information from the board of directors on the proposed transaction(s) to make an informed decision on the significant transaction, merger, acquisition, separation or dissolution.

Governors will recall that their general duties in legislation are to hold the non-executive directors (individually and collectively) to account for the performance of the board of directors, and to represent the interests of the NHS foundation trust members and the public. With that in mind, governors should assure themselves that the board of directors has followed an appropriate process in deciding to undertake the transaction and that it has taken account of the interests of members and of the public in that process in approving such a transaction.

How might governors take such decisions in practice?

Governors are responsible for satisfying themselves that the board has been thorough and comprehensive in reaching its decisions and that NEDs have demonstrated that they have scrutinised proposals thoroughly and tested them out as being in the best interests of the trust and those it serves. NEDs should be able – individually and collectively – to explain their assurance of a decision. This applies to all board decisions but is particularly important for statutory and significant transactions as they have far-reaching consequences.

If the Council of governors is assured, then it should not stand in the way of the decision, even if individual governors have personal reservations about it. But if the Council is not content with the assurances it is given, then it must push back and hold the NEDs – and through them, the board as a whole – to account for the process adopted to make its decisions.

Governors should be able to trust their NEDs – such trust goes to the heart of a well-functioning governance process. But an important element of that trust is the – rightful – checking of supporting evidence, asking "What is the evidence that shows me how our NEDs have been assured?", "How have the directors explained and justified their actions?", "Has due process been followed, and been shown to have been followed, ensuring where necessary that the views of the public and trust members have been appropriately taken into account?"

Members of the Board should welcome such questions as part of justifying and demonstrating their assurances. If they are able to, the Council can support them and if they can't, the Council will collectively have done its job in testing them and seeking better assurance.

Governor liability

We recognise that governors may be concerned that they will be held responsible should such a transaction turn out to be financially or otherwise damaging for the trust. The 2006 Act, as amended, does not make explicit reference to governors' liability in this regard.

Governors' duty to "hold the non-executive directors, individually and collectively to account for the performance of the board of directors" does not mean that governors are responsible for the decision itself, or the operational detail behind it. Responsibility for a decision remains with the board of directors, acting on behalf of the NHS foundation trust. It is only through the power to make decisions (and therefore not to make decisions) that liability accrues. Assuming governors' decision-making powers are limited to appointing, advising and approving (or disapproving) transactions (as long as proper process has been followed), the potential for liability is negligible. There is no legal requirement for trusts to provide an indemnity for governors, or insurance to cover their service on the council of governors.

Why we need this Guidance

This guidance sets out how the Board of Directors will engage with the Council of Governors over transactions as defined within this document. NHS Improvement's (NHSI) Risk Assessment Framework and latterly Transaction guidance, provides examples of what constitutes a transaction.

Transactions for the purposes of this policy are defined as either 'Statutory', 'Significant' or 'Material'.

Supplement 1 is designed to provide an easy reference guide to the guidance outlining definitions and associated actions relating to transactions covered by this policy and to provide governors with a reference point in terms of the scrutiny by regulators of significant transactions.

The Trust may only enter into a merger, acquisition, separation or dissolution with the approval of more than half of the members of the Council of Governors.

The Trust may enter into a Significant Transaction only if more than half of the members of the Council of Governors voting approve entering into the transaction.

In addition to *consulting with and ultimately seeking approval from* the Council of Governors on Statutory and Significant transactions, the Trust will also *discuss* with the Council of Governors any planned transaction which meets the description of a "Material transaction". A Material transaction for the purposes of this Policy is that used within NHSI's transaction guidance. The definition of a Material transaction for the purposes of this Policy is the income attributable to the assets or the contract associated with the transaction, divided by the income of the trust is greater than 10%.

Other transactions for the purpose of this Policy (within definition of 'significant')

The Trust will also report to and discuss with the Council of Governors, either directly or via a relevant delegated sub group, other transactions which meet one or more of the following criteria:

- Proposals to establish/enter into new organisational models e.g. joint ventures, community interest companies where outside the national NHS direction (eg not in the NHS LTP);
- Additions of new services to the Trust's existing service portfolio where these are significantly unique and outside the Trust's current service delivery experience;
- Removal of services from Trust's existing service portfolio when not removals as a result of commissioning decisions or competitive tenders;
- Establishment or expansion of any service which is beyond the Trust's existing county boundaries unless part of the NHS Long Term plan ambitions or published Trust strategy/plans. (eg New Care Models by definition exceed geographical boundaries)

These discussions may be informed/ contextualized by bids and tender activity and wider market intelligence/environment analysis.

The discussion process for Statutory, Material and Significant transactions

Transactions that meet the relevant thresholds set out above will be discussed at a Council of Governors' meeting either in public or private session depending on the degree of commercial confidentiality.

Other Transactions as defined above will be discussed at a Council of Governors meeting or at a relevant delegated sub group. In the event these transactions are discussed at sub group level, the sub group may provide a summary to full Council as part of its regular sub group report. Notwithstanding this arrangement the full Council will be directly briefed on transactions relating to new organisational models.

In the event that Council of Governors' meeting schedules preclude such discussions taking place in a timely manner, the Governance sub group will be used as an alternative forum, with the outcome from the Sub Group being reported to the next Council of Governors' meeting. If this alternative option does not permit timely discussion, the mechanism for engaging with Governors will be agreed with the Lead Governor.

The Chairman will report to the Board of Directors key issues arising from the Council of Governors' discussions on Statutory, Significant, Material and Other transactions as appropriate.

Aggregation

The thresholds pertaining to Significant and Material transactions are set on a 'single' transaction basis. However, if it is known or highly probable that the threshold for a Significant or Material transaction will be triggered through multiple phases relating to the same transaction within a 12 month period, this will be deemed as having met the transaction definition.

SUPPLEMENT 1

Table 1: NHS Improvement reporting requirements – defining Significant Transaction

		Reporting requirements	
Ratio	Description	Non-healthcare/ international	UK healthcare
Assets	The gross assets* subject to the transaction* divided by the gross assets of the trust	>5%	>10%
Income	The income attributable to the assets or contract associated with the transaction* divided by the income of the trust	>5%	>10%
Consideration to total foundation trust capital	The gross capital** or consideration associated with the transaction divided by the total capital*** of the foundation trust following completion or the effects on the total capital of the foundation trust resulting from a transaction	>5%	>10%

Key:

** Gross assets are the total of fixed assets and current assets.*

*** Gross capital equals the market value of the target's shares and debt securities, plus the excess of current liabilities over current assets.*

**** Total capital of the foundation trust equals taxpayers' equity.*

Regulatory framework governing transactions

NHSI's regulatory framework is designed to ensure that transactions work well for patients. It has two main components: competition review of mergers by the Competition and Markets Authority (CMA) and risk assessment of transactions by NHS Improvement. In practice, these two components are closely aligned and interrelated with similar objectives and overlapping key lines of enquiry. The ability to demonstrate why a transaction will improve care for patients will help trusts navigate both any CMA merger review and our risk assessment review process.

Even where a proposed transaction does not trigger the reporting requirements set out above, trust boards are encouraged to take account of best practice advice when evaluating the processes they should follow to ensure reputational and financial risks are fully understood and governance obligations are met.

Approach to transaction review

The degree to which we scrutinise any proposed transaction depends on our perceived level of its inherent risk. This level determines whether a transaction is classified as 'small', 'material' or 'significant'.

Transactions that do not meet the reporting requirements (see Table 1) are classified as **'small'** transactions. But if a small transaction is a statutory transaction, the trust(s) must make a formal application to NHS Improvement and demonstrate that it has taken the necessary preparatory steps, as set out in Supplement 1. We would not normally expect to be notified or otherwise involved in any other types of small transaction.

All reportable transactions are classified as **'material'** or **'significant'** (as defined earlier in this policy).

Transaction guidance: Board certification

All trusts undertaking material and significant transactions should complete this certification as part of the transaction review process.

For a merger both parties should jointly make the board certification.

Where a potential transaction is deemed to be material, as defined in Section 2.2 of our guidance, NHS Improvement will, as part of our overall assessment of financial risk and governance, request evidence that the trust board is satisfied that it has:

- considered a detailed options appraisal before deciding that the transaction delivers benefits for patients and the trust in delivering its strategy
- assured itself that a proposed transaction will meet the requirements of the choice and competition licence conditions
- conducted an appropriate level of financial, clinical and market due diligence relating to the proposed investment or divestment
- considered the implications of the proposed investment or divestment on the resulting entity's Single Oversight Framework (SOF) segment, focusing in particular on the use of resources metric and having taken full account of reasonable downside sensitivities
- conducted appropriate enquiry about the probity of any partners involved in the proposed investment or divestment, taking into account the nature of the services provided and the likely reputational risk
- conducted an appropriate assessment of the nature of services being provided as a result of the investment or divestment and any implications for reputational risk arising from these
- received appropriate external advice from independent professional advisers with relevant experience and qualifications
- taken into account the good practice advice in NHS Improvement's transaction guidance or commented by exception where this is not the case
- resolved any accounting issues relating to the proposed investment or divestment and its proposed treatment

- addressed any legal issues, including those associated with the transfer of staff (either via an acquisition, divestment or fixed-term contract)
- complied with any consultation requirements
- established the organisational and management capacity and skills to deliver the planned benefits of the proposed investment or divestment
- involved senior clinicians at the appropriate level in the decision-making process and received confirmation from them that there are no material clinical concerns in proceeding with the proposed investment or divestment, including consideration of the subsequent configuration of clinical services
- in the case of a contract for a specified period, ensured appropriate legal protection in relation to staff, including on termination of the contract
- ensured relevant commercial risks are understood
- made provision for the transfer of all relevant assets and liabilities
- at the time of the acquisition, provided a corporate governance statement (see Appendix 13) for the acquiring trust
- at the time of the acquisition, provided a board statement that plans are in place to make the corporate governance statement (see Appendix 13) within six months of formation of the new organisation, with the exception of the following statement concerning quality governance:

"The board is satisfied:

(f) that there is clear accountability for quality of care throughout [insert name] trust including but not restricted to systems and/or processes for escalating and resolving quality issues including escalating them to the board where appropriate."

This requires an appropriate timescale for compliance, which should be determined by the trust board and agreed with NHS Improvement.