



House of Commons  
Transport Committee

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# The London Underground and the Public–Private Partnership Agreements

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**Second Report of Session 2007–08**

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

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## The Transport Committee

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# 1 Introduction

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1. The Secretary of State for Transport told this Committee that the collapse in July 2007 of Metronet, one of the two private sector consortia that had signed three 30 year contracts to renovate and modernise sections of the London Underground network, was a “terrible failure”.<sup>1</sup> She said:

Metronet’s failure has cost its shareholders significant sums and damaged the reputation of those companies involved. Importantly, Metronet’s failure let down Tube travellers, London Underground and taxpayers. [...] It remains essential that we continue to improve the Tube and minimise the risk of additional costs falling to the taxpayer or passenger and find a way forward that delivers the best value for money. It is of great importance to us that we fully understand why Metronet failed so that we can learn the appropriate lessons for the future. I am completely committed to doing that and this Committee’s hearings and its conclusions will, of course, be important in that process.<sup>2</sup>

2. Like the Secretary of State, we recognise the importance of learning lessons from a Government initiative that has resulted in significant unforeseen costs to the public. We therefore decided to conduct a short inquiry in order to identify the key reasons for Metronet’s failure and make recommendations about the future delivery of the vital improvements to the Underground.

## Background

3. The Government announced its proposals for modernising the London Underground network by means of Public-Private Partnership (PPP) agreements in 1998. London Underground Limited entered into three separate PPP Agreements between December 2002 and April 2003:

- a) with Tube Lines for the maintenance and renewal of the Jubilee, Piccadilly and Northern Lines;
- b) with Metronet Rail BCV for the maintenance and renewal of the Bakerloo, Central, Victoria and Waterloo & City Lines; and
- c) with Metronet Rail SSL, which is responsible for the maintenance and renewal of the “sub-surface lines”: the Circle, District, Hammersmith & City, Metropolitan and East London Lines.<sup>3</sup>

Under the PPP Agreements, which are for 30 years, these private sector infrastructure companies (Infracos) maintain, renew and upgrade discrete parts of London Underground’s infrastructure. London Underground remains responsible, in the public

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1 Q 388

2 Q 318

3 The sub-surface lines are those originally built using the cut-and-cover method. See Wolmar C, *The Subterranean Railway* (London, 2004), p. 4.

sector, for delivering services to customers. The Government estimated at the time that the PPP would realise over £16 billion of investment in the Underground over the first 15 years and that £4 billion would be saved over the same period.

4. The PPP Agreements set out a performance-related incentive and penalty scheme to remunerate the Infracos for the improvements they make to the network. The Infracos have a large degree of flexibility in how they choose to deliver improvements but London Underground also specify a number of achievements that must be met by given target dates, such as station refurbishments, replacement of train fleets and track replacement. The Agreements also contain provisions for a Periodic Review of the contractual obligations and remuneration every 7½ years, the first of which is due in 2010. These reviews are conducted by the PPP Arbiter, an independent office-holder appointed under the Greater London Authority Act 1999.<sup>4</sup> The prices submitted in the bids from the Infracos are only fixed for the first of the four 7½ year periods, in which the Infracos' obligations focus on reliability improvements, station works and initiation of line upgrades, which are long-term projects generally spanning the first and second contract periods.

5. However, the Agreements contain provisions for an Extraordinary Review where an Infraco considers that it is incurring additional costs above the level allowed for in its bid. This effectively allows an Infraco to claim additional remuneration from London Underground where its costs exceed the level that it had originally anticipated. These additional costs are known as "Net Adverse Effects" and are calculated by reference to the additional costs which would be incurred by an Infraco operating in an overall efficient and economic manner and in accordance with Good Industry Practice. Where Net Adverse Effects in a 7½ year Review Period exceed the contractual "Materiality Threshold" (i.e. the limit below which additional costs cannot be claimed by the Infracos) the Arbiter can direct that the Infrastructure Service Charge (ISC) payable by London Underground should be increased. The PPP Agreements also envisage that the Arbiter can be asked to give directions on an interim adjustment to ISC pending completion of the full Extraordinary Review.

## Metronet's failure

6. In May 2007 Metronet admitted that it was expecting an overspend of more than £1 billion<sup>5</sup> and in early June it was reported that the company had been refused access to its loan facilities by the banks.<sup>6</sup> On 28 June Metronet BCV made a reference to the PPP Arbiter, triggering an Extraordinary Review, and sought a direction on the interim level of Infrastructure Service Charge (ISC) to be paid by London Underground while the Review was being completed. Metronet claimed for an increase in ISC of £551 million over the twelve-month period from the date of the reference.<sup>7</sup>

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4 *Ibid.*, pp 225–237

5 "Tube contractor pins hopes on review as overshoot hits £1bn", *The Guardian*, 23 May 2007

6 "Metronet in cash plea", *The Sunday Times*, 3 June 2007

7 See "Arbiter's draft directions on Interim Infrastructure Service Charge ("ISC") for Metronet BCV", Office of the PPP Arbiter press release 03/07, 16 July 2007.

7. At the time Metronet Chairman, Graham Pimlott, made the following statement:

Metronet entered into the Public Private Partnership in good faith. Where we have made mistakes our shareholders have borne the cost. However, the PPP terms are clear—where additional spending is required to meet London Underground’s demands, then we are entitled to be paid. It’s disappointing that we have been unable to reach a mutually acceptable solution with London Underground, therefore we are now left with no option other than to begin this process of Extraordinary Review.

We have advised London Underground over the last 18 months that their insistence on the present high specification for the stations upgrade programme, is rendering the programme unaffordable and will result in a great deal of further overspend.

About half of the £992 million we are seeking relates to additional economic and efficient projected costs beyond the beginning of July 2008. London Underground can still save money through such measures as de-scoping.

Metronet’s shareholders remain fully supportive—and we are confident of a large recovery from London Underground.<sup>8</sup>

8. On 16 July the PPP Arbiter provisionally concluded that the interim level of ISC, based on what would be appropriate for an Infraco performing in an efficient and economic manner, should in fact be increased by £121 million.<sup>9</sup> The Metronet Infracos went into Administration on 18 July 2007.

9. On 21 September 2007, the Arbiter published the results of his initial analysis of Metronet BCV’s request for an increase in ISC for the first 7½ years of the contract.<sup>10</sup> While Metronet BCV claimed for an additional £992 million, the Arbiter’s view was that the appropriate figure for an efficient company would be in the range £140–470 million. The Arbiter had also reviewed the financial model for Metronet SSL, which shows an underlying increase in costs of some £1.1 billion, and considered that the potential scale of the increase in efficient and economic costs recoverable by Metronet SSL likely to be in the range £230–600 million.

## Transport for London’s bid for Metronet

10. After Metronet entered administration the Mayor of London signalled his aspiration for Transport for London to take over Metronet and restructure its contracts for maintaining and renewing the network.<sup>11</sup> The Mayor wanted to bring the maintenance element of the contracts back into the public sector, and let individual contracts for the upgrade and major investment work.

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8 “Metronet Rail BCV launches PPP Extraordinary Review”, Metronet press release, 29 June 2007

9 “Arbiter’s draft directions on Interim Infrastructure Service Charge (“ISC”) for Metronet BCV”, Office of the PPP Arbiter press release 03/07, 16 July 2007

10 PPP Arbiter, *Reference for Directions from Metronet Rail BCV Ltd; Directions on Form and structure of Extraordinary Review and Net Adverse Effects and Infrastructure Service Charge at Extraordinary Review; Initial thoughts*, 21 September 2007

11 For example, at Mayor’s Question Time on 12 September 2007.

11. On 25 October Transport for London announced that it had lodged a formal bid to take control of Metronet<sup>12</sup> and on 6 November the PPP Administrator confirmed that Transport for London's bid was the only one that had been received for Metronet.<sup>13</sup> The people and assets of the two Metronet companies will now be transferred into two Transport for London nominee companies to be managed on a stand-alone basis while the long-term structure is agreed. The Administrator confirmed to us that he was working towards transferring the Metronet Infracos into the control of Transport for London by around the middle of January 2008.<sup>14</sup> The Arbiter had proposed a timetable for completing the Extraordinary Review process, with the publication of draft directions on efficient costs scheduled for 12 November 2007. However, the reference requesting an Extraordinary Review was withdrawn by the PPP Administrator on 31 October.<sup>15</sup>

### Longer-term delivery of the upgrades

12. Meanwhile, discussions are ongoing between the Government, the Mayor of London and Transport for London as to the appropriate way to undertake the maintenance and modernisation of the Underground in the long-term. Although the Secretary of State told us that long-term management of the work would be the responsibility primarily of the Mayor of London and Transport for London, she indicated that the Mayor had agreed to work closely with the Government to determine the appropriate "vehicle" to deliver the upgrades in an attempt to secure the best value for money in the future.<sup>16</sup> She was "completely open-minded" about the outcome of those discussions and said that she was "not in the business of imposing anything on anyone". She said that there was an argument in principle for asking the private sector "to deliver in the most innovative manner it can" but acknowledged that this might not represent the best value-for-money option.<sup>17</sup>

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12 "Transport for London bids for control of Metronet", Transport for London press release, 25 October 2007

13 "PPP Administrator Ernst and Young confirms Transport for London as only bidder for Metronet", Transport for London press release, 6 November 2007

14 Q 282

15 "Metronet Rail BCV Ltd withdraws its reference for Extraordinary Review", Office of the PPP Arbiter press release, 31 October 2007

16 Q 349

17 Qq 349–355

## 2 Metronet's tied supply chain

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13. A significant part of Metronet's obligations under its PPP Agreements was intended to be delivered through contracts with its shareholders with some 60% of its projected capital expenditure in the first 7½ year period to be awarded to its parent companies—Atkins, Balfour Beatty, Bombardier, EDF Energy, and Thames Water. Other than for rolling stock work, which was managed by Bombardier, this was organised through another company, Trans4m, which was in turn owned by the remaining four of the Metronet shareholders. This structure has been widely recognised as having contributed to the inefficiencies of Metronet, a conclusion which the Arbiter reached in 2006.<sup>18</sup> Metronet's former Chairman, Graham Pimlott, conceded that

I think that there is little doubt that in the case of stations the contractual arrangements with the shareholders was a very negative factor from Metronet's point of view. Metronet had a contract with Trans4m, which was a contract that gave Metronet very little in the way of leverage over Trans4m. It had to pay money when bills were presented and it did not have the ability to withhold it, for example for performance failure.

14. Outside the stations modernisation programme, the problem also appears to have plagued Metronet's track replacement work, which was contracted solely to Balfour Beatty, and the Arbiter assumed during the Extraordinary Review that a notional Infracore operating in an efficient and economic manner would not have had Metronet's tied supply contract for track replacement.<sup>19</sup> The contract was in the process of being renegotiated by Metronet prior to administration. Conversely, Metronet's contract with Bombardier for rolling stock upgrades appears to have been working better. Mr Pimlott suggested this might have been because it was more "output-based", whereas the stations contract was more like a building contract.<sup>20</sup> In fact, the Arbiter was satisfied that it was, on the whole and following inefficiencies during the first two years of the PPP Agreement, being operated efficiently and economically, and that price increases were as a result of omissions from the bid.<sup>21</sup>

15. Metronet responded to concerns about the tied supply chain by beginning to award contracts for station upgrades outside the chain using competitive tendering.<sup>22</sup> However, in September 2007 the Arbiter reported that Metronet's issues with its supply chain had not been fully addressed prior to the Extraordinary Review and Metronet's subsequent administration.<sup>23</sup> He told us that "a well-managed company would have resolved those issues well before Metronet started addressing them."<sup>24</sup> Mr Pimlott agreed that

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18 Office of the PPP Arbiter, *Annual Metronet Report 2006*, 16 November 2006

19 PPP Arbiter, *Initial Thoughts*, 21 September 2007

20 Q 179

21 PPP Arbiter, *Initial Thoughts*, 21 September 2007

22 "Metronet awards first six station projects outside of its supply chain: further initiatives to accelerate programme", Metronet press release, 23 February 2007

23 PPP Arbiter, *Initial Thoughts*, 21 September 2007

24 Q 9

the problem was known [...] The Arbitrator and London Underground and Metronet and the shareholders were over a period of time trying to do something about it but they did not get it done fast enough.<sup>25</sup>

16. However, his subsequent claim that he was threatened with litigation when he tried to reduce the amount of work going to the shareholding companies casts serious doubt on the suggestion that the shareholders were committed to doing anything about the problems caused by the tied supply chain.<sup>26</sup> **We are not persuaded that Metronet's shareholders had any inclination to address the problem of the tied supply chain nor, as the intended beneficiaries of the system, did they have very much incentive to do so.**

17. The Arbitrator insists that it is possible to operate a successful tied supply chain, although he stressed the importance of a clear distinction between the roles of shareholder and supplier.<sup>27</sup> However, he was also of the opinion that some of the problems with the supply chain could have been anticipated.<sup>28</sup>

18. **When the bids for the PPP contracts were being assessed, it should have been possible for the Government and London Underground, then under national control through London Regional Transport, to foresee that Metronet's proposed tied supply chain model, which guaranteed the lion's share of work to its parent companies, did not include the necessary safeguards. The fact that such a management structure was judged to be capable of efficient and economic delivery seems extraordinary now that Metronet has collapsed but the ultimate recipients of the money which was paid to the company have walked away with limited losses. The Government must not allow this blurring between the roles of shareholder and supplier in future bids to carry out work by the private sector. Bids where competitive tendering for sub-contracts is proposed are likely to ensure that the best price is obtained.**

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25 Q 199

26 Q 227

27 Q 42

28 Q 57

## 3 Risk transfer

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19. The DfT told us that when considering the potential value for money of the PPP contracts, the Department and London Underground considered “wider, non-quantitative factors”, including “the strategic benefits, the ability to create a partnership and the risk share between public and private sectors.”<sup>29</sup> It says that the PPP Agreements “struck a balance between the level of risk transferred to the private sector and that retained in the public sector” and that, because the PPP Agreements are outcome-based, they expose the companies to risk of performance payment abatements if contractual targets are not achieved.<sup>30</sup>

20. However, the PPP Arbiter, Chris Bolt, argued that risk transfer under the PPP Agreements “was not as great as I think some people understood”. He also said, “This is not a fixed price deal, and I think there has been some misunderstanding about the scale of risk transfer from the public sector to the private sector.”<sup>31</sup> He suggested that there were differences of understanding between Metronet and London Underground about the allocation of different risks under the contract. In particular, the cost consequences of increases in the scope of work required to deliver obligations were mostly borne by London Underground; only the low Materiality Threshold and the cost consequences of delivering inefficiently were borne by Metronet.<sup>32</sup>

21. The Arbiter identified four elements of risk that were borne by the private sector under the Metronet contracts:

- a) the shareholders’ equity, totalling £350 million (£70 million from each of the parent companies);
- b) 5% of Metronet’s borrowing, borne by Metronet’s funders (the remaining 95% was guaranteed by TfL);
- c) the first £50 million of efficient cost overruns (up to the Materiality Threshold);
- d) the cost of any inefficiency.<sup>33</sup>

22. There is a clear argument for seeking to contain the risk borne by PPP contractors. As the National Audit Office noted in its 2004 Report on the PPP, seeking to transfer too much risk would have been likely to lead to higher-priced bids due to increased contingency provisions by prospective contractors.<sup>34</sup> However, the question remains whether the allocation of risk between the undertakers and the Government was in this case balanced appropriately.

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29 Ev 72

30 Ev 72

31 Q 18

32 Ev 46

33 Q19

34 National Audit Office, *London Underground PPP: Were they good deals?*, 17 June 2004

## Risk borne by Infraco shareholders

23. Private sector shareholders, who put up a total of some £725 million capital in the three PPP Agreements, stood to receive nominal returns of 18–20% a year. As the first deal of its kind, it was considered that such a rate of return was proportionate to the risks involved, even though it would have been about one third higher than for other recent PFI deals if the Infracos had delivered their obligations at the costs and speeds described in their bids.<sup>35</sup>

24. The former Chairman of Metronet told us that “the shareholders did not behave as if they were taking no risk,” and that the loss of £70 million would be a significant one. He did not think that the shareholders would have behaved differently if their investment had been greater.<sup>36</sup> The Secretary of State added that the shareholding companies have “felt the pain, not only financially but reputationally as well.”<sup>37</sup> In any case, it is clear that the shareholders’ exposure to risk and their net losses as a result of Metronet’s failure were reduced by their profit margin on the work, which they were guaranteed through the tied supply chain.

**25. The return anticipated by Metronet’s shareholders appears to have been out of all proportion to the level of risk associated with the contract. The parent companies were effectively able to limit their liability to the £70 million they each invested in Metronet at the outset. Had Metronet survived, they would also have borne the cost of their own inefficiency along with a minimal amount—£50 million—of any other cost overruns. In the face of this very limited liability it is difficult to lend any credence to the assertion that the Metronet PPP contracts were effective in transferring risk from the public to the private sector. In fact, the reverse is the case: Metronet’s shareholders, had the company been operated effectively, stood to make quite extravagant returns. Now that it has failed, it is the taxpayer and the Tube passengers who must meet the cost.**

## Risk borne by Infraco lenders

26. The risk borne by the Infracos’ lenders is heavily offset by the fact that 95% of their debt is guaranteed by London Underground. As the National Audit Office has reported, during the negotiation of the PPP Agreements, ongoing political opposition to the PPP, and Railtrack being placed in administration in 2001, affected lending market sentiment.<sup>38</sup> Before the deals were finalised, the PPP preferred bidders persuaded London Underground that increasing the level of guaranteed debt from 90% to 95% was essential to raise the total amount of finance required. Although one bidder did tell the NAO in 2004 that, before London Underground had agreed to secure 95% of the Infracos’ debts, it had been possible to arrange indicative financing without any requirement that the minimum amount of guaranteed debt be specified.

27. Although they ultimately carried risk reduced to 5% or less, lenders charged about £450 million more than they would have charged on the same level (£3,800 million) of direct

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35 *Ibid.*

36 Q187

37 Q387

38 National Audit Office, *London Underground PPP: Were they good deals?*, 17 June 2004, p 25

Government loans. Following the reclassification by the Office for National Statistics of Tube Lines and Metronet's borrowing from the private sector to the public sector in September 2007, it appears with hindsight that this higher cost of borrowing could have been avoided by procuring loans direct to the Government with no additional risk to the public sector.<sup>39</sup>

28. Moreover, the Arbiter considers that Metronet's lenders could have done more under their funding agreements to hold Metronet to account for its escalating costs—for example, by withholding funding and effectively compelling Metronet to trigger an Extraordinary Review much sooner.<sup>40</sup> He indicated that the fact that 95% of Metronet's debt was guaranteed may have reduced the incentive for its creditors properly to look after their loan.<sup>41</sup> In fact, Metronet's former Chairman told us that, over and above a lack of confidence in Metronet's financial model, it was a warning that further lending might not be guaranteed to 95% that finally convinced the banks to stop advancing Metronet more money.<sup>42</sup>

**29. In terms of borrowing, the Metronet contract did nothing more than secure loans, 95% of which were in any case underwritten by the public purse, at an inflated cost—the worst of both possible worlds. As with the shareholders, what minimal risk was borne by Metronet's lenders was disproportionately well rewarded, at the expense of tax- and fare-payers. Public sector negotiating parties must be hard-headed in their determination to achieve the best possible terms for financing private sector delivery organisations. The banks should be required to take on substantial risk to reflect the large sums of money available. Additional risk would also increase the incentive for lenders to look after their debt properly. A proper assessment should be made of the cost of higher-risk lending against that of guaranteeing large quantities of private sector debt in the event of a company's failure. If finance cannot be secured at reasonable terms without guaranteeing the vast majority of the debt, loans direct to the Government, which would enjoy the highest credit rating and significantly lower costs, would seem to be the more cost-effective option.**

## The Materiality Threshold

30. The Materiality Threshold during the first Review Period—the cost increase below which the Infracos cannot claim for additional funds from London Underground—was £50 million for each of the Metronet Infracos and £200 million for Tube Lines. The Materiality Threshold for Tube Lines' PPP Agreement is set to be reduced from £200 million to £50 million for the second 7½ year period. Tube Lines' higher Materiality Threshold of £200 million has given it a powerful incentive to make savings in order to offset any cost increases, rather than seeking additional payments from London Underground. This has encouraged a considerable level of innovation by Tube Lines, for example:

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39 See Ev 74.

40 Q 23

41 Qq 51–52

42 Q 202

- a) a significant reduction in the time taken to refurbish escalators (from up to nine months to around nine weeks);
- b) a reduction in the time taken to implement station modernisations (from around two years to as little as four months) alongside a reduction in costs of some 40%;
- c) the introduction of a number of new processes and new equipment to make maintenance more efficient; and
- d) more emphasis on preventative maintenance, rather than simply waiting for infrastructure to fail.<sup>43</sup>

31. Tube Lines attributes its innovations to the long-term and output-based nature of the contract and warns that, “Should part of the work undertaken under the PPP be returned in-house, there would be a risk of a return to the resistance to change and entrenched attitudes which militated against innovation before transfer.”<sup>44</sup> We do not want to see the baby thrown out with the bathwater; the involvement of the private sector working to an output-based contract has in some areas resulted in significant innovations to approaches that have hitherto remained the same for many decades. It is clear that the private sector will need to be involved to a large extent in delivering the necessary future volume of work, and it is to be hoped that the potential of output-based, fixed-price contracts to result in cost savings can be realised. However, the failure of Metronet fatally damages the Government’s assumption that the involvement of the private sector will always result in efficient and innovative approaches to contracts.

**32. Metronet’s inability to operate efficiently or economically proves that the private sector can fail to deliver on a spectacular scale, although Tube Lines’ performance provides an example of private sector innovation and efficiency. The evidence is clear: it cannot be taken as given that private sector involvement in public projects will necessarily deliver innovation and efficiency, least of all if the contracts lack appropriate commercial incentives. Future assessments of the comparative value for money of private sector-managed models for infrastructure projects should not assume a substantial efficiency-savings factor; a detailed assessment should be made of the suitability of the proposed structure of delivery organisations, of bidders’ specific expertise and of the strength of the incentives to efficiency. It is worrying that the Government’s confidence in such savings appears to stem from a belief that inefficiency is more endemic and irreversible in the public than the private sector.**

33. The Arbiter argued that Metronet’s relatively low Materiality Threshold of £50 million per Infraco contributed to both a limited transfer of risk away from the public purse and a flawed approach by Metronet to cost management.<sup>45</sup> He considered that Metronet’s approach to negotiating cost increases prior to commencing work on projects contributed to delays, particularly in respect of the stations programme.<sup>46</sup> In contrast, he described the original “structure and philosophy” of the Tube Lines contract as “very much around

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43 Ev 56

44 Ev 58

45 Q 21

46 Qq 5-7

delivering within the amount bid rather than seeing it, as I think Metronet almost did, as a cost-plus contract”.<sup>47</sup>

**34. It is clear that in negotiating future agreements the Government should seek as high a Materiality Threshold as possible in order that public liability is minimised in the event of an overspend by the private sector. The level of the Materiality Threshold is crucial in encouraging efficiency and innovation. If it is set so low as to be, in effect, a cost-plus contract, this encourages the contractor to hold out for ever-larger payments over and above what was originally bid.**

### **Inefficient costs and the principle of the PPP**

35. High-profile public sector overspends, such as the Jubilee line extension project, made the PPP arrangement for the London Underground attractive to the Government because an output-based contract should ensure that inefficient expenditure is entirely the burden of the contractor. The Department maintains that the PPP was introduced by the Government to guarantee value for money for taxpayers and passengers, as well as to utilise the private sector’s capacity “to overcome the investment backlog, and maintain and modernise infrastructure”.<sup>48</sup> It is therefore surprising that Metronet’s collapse seems to have done little to dent the Government’s confidence in the PPP model. The PPP Arbiter told us that he believed the basic structure of the PPP—that the private sector delivers best when it is told what outputs to deliver and is free to decide what approach it should take to delivery of those outputs—remains sound and that Metronet’s failure should not invalidate the principle of an output-based contract.<sup>49</sup>

36. The Secretary of State was clearly of the view that additional costs to the public are the fault of Metronet itself, particularly the company’s structure and corporate governance, rather than an inherent problem with the PPP model.<sup>50</sup> She argued that the model “in theory at least” could deliver good value for money and that Metronet, if it had had “appropriate leadership in place” could have resolved its problems.<sup>51</sup> Even Tim O’Toole, the Managing Director of London Underground, seems to have softened his attitude towards the PPP telling us that Metronet’s own structure, rather than the PPP system itself, was at fault for its collapse—although he did point to deficiencies in provisions in the PPP to allow early visibility of problems.<sup>52</sup>

37. On the other hand, the unions have reiterated their opposition to private-sector management of the upgrades. Gerry Doherty, General Secretary of the Transport Salaried Staffs’ Association (TSSA), said that Metronet’s collapse had confirmed the Union’s view that PPP was poorly conceived in the first place and unable to deliver the necessary improvement to the London Underground system.<sup>53</sup> He suggested that a not-for-profit

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47 Q 48

48 Ev 70

49 Qq 2, 3 & 50

50 Q 325

51 Qq 320 & 325.

52 Q 258

53 Q 68

model similar to that employed on the mainline railway network after the collapse of Railtrack might be appropriate for the Underground.<sup>54</sup> Since Metronet's administration, the Mayor of London has signalled his aspiration for Transport for London to take over Metronet, with maintenance carried out in-house and individual contracts being let for upgrades and major investment work.<sup>55</sup>

38. Tube Lines Chief Executive, Terry Morgan, expressed concern over the possibility of Transport for London taking over the Metronet Infracos.<sup>56</sup> Tube Lines also says that its “whole-life asset management approach” allows it to “take a long term and holistic approach to planning” and deliver more quickly as the scoping, design and construction phases can be undertaken without spending time securing new money or tendering for new suppliers.<sup>57</sup> Losing the advantages of whole-life asset management, which are a consequence of the selection, maintenance and renewal of Tube infrastructure being the responsibility of a single party, could certainly be a particular risk of splitting maintenance and upgrade work. If one organisation has long-term responsibility for both upgrading and maintaining infrastructure (which is still the case for Tube Lines), it has an incentive to consider future maintenance requirements when designing and installing upgrades.

**39. Now that TfL is in control of the Metronet contract, there is a danger that private contractors brought in to upgrade the network will not be alive to its future maintenance needs, which will be met by TfL. This is not an insurmountable problem but it means that careful attention must be paid to the future maintenance of the underground network at a very early stage in the process of commissioning upgrade work. It might be that, for part or all of the network, letting combined contracts for upgrading and maintenance offers the best value for money.**

## Value for money

40. Tony Travers of the London School of Economics estimates that £5–7.5 billion has been spent on the Tube network in the past five years, which, he says, “is a huge amount of money to have delivered—at the very best—a train service that’s overall no different [from] when we began.”<sup>58</sup>

41. In order to assess the relative value for money of the PPP bids, London Underground (then under central Government control through London Regional Transport) undertook an exercise to assess what the work might cost if it were undertaken in the public sector. London Underground acknowledged that its public sector comparators were always subject to a high degree of inherent uncertainty and therefore only gave limited assurance about the reasonableness of the prices quoted by bidders.<sup>59</sup> Broadly speaking, Tube Lines' and Metronet BCV's bid costs were within the range of the projected public sector costs; for the sub-surface lines, the Metronet bid cost was £500–1,000 million less than the public

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54 Q 82

55 See, for example, Mayor's Question Time on 12 September 2007.

56 Q 116

57 Ev 57

58 “Is this a new Metronet timebomb?”, *The Evening Standard*, 29 October 2007

59 National Audit Office, *London Underground PPP: Were they good deals?*, 17 June 2004

sector cost for the first 7½ years.<sup>60</sup> However, both Metronet companies ended up operating with significantly higher costs than were anticipated in their bid and were projecting a total overspend of around £2 billion by 2010. Some, but not all, of those cost increases would have also been borne by an organisation operating economically and efficiently, for example, those arising as a consequence of the state of the assets.

42. The Committee of Public Accounts published a Report on the PPP in March 2005 that was broadly critical of how the PPP had been put together.<sup>61</sup> The Report's conclusions included the following:

- a) The PPP model might have been used only for major upgrade work, rather than for both upgrade and maintenance.
- b) Departments should not use the Public Sector Comparator as conclusive evidence of the value for money of the PPPs.
- c) Issuance of a public sector bond should be considered for financing future infrastructure projects in which significant risk transfer to the private sector may not be achievable.

43. In our Report of 2005, we reserved judgement on whether the private sector would upgrade the network more efficiently and effectively than would have been the case through the public sector. The major achievement of the PPP, we concluded, had been “to ensure that the Government [committed] itself to providing sustained funding for London Underground; a commitment which, given the political will could have been made without any PPP.”<sup>62</sup>

44. The Department says that it introduced the PPP to utilise “the private sector's capacity [...] to overcome the investment backlog” and in order to “improve the Underground, safeguard its commitment to the public interest and guarantee value for money for taxpayers and passengers.”<sup>63</sup> However, given its complexity and associated administrative costs—some £500 million has been estimated as the cost of setting the London Underground PPP Agreements—and the demonstrable uncertainty associated with ‘private sector efficiency gains’, the value of paying the private sector to manage public sector infrastructure projects is crucially dependent on the level of risk transfer achieved by the contracts, and it is clear that in the case of the Metronet PPP Agreements the level of risk transfer achieved was not as high as had been thought.<sup>64</sup>

**45. The Government should not enter into any further PPP agreements without a comprehensive and accurate assessment of the level of risk transfer to the private sector and a firm idea of what would constitute an appropriate price for taking on such a level of risk. If it is not possible in reality to transfer a significant proportion of the risk away**

60 London Underground, *Final Assessment Report*, 2 February 2002

61 Public Accounts Committee, Seventeenth Report of Session 2004-05, *London Underground Public Private Partnerships*. HC 446

62 Transport Committee, Sixth Report of Session 2004-05, *The Performance of the London Underground*, HC 94

63 Ev 70

64 Q 43 refers to the £500 million cost of setting up the agreements.

**from the public purse, a simpler—and potentially cheaper—public sector management model should seriously be considered.**

## 4 The powers of the Arbiter

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### Reporting on the performance of the Infracos

46. There are two mechanisms under the PPP Agreements for monitoring and reporting on the performance of the Infracos:

- a) London Underground has responsibility as the customer for monitoring delivery of the obligations in the contract and has produced an annual report on performance under the PPP for each year other than 2006–07.
- b) The Arbiter, at the request of London Underground and Metronet produces a report on economy and efficiency and Good Industry Practice.<sup>65</sup>

47. Under the terms of the two Metronet Agreements, the Arbiter could be asked annually to prepare a report on performance (no provision for an annual performance reporting by the Arbiter exists in the Tube Lines contract). This process was intended by Metronet to enable each Metronet Infraco to understand on an ongoing basis whether it was meeting the criteria of efficiency and economy and Good Industry Practice contained in the PPP Agreements and, if not, to identify the areas in which improvement was required in order to ensure that those criteria were met as soon as possible, and certainly before the first Periodic Review.

48. The Arbiter contends that such a report would have identified the following:

- a) the scale of the shortfall in delivery by Metronet, in particular on the stations and track programmes;
- b) the emerging projected overspend, which by late 2005 already exceeded the Materiality Threshold for Metronet BCV; and
- c) weaknesses in financial and risk management, and in management of the supply chain.<sup>66</sup>

49. The Arbiter expected a request to prepare the first Metronet annual performance report in 2005, to cover the two year period from Transfer in April 2003. However, he told us that, in the event, it was agreed by Metronet and London Underground not to seek the 2005 report, and that Metronet secured a waiver from its funders to permit this.<sup>67</sup> Metronet's former Chairman, Graham Pimlott, who was appointed in 2007, thought that Metronet "wanted to try to sort [its] difficulties out with London Underground before subjecting itself to a public examination."<sup>68</sup>

50. The Arbiter considered the absence of a report in 2005 to have been detrimental:

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65 This is the description of the monitoring process given to us by the Arbiter, Mr Bolt, at Q12.

66 Ev 47

67 Q 13 and Ev 48

68 Q 189

My view is that had these issues been brought out publicly sooner, Metronet with London Underground would have started to address the problem sooner. It might not have been sufficient to avoid administration, but it would certainly have avoided some of the additional costs which are now being incurred.<sup>69</sup>

In particular, he took the view that a 2005 report would have made it clear at an early stage to shareholders and lenders that some of the costs to date had not been incurred by Metronet in an efficient and economic manner, and were not therefore recoverable from London Underground, and that early action was therefore essential if financial difficulties were to be avoided.<sup>70</sup> When the Arbiter did come to produce his first Metronet Report in 2006, he concluded that progress under the main performance measures had been mixed and that neither of the Metronet Infracos had performed in an efficient and economic manner, or in accordance with Good Industry Practice.<sup>71</sup>

51. On the whole the Arbiter reported that Metronet had delivered significantly less than was expected in its bids, at higher unit costs, and had earned less performance revenue than expected. For example, over the first three years of its contract, Metronet SSL delivered 10 of an anticipated 18 station refurbishments, at a unit cost of £7.5 million rather than the expected £2 million. Metronet BCV delivered only 4 of 17 anticipated stations. Track renewals were also grossly behind schedule. The Arbiter identified asset management and risk management as important weaknesses. He recognised that Metronet had introduced a number of initiatives over the previous year to address shortcomings in its performance and to put more emphasis on whole-life asset management. He considered that these changes had helped to improve Metronet's performance but that the full benefits of the changes had yet to be realised.

52. Metronet announced a number of important changes on 13 March 2007:<sup>72</sup>

- a) Following a competitive tender process, the first tranche of six contracts for station upgrades worth more than £150 million was awarded outside of its tied supply chain in early 2007. Metronet had accelerated its station upgrade programme in the previous year but planned to complete the balance of 84 stations using an open competitive tendering procedure.
- b) Metronet had converted the contract for its track renewal programme into a Metronet/Balfour Beatty alliance in an attempt to take advantage of lessons learned from the first two years and improved performance in the third year. Metronet had also invested £80 million in a new engineering train fleet to boost delivery of its programme.
- c) 550 additional front-line staff were being recruited to support the move to a planned, preventative maintenance regime and priority was being given to the engineering issues which have the potential to create the greatest adverse impact.

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69 Q 16

70 Ev 49

71 Office of the PPP Arbiter, *Annual Metronet Report 2006*, 16 November 2006

72 "Metronet responds to PPP Arbiter's Guidance on Additional Costs", Metronet press release, 13 March 2007

- d) A new independent non-executive chairman (Mr Pimlott) and three senior independent advisors had been appointed in an attempt to ensure Metronet had access to best practice in the international market.

53. Mr Pimlott recognised that the Arbiter's 2006 report been a significant factor in encouraging Metronet to address its poor performance and conceded that a report in 2005 might have been similarly beneficial.<sup>73</sup> The Secretary of State agreed that there were not adequate systems in place to highlight poor performance and that Metronet's contract should have incentivised more strongly the production of the 2005 annual performance report.<sup>74</sup> Tim O'Toole of London Underground expressed serious concerns over the lack of information that was available in order for LUL to assess the performance of the Infracos and called for clearer specification in the PPP contracts with respect to information sharing and transparency.<sup>75</sup> However, he rejected the assertion that the production by the Arbiter of a report in 2005 would have significantly improved Metronet's performance, describing the annual review as something that was incorporated into the agreement "by Metronet to protect Metronet". London Underground was

very, very sceptical of this proceeding, very worried about it [...] that proceeding was not designed to give us information; it was designed to help Metronet get through a Periodic Review.<sup>76</sup>

54. The Secretary of State indicated that a formal power to allow the Arbiter to report on the performance of the Infracos unbidden might not be required and that there might be other ways of ensuring that poor performance is addressed.<sup>77</sup> The DfT's Paul Collins, Head of Regional Transport London and South East, told us that the Arbiter's reporting powers and the clear and timely provision of information were areas that the Department would be looking at very carefully.<sup>78</sup>

**55. We consider that the gathering and publication of information by the PPP Arbiter will generally tend to benefit all interested parties: London Underground as client, the Infracos as suppliers and the public as users. The Government should also find such information useful for assessing the benefits and costs of similar proposals in the future. There is some evidence to indicate that an earlier review could have mitigated the impact of Metronet's collapse, if not averted it entirely. However, it is important that any reporting process is seen as neutral and is designed to provide the information that both the Infracos and London Underground require to address performance issues and to prepare for Periodic Review. It would have been wiser to make the annual review an automatic process rather than one which had to be initiated by a party to the contract.**

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73 Qq 190–193

74 Qq 336–337

75 Q 240

76 Qq 260–268.

77 Q 357

78 Q 363

56. **Though we have not sought to evaluate Tube Lines’ performance in the course of this inquiry, we believe that, in principle, annual reports on Tube Lines would be just as valuable as it could have been in the case of Metronet. An independent report from the Arbiter in 2008 on the performance of Tube Lines to date would be timely, particularly in the absence of a 2006–07 London Underground report on the performance of the Infracos.**

57. **We recommend that a mechanism be put in place to allow the PPP Arbiter to report annually on the performance of the Infracos, including Tube Lines, whether or not he is called on to do so; this might require the granting of additional powers to the Arbiter under the Greater London Authority Act 1999.**

58. If part of the management of the Tube upgrade programme is to come back under public control in the long-term, the requirement for transparency in terms of progress and value for money will not be diminished. The Arbiter, giving evidence before TfL took over Metronet, suggested that it would “remain important to benchmark performance between Metronet and Tube Lines to establish and demonstrate value for money” if Metronet were to come into public ownership and that there would therefore still be a need for some independent body or person to be involved in that benchmarking performance.<sup>79</sup> He also noted the importance of benchmarking against the performance of Network Rail for tasks that it has in common with the Infracos, such as track renewal.<sup>80</sup>

59. When Transport for London takes over the Metronet companies, it will effectively be on both sides of the contracts, as purchaser and provider. It therefore appears unlikely that the Arbiter will be requested to perform his functions in relation to Metronet. **As long-term arrangements for upgrading the Tube are devised, the Government should ensure that there is a mechanism to guarantee independent reporting of progress and value for money, no matter what delivery vehicle takes the place of Metronet’s PPP Agreements.**

## The performance of London Underground

60. Metronet have previously blamed cost overruns on a wasteful approach to job specification by London Underground and a misconception by London Underground that the PPP Agreements represent fixed-price contracts. Metronet contends that it has sought to make London Underground aware of the financial impact of changing requirements and that London Underground has not re-defined the scope of the works to keep the overall cost to that set out in the PPP Contract. London Underground, in Metronet’s view, has continued to act as if the PPP contract were a fixed price contract, whilst at the same time seeking to secure more scope and increased specification.<sup>81</sup> Mr Pimlott told us that there had been “some difficulty in interpreting what the area of the contract relating to stations truly meant.”<sup>82</sup> Metronet had assumed that stations would be put into one of three categories to be given varying levels of refurbishment but Mr Pimlott explained that the stations were “more unique than that” and the client’s requirements were different from

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79 Q 31

80 Q 36

81 “Metronet Rail BCV launches PPP Extraordinary Review”, Metronet press release, 29 June 2007

82 Q 176

those for which Metronet had bid.<sup>83</sup> He asserted that if the original specification had been clearer many of Metronet's problems on the stations programme would have been avoided.<sup>84</sup>

61. On the other hand, Tim O'Toole thought that Metronet's differences of opinion were mainly with its subcontractors—resulting in “armies” of people “standing around and nothing getting done.”<sup>85</sup> In any case, the Arbiter suggested in his 2006 report that there could be considerable benefit in terms of value for money if Metronet and London Underground were to “adopt procedures which allowed the specification of works, for example at stations, to be agreed without recourse to dispute resolution, and to have a single process for agreeing the appropriate payment if efficient and economic costs are above those provided for”.<sup>86</sup>

62. In his September paper on the likely outcome of the Metronet Extraordinary Review, the Arbiter estimated that London Underground could be liable for £370–1,070 million of Metronet's projected overspend during the first 7½ years of the contracts.<sup>87</sup> This judgement is primarily the result of efficiently undertaken work that was not costed in the original bids.

**63. A contractual arrangement which fails to incentivise efficiency in the private sector and at the same time fails to deter poor planning, lack of forethought and gold-plating in the public sector is one which is pretty much useless. Metronet alleges that part of its overspend is a consequence of decisions by London Underground, such as changes to the specification of ongoing works. We recommend that in the future the Arbiter, alongside reporting the performance of the Infracos, reports the effectiveness of London Underground as client during the modernisation of the Tube network.**

## The Extraordinary Review

64. The process of Extraordinary Review is designed to determine the respective liabilities of an Infraco and London Underground in the event of an increase in costs. London Underground is liable to remunerate the Infracos for costs that are efficiently incurred, even if they were not anticipated in an Infraco's bid. Responding to the Arbiter's 2006 performance report, which noted a projected overspend of £750 million by 2010, Metronet blamed a significant part of the cost variance on “bid omissions” (i.e. work that was required but not anticipated in the original bid), or attributed it to the effects of the assets being in a different condition from that expected at the time of the bid, and was seeking to negotiate additional payments from London Underground. Mr Pimlott described the situation:

As I understand it, the view of London Underground was that the work had been bid for and therefore if more work was done the contractors would have to swallow it,

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83 Q 177

84 Q 178

85 Q 234

86 Office of the PPP Arbiter, *Annual Metronet Report 2006*, 16 November 2006

87 PPP Arbiter, *Initial Thoughts*, 21 September 2007

and the view of the contractors was that if more work had been done and it was done efficiently, economically and in accordance with good industry practice, they would be paid for it. That difference of opinion, in my view, when applied to the facts, was the reason for doing the Extraordinary Review.<sup>88</sup>

65. London Underground made it clear publicly in February 2007 that it did not consider it possible to reach a negotiated settlement with Metronet over its cost increases and that Metronet should use its contractual right to seek an Extraordinary Review to recover the additional sums that it was claiming. However, the Arbiter did not receive a request for an Extraordinary Review from Metronet BCV (subsequently withdrawn) until June 2007 and has not been asked to undertake such a review of Metronet SSL's costs. Mr Pimlott acknowledged that it would have been better if there had been an earlier Extraordinary Review,<sup>89</sup> and the Arbiter considered that, had a Review been started twelve months earlier, some of Metronet's additional costs might have been avoided.<sup>90</sup>

**66. As with the annual report, there is evidence that had the Extraordinary Review been initiated at an earlier stage, it might have mitigated the worst effects of Metronet's failure. We recommend that, for future PPP Agreements, the Government extend the power to trigger an Extraordinary Review to both contract parties, rather than only the Infracos. Such a change could reduce the possibility that an overspend would be allowed to get as far out of control as it did in the case of Metronet.**

67. In order for Tube Lines to seek additional payments from London Underground, it would first be required to submit to assessments by the Arbiter of non-recoverable cost increases (i.e. efficient cost increases below its Materiality Threshold of £200 million) in £50 million tranches (although to date relatively effective cost controls have ensured that this mechanism has not yet been necessary). The Arbiter, who was not asked to take a view as to whether cost overruns were efficient or not until they had surpassed the Materiality Threshold by many times,<sup>91</sup> suggested that a mechanism to oblige Metronet to seek a determination at an early stage should have been included in its PPP Agreement. This, he indicated, would have resulted in a clear allocation of responsibility for cost increases between London Underground and Metronet and would have forced earlier action to address some of the problems that Metronet experienced.<sup>92</sup>

68. The Secretary of State also told the Committee that the incentives which were built into Metronet's contract to encourage it to seek an early opinion from the Arbiter as to liability for cost overruns were not "sharp" enough. She also thought that cost overruns had been allowed to build up without anybody being clear whose responsibility it was to address them.<sup>93</sup>

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88 Q 218

89 Q 222

90 Q 23

91 Q 21

92 Q 25

93 Qq 329, 336 & 337

69. The uncontrolled spiral of cost overruns, without any assessment being made of its causes or of the respective liabilities of the parties to the contract, must never be allowed to happen again. A mechanism similar to that which is built into the Tube Lines contract to ensure an early examination of any cost increases should be included as a matter of course in any future contracts.

## 5 Costs to the public

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70. The collapse of the Metronet PPP Agreements will inevitably have an impact on taxpayers and Tube passengers. As Tim O'Toole of London Underground told us:

I cannot sit here looking at a catastrophe of this dimension and say, 'Don't worry, it is not going to cost anyone anything'.<sup>94</sup>

None of our witnesses was able to provide an estimate of the total public cost of Metronet's failure. However, on top of liability for 95% of Metronet's overspend, which was projected to reach some £2 billion by 2010, Transport for London has made available a £900 million loan facility to Metronet's Administrators to cover its operating deficit of around £13 million a week in the absence of further funding from the banks.<sup>95</sup>

71. In September 2007 the Office for National Statistics reclassified Metronet and Tube Lines from the private sector to the public sector for the purposes of the National Accounts and Public Sector Finances. Hence, according to the Secretary of State, the entry into administration does not, of itself, change the public expenditure treatment for Metronet's existing debt, and so does not represent a net impact on the public purse.<sup>96</sup> To the extent that the loan of £900 million is utilised (the Administrator has previously indicated that he expects to use the entire amount),<sup>97</sup> this would also have been borrowed by Metronet anyway to cover its operating deficit and would have been classified as public expenditure, less the additional cost of administration.<sup>98</sup>

72. The additional costs to the public purse are made up of Transport for London's liability for the additional cost of administration and the cost of inefficient work by Metronet. Otherwise, Transport for London's liability for Metronet's efficient overspend and for the additional cost of administration represents a transfer of liability from central Government to Transport for London. In any case, the actual total cost overrun, whoever is liable, is unlikely to amount to the figure that Metronet were projected to overspend by 2010 if future work can be delivered more efficiently than Metronet were expected to, and some of the additional expenditure would have been necessary in any case, even if the work had been delivered efficiently.<sup>99</sup> As Mr O'Toole put it, "The issue is how much of that debt did not deliver work that now has to be delivered by somebody else and that is the cost to us."<sup>100</sup> Additionally, the equity written off by Metronet's shareholders, some £300 million to date, will contribute to paying for its overspend.<sup>101</sup>

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94 Q 309

95 Q 298

96 Ev 74

97 For example, at the London Assembly Transport Committee evidence session of 11 September 2007.

98 Ev 74

99 Ev 74

100 Q 295

101 Ev 74

73. The Arbiter's report of September 2007 made public the results of his initial analysis of Metronet BCV's Extraordinary Review (subsequently suspended) and sheds some light on the likely scale of inefficiently undertaken work.<sup>102</sup> While Metronet BCV identified a likely overrun to 2010 of £1,047 million, the Arbiter's view was that the appropriate figure for Net Adverse Effects for an efficient company would be in the range £140–470 million. The Arbiter had also reviewed the financial model for Metronet SSL, which shows a projected cost overrun of some £1.15 billion to 2010, and considered that the potential scale of recoverable Net Adverse Effects would likely be £230–600 million. The Arbiter's figures therefore put the cost of Metronet's projected inefficient overspend to 2010 in the range of £1.1 billion to £1.8 billion.

74. Mr O'Toole told us that the Mayor of London has asked for an assessment of additional costs and the resultant impact to the future programme by late spring, although he noted that the results will be partly dependent on negotiations with the Government and other stakeholder as to the particular vehicle to deliver Metronet's upgrade work.<sup>103</sup> He was not confident that there would not be any scaling back of the investment programme:

Everyone will do everything to protect the line upgrades because to not deliver that is simply unthinkable. This system, as I said, is bursting at the seams and it is becoming ever more important to London and it has to be renewed. We already know as a result of Trans4m just cancelling and walking off that the stations programme has kind of sat down. We are trying to continue the work that is on site right now so that at least there is not a compounding of waste, but the starting of new jobs has definitely fallen behind the original schedule, so at a minimum some of that work is going to be pushed into the future—at a minimum.

When we get into further analysis of the costs and what can be done and when, the sort of things you have to worry about is the completion of the stations programme, completing the tunnel cooling programme [...], and the accessibility programme and the congestion relief programme. [...] those are going to be some very tough choices that will be faced in the future.<sup>104</sup>

75. On the delay to the station programme, Mr O'Toole explained that, although the analysis was not yet complete, the schedules for at least 50 station refurbishments have had to be changed, which represents a separate cost in lost utility to passengers.<sup>105</sup> He confirmed that he had only two potential sources of funding to cover the costs of Metronet's inefficiency and other cost increases: fares and a grant from central Government.<sup>106</sup> Discussing a potential Government contribution to the costs of Metronet's failure, he said that the Government had been "very constructive" in its approach but had "not signed a blank cheque".<sup>107</sup>

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102 PPP Arbiter, *Initial Thoughts*, 21 September 2007

103 Q 283

104 Qq 284–285

105 Q 311

106 Q 303

107 Q 305

76. While expressing an aspiration to minimise additional costs to the taxpayer or passenger,<sup>108</sup> the Secretary of State would not confirm how much of the additional cost central Government would be willing to cover:

[...] these issues were explored between myself and the Mayor in the run-up to the Comprehensive Spending Review and we were clear that the amount of money provided to London as a settlement was appropriate to cover both the costs of Crossrail and made appropriate accommodation for Metronet as well as delivering for Londoners in other respects. Obviously within that envelope the Mayor and TfL will have to make choices about priorities, but I think it was an appropriate long-term funding settlement.<sup>109</sup>

77. It was always recognised that efficiently expended increases in costs—for instance, due to the unexpected condition of assets—would need to be assessed at the first Periodic Review in 2010. Unless additional funding can be secured such cost increases in the first review period will have to be offset by reductions in scope in the second review period.

78. It was the Government that insisted on the PPP structure for the modernisation of the London Underground in the face of opposition by the Mayor of London. Now Metronet has failed, it is unclear how much of the financial responsibility the Government is prepared to bear. Both the Mayor and the Secretary of State have insisted that transport in London will benefit from a favourable settlement from the Comprehensive Spending Review but money for Crossrail and the Olympics obscures the scale of central Government's contribution to the cost of Metronet's collapse.

**79. We recommend that the Government, as a matter of urgency, make a full assessment of the additional costs that have been incurred as a result of the failure of Metronet—including the cost of work that has been inefficiently undertaken and the cost of administration. The Secretary of State should then come to the House to make a statement on what proportion of these costs are to be met by central Government and what proportion she expects residents of London and Tube passengers to pay. The Government should also consider its contribution to efficient increases in costs as a result of the unknown condition of the infrastructure, in order that London Underground is not forced significantly to reduce the scope of the upgrade programme during the second Review Period from 2010.**

80. When Metronet entered administration on 18 July 2007, the Prime Minister told the House that, "If Metronet pulls out, another company will be found to take its place"<sup>110</sup> In August the PPP Administrators engaged an advisory investment bank, N M Rothschild & Sons Limited, to carry out an independent valuation of the Metronet companies in order that the market might be tested for interest from potential purchasers. However, no private sector interest was forthcoming. As Alan Bloom, Metronet's PPP Administrator, told us

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108 Q 318

109 Q 347

110 HC Deb, 18 July 2007, col 276

an active medium to long-term marketing campaign for the business would have been fruitless. We would not have generated any [...] interest in what we had to sell.<sup>111</sup>

This negligible prospect of finding buyers persuaded the Administrator that continuing with the Extraordinary Review of Metronet BCV or requesting a Review of Metronet SSL, which could have increased the companies' values by establishing London Underground's liability for the cost increases, would have been unproductive. The request for an Extraordinary Review was therefore withdrawn on 31 October 2007.<sup>112</sup> London Underground supported this withdrawal. The Review, in the view of Tim O'Toole, was "a proceeding that was not going to tell [London Underground] anything, seemed a complete waste of time and, quite frankly, from our point of view, was vexatious."<sup>113</sup>

81. The failure to sell Metronet to the private sector means that the costs of operating Metronet during administration and of the overspend will ultimately be paid for entirely by the public. Although we are not surprised that a buyer could not be found, it is regrettable that the Extraordinary Review was not completed, particularly because the Arbiter expected to publish his results less than two weeks after the Review was called to a halt. Not only did the cessation of the Review effectively eliminate any private sector competition to London Underground's bid to take over the Metronet Infracos, but it curtailed an in-depth analysis by the Arbiter of exactly what led to Metronet's cost overruns and eventual collapse. It is at least possible that the Review could have pointed out some of the lessons that needed to be learned from the experience. Nonetheless, the Arbiter's September report,<sup>114</sup> along with his draft determination on additional interim payments of the Infrastructure Service Charge<sup>115</sup> and the 2006 Metronet performance report,<sup>116</sup> provide a useful commentary on Metronet's failure.

**82. We hope that, in its discussions with Transport for London as to the future of Metronet's PPP Agreements, the Government makes full use of the Arbiter's analysis for the partial Extraordinary Review of Metronet BCV and for a potential Extraordinary Review of Metronet SSL, and that his insights are utilised to minimise the chance that further unexpected and wasteful costs to the public purse might be incurred.**

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111 Q 250

112 "Metronet Rail BCV Ltd withdraws its reference for Extraordinary Review", Office of the PPP Arbiter press release, 31 October 2007

113 Q 242

114 PPP Arbiter, *Initial Thoughts*, 21 September 2007

115 Office of the PPP Arbiter, *Draft directions on Interim Infrastructure Service Charge for Metronet BCV*, 16 July 2007

116 Office of the PPP Arbiter, *Annual Metronet Report 2006*, 16 November 2006

## 6 Safety

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83. Track work on London Underground is potentially very dangerous. Work is carried out underground, in the middle of the night, by groups of staff working for different employers, to tight deadlines. Contractors have only the five-hour period when trains are not running to move their equipment in, carry out the work and clear it all away again. Work that would be carried out mainly by machines on the surface is carried out by hand underground because of the difficulty of getting plant down the tunnel. In some cases, for example, rubble and debris is carried out of the station by hand, in sacks. We are grateful to Tube Lines for allowing members of the Committee secretariat to observe some of this work in progress. The unions are concerned that the structure of the PPP contracts is having a detrimental effect on safety for Underground passengers and employees engaged in the upgrade work. A number of specific incidents were highlighted to the Committee as examples of poor communication, slow incident resolution and non-compliance with safety regulations.<sup>117</sup> Unite described health and safety procedures on London Underground as “alarmingly fragmented”, with poor communication between LU’s safety committees and private sector staff.<sup>118</sup> Metronet was in their view the worst offender and they suggested that Tube Lines was able to respond more quickly to safety concerns.<sup>119</sup>

### Employee safety

84. Written evidence from ASLEF suggests that the PPP has led to poor communication between the Infracos and their employees, and between London Underground employees and the Infracos.<sup>120</sup> For example, ASLEF reports that London Underground drivers often do not know to whom they should be addressing infrastructure issues, which are the responsibility of the Infracos. ASLEF gives examples of local disputes at Arnos Grove depot, Acton Town depot, and North Greenwich depot, and of disputes on the District line and the East London line.

85. While Terry Morgan, Chief Executive of Tube Lines, accepted the number of organisations involved in carrying out the upgrade work as a risk, he vigorously disputed accusations of lax safety standards or inadequate systems.<sup>121</sup> He told us that employees of Tube Lines are now four times less likely to suffer an injury than they would have been four years ago, before they were transferred from London Underground.

86. Safety is clearly critical in the dangerous environment inhabited by those who work on London’s underground railway. It requires a relentless effort to maintain high standards of safety and low rates of injury. Poor communication could lead to life-threatening safety breaches, and the unions highlighted serious concerns with communication structures as a result of employees of several different organisations working alongside one another. In the short term, we hope that Transport for London will take the opportunity to work with the

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117 Qq 67–69

118 Ev 78

119 Q 81

120 Ev 63

121 Q 101 & Ev 58

unions to address these concerns when it takes over the Metronet Infracos and brings responsibility for infrastructure and operations together.

**87. To maintain the highest standards of safety for employees in the longer-term, the Government must work with Transport for London and the unions to identify existing communication deficiencies and ensure that the future structure of the contracts does not contain inherent safety weaknesses. Where it is necessary for employees of different organisations to work together, the utmost effort must be made to ensure the clarity of procedures for reporting safety concerns.**

## Passenger safety

88. London Underground is in possession of its safety certificate and safety authorisation from the Office of Rail Regulation (ORR), which, while not guaranteeing safety, indicates that the ORR is satisfied that an effective safety management system is in place. Responsibility for adhering to the terms of the certificate and authorisation rests with London Underground, and the Infracos must cooperate with LU on all safety matters. London Underground will need to obtain an updated certificate and authorisation by March 2012 at the latest. The ORR's own indicators show that overall safety on the railway has not deteriorated since the inception of the PPP Agreements and it describes LU as providing "good levels of passenger and worker safety" though, as with all railways, there is the potential for derailments and other serious incidents.<sup>122</sup>

89. The ORR has investigated four train derailments since the introduction of PPP and concludes that the number and causes of derailments appears to have been unaffected by the PPP. Similarly, the ORR does not believe that PPP has resulted in a change to the number of signals passed at danger. On track maintenance and renewals the ORR says:

The quality of track has implications for train safety, and was implicated in the 2003 Hammersmith derailment. The PPP Infracos took time to develop their priorities for maintaining and renewing track and this meant that some of the most pressing renewals work was not done as quickly as it should have been. In April 2006 we took enforcement action to require Metronet SSL to maintain the District Line to an appropriate standard.<sup>123</sup>

Finally, the ORR report that, as a result of the PPP, rail defects are now more likely to be detected before they become rail breaks, and that there is no indication that the PPP has had a detrimental effect on rolling stock maintenance.

90. When Metronet entered administration, the ORR carried out additional inspections to ensure that track, signals and rolling stock continued to be safely maintained. However, Gerry Doherty, General Secretary of the Transport Salaried Staffs' Association, expressed grave concern that the PPP structure had, in fact, increased risk on the Underground network:

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122 Ev 66

123 Ev 66

Do not wait until you get the same specific instances that you had on the mainline railway through fragmentation and through privatisation before we do something about bringing the railway infrastructure back into where it should be and get proper control over it. What we are saying is that what happened on the Underground is a mirror of what happened on the railway before we had all of those accidents and before we took action by bringing infrastructure and maintenance back in-house.<sup>124</sup>

91. The ORR's evidence supports the view that passenger safety levels on the Tube have been broadly maintained, and in some areas improved, since responsibility for the infrastructure transferred to the Infracos. There is no room for complacency, however—the unions have highlighted the fact that divisions of responsibility, particular during periods when responsibilities are being transferred between organisations, could potentially increase the risk of safety breaches occurring.

**92. During the transition of Metronet's ownership from its shareholders to Transport for London and for the duration of Transport for London's stewardship of the Infracos, as well as in the longer-term under whatever vehicle is chosen to deliver the upgrades, passenger safety must be the primary concern of everyone who is involved. A key role for the Government in its discussions with the Mayor and Transport for London will be to ensure that future contracts incentivise the actions that are necessary to guarantee the highest standards of safety on the network.**

## 7 Conclusion

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93. Contracts that were supposed to deliver 35 station upgrades over the first three years in fact delivered 14—40% of the requirement; stations that were supposed to cost Metronet SSL £2 million in fact cost £7.5 million—375% of the anticipated price.; by November 2006, only 65% of scheduled track renewal had been achieved.<sup>125</sup> They have ended in collapse and chaos. It was a spectacular failure.

94. The Secretary of State was adamant that the Government would be working in partnership with the Mayor of London to decide on how best to proceed with the maintenance and upgrade of the Tube system:

We are not in the business of imposing anything on anyone. I think both the Mayor and I accept there will be private sector involvement in the future, and it is right that there should be, including an element of risk transfer. Quite what the appropriate way of doing that is, as I say, I am open-minded. We need to do the work, we need to understand the state of the assets, we need to understand the cost to the taxpayer and see what interest there is.<sup>126</sup>

It was, of course, the imposition of the PPP on Transport for London—before London Underground was released from central Government control when the contracts were signed—that led us to the present lamentable state of affairs. The future of most of London Underground’s upgrade and maintenance work is in doubt and the public, whether as taxpayers or Tube passengers, must pay for the private sector’s inefficiency and failure. Any reasonable person, looking at the current situation, would find scant evidence to sustain a dogma that the private sector will always deliver greater efficiency, innovation and value for money than the public sector.

95. While the Government and the Mayor of London negotiate over who should foot the bill for Metronet’s collapse, the parent companies are left with relatively modest losses of £70 million each. Metronet itself was little more than a buffer-zone between its parent companies and the obligations of the PPP Agreement. The shareholders were able to reap the rewards of the PPP contracts while Metronet, a company with few assets and little real purpose beyond acting as an intermediary between London Underground and its owners, absorbed all the risk. The Secretary of State told us that the companies concerned had suffered significant “reputational” damage as a result of Metronet’s collapse. **The Government should bear the Metronet debacle in mind if and when its parent companies—Atkins, Balfour Beatty, Bombardier, EDF Energy, and Thames Water—next come to bid for publicly-funded work.**

96. **The Government should remember the failure of Metronet before it considers entering into any similar arrangement again. It should remember that the private sector will never wittingly expose itself to substantial risk without ensuring that it is proportionally, if not generously rewarded. Ultimately, the taxpayer pays the price.**

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<sup>125</sup> Office of the PPP Arbiter, *Annual Metronet Report 2006*, 16 November 2006

<sup>126</sup> Q 352

97. If the Government is again tempted by a seemingly good deal from the private sector, it should recall Metronet's pathetic under-delivery and the deficiencies in the contracts that allowed it to happen. We recommend that the Government publishes a candid analysis of the events preceding Metronet's collapse and its consequences, both in terms of increased costs to the public and delays to the work programme.

98. It is doubly unfortunate that the product of Metronet's efforts bore such scant resemblance to the expectation of its contracts because information as to the efficacy in principle of this private sector management model has been thoroughly confused. Whether or not the Metronet failure was primarily the fault of the particular companies involved, we are inclined to the view that the model itself was flawed and probably inferior to traditional public-sector management. We can be more confident in this conclusion now that the potential for inefficiency and failure in the private sector has been so clearly demonstrated. In comparison, whatever the potential inefficiencies of the public sector, proper public scrutiny and the opportunity of meaningful control is likely to provide superior value for money. Crucially, it also offers protection from catastrophic failure. It is worth remembering that when private companies fail to deliver on large public projects they can walk away—the taxpayer is inevitably forced to pick up the pieces.

99. Finally, now that the Government is considering the future of the Underground upgrade programme, it should prioritise transparency and clarity to taxpayers and ensure that any future contracts result in clear accountability to national or regional Government, thereby providing the public with the opportunity of applying sanctions in the event of poor performance.

## Conclusions and recommendations

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### Metronet's tied supply chain

1. We are not persuaded that Metronet's shareholders had any inclination to address the problem of the tied supply chain nor, as the intended beneficiaries of the system, did they have very much incentive to do so. (Paragraph 16)
2. When the bids for the PPP contracts were being assessed, it should have been possible for the Government and London Underground, then under national control through London Regional Transport, to foresee that Metronet's proposed tied supply chain model, which guaranteed the lion's share of work to its parent companies, did not include the necessary safeguards. The fact that such a management structure was judged to be capable of efficient and economic delivery seems extraordinary now that Metronet has collapsed but the ultimate recipients of the money which was paid to the company have walked away with limited losses. The Government must not allow this blurring between the roles of shareholder and supplier in future bids to carry out work by the private sector. Bids where competitive tendering for sub-contracts is proposed are likely to ensure that the best price is obtained. (Paragraph 18)

### Risk borne by Infraco shareholders

3. The return anticipated by Metronet's shareholders appears to have been out of all proportion to the level of risk associated with the contract. The parent companies were effectively able to limit their liability to the £70 million they each invested in Metronet at the outset. Had Metronet survived, they would also have borne the cost of their own inefficiency along with a minimal amount—£50 million—of any other cost overruns. In the face of this very limited liability it is difficult to lend any credence to the assertion that the Metronet PPP contracts were effective in transferring risk from the public to the private sector. In fact, the reverse is the case: Metronet's shareholders, had the company been operated effectively, stood to make quite extravagant returns. Now that it has failed, it is the taxpayer and the Tube passengers who must meet the cost. (Paragraph 25)

### Risk borne by Infraco lenders

4. In terms of borrowing, the Metronet contract did nothing more than secure loans, 95% of which were in any case underwritten by the public purse, at an inflated cost—the worst of both possible worlds. As with the shareholders, what minimal risk was borne by Metronet's lenders was disproportionately well rewarded, at the expense of tax- and fare-payers. Public sector negotiating parties must be hard-headed in their determination to achieve the best possible terms for financing private sector delivery organisations. The banks should be required to take on substantial risk to reflect the large sums of money available. Additional risk would also increase the incentive for lenders to look after their debt properly. A proper assessment should be made of the cost of higher-risk lending against that of guaranteeing large quantities of private

sector debt in the event of a company's failure. If finance cannot be secured at reasonable terms without guaranteeing the vast majority of the debt, loans direct to the Government, which would enjoy the highest credit rating and significantly lower costs, would seem to be the more cost-effective option. (Paragraph 29)

### The Materiality Threshold

5. Metronet's inability to operate efficiently or economically proves that the private sector can fail to deliver on a spectacular scale, although 'Tube Lines' performance provides an example of private sector innovation and efficiency. The evidence is clear: it cannot be taken as given that private sector involvement in public projects will necessarily deliver innovation and efficiency, least of all if the contracts lack appropriate commercial incentives. Future assessments of the comparative value for money of private sector-managed models for infrastructure projects should not assume a substantial efficiency-savings factor; a detailed assessment should be made of the suitability of the proposed structure of delivery organisations, of bidders' specific expertise and of the strength of the incentives to efficiency. It is worrying that the Government's confidence in such savings appears to stem from a belief that inefficiency is more endemic and irreversible in the public than the private sector. (Paragraph 32)
6. It is clear that in negotiating future agreements the Government should seek as high a Materiality Threshold as possible in order that public liability is minimised in the event of an overspend by the private sector. The level of the Materiality Threshold is crucial in encouraging efficiency and innovation. If it is set so low as to be, in effect, a cost-plus contract, this encourages the contractor to hold out for ever-larger payments over and above what was originally bid. (Paragraph 34)

### Inefficient costs and the principle of the PPP

7. Now that TfL is in control of the Metronet contract, there is a danger that private contractors brought in to upgrade the network will not be alive to its future maintenance needs, which will be met by TfL. This is not an insurmountable problem but it means that careful attention must be paid to the future maintenance of the underground network at a very early stage in the process of commissioning upgrade work. It might be that, for part or all of the network, letting combined contracts for upgrading and maintenance offers the best value for money. (Paragraph 39)

### Value for money

8. The Government should not enter into any further PPP agreements without a comprehensive and accurate assessment of the level of risk transfer to the private sector and a firm idea of what would constitute an appropriate price for taking on such a level of risk. If it is not possible in reality to transfer a significant proportion of the risk away from the public purse, a simpler—and potentially cheaper—public sector management model should seriously be considered. (Paragraph 45)

## Reporting on the performance of the Infracos

9. We consider that the gathering and publication of information by the PPP Arbiter will generally tend to benefit all interested parties: London Underground as client, the Infracos as suppliers and the public as users. The Government should also find such information useful for assessing the benefits and costs of similar proposals in the future. There is some evidence to indicate that an earlier review could have mitigated the impact of Metronet's collapse, if not averted it entirely. However, it is important that any reporting process is seen as neutral and is designed to provide the information that both the Infracos and London Underground require to address performance issues and to prepare for Periodic Review. It would have been wiser to make the annual review an automatic process rather than one which had to be initiated by a party to the contract. (Paragraph 55)
10. Though we have not sought to evaluate Tube Lines' performance in the course of this inquiry, we believe that, in principle, annual reports on Tube Lines would be just as valuable as it could have been in the case of Metronet. An independent report from the Arbiter in 2008 on the performance of Tube Lines to date would be timely, particularly in the absence of a 2006–07 London Underground report on the performance of the Infracos. (Paragraph 56)
11. We recommend that a mechanism be put in place to allow the PPP Arbiter to report annually on the performance of the Infracos, including Tube Lines, whether or not he is called on to do so; this might require the granting of additional powers to the Arbiter under the Greater London Authority Act 1999. (Paragraph 57)
12. As long-term arrangements for upgrading the Tube are devised, the Government should ensure that there is a mechanism to guarantee independent reporting of progress and value for money, no matter what delivery vehicle takes the place of Metronet's PPP Agreements. (Paragraph 59)

## The performance of London Underground

13. A contractual arrangement which fails to incentivise efficiency in the private sector and at the same time fails to deter poor planning, lack of forethought and gold-plating in the public sector is one which is pretty much useless. Metronet alleges that part of its overspend is a consequence of decisions by London Underground, such as changes to the specification of ongoing works. We recommend that in the future the Arbiter, alongside reporting the performance of the Infracos, reports the effectiveness of London Underground as client during the modernisation of the Tube network. (Paragraph 63)

## The Extraordinary Review

14. As with the annual report, there is evidence that had the Extraordinary Review been initiated at an earlier stage, it might have mitigated the worst effects of Metronet's failure. We recommend that, for future PPP Agreements, the Government extend the power to trigger an Extraordinary Review to both contract parties, rather than only the Infracos. Such a change could reduce the possibility that an overspend

would be allowed to get as far out of control as it did in the case of Metronet. (Paragraph 66)

15. The uncontrolled spiral of cost overruns, without any assessment being made of its causes or of the respective liabilities of the parties to the contract, must never be allowed to happen again. A mechanism similar to that which is built into the Tube Lines contract to ensure an early examination of any cost increases should be included as a matter of course in any future contracts. (Paragraph 69)

### Costs to the public

16. We recommend that the Government, as a matter of urgency, make a full assessment of the additional costs that have been incurred as a result of the failure of Metronet—including the cost of work that has been inefficiently undertaken and the cost of administration. The Secretary of State should then come to the House to make a statement on what proportion of these costs are to be met by central Government and what proportion she expects residents of London and Tube passengers to pay. The Government should also consider its contribution to efficient increases in costs as a result of the unknown condition of the infrastructure, in order that London Underground is not forced significantly to reduce the scope of the upgrade programme during the second Review Period from 2010. (Paragraph 79)
17. We hope that, in its discussions with Transport for London as to the future of Metronet's PPP Agreements, the Government makes full use of the Arbiter's analysis for the partial Extraordinary Review of Metronet BCV and for a potential Extraordinary Review of Metronet SSL, and that his insights are utilised to minimise the chance that further unexpected and wasteful costs to the public purse might be incurred. (Paragraph 82)

### Employee safety

18. To maintain the highest standards of safety for employees in the longer-term, the Government must work with Transport for London and the unions to identify existing communication deficiencies and ensure that the future structure of the contracts does not contain inherent safety weaknesses. Where it is necessary for employees of different organisations to work together, the utmost effort must be made to ensure the clarity of procedures for reporting safety concerns. (Paragraph 87)

### Passenger safety

19. During the transition of Metronet's ownership from its shareholders to Transport for London and for the duration of Transport for London's stewardship of the Infracos, as well as in the longer-term under whatever vehicle is chosen to deliver the upgrades, passenger safety must be the primary concern of everyone who is involved. A key role for the Government in its discussions with the Mayor and Transport for London will be to ensure that future contracts incentivise the actions that are necessary to guarantee the highest standards of safety on the network. (Paragraph 92)

## Conclusion

20. The Government should bear the Metronet debacle in mind if and when its parent companies—Atkins, Balfour Beatty, Bombardier, EDF Energy, and Thames Water—next come to bid for publicly-funded work. (Paragraph 95)
21. The Government should remember the failure of Metronet before it considers entering into any similar arrangement again. It should remember that the private sector will never wittingly expose itself to substantial risk without ensuring that it is proportionally, if not generously rewarded. Ultimately, the taxpayer pays the price. (Paragraph 96)
22. If the Government is again tempted by a seemingly good deal from the private sector, it should recall Metronet's pathetic under-delivery and the deficiencies in the contracts that allowed it to happen. We recommend that the Government publishes a candid analysis of the events preceding Metronet's collapse and its consequences, both in terms of increased costs to the public and delays to the work programme. (Paragraph 97)
23. Whether or not the Metronet failure was primarily the fault of the particular companies involved, we are inclined to the view that the model itself was flawed and probably inferior to traditional public-sector management. We can be more confident in this conclusion now that the potential for inefficiency and failure in the private sector has been so clearly demonstrated. In comparison, whatever the potential inefficiencies of the public sector, proper public scrutiny and the opportunity of meaningful control is likely to provide superior value for money. Crucially, it also offers protection from catastrophic failure. It is worth remembering that when private companies fail to deliver on large public projects they can walk away—the taxpayer is inevitably forced to pick up the pieces. (Paragraph 98)
24. Finally, now that the Government is considering the future of the Underground upgrade programme, it should prioritise transparency and clarity to taxpayers and ensure that any future contracts result in clear accountability to national or regional Government, thereby providing the public with the opportunity of applying sanctions in the event of poor performance. (Paragraph 99)

## Formal Minutes

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**Wednesday 16 January 2008**

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Mr David Clelland  
Clive Efford  
Mrs Louise Ellman  
Mr Philip Hollobone

Mr John Leech  
Mr Eric Martlew  
David Simpson  
Mr Graham Stringer

Draft Report (*The London Underground and the Public-Private Partnership Agreements*), proposed by the Chairman, brought up and read.

*Ordered*, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 99 read and agreed to.

*Resolved*, That the Report be the Second Report of the Committee to the House.

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

*Ordered*, That the provisions of Standing Order No.134 (Select committees (reports)) be applied to the Report.

[Adjourned till Wednesday 23 January at 2.30 pm.]

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## Witnesses

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### Wednesday 17 October 2007

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<b>Mr Chris Bolt</b> , PPP Arbiter	Ev 1
<b>Mr Bob Rixham</b> , National Officer, Unite Amicus Section, and <b>Mr Brian Harris</b> , Regional Officer, Unite Amicus Section, <b>Mr Gerry Doherty</b> , General Secretary, and <b>Mr Andy Young</b> , Regional Organiser, Transport Salaried Staffs' Association (TSSA)	Ev 8
<b>Mr Terry Morgan</b> , Chief Executive, Tube Lines	Ev 13
<b>Mr Roger Evans AM</b> , Chairman of the London Assembly Transport Committee	Ev 18

### Wednesday 7 November 2007

<b>Mr Graham Pimlott</b> , former Chairman, Metronet	Ev 22
<b>Mr Alan Bloom</b> , PPP Administrator, Ernst and Young, Metronet Administrators, <b>Mr Tim O'Toole</b> , Managing Director, London Underground	Ev 27
<b>Rt Hon Ruth Kelly MP</b> , Secretary of State, <b>Ms Lucy Chadwick</b> , Director of Regional and Local Transport Delivery Directorate, and <b>Mr Paul Collins</b> , Head of London Transport Division, Department for Transport	Ev 36

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2	T Martin Blaiklock	Ev 49
3	London TravelWatch	Ev 52
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### Session 2007–08

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Third Report	Work of the Committee in 2007	HC 248

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Second Report	The Ports Industry in England and Wales	HC 61-I & 61-II
Third Report	Transport for the London 2012 Olympic and Paralympic Games: The Draft Transport Plan	HC 199
Fourth Report	Department for Transport Annual Report 2006	HC 95
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Sixth Report	The new National Boatmasters' Licence	HC 320-I & 320-II
Seventh Report	Novice Drivers	HC 355-I & 355-II
Eighth Report	Passengers' Experiences of Air Travel	HC 435-I & 435-II
Ninth Report	The draft Local Transport Bill and the Transport Innovation Fund	HC 692-I & 692-II
First Special Report	Passenger Rail Franchising: Government Response to the Committee's Fourteenth Report of Session 2005–06	HC 265
Second Special Report	Roads Policing and Technology: Getting the right balance: Government Response to the Committee's Tenth Report of Session 2005–06	HC 290
Third Special Report	Bus services across the UK: Government Response to the Committee's Eleventh Report of Session 2005–06	HC 298
Fourth Special Report	Local Transport Planning and Funding: Government Response to the Committee's Twelfth Report of Session 2005–06	HC 334
Fifth Special Report	The work of the Civil Aviation Authority: Government Response to the Committee's Thirteenth Report of Session 2005–06	HC 371
Sixth Special Report	Transport for the London 2012 Olympic and Paralympic Games: The Draft Transport Plan: Olympic Delivery Authority Response to the Committee's Third Report of Session 2006–07	HC 484
Seventh Special Report	Department for Transport Annual Report 2006: Government Response to the Committee's	HC 485

	Fourth Report of Session 2006–07	
Eighth Special Report	The Government’s Motorcycling Strategy: Government Response to the Committee’s Fifth Report of Session 2006–07	HC 698
Ninth Special Report	The Ports Industry in England and Wales: Government Response to the Committee’s Second Report of Session 2006–07	HC 954

# Oral evidence

## Taken before the Transport Committee

on Wednesday 17 October 2007

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Clive Efford  
Mrs Louise Ellman  
Mr Philip Hollobone

Mr John Leech  
David Simpson  
Graham Stringer

*Witness: Mr Chris Bolt, PPP Arbiter, gave evidence.*

**Chairman:** Good afternoon. I am sure you already know our ground rules, Arbiter General. I would be grateful if you would allow us the indulgence of two seconds for a little bit of housekeeping. Any Member having an interest to declare?

**Clive Efford:** A member of Unite.

**Graham Stringer:** A member of Unite.

**Chairman:** A member of ASLEF.

**Mrs Ellman:** A member of Unite.

**Q1 Chairman:** I would be very grateful, sir, if you would identify yourself. Did you actually have something you wanted to say to us before we begin?  
**Mr Bolt:** I am Chris Bolt, PPP Arbiter. I have set out in my submissions the background to my role and the issues I have been involved in recently. I would be very happy to move straight into questions.

**Q2 Chairman:** We are grateful for that. We know that you are very well versed both in the ways of this Committee and in the subject. Can I ask you why you have said in your written evidence that the basic structure of the PPP remains sound?

**Mr Bolt:** The reason I expressed that view is because of the principle of the PPP, which is that the private sector delivers best when it is told what outputs to deliver and is free to decide what approach it should take to delivery of those outputs. That, I think, is a principle which has been well established in a number of sectors and is the approach, for example, of Network Rail in delivering the high level outputs which Ministers have now specified for the heavy rail sector is another example. So I think that principle of specifying outputs is one which has been well established, and of course in the context of the PPP we have got the example of Tube Lines, which is in clear contrast to the experience of Metronet.

**Q3 Chairman:** Yes. We will come to Tube Lines, because although it is better there are still some considerable difficulties, as you know. The reality is that Metronet was unable to work successfully within its existing PPP agreements, was it not?

**Mr Bolt:** Clearly Metronet did not succeed in delivering the outputs in the contract at the price it had bid and the consequence, as we know, is that both Metronet Infracos are now in administration. I do not think that invalidates the principle of an

output-based contract. It says much more about the way that contract was originally entered into by Metronet and the way the company was managed.

**Q4 Chairman:** So you really do not accept that there was a flaw in the original idea? You simply think it was the way the contract was written and carried out?

**Mr Bolt:** That is my view, yes.

**Q5 Chairman:** Metronet Infracos before they actually collapsed were not delivering either improvements in respect of stations and track work or some of the other targets which they had been set. What are the factors which led them to such a poor performance?

**Mr Bolt:** I think there is a whole range of factors which led to that, and some of them I set out in the annual report which I produced last November. If I would highlight two—and both of them are relevant, particularly in the context of the stations programme—one is that it took a particular approach to decide on its work programme, which is where there was any question about the scope of works to deliver it sought to agree that with London Underground before it started work on the ground, and that contributed to the delays. The other major factor –

**Q6 Chairman:** I need a better explanation than that. By talking to the customer and deciding what it was they needed, that somehow contributed to the delay?

**Mr Bolt:** It was the level at which that was discussed and agreed. If you have got a contract which requires you to modernise or refurbish a station and the contract says broadly what that involves, then you have got a choice in a sense, whether you take your own view about what that means in terms of complying with the contract or whether you work up a detailed plan and take it along to your customer and say, “Do you agree that that’s the right sort of handrails we install?”

**Q7 Chairman:** In general terms, although it may seem very old-fashioned in a modern industry, is it not quite a good idea to ask the people who are

paying the bill whether they know what they want and whether it happens to coincide with what you are offering?

**Mr Bolt:** If that is the basis on which the contract is written, yes, provided it does not slow up the process unduly, and with Metronet it contributed to a very slow start to the stations programme. The other element—not attributing a proportion to those things—clearly was the structure of the supply chain with Metronet’s shareholders being the main contractors for carrying out this work. That raised a number of issues which also applied in other parts of the programme, such as the track renewal programme, where it was contributing to Metronet’s failure to ramp up its delivery in the way the contract envisaged.

**Q8 Chairman:** If you were running such a contract yourself and you knew that you were operating under what in effect was a tied contract, would you not assume that an efficient company would at some point not only go back to the people with whom it had this relationship but also to its customers and say, “This is not working. We need to change it somewhat quickly”?

**Mr Bolt:** The principle of the PPP clearly was it was left to the Infracos to decide how to deliver the obligations and in the initial bid evaluation (not a process I was involved with) my understanding is that London Underground did look at the supply chain arrangements being proposed by all of the Infracos and take a view on whether they were capable of delivering the obligations, and it is reflected in the wording in the contract that London Underground accepted that a “tied” supply chain was one that was capable of delivery.

**Q9 Chairman:** Yes, but from the first, Mr Bolt, was it not clear that London Underground were actually quite restrained and restricted in what they could ask for in relation to the Infracos? Surely it is the other way round? If you are an administrator in a company and you are required to deliver the goods and it becomes clear to you that you are not delivering the goods, would you not expect to take some responsibility and not say, “Well, it’s because the customer is taking a long time to discuss it”?

**Mr Bolt:** That is why I was not attributing proportions to those different causes. I think the fundamental problem with Metronet’s cost overruns and failure to deliver was its management of the arrangements, including the supply chain. I would have expected—and I said this in my report on Metronet last year—that a well-managed company would have resolved those issues well before Metronet started addressing them.

**Q10 Chairman:** They were doing some of the things you had asked them to. They were getting a bit better. Do you think if they had been given a lot more money they would have been able to become efficient and economic?

**Mr Bolt:** I think they were moving in the right direction but not quickly enough. That was essentially the conclusion I reached last November,

and the work I have been doing subsequently suggests they are still not operating at a level which is in line with the test of efficiency, economy and good industry practice.

**Q11 Clive Efford:** TravelWatch have said in their evidence that they do not want to see periodic reviews become an opportunity for unfunded price rises and for the scope of investment plans to be cancelled or reduced in scope. Do you agree with that, or do you have any comment on it?

**Mr Bolt:** I think we need to be very clear about the way the contract was originally set up. It is a 30 year contract, but with a clear recognition on both sides that to try and price obligations on a 30 year basis would be unduly risky for both sides because changes in prices and changes in technology can lead to increases and reductions in price. So the periodic review process was always seen as one which allowed that re-pricing to reflect the emerging view on what was efficient costing, but with the additional factor that if prices were rising—and that was a risk which London Underground accepted—and there were issues about affordability it might need to de-scope its requirements at the periodic review. That is entirely a decision for London Underground. My job is simply to price whatever obligations and outputs London Underground believes it wants delivered.

**Q12 Clive Efford:** Can you just clarify something for me in terms of how we got to this position? The situation is that Metronet has delivered significantly less than was expected in its bids at high unit cost. It earned less performance revenue than expected, for example over the last three years of its contract Metronet’s subsurface lines delivered ten of an anticipated 18 station refurbishments at a unit cost of £7.5 million rather than £2 million, and Metronet BCV delivered only four of 17 anticipated stations. That must have taken a heck of a lot of time to deliver that sort of failure. What is the reporting mechanism for actually highlighting that there is a serious problem?

**Mr Bolt:** There are essentially two and one is London Underground’s responsibility as the customer under this contract for monitoring delivery of the obligations in the contract, and delivering stations on time is one of the obligations. London Underground has, other than this year, produced an annual report on performance under the PPP. The other mechanism is the annual report process envisaged in the contract, whereby London Underground and Metronet come jointly to me for a report on economy and efficiency and good industry practice, and the words you were quoting I recognise as ones I wrote in my annual report on Metronet last November.

**Q13 Clive Efford:** Can you clarify the position of when you were anticipating doing an interim report, and was that not delayed? Why was that?

**Mr Bolt:** The contract envisaged that the first annual report would be produced in 2005 for the period from transfer, which was April 2003 up to the end of

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the financial year, 31 March 2005. I should say that I only produce that report when I am asked to do it by the parties. I do not have powers under the GLA Act to produce it unilaterally. In the event, London Underground and Metronet agreed between themselves not to seek that report in 2005 and Metronet under the terms of its loan agreements sought and obtained a waiver from its lenders from seeking that report. It was originally envisaged that it would happen then. Metronet and London Underground agreed not to ask for that report in 2005.

**Q14 Clive Efford:** That is what happened. Did anyone say why that is what they were asking for?

**Mr Bolt:** Not explicitly. I think there was a recognition, even at that stage, that Metronet's performance was not as anticipated and a view that Metronet needed to take some action internally to improve its performance before it was reported on publicly.

**Q15 Clive Efford:** So there was a concern that your report might have had the sort of dramatic impact that it subsequently had a year later?

**Mr Bolt:** I think they were concerned that my report would highlight issues, some of which they had already identified.

**Q16 Clive Efford:** Do you think that added to the problems?

**Mr Bolt:** The absence of a report in 2005? Yes, my view is that had these issues been brought out publicly sooner, Metronet with London Underground would have started to address the problem sooner. It might not have been sufficient to avoid administration, but it would certainly have avoided some of the additional costs which are now being incurred.

**Q17 Clive Efford:** So the people of London, who rely on the London Underground, are really poorly served by that decision to delay that report?

**Mr Bolt:** That is my view, yes.

**Q18 Clive Efford:** Has the PPP agreement succeeded in transferring risk from the public sector to the private sector?

**Mr Bolt:** Yes, and the fact that the original shareholders in Metronet have written off their shareholding shows that there was some risk transfer, but it was not as great as I think some people understood just in terms of the way the contract is written. As I have already highlighted, any increasing costs which are efficiently incurred were always a risk to be borne by London Underground. This is not a fixed price deal, and I think there has been some misunderstanding about the scale of the risk transfer from the public sector to the private sector.

**Q19 Clive Efford:** Is it the case that Metronet, where shareholders invested £350 million, was awarded potentially profitable contracts for the maintenance and upgrade work and where at least a 95% debt was

secured by the taxpayer? In what sense then do you think risk is significantly transferred to the private sector?

**Mr Bolt:** The four elements of risk clearly are the equity, the 5% on the borrowing, and Metronet also for each Infracore bore the first £50 million of efficient cost overruns, and of course it bore wholly the risk of any inefficiency.

**Q20 Clive Efford:** Explain to me, if I am being a bit dim then, if TfL, as it seems to have confirmed, guarantees 95% of Metronet's debt and it could be liable for up to £2 billion, how have we significantly transferred the risk from the public to the private sector?

**Mr Bolt:** This was always set up as a limited recourse contract. It was not unlimited in the risk that was transferred. That was the basis of the original contract. I emphasise again, it is not a process I was involved in. My job is simply to take decisions under the basis of the risk allocation in the contract as signed by the Infracores and London Underground.

**Q21 Clive Efford:** So did the different levels of Materiality Threshold for Metronet and Tube Lines affect the relative transfer of risk, and what impact might this have had on the approaches of the two organisations?

**Mr Bolt:** My view is that it did have an impact. Clearly, the £200 million Materiality Threshold in the first review period for Tube Lines means that more of the efficient cost overrun is potentially borne by the shareholders. But the other important element which distinguishes the two contracts is that there is a mechanism within the Tube Lines agreement requiring them to come to me for, in a sense, endorsement of any cost overruns in £50 million tranches being efficient. So there is a very clear signal well before Tube Lines would get to the Materiality Threshold. I emphasise they have not had to come to me because they have not incurred cost overruns. With Metronet, not only could they use up all the Materiality Threshold but I was not asked to take a view on the efficient level of cost overruns until the actual number was £1 billion per Infracore, 20 times the Materiality Threshold.

**Q22 Clive Efford:** Is there an explanation for the different approach?

**Mr Bolt:** It was an outcome of the original contract negotiations, as I say, to which I was not a party.

**Q23 Clive Efford:** You also say in your submission that there are questions about the effectiveness of lenders to hold Metronet to account. What did you mean?

**Mr Bolt:** What I meant was that under the terms of the lending agreements the lenders have certain rights both for information and in a sense to get more involved in decision making if there were cost overruns of this sort. I am surprised that they did not exercise those rights sooner and more vigorously than they did. My understanding is that from March 2006, so for more than 12 months before the Extraordinary Review was triggered, they were

waiving the right they had to stop Metronet drawing down on its debt and effectively requiring it to trigger an Extraordinary Review. Going back to the answer previously, if the Extraordinary Review had been triggered twelve months sooner, I think we might have avoided some of the problems we are now facing.

**Chairman:** We might want to actually discuss some of that.

**Q24 Mrs Ellman:** Looking at the lessons of what has happened, do you think the position that Tube Lines have to approach you if there is an overspend should be applied in the same way to Metronet?

**Mr Bolt:** As I have just explained, the detailed risk provisions in terms of what each Infraco was exposed to was different and that was a feature of –

**Q25 Mrs Ellman:** I accept it is different. I am asking you now, looking at what should be done to change the situation, do you think it would be better if the agreement with Metronet had reflected the same points as that with Tube Lines?

**Mr Bolt:** It would clearly be better, in my view, if there was a mechanism which stopped an Infraco building up, in a sense, expected cost overruns without a clear view being taken about the responsibility for that, whether they are London Underground's risk or the shareholders' risk. That would have prompted and forced earlier action to address some of the problems which Metronet has experienced.

**Q26 Mrs Ellman:** How did it come about that the two were different?

**Mr Bolt:** I think you would have to ask those who were involved in the initial negotiation.

**Q27 Mrs Ellman:** What would you say the liability or the responsibility of London Underground was?

**Mr Bolt:** I think, as the Chairman indicated at the start, there are limits to the powers of London Underground to take action under the terms of the contract and to get information on the detailed activities of the Infracos. In that respect, ironically my information powers given by Parliament are broader than London Underground's, but they still are monitoring delivery on a day to day basis and have powers to take corrective action, as indeed they have sought to do on the Metronet stations programme, which could ultimately lead to them stepping in if an Infraco is in breach of its contractual obligations. Whether it could or should have done more than it did I think is again a matter for them to explain.

**Q28 Mrs Ellman:** What is your view on that?

**Mr Bolt:** Going back to the answer I gave earlier, with hindsight (which is a wonderful thing) it might have been preferable, for example, if London Underground had not agreed with Metronet to waive the requirement for the 2005 Annual Report. That would have actually strengthened its own position in taking action under the contract to deal with under-delivery and cost overruns.

**Q29 Mrs Ellman:** What about the issue of the condition of the assets of London Underground? Were they in a poorer condition than was disclosed?

**Mr Bolt:** Again, it was always recognised that some of the assets, the so-called grey assets, were ones where the condition was not properly understood and where the detailed provision for costs would be addressed at the first periodic review. One of the other things which Metronet has claimed is that in other areas, other than grey assets, the condition of the assets was worse than they expected. Again, if they did not price properly in the bid for those assets, but the costs of maintaining and renewing them are efficiently incurred, London Underground bears that risk. So it may be an area which, given a better understanding of the risk allocation, might suggest that if we were going through this exercise again a better understanding of the condition of assets and the action needed to maintain them would lead to better value for money.

**Q30 Mrs Ellman:** Tim O'Toole suggested to the London Assembly Transport Committee that perhaps your analysis was not sufficiently accurate. Have you any views on that?

**Mr Bolt:** Clearly, I am working on the basis of information provided to me in their representations by Metronet and London Underground, but also other analyses and information including benchmarking with other operators, and I am starting to work on international benchmarking. This is one of the reasons the initial thoughts document I published a couple of weeks ago had ranges in them. I have not come to a firm view on the precise numbers, but I believe that the analysis is sufficiently robust to say that some of the cost overrun has been efficiently incurred—not the majority of it, but some of it—and under the terms of the contract the efficient cost overrun is borne by London Underground, apart from the Materiality Threshold. So there is further work to do, but I believe it is robust within the terms of the analysis so far.

**Q31 Mrs Ellman:** Do you have a view on the legality of Transport for London taking over Metronet's PPP Agreement?

**Mr Bolt:** That is clearly an issue for the administrators to work through the options and what represents the best outcome in terms of their responsibility to creditors. If Metronet is acquired by a public sector company, my view would be that it will remain important to benchmark performance between Metronet and Tube Lines to establish and demonstrate value for money. I think the need for some independent body or person to be involved in that benchmarking performance would remain valid in those circumstances.

**Chairman:** Value for money is not just something that comes to mind, is it?

**Q32 Mrs Ellman:** You would not raise any issues of legality?

**Mr Bolt:** Not as far as I am aware, no.

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**Q33 Mr Hollobone:** Are there any powers which you, with hindsight, think the Arbiter should have, perhaps to be enacted in a pre-emptive way, which might have avoided this situation?

**Mr Bolt:** As I said earlier, I can only give guidance or directions when asked by one or other of the parties. I have further powers to prepare for giving guidance or directions, but cannot act unilaterally. With hindsight, possibly—and it reflects my answer to the last question—a power to report on performance whether or not I was asked to might have highlighted the problems at an earlier stage. If I had, for example, the power to produce an annual report on performance without being asked. But the way that was set up very much reflected the negotiations which led to the initial agreement and I am well aware that Tube Lines took the view that they did not want that sort of annual report process in their agreement.

**Q34 Mr Hollobone:** But going forward from where we are now, would it be a sensible recommendation to the Government that that aspect of your role be changed?

**Mr Bolt:** If that was the view the Committee came to, it is certainly a role which I would be happy to fulfil, and in a sense the work I have been doing on Metronet's performance, which has included looking at Tube Lines' performance for benchmarking purposes, would make that a natural extension.

**Q35 Mr Hollobone:** If Transport for London was to take over Metronet, what do you think your role in relation to the Metronet PPP Agreement might consist at that point?

**Mr Bolt:** It is a bit difficult to say at this stage, because it clearly depends on the structure of the arrangements that we put in place in those circumstances. In terms of the statutory provision, my role remains but, as I say, I only exercise statutory functions when asked by one or both of the parties and if London Underground is in a sense on both sides of the contract it might take the view that it did not want to ask me to give guidance or directions.

**Q36 Mr Hollobone:** Do you think there might be a useful role, though, for a regulator regarding maintenance and improvement to the Underground network for those bits which are taken back into the public sector?

**Mr Bolt:** I think you are reflecting the answer I just gave. Having an independent review of value for money looking across different modes of delivery—so my role clearly continues in terms of Tube Lines for the periodic review—would be a natural extension and although, clearly, as PPP Arbiter I do not have any direct access to Network Rail, my two offices (putting my other hat on for a moment as Chairman of ORR) do collaborate so that we can compare the performance of Network Rail on, say, track renewal, which is an obvious comparator with a lot of the work we have done on the Metropolitan line in the other sections. So to have that role,

looking at value for money, on an independent basis and reporting on it is a valuable protection for value for money.

**Q37 Mr Hollobone:** If Transport for London did take over Metronet, would you be surprised if they did not try to scrap some of the upgrade work?

**Mr Bolt:** That, as I said earlier, is entirely a matter for them in terms of what they are able to afford and the priorities between different parts of the programme. If they were to decide to de-scope some elements of the programme, whether it is stations or upgrade, in terms of my role it is simply pricing at an efficient level the programme of outputs they would like to see delivered.

**Q38 Mr Hollobone:** Would you like to have a say in the quantity and quality of the upgrade work that London might require, or are you happy simply to price the programme which is put before you?

**Mr Bolt:** No, I am happy just to price it, and I think that model very much reflects the division of responsibilities between ministers and DfT and ORR in the case of the heavy rail network. It is entirely appropriate that elected officials decide how much public money is spent and what the priorities are. Having an independent verification that that is being delivered efficiently, I think reinforces those roles.

**Q39 Mr Hollobone:** My last question is that other regulators with other utility companies do take a proactive role in engaging with the public as to what services are required and then price those into the programme, but you would not want to absorb those powers into your brief?

**Mr Bolt:** That issue of public engagement I think is important where the private sector has choices. In the case of the PPP, the choices are about effectively the technique and the way of delivering obligations. It is TfL, in this case London Underground, who are reflecting the views of passengers about priorities for the services. If you had a different model, if you had the equivalent of the franchising model on the national rail network where the franchise operators had some degree of commercial freedom at the margins, then the position might be different.

**Chairman:** You would not have got 10 out of 18 stations, you would have got five!

**Q40 Graham Stringer:** You have said that it might have helped had you been required to do an annual report. Are there any other things, with the benefit of hindsight, which could have been done to avoid this?

**Mr Bolt:** I think the two key issues are monitoring of progress and I think highlighting the problems of Metronet sooner, potentially through an annual report, is one of those issues. The other question is, were there things which, with hindsight and certainly learning lessons going forward, could or should have been done differently at the time of the initial contract award? Again, clearly those are questions which need to be addressed to London Underground, but certainly my view is that although a tied supply chain of the form Metronet entered

into is capable of delivering efficiently, in the circumstances of the PPP it was highly unlikely to achieve that and maybe in the initial bid evaluation those are issues which London Underground might have taken a different view on.

**Q41 Graham Stringer:** That is highly unlikely. It is very easy money, is it not? They are paying themselves to do the work.

**Mr Bolt:** Yes.

**Q42 Graham Stringer:** I am not using it in the legal sense, but it is corrupt, is it not, to allow a contract like that?

**Mr Bolt:** There are supply chains of that sort which work, but what is very important is that the role of the partners as shareholders is very clearly distinguished from their role as providers. That was one of the reasons why, in the annual report I produced last November, I argued for an independent chairman to help the board of Metronet separate those two roles, because my impression is that before Andrew Lezala was appointed as managing director he did not have as much freedom to decide on the efficient supply chain that a managing director would expect to have.

**Q43 Graham Stringer:** Do you know, and if you do can you remind us, what was the cost of setting up this contract?

**Mr Bolt:** The figure which is referred to is of the order of £500 million, but some of that included restructuring, which I think London Underground would have had to have undertaken itself even without these contracts. I do not have any more detailed breakdown of that figure.

**Q44 Graham Stringer:** It is significant. What I am trying to get at, which is what I suspect the public will want to know, is how much does this cost the taxpayer? When you put the cost of what was a very complicated contract and the cost of this failure, how much has the taxpayer been charged for this? I know it is difficult to get a baseline for that assessment, but I would be interested in your assessment.

**Mr Bolt:** One question, clearly, is what are you comparing it with, and that was the purpose of the public sector comparator work which London Underground did at the time of the initial bid evaluation. Broadly, for Tube Lines and Metronet BCV the bids were within the range of the numbers of the public sector comparator. For sub-surface lines, the Metronet bid was well below the level of the public sector comparator. So that suggests that had there not been a PPP, London Underground's costs would have started at a higher level. Whether they would have been able to manage the cost increases which Metronet has experienced better than Metronet did is, in a sense, the hypothetical issue on which you would need to take a judgment.

**Q45 Graham Stringer:** That is what I am asking you to judge with, in terms of the extra costs which have been incurred here, where risk has not been transferred, plus the cost of the contract. How much has this cost the taxpayer against a baseline?

**Mr Bolt:** I think it would be very difficult to –

**Q46 Graham Stringer:** I am not saying it is easy.

**Mr Bolt:** No, and it is not a calculation I am required to do, or indeed have done. I think the important question is to be able to compare like with like. Had the PPP delivered efficiently—and in terms of the costs and the delivery of obligations broadly Tube Lines have—then I think you would have expected the outcome for the travelling public and the taxpayer to be beneficial. Given the experience of Metronet, there are clearly some significant additional costs which will fall on the public sector.

**Q47 Graham Stringer:** But we cannot quantify them?

**Mr Bolt:** I think it would be very difficult to quantify them without a fair bit of work. It is probably an exercise which would be worth having a go at to learn the lessons from this experience going forward, both for the Underground PPP and for PPPs and PFIs generally.

**Q48 Mr Leech:** What do you see as the reasons for the relative success of Tube Lines?

**Mr Bolt:** There is a number of factors. I think the supply chain structure, which has been based on competitive tendering of the major contracts, is more appropriate for this sort of arrangement has been one of the factors. Given the nature of the shareholders—as you would expect, with a company with Bechtel as one of its shareholders—project management has been one of the relative strengths of Tube Lines. So it is a variety of factors like that, but I think also the original structure and philosophy of the Tube Lines deal, which was very much around delivering this within the amount bid rather than seeing it, as I think Metronet almost did, as a cost-plus contract, has been an important factor.

**Q49 Mr Leech:** Do you see them continuing to succeed then?

**Mr Bolt:** Certainly on the basis of the evidence I have seen so far, I see no reason why they should not.

**Q50 Mr Leech:** So if this is a successful model, do you think we should be replicating their model to replace Metronet's, or if not the exact model what changes would you like to see to get the perfect model?

**Mr Bolt:** I think, as we have been discussing, there are some changes at the margin which might increase the transparency of the arrangement and the effectiveness of monitoring, but my view is that an output-based contract of the broad sort of the PPP, provided you have got the appropriate quality testing of the bidders, so you have confidence in their ability to deliver within that structure, will deliver the best outcome for passengers and taxpayers.

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**Q51 David Simpson:** I do not think you have dealt with this point, but you say in your report, or your submission, that there are questions about the effectiveness of lenders in using their powers under the funding agreements to hold Metronet to account. What did you mean by that?

**Mr Bolt:** I think it goes back to the point I was making before. Under the terms of the lending agreement the lenders could, as I understand it, have required Metronet to trigger an Extraordinary Review sooner. The lenders also had to waive their rights, or decided to waive their rights, to stop Metronet drawing down its funding. They could have taken the view well before they did in the middle of this year that it was right to go through a process of clearly allocating responsibility for the overspend between the shareholders and London Underground and I am surprised that they allowed the position to run on as long as they did.

**Q52 David Simpson:** So do you think the fact that the vast majority of Metronet's debt was secured reduced the incentive for the funders to look after the debt?

**Mr Bolt:** I think that may have affected their view, yes.

**Q53 Chairman:** Can I ask you why you are going ahead with your Extraordinary Review? Mr O'Toole said he thought it was bizarre and the administrator for Metronet said that he considers the review process ought to be in suspense.

**Mr Bolt:** A reference has been made to me by Metronet BCV. It has not been withdrawn and the administrators have told me they do not intend to withdraw it. In that situation, I have functions given to me by Parliament which Parliament says I shall fulfil, and I intend to fulfil them.

**Q54 Chairman:** Admirable! You asked for representations by 12 October. Have London Underground and the administrators responded?

**Mr Bolt:** Yes.

**Q55 Chairman:** Given the opposition to the Extraordinary Review and the view of Metronet's administrator, do you expect to complete that process?

**Mr Bolt:** I expect to complete that process. The only situation in which I will not is if Metronet BCV withdraws the reference.

**Q56 Chairman:** But you are not expecting that to happen?

**Mr Bolt:** Not currently, no.

**Q57 Chairman:** Would I be unkind if I summed up your view that the original contracts were not only deficient but useless, that the differences between the two companies was so marked that one did not sort out its situation in relation to its own suppliers and the other was more ruthless and did more limited work, and therefore knew what it was about, that in fact what has happened has made it very clear that no real risk was transferred to the private companies

because although in theory they invested £250 million, in fact they were getting a Hell of a lot of money back, and that as far as you can see there is still no very clear indication that anybody is going to finish up with two effective contracts at the end of all this, or do I paraphrase unfairly?

**Mr Bolt:** You paraphrase the words I would have used. The risk transfer was not as great as some people understood. Metronet's performance clearly has been deficient and I think even on the basis of the evidence at the time some of the problems with the supply chain could have been anticipated and should have been dealt with sooner. There are clearly big issues about how, from the position we are now in, we can move forward in a way which gets best value for money going forward.

**Q58 Chairman:** So we do not know how much it has cost, we do not really have at the moment anybody trying to find out how much it has cost, and we are not even sure whether from this position we can go forward to an efficient deal?

**Mr Bolt:** One of the outcomes of the Extraordinary Review will be a clear number which says, "These are the costs which an efficient company would have incurred in addition to its bid." That is one element of the calculation.

**Q59 Chairman:** With respect, Mr Bolt, I have the greatest admiration for you and I have never had any problems with your professionalism, but you do give a range of costs which are really quite remarkable, £150 million—I am not good at arithmetic, but even I perceive that from £100 million to nearly £500 million is quite a broad spectrum.

**Mr Bolt:** But that is against the background that Metronet claimed (Metronet BCV) that the efficient cost overrun for the seven and a half year period was £992 million and London Underground argued it was zero, so the range has narrowed.

**Q60 Chairman:** I am not saying that they were not asking for five times more, I am saying that the range you have come back to is still, even though you said, "Knock it off, lads, you are pushing for too much," or whatever the arbitrator's language is for that sort of phrase, you still said it is somewhere between £100 million and nearly £500 million?

**Mr Bolt:** Yes, and that was on the basis of initial work. I have now had, as I explained earlier, the further submissions from Metronet and London Underground and on 12 November I will publish a number for the efficient cost overrun, a single number.

**Q61 Chairman:** We will have to wait in some suspense until that moment!

**Mr Bolt:** I am afraid you will.

**Q62 Clive Efford:** I just want to ask one last question. You have said that had you been allowed to go ahead with your independent review in 2005 you

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may have been able to highlight the problems earlier. How early in the contracts were you aware that there were difficulties?

**Mr Bolt:** I was aware that there were issues about delivery pretty early on, because one of the bits of information my office gets is delivery of the stations programme and you could see that slipping. What I was not aware of was the scale of the cost overrun until I carried out the 2006 Annual Report.

**Q63 Clive Efford:** So has your inability to actually step in and insist on an independent report at that stage, when you became aware of those concerns, contributed to the problem?

**Mr Bolt:** My view is that had I carried out the Annual Report in 2005, some of the issues would have been put on the table –

**Q64 Clive Efford:** Would you have been able to do it earlier, had you had that power?

**Mr Bolt:** We were ready to do it. I was fully staffed and we had developed the work programme to carry it out.

**Chairman:** As always, Mr Bolt, you have been very instructive. We are always very impressed with your use of language. It does not always convey exactly what we would like, but I think we have got there. Thank you very much for coming. We look forward to seeing your report.

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*Witnesses:* **Mr Bob Rixham**, Amicus National Officer, **Mr Brian Harris**, Amicus Regional Officer, Unite; **Mr Gerry Doherty**, General Secretary, and **Mr Andy Young**, Regional Organiser, Transport Salaried Staffs' Association (TSSA), gave evidence.

**Q65 Chairman:** Good afternoon, gentlemen. Thank you very much for coming. I am sorry to say that Mr John Leach—not the John Leech who graces this Committee but the John Leach who should have been with us from RMT—has unfortunately been taken ill, so we will have to proceed without him. Gentlemen, can I ask you firstly to identify yourselves for the record, starting on my left?

**Mr Young:** I am Andy Young, Regional Organiser for the TSSA with responsibility for Metronet.

**Mr Doherty:** Gerry Doherty, General Secretary, Transport Salaried Staffs' Association.

**Mr Rixham:** Bob Rixham, National Officer for Unite Amicus, section railways, buses and ferries.

**Mr Harris:** Brian Harris, Regional Officer for Amicus Unite. I look after Metronet at the moment.

**Mr Doherty:** We have certainly got concerns that safety levels are being undermined by the very structure of PPP itself. Only last month we had emergency brake problems which led to the suspension of the Hammersmith, City, Circle and District lines, and in July hundreds of passengers were stranded and 11 were taken to hospital when three carriages came off the rails between Mile End and Bethnal Green on a westbound Central line tube train. We have sought the views of our workplace representatives with regards specifically to safety and the feedback we have had from one indicates that the main problem is that the contractors do not comply with safety regulations on the Underground, and indeed the auditing by LUL is limited and pressure is put on management and staff to allow the contractors to get on with things and to turn a blind eye. To give you one specific example, one of our safety representatives came across the storage of explosives in Golders Green Station. This is Tube Lines, it is not under the remit of Metronet, but these explosives were stored without any permission and this was resolved following an HMRI investigation, but what we actually found was unauthorised storage of detonators at Golders Green Station without licence. Our concern is not that specific incident, because I am certain that the media—and I did some media interviews this morning—is concerned that in light of the terrorist attacks in recent times on the Tube that is a danger in itself. We do not think in itself it was a danger, but what it does do is it says to us that safety standards are slipping under PPP—and this is not Metronet, this is Tube Lines.

**Q66 Chairman:** Thank you very much. Do any of you have anything you wanted to say briefly, or may we go directly to questions?

**Mr Doherty:** I understand the inquiry is into PPP, but having listened to the last witness you interviewed and having been back over the research that we have had, can I just say at the outset that we wholeheartedly agree with comments which you yourself made in respect of the last investigation this Committee had, and I do quote: “I welcome the fact that the Government is at last putting real money into the Tube, but I cannot see why it needs the PPP to do it.” Nothing has happened since then to have changed their minds, and indeed with the Metronet debacle has only served to confirm our view that PPP was poorly conceived in the first place, it was inappropriate, it was unable to deliver the improvement to the London Underground system and we think what has happened in recent times just bears out our view, and yours.

**Q68 Chairman:** Unite actually said in their evidence that a lack of “joined up thinking” could have been to blame for the incident on the Central line on 4 July 2007. Do you want to tell us a bit about that?

**Q67 Chairman:** Thank you very much. Can we just explore some of the aspects of this? What has happened to safety levels on the network since our last inquiry in 2005?

**Mr Rixham:** Yes. Some debris was left on the line by contractors. I think the reports we are getting back about that incident and others is the lack of

communications between the various contractors undertaking the work. This repeats itself over and over again.

**Q69 Chairman:** What are we talking about, Mr Rixham, when you say something like “over and over again”?

**Mr Rixham:** We are told by the shop stewards that you have got companies which work in isolation and they tend not to share information with the other companies or communicate with other sectors of workers, and that seems to be a general problem not with just one of the groups but, as I say, across the range of contractors.

**Q70 Chairman:** Mr Doherty, I should have asked you, what length of time was there before you got an immediate response to your Health & Safety officer on that particular one at Golders Green?

**Mr Doherty:** It was discovered on 17 September, so we are a month away from it now, and I have to say that Tube Lines have dealt with it. Our concern is what else is out there that we have not found.

**Chairman:** I am sure that is an interesting point.

**Q71 Mrs Ellman:** In the evidence we have got from the Office of Rail Regulation they say that as a result of the PPP rail defects are now more likely to be detected before they become rail breaks and that there is no indication that the PPP has had a detrimental effect on rolling stock maintenance. Is that a finding you would agree with, or is it something which surprises you?

**Mr Rixham:** I do not think we would oppose that on rolling stock maintenance. We have said in our evidence that we have not provided anything on that, so we would accept that to be the case. Just going on to our evidence, before we move off to Health & Safety, we have also indicated the incidents in March 2007 when 12 electricians were actually found on site to be working over and above—they had been working all week and then coming on to Tube Lines to actually do additional work, and they were thrown off, so it is a lack of control over people working on the contracts.

**Q72 Chairman:** Can we establish what the circumstances were? Are you saying they were working beyond the hours they would be expected to work?

**Mr Harris:** It was a group of individuals who had done already a shift of work on day shift for a company and had then been found to have come on for another subcontract company to work the night shift on the Underground, and for us that breaks any Working Time Directive, the length of time, it breaks safety regulations, et cetera, and that for us is not acceptable.

**Mr Doherty:** Just to answer your specific point, Mrs Ellman, on the train maintenance, I did indicate that it was only last month that emergency brake problems led to the suspension of the Hammersmith & City and the Circle and District lines, and that is directly attributable to maintenance of the trains, not of the track.

**Q73 Chairman:** Is there any other incident? That is a major incident, but is there any other incident which comes to mind at the moment?

**Mr Doherty:** Not that comes immediately to mind, Chairman.

**Q74 Mrs Ellman:** Are there any problems with communications on reporting concerns or faults with the Infracos or the Underground?

**Mr Harris:** I think the basic problem we have with the structures that exist is that the structures with the Infracos themselves, with Tube Lines and with Metronet, on safety are set up as per the London Underground systems previously and where those are working—I say that in a loose form—it takes an awful lot of time to get minor concerns driven through and safety changed quickly because of the disjointed nature of management within the companies. Where there is an emergency situation, such as the brake failures, then that is dealt with quickly because quite clearly that is a major safety concern and it is in the public eye, but where we have a major problem is in the systems which are in place. They just do not work. The lack of communication between the companies and the contractors where you may have a gang who are a contract gang working on a repair who are not employed and under the control of the foreman from Metronet or Tube Lines and there seems to be a lack of communication or communication systems to enable safety to be taken seriously.

**Q75 Mrs Ellman:** Is that problem being addressed?

**Mr Harris:** That problem in terms of the problems with Metronet, in my experience of working with the company on a day to day basis, no, because if you look at the history over the past six to eight months of what we have been doing as a body of employees working within the company is that we have lurched from one crisis to another in terms of issues which the company raised. First of all, we had an issue with the fleet transfer, which basically was a transfer of up to 1,000 people initially to Bombardier, who then lurched from that, once that was resolved, to a reorganisation which could have resulted in over 700 people losing their jobs. We then lurched from that and in the middle of that straight into PPP, which is where we find ourselves now. So we have been trying to work these things through, but I think the management’s priority has been elsewhere and what has resulted is that safety has been put on the back burner and has been let go in the medium term.

**Mr Young:** There were just two quick points I was going to make. Firstly, to go back to the explosives detonators issue at Golders Green, the safety rep for a TSSA who was looking to deal with that situation, when he came upon it, actually had some real problems about who to address the issue to because it was a Tube Lines storage area, if you like, but on a London Underground station. So there were real issues about who to report it to and ultimately resolution was by him writing to the HMRI, which cut through those kinds of problems.

**Q76 Chairman:** Has anybody done an audit of similar circumstances where the lines of communication are not clear?

**Mr Young:** Not to my knowledge. The other point I was going to make is that it struck me—and I am relatively new to the industry—at the Health & Safety committees for London Underground the Infracos are not represented at the highest level at the company Health & Safety committee.

**Q77 Chairman:** You have made that point, presumably?

**Mr Young:** Yes. There are inevitably some issues there. That lack of communication is almost built into the system.

**Q78 Chairman:** Has there been a report from the HMRI on that?

**Mr Young:** There was into the Golders Green situation, yes, which made recommendations for Tube Lines.

**Q79 Mrs Ellman:** But on the other point of not being represented, has anything happened on that?

**Mr Young:** I think the argument that LU and the Infracos would make is that they are involved in different structures, but it has struck me that when we go there—and one of the issues we were discussing, for example, last week at the Health & Safety Council, and that is the highest level within London Underground—a lot of the issues related to lack of consultation, lack of involvement of our safety reps, related to issues with Tube Lines or Metronet, and obviously London Underground management then have to undertake to go away and talk to them, et cetera. So it is bound to add in an extra element of complication.

**Q80 Mrs Ellman:** Is there any difference in dealing with Metronet or Tube Lines?

**Mr Young:** Well, one is in less crisis than the other, I think! Other than that, I have had limited experience with Tube Lines thus far, but in terms of safety mechanisms, if you like, on London Underground then no, I do not think there is any difference. In terms of the companies, then yes, they are somewhat different, but one at the moment is completely driven by the fact that it is financial meltdown, clearly.

**Mr Harris:** The difference I have experienced between the two companies is that one is vastly bigger than the other. One seems to be much more focused on delivery and the other seems to be much more focused on its profit margins for its previous shareholders.

**Q81 Clive Efford:** Name names!

**Mr Harris:** The five shareholders as are listed in the report, so the five shareholders of Metronet, if I can recall them, are Balfour Beatty, WK Atkins, Thames Water, Bombardier, and the fifth one escapes me. The difference between the two companies, despite the fact that they are doing very similar jobs, is that Tube Lines just seem to be leaner and just seem to be able to respond quicker and better than Metronet. Whether one is in a worse financial state than the

other—if you believe the press reports, they are both obviously in serious financial difficulty. I think the main difference at the moment is that one is in PPP administration and one is not. Whether that will happen, time will tell.

**Q82 Mrs Ellman:** What do you think should happen to Metronet now?

**Mr Harris:** Without a doubt, in Amicus Unite's opinion, it should be brought back under a public umbrella of some sort, back into TfL. That is our view.

**Mr Doherty:** From our point of view, as far as Metronet is concerned, we would like to see Metronet coming under the auspices of Transport for London and therefore under the Mayor. There is another model. We have had experience of what happened in the mainline railway where both performance in terms of delivery and performance in terms of finance was turned round specifically when Network Rail came in and ran the business on a not-for-profit basis. So that is another model that is a possibility. What we certainly do not want is Metronet being handed back to the private sector on a different model where we still have the profit margin being built in, because it is quite clear that as far as infrastructure is concerned and our railways it is a failure. It has happened in both the mainline and now it has happened in the Underground.

**Q83 Mrs Ellman:** Would you leave Tube Lines as it is?

**Mr Doherty:** At the moment nobody knows what is happening with Tube Lines. If we believe what is being said in the press, as my colleague says, if we believe what is being said from our own members from within, then they are not that far behind Metronet. But I cannot give you any concrete proof to that effect, I can only tell you what has been said.

**Mr Rixham:** From the Unite Amicus point of view, I just confirm that we, too, would really look at the Network Rail model as well. We think that has been successful. Obviously Brian has already mentioned TfL, but either of those two options, we think, has got to take the programme forward.

**Q84 Clive Efford:** I just want to go back to something that was asked earlier on, because the Office of the Rail Regulator has concluded in the evidence they have given to the Committee that overall safety on LUL continues to improve. "We have no evidence that the PPP has or is having a detrimental effect on safety performance." Is what you are saying about the communication that we could improve safety, or are you actually saying, contrary to what we are being told by the Office of the Rail Regulator, that safety has actually got worse under the PPP?

**Mr Doherty:** We have given you some examples this afternoon as to specific incidents. Safety is one of these things that you either have your finger on the pulse and you learn the lessons from near-misses and you get the structures right to prevent any accidents, because accidents, whether it is on the mainline railway or on the Underground, are huge, huge

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incidents. There is a big loss of life. There is a lot of interest in it. What we are saying is, do not wait until you get the same specific instances that you had on the mainline railway through fragmentation and through privatisation before we do something about bringing the railway infrastructure back to where it should be and get proper control of it. What we are saying is that what has happened on the Underground is a mirror of what happened on the railway before we had all of those accidents and before we took action by bringing infrastructure and maintenance back in-house. Do we really want to wait until we actually have an accident before we say these structures are not delivering and we have to change them? There are some instances there. We have given you some of the instances. At the end of the day the more near-misses there are, one of these days it will not be a near-miss, it will be a big hit. We say learn the lessons beforehand, and we have got a model. We have seen what has happened on the mainline. Certainly safety has improved since Network Rail has come in, so has performance and so has financial performance.

**Q85 Clive Efford:** When you raised those concerns—and you raised them with LUL, not with the Infracos—you are saying those concerns, where you feel you could contribute to improving safety, are just not being heard?

**Mr Doherty:** When we speak to perhaps two individual companies, individual companies will say they are not responsible for the structure. They will deal with us under the ambit of their own responsibility. They will not say, “We’ll go off and talk to people and try and get a better structure in place.” The structure that they have is the structure they will deal with. They are not interested in changing the structure; we are.

**Q86 Clive Efford:** So that I am clear, just specifically how would you change that structure?

**Mr Doherty:** Hopefully, we will get some sort of report coming from this Committee which gives us some political leverage to say, “Can we learn the lessons?” I would love to be able to go to the Secretary of State for Transport and say, “We have spoken to the Transport Select Committee. The Transport Select Committee agree with us,” and you do agree with us on a lot of things we have said about the mainline railway. Unfortunately, because of the changes in the number of Secretaries of State for Transport that we have had, by the time they catch up with what is going on in the mainline railway they have moved on again.

**Chairman:** I think this Committee has quite enough troubles without micro-managing the Underground, but that is only a personal view.

**Q87 Clive Efford:** Just to move on, if we are to proceed, if London Underground were to be both the provider and the contractor side of it, do you see similar problems continuing in that relationship?

**Mr Doherty:** If London Underground were to have both, I can see, for example, the communication problems that have been exposed here this afternoon at least being addressed, if not resolved. It is one body then.

**Q88 Clive Efford:** What I am trying to understand is where the problem lies in the communication. I think people who are actually doing the job have probably a lot to contribute towards highlighting deficiencies in the system. If that is not being listened to, that seems to be a serious problem. Where do we actually have to go to improve those lines of communication? Going through the Secretary of State or this Committee is a very disjointed way of doing it. How do we improve communication within the industry, within the service itself?

**Mr Doherty:** If you are not going to change the structure of the industry, then certainly we could put some sort of pressure in the industry to some overarching body as far as safety is concerned. There are other issues as well, but as far as safety is concerned, when all of the representatives from all of the companies are coming together and sharing information—because that is not going on either.

**Mr Harris:** From Unite Amicus’s perspective, in terms of improving safety there are always margins on safety that can be improved. Where I see the main issues are at the top level of the company, that you speak to the directors, the senior vice-presidents, et cetera, on safety, and that we are all singing off the same hymn sheet. There is no difference in our approach, it is that as it filters down, somewhere from the top level to the operational level, the message is lost and the issues of safety are not being made clear. Also, from the bottom up the issues being raised by our safety reps locally with their management are not getting to the appropriate level. One piece of legislation that would focus senior executives’ minds on safety is a corporate manslaughter bill, which would enable unions and people who do get injured and the families of those who get killed to attribute blame at the top level of companies so that individuals who make the profits out of these companies are brought to book when safety issues cause a major loss of life.

**Q89 Clive Efford:** So if one of your safety officers raises a serious concern with their line managers, because of the structure of the PPP that just gets lost and no one responds?

**Mr Harris:** I am not saying every single individual issue, but it seems to me, looking at an overview of it, that a lot of issues which are raised take either an inordinate amount of time to get through the system and resolved or they just never get resolved, they get swept to one side.

**Q90 David Simpson:** Now that Metronet has gone into administration, and listening to your comments, I take it that you have not a lot of time for Tube Lines either. I do not know why I have come to that conclusion! However, if you had a clean sheet of paper, what would you say would be the best way forward, the most appropriate way forward

from here on in? Secondly, are you concerned that the withdrawal of private investment, the long-term funding arrangement, will have a negative effect on your members?

**Mr Rixham:** I think immediately we have got a situation where the administration in itself is costing a lot of money and the sooner we can pass through this phase and focus the operation on what it should be doing, the better. I think we have already indicated that we believe the contract should be taken in-house by TfL. There are other options, as indicated earlier. In respect of the money put in by the private investors, then quite clearly each company had a hit of something in the order of £70 million when they lost, but if you have a look at the £2 billion worth of debts then it really is not a shared risk basis that the PPP was founded upon. So although we do recognise that the PPP up to now has pushed forward in some areas the improvements that are required on the Underground, the fact of the matter is that the risk has not been equally shared. Therefore, it is our belief that taken in-house with TfL and given the proper management structures and good management, then it could go forward and be successful. Obviously, that is what the workforce, our members, want to happen.

**Q91 Mr Leech:** Do you think if the risk had been more equally shared there would have been better performance by Metronet?

**Mr Harris:** No.

**Mr Rixham:** I think we are star-gazing. I do not know. I am sorry, just repeat the question.

**Q92 Mr Leech:** If the risk had been properly shared between the private and public.

**Mr Rixham:** Would it have been more focused on actually delivering? Yes, we think it would have been. Quite clearly, as Brian said earlier, as an officer dealing with it on a hand to hand basis you can see the difference in focus of the two companies, Tube Lines and Metronet.

**Q93 Mr Leech:** You do not believe, though, that if the new contract was won by another company, or Tube Lines for that matter, where the risk was shared, that could produce better outcomes than taking it in-house?

**Mr Harris:** No.

**Mr Rixham:** It may do. We believe that the right way forward is to take it in-house within TfL.

**Q94 Chairman:** Can I just ask you one or two things? I take it you do not really think the private sector has contributed a great deal?

**Mr Doherty:** I do not think it has contributed to anything as far as the passenger is concerned and as far as the public purse is concerned.

**Q95 Chairman:** Why do you think Tube Lines were able to reduce the time taken to refurbish an

escalator by nine months to around nine weeks when they took over?

**Mr Doherty:** From our perspective, Tube Lines is a better run company than Metronet, but being better does not mean good, and it certainly does not mean best. We think there are better ways to deliver contracts than either Tube Lines or Metronet. I am repeating myself, but we have had the experience in the mainline and we have seen the money that has been wasted in the public purse. We have seen the deterioration in services and we have not yet even touched on the effect on the employees, and it has been quite enormous as far as Metronet is concerned. Even when Metronet went into liquidation there were still threats hanging over a number of employees of redundancies in one instance, of being transferred to Bombardier in the maintenance contract, and it was only the threat of industrial action that has managed to stave that off. Coming back to Mr Simpson's question about what we think should be done, we think the sooner Transport for London—and their view is that they should take it back in-house—the sooner that is done, the better we can quickly get on with what needs to be done. We are less than five years away now for looking to try and upgrade the Underground as far as the Olympics is concerned. London is going to be on show to the rest of the world and unless we get our act together rather quickly, because a lot needs to be done, then we do not think that trying it out in the private sector is an option or even a luxury that the country can afford, because if you give it time and it fails again, how near are we going to be to the Olympics then and what is this country going to look like to the rest of the world at that time?

**Q96 Chairman:** Can I ask you very specifically, when you say, "We've got an example that works. We know what we can and cannot do," are you referring very specifically to taking back infrastructure in the sense of lines and stations, or are you referring to a wider recovery by the public sector?

**Mr Doherty:** There is the infrastructure side and there is the stations side, but there is also the train maintenance side. Bombardier are still at this stage saying they have a contract. That is a contract they signed while they were a partner of Metronet. They were an integral part of it and that is the way that Metronet operated. Whatever contracts it had, it did not put them out to tender in the private sector, they dished them out amongst themselves and that was an integral part of the problems, I think. Bombardier are still saying they have got this contract. We have managed to control the situation as far as Metronet in administration is concerned, but if we end up with it back in the private sector and if we end up with Metronet still insisting that we are going to have 500 people, or whatever it is, transferring across to Bombardier in order to fulfil these contracts, then I am afraid we will have further industrial relations

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problems in the future. The way to get around that, in our view, is to give control of the Underground to the Mayor via TfL.

**Q97 Chairman:** There is the suggestion that Tube Lines invested £10 million in the training facility in Stratford. Do you think that would have been possible if they had been publicly owned?

**Mr Doherty:** It is about priorities, Chairman. We would always argue for investment for the training of staff. Staff is the biggest cost that any company has and if you value your staff, as most companies tell us they do, then why would you not want to

invest in them, whether in the private sector or in the public sector? Trades unions would always argue for that investment.

**Q98 Chairman:** So if I say that your view is that the original contracts were flawed, that there were very clear problems of communication, particularly in terms of Health & Safety, that these continue in one form or another, and that you assume that were there to be a re-letting of these contracts under the same sorts of conditions you would have continuing problems, am I misrepresenting what you say?

**Mr Doherty:** Not my view, Chairman.

**Chairman:** Gentlemen, you have been very helpful. Thank you very much indeed.

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*Witness:* **Mr Terry Morgan**, Chief Executive, Tube Lines, gave evidence.

**Q99 Chairman:** Good afternoon. I know, sir, that you know our ground rules, so may I invite you to identify yourself for the record?

**Mr Morgan:** My name is Terry Morgan. I am Chief Executive of Tube Lines.

**Q100 Chairman:** Did you have something you wanted to say to us?

**Mr Morgan:** I did. I wanted to make a few points, but in terms of the last session I also wanted to add a little bit more, if I could, just to balance the story.

**Q101 Chairman:** Please do. On the whole, we do not restrict freedom of speech.

**Mr Morgan:** I know you do not. I would like to say Tube Lines has made good progress since we were last here three years ago. We are investing more. We employ more people, 1500 more people than when we first started. We continue to deliver all our projects on time. That was a statement we made three years ago and that is still the case today. The service is more reliable. Yes, there are huge challenges out there, but it is more reliable and we are able to do our upgrade and maintenance programmes much quicker than before. My second point is that I do believe quite strongly that PPP is working. Risk is transferred, investment has increased and performance has improved, but I always caveat that by saying there are huge challenges and obstacles along the way, particularly around making the partnership work as effectively as we would all wish it to, but we are confident we can overcome those challenges as we have overcome those that we have faced to date. My supplementary comment was really on the question of safety. I cannot tell you how important safety on the railway is to everybody in Tube Lines, including myself. I listened to a few comments made this afternoon and I just feel very strongly the need just to try and clarify what I think is happening. We ask our employees, everybody in the business, what they think about working for Tube Lines. One of the key questions we ask them is, "How do you feel about safety?" There is a number of themes you have through an employee survey and safety and their views about safety is the strongest response we get back in terms

of the approach which everybody in the business takes. Yes, there are examples, as we heard this afternoon, and I do agree with the comment made this afternoon. When we find those examples through audit the criticality is to ensure that we respond to what we have learnt and make sure that it cannot be repeated. There is a couple of things I would like to say. If you are an employee of Tube Lines, you are four times less likely to have an injury at work today than you would have done four years ago. Four times. When we first started there is a process in London Underground, as you would expect, that if there are systematic concerns around safety then there is a process in London Underground to regularise that process and you have to confirm, where there is a concern, what actions you have taken and you formally close it off. When we started four years ago there were 290 examples of regulatory notices on Tube Lines to actually deal with issues the engineering function had with regard to the railway. Today there are four concerns. So we have focused very, very heavily on the whole question of safety. There were some things talked about representation. There is representation, both at management and at shop steward level with regard to London Underground and its mechanism for safety. It is clearly a risk when you have a number of different organisations delivering a service to the public and it is a risk that we are only too consciously aware of and something which drives us. If I use an example, every Monday I have an executive meeting. First on the agenda is safety. "What were the issues we had last week? What are we going to do about them and how do we ensure that they can't be repeated?" So it is a really important subject for us.

**Q102 Chairman:** I do not think, Mr Morgan, to be fair, the criticism of you was that you were not particularly interested in safety. The difficulty which was being highlighted was that when there was a specific problem the communications within the company were so poor that it appeared to get stuck at a certain level in middle management and never reach much higher than that.

**Mr Morgan:** I am not aware of that, and it is interesting that it has stuck. This incident took place five weeks ago and was dealt with five weeks ago. HMRI confirmed their satisfaction with our mitigation three weeks ago. It is pretty obvious to me that this story came up today because this event is happening today.

**Q103 Chairman:** But then, on the other hand, you would not presumably dissent from their suggestion that it was only when they went to HMRI that they managed to get that clearance because there were no obvious lines of communication?

**Mr Morgan:** Let me assure you. I mentioned that on Mondays we have an executive meeting. This particular incident was discussed at the executive a few days after the incident. I have—which I switched off this afternoon—a Blackberry in my pocket. Every single incident which occurs on the railway with regard to safety gets text'd to me the minute it is reported. I get that and so does the whole of my executive.

**Q104 Chairman:** Then do you think you are not communicating too clearly to your own employees how you are dealing with the safety problems if they really think that they do not know who to report to and they do not know that anybody is taking any notice when they do report? Do you think maybe there is a failure in communication? I put it no higher.

**Mr Morgan:** I hope not. Clearly there is a distinction—and perhaps I have tried to make that—between the way I would want to represent it, which is the views of the employee, and the membership views in the way that it got expressed in the previous session. What I would say is that again in terms of communication –

**Q105 Chairman:** Let me be sure. You are saying that your individual employees have not given you a problem, so the unions must be wrong?

**Mr Morgan:** Let me use an example. I said we use an employee survey. We asked our people were they satisfied with the level of communications they get. We had a measure which four years ago, just after we started, said that 40% of our people were satisfied with the level of communication. It moved within two years to 70% of our people saying they were satisfied with the level of communication. A 30% change in two years is huge in terms of changing attitudes and people responding to those sorts of questions. So it is a measure we take very seriously. Yes, we can improve, but we do things, the things you would expect us to do, weekly news, team briefs, platform magazines. So there is a lot of things we try to do to communicate with people in our business to ensure they are engaged with the things we are trying to do. It is very important.

**Q106 Clive Efford:** You are talking about your own survey of your staff. Does that lead you then to ignore legitimate concerns which may come through the trade union representatives of your employees?

**Mr Morgan:** Not at all. As you would expect me to say, we have a very robust Health & Safety regime which includes a full representation from trade union shop stewards in the business and they are very heavily engaged throughout the business in terms of carrying out both the duties they see as a responsible trade union, but equally importantly representing the views of many people in the organisation in terms of changes we could make. We have a process. It is there to identify concerns and to deal with them. The point I was trying to make was that in terms of that process, my measures which come back to me suggest that we are making progress.

**Q107 Chairman:** Can I come back to why you are going better than Metronet? Why do you think? Do you think that the £200 million Materiality Threshold, which is different from the £50 million which was your opponent's, has had any effect upon how you work?

**Mr Morgan:** I honestly do not think so. Chris Bolt made reference this afternoon to the fact that we have a mechanism within our deal that says at £50 million we are obliged to report a concern that we have that we are working into an area which is beyond the cost we had indicated we could do the work for. We have never needed to trigger that mechanism, so although it is slightly different we have never got to the £50 million level.

**Q108 Chairman:** Why is that? Because you are so very much better at housekeeping? Because you are doing less complicated systems? Because you have a much higher level of executive planning? What is the reason, Mr Morgan?

**Mr Morgan:** I can tell you about Tube Lines. It would be very difficult for me, obviously, to start making comparisons.

**Q109 Chairman:** You must have thought about it?

**Mr Morgan:** Of course.

**Q110 Chairman:** You must benchmark yourself against someone who is a private company working within an exactly comparable organisation, surely, or are you above these things?

**Mr Morgan:** No, of course not. We take a view that we started from the same place, and clearly throughout the four or five years we have been engaged in this process we are continually assessing ourselves, "Are we doing the right things? What can we learn?" and we continually compare ourselves with Metronet because not everything in Metronet actually is in the sort of category of failure. There are some very good things that occurred in Metronet that we have taken back into the business and learned from.

**Q111 Chairman:** So I ask you again, why are you operating much more successfully than Metronet?

**Mr Morgan:** Tube Lines is delivering its objectives because, first of all, I have to say the management team which is in Tube Lines was there in 2003 with a few changes. So we have seen this journey all the

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way through. So we knew where we started and we know where we are today. Reference is often made to the supply chain and those arrangements. I am in no doubt at all. I would not wish to have the Metronet supply chain running in Tube Lines. It would be an impediment to the effectiveness of the business. We procure competitively, but at the same time we have recruited a lot of very good people who can manage those projects so that they deliver the objectives that we set for them. The one thing I would say, and perhaps in a way I have already emphasised this at the beginning, which is that we have spent a lot of time talking to our people. We have spent a lot of time trying to understand what are the blockers, to actually allow them to perform and we have spent a great deal of time and effort talking about the cultural changes that we need to achieve now you are in the private sector. So this whole driver around delivering performance, "Don't tell me why you have failed, tell me how you are going to succeed," is very much the language of the private sector which I think brings out the best in people and that is something we place huge emphasis on. Our investment at Stratford which you made reference to, I can well remember why we did it. I went to Acton, where there was a training centre. It was raining. This is what we inherited. I gave up counting how many buckets were actually catching the water coming through the roof. For me, that was just not the message. So Stratford was my answer to actually say to people that we care about them. If they make a contribution, we are going to look after them. Stratford is now turning out superb technical officers to the extent—you may remember, or not, last time we talked about the concern of our huge dependence on subcontractors with core skills that we needed to have in the business. I can say today that we have now almost a 100% complement of competencies that we need to sustain this business through training.

**Q112 Chairman:** Yes. You are not actually blaming God for raining on the public sector?

**Mr Morgan:** I am blaming somebody for not looking after the training facility in such a way that it creates the message, "We really don't care about your training needs."

**Chairman:** Thank you very much.

**Q113 Mrs Ellman:** Is Tube Lines considering a bid to take over Metronet's PPP Agreement?

**Mr Morgan:** I think the first answer to that is that whatever we consider, I am not going to sacrifice what we are doing on the Jubilee, Northern and Piccadilly lines.

**Q114 Chairman:** That is not the question, Mr Morgan.

**Mr Morgan:** I know, but it is really important for me. The answer would be that people say, "Well, why don't you take it all on?" We are not capable of taking it all on, not at the same time having the risk that what we have achieved on the other three lines would be put at risk by taking on too much. Do we have the capacity to do more? The answer to that is,

yes, and we have expressed that interest, that we would be able to take on more if the opportunity existed.

**Q115 Mrs Ellman:** Does that mean that you are considering a partial takeover?

**Mr Morgan:** My view is that we would do nothing in terms of trying to widen our interest in the Underground without the support of TfL and LU. It would not work unless they supported that proposition. Clearly, under a PPP regime we have learnt a lot about the benefits of working together and the disadvantages of being adversarial. So for us, if there was some encouragement to do that then there is interest in us doing more.

**Q116 Mrs Ellman:** What are your views on Transport for London taking over Metronet's PPP?

**Mr Morgan:** I have a concern because it feels like the way it used to be. It is the old model. I know what we have changed in the organisation to deliver what we have said. The one thing that is absolutely true in terms of PPP is the level of transparency between the operational side of the business and the support for the infrastructure, and my concern would be that if Metronet was to stay in the public sector this level of transparency and the level of risk would be much more difficult to find and see compared with what we are trying to achieve in Tube Lines.

**Q117 Mrs Ellman:** Tube Lines has been praised, but it has also been criticised for its work on the Northern line. What are you going to do about that?

**Mr Morgan:** When we came to this Committee three years ago that was a very, very hot topic and I gave certain assurances at that time that we would accelerate investment and that we would put additional investment into the Northern line, and that we had a PFI contract with Alstom on the fleet and that we would try to negotiate that contract so that it actually delivered the objectives we were committed to achieve. It was like pulling teeth, but I can proudly say today that we have now renegotiated the Alstom contract as of today. It is useful coming to meetings like this, but it is now concluded.

**Q118 Chairman:** I am glad we have concentrated your mind, Mr Morgan!

**Mr Morgan:** It concentrated everybody's mind that this was something which just could not be allowed to continue. So that is now done. The acceleration of investment means that on the Northern line, since the diabolical year that we had when we first reported to you, this year it is 30% better than it was in our first year and we are actually starting in bonus on the Northern line for the first time. But I am not going to get carried away. The Northern line is a huge challenge. It is a very old facility. Yesterday, for example, we had a very difficult day where a cable which was 50 years old failed on it, and that is something that we are just going to have to keep working at until we get all of our investment in place,

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which obviously for me is a very important message. The investment needed on the Underground has started. It is really important to keep that going.

**Q119 Mrs Ellman:** But your costs for station refurbishment have been higher than the bids?

**Mr Morgan:** They have.

**Q120 Mrs Ellman:** Why is that?

**Mr Morgan:** Managing the expectations is a challenge.

**Q121 Chairman:** What does that mean, Mr Morgan? It is a nice phrase, but what does it mean? It means people expect you to produce what you promised?

**Mr Morgan:** No. The issue is really about the fact that on the stations there was an affordability issue for the Underground and public sector. So in terms of stations, there were two types of stations, or three types of stations developed, one of which was a modernisation, which was a full kit-out with PA, tiling, flooring, new ticket hall, all sorts of things, the full works. There were other stations that were in what was called a better state but required some refurbishment, so a lighter touch. You will not be surprised that the stations that were going to get the lighter touch wanted the full modernisation, and that is where the expectations were, where one station was getting a full fit-out and another station was actually getting a less full fit-out because it did not need it. That is where a lot of the expectations that I referred to came across in terms of the challenge we faced. It is also true to say that on stations, when we took the contract they all had an end date. If I did not get to the end date, then I pay the penalty. But that required approvals from London Underground to start the work and that was very, very challenging. It meant that we threw a lot of time, resources and effort to get those first stations started and it cost us. I have to tell you as an example that stations we have completed in the last three months are 40% lower cost for the same specification than when we first started four years ago, because we are able now to get the process optimised, a common understanding about what the scope should look like and the opportunity to use what we have learnt to actually improve the next station that we work on.

**Chairman:** I want to bring both Mr Leech and Mr Efford in on this one, certainly Mr Leech.

**Q122 Mr Leech:** Just to bring you back on the Metronet contract, there have been some suggestions that TfL have been actively dissuading potential bidders. Have you come across that at all, or is there any evidence to suggest this is true?

**Mr Morgan:** I think it is on the public record that TfL and London Underground believes that the Metronet business has no value.

**Chairman:** Not too intimate, please, Mr Morgan, we are taking a record.

**Q123 Mr Leech:** In terms of them actively dissuading bidders, do you think that is right?

**Mr Morgan:** No, I do not think that is the case. It is not a question of actively dissuading, it is a question of what is offered that is of interest to the private sector and I think with the condition that Metronet found themselves in and the way the administrator is carrying out his role there remains a challenge to actually understand how the private sector might be able to take on the risk that is there and actually be able to deliver value both for the client in the London Underground and TfL environment and obviously demonstrate to the investors that this was a risk that could give a reasonable return.

**Q124 Mr Leech:** But do you believe there is a viable contract?

**Mr Morgan:** I think it is very difficult to imagine that anybody would pick up the Metronet contract as it went into administration. I think it is also true to say that it is on the public record that London Underground would wish to take it back into the public sector, and as soon as they do they would change the contract. That clearly is not available to the private sector.

**Q125 Chairman:** What is also on the public record is that the risk was not actually shifted, was it?

**Mr Morgan:** I vehemently believe it was.

**Q126 Chairman:** Which bit do you think was shifted, Mr Morgan, because we have obviously missed that?

**Mr Morgan:** Tube Lines is not in administration because it actually managed the risk, would be my argument. I have used the example on stations. We incurred an additional £200 million worth of cost on delivering the station programme. We had to manage that within the scope of work available to us, which meant that we delivered all our programme objectives but we used our contingency and had to find efficiencies elsewhere to ensure that we could do our station work. That to me is all about risk transfer. In the old model, it would have been, "I've done a station here. Here's my claim for some additional funding from London Underground." I could not do that. As an example, Arsenal Station, we went in there with a scope of work to complete. When we started we found that the roof actually required complete replacement. I did not make a claim on London Underground for the roof, I had to pay for that myself. So I do think there has been risk transfer, but of course in the example of Metronet that is more difficult to balance given the scale of the overrun.

**Q127 Clive Efford:** Just on that briefly, what Metronet have lost is the capacity to make money out of the Underground? Is that not all that has been lost in the sense that that is the only risk they ran?

**Mr Morgan:** I thought the shareholders lost their equity, so I think that is quite a bit. You will not be surprised that within Tube Lines we have taken a view of what actually happened in Metronet and I am very clear that we, in the way we run our business, would have called for an Extraordinary Review earlier than was actually called for. I think Chris Bolt has referred to that. The mechanism is

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intended to cap the overrun. From my point of view, it is intended to cap the overrun at £200 million. At that level of risk, if it is £200 million overrun, I pay for it. My shareholders pay for that. That is their risk. Over that, there is a process to be followed which is intended to actually call for an Extraordinary Review involving the Arbiter, and my view is that if we were in a similar position that is the mechanism we would have used.

**Q128 Clive Efford:** A previous witness alleged, I think it is more or less a quote, that Tube Lines is not far behind Metronet. I thought I would give you the opportunity to comment on that.

**Mr Morgan:** I heard the comment. I have no basis on understanding where that came from. We contracted to complete 47 stations by the end of August. We did so. We contracted to increase capacity on the Jubilee line. We did so. So we do not have a single programme that is running late. We have filed our results and as far as I am concerned, as we look forward to 2010/11, when the Periodic Review is in place, we expect to be there with a good performance.

**Q129 Clive Efford:** In your evidence you suggest that innovation has led to costs savings which could be shared with the public purse at Periodic Review in 2010. Is that not pie in the sky?

**Mr Morgan:** I wish it was. I could keep the innovation benefits for myself if that was the case. The model that is in place—and that is the role of the Arbiter—for example, I made reference to the fact that our station work now is 40% lower cost than we first started. When we come to a Periodic Review, the costs of a station going to the second review period will be based on the cost that I completed that last station at. So all the innovation benefits, in terms of cost reductions, in terms of time to complete work, is actually handed back to the public sector and I start again. I have to look for more ways of being more innovative.

**Q130 Clive Efford:** So if Metronet maintenance and upgrade work came back into the public sector, do you think it would be undertaken in the same effective way as you claim to be carrying out your work?

**Mr Morgan:** I think I have already said that my concern would be about transparency, risk and some understanding about how would that be different to what used to exist five years ago, and that would give me cause for concern with what I have learnt over the last four or five years about what we have improved upon.

**Q131 Clive Efford:** Are all the PPP agreements fixed price contracts?

**Mr Morgan:** Our view in Tube Lines is that we inherited a fixed price contract. It might sound semantics, but they are on the edges. For example, we take a view that there is a change in the scope requirements that London Underground wish to see happen or there is a change in the standards that London Underground want to apply, then there is a

mechanism for us to actually make a claim for some additional expenditure, but at the heart of the business we do take the view it is fixed price, yes.

**Q132 Clive Efford:** Is there a significant level of risk transfer for the station programme?

**Mr Morgan:** All of it, except where we have disagreements about the scope of work.

**Q133 Clive Efford:** So does London Underground's approach to these projects affect your ability to deliver and on budget?

**Mr Morgan:** Totally, because if you take the station work, all of our projects not only are fixed price but they are fixed in time and any delays in a project will cost us huge amounts of money unless we deliver on time. But the mechanism is as you would expect. If we take a view that the behaviour of London Underground had delayed the project, then we would make a claim for the effects of that, but I have to say that on the 47 stations to date there are issues around scope and the work we have completed, but in time terms they have all been delivered on time.

**Q134 Clive Efford:** Will the fact that Tube Lines' Materiality Threshold will be reduced from £200 million to £50 million in 2010 in the periodic review affect the level of risk transfer from the public sector?

**Mr Morgan:** It means that we are less exposed to the Materiality Threshold in terms of risk in 2010. Obviously, from running the business successfully I do not want the Materiality Threshold ever to be a consideration and it has not been for Tube Lines to date.

**Q135 Clive Efford:** The question is about in terms of public risk and you think that it affects the level of transfer of public risk?

**Mr Morgan:** I just think there is a difference in risk in terms of as we move forward. When we first started our knowledge of the assets was low, as it was in London Underground. What we now have is a single asset register. We have a lot of our assets now in a known condition, so the level of risk around what we need to do with those assets is lower because we have a much higher knowledge of the assets that we are running.

**Q136 Chairman:** Government funding has tripled between 2001 and 2004/5, so what has the private sector actually added beyond a commitment to investment for which, after all, your shareholders are very well rewarded?

**Mr Morgan:** We have delivered 20% improvement on the Jubilee line in terms of capacity. I was going to say on time, but actually two days early. Delivered on time and for lower cost. When I came to this Committee last time, we discussed Wembley Stadium and the station work there and some concerns about whether the station would be ready in time for the new stadium. It was delivered twelve months before the stadium was actually opened.

**Graham Stringer:** Possibly because of the stadium being late!

**Q137 Chairman:** Yes, I was going to say that luckily you were assisted by the stadium being late.

**Mr Morgan:** The station, though, was delivered on time and on budget. The thing for me is really that we obviously have some experiences around what we inherited and what we are trying to do now and I do think, in terms of value for money and the projects we are delivering we are delivering for the cost profiles –

**Q138 Chairman:** So are you value for money?

**Mr Morgan:** I believe we are.

**Q139 Chairman:** When the review of 2010 provides you with an opportunity for the PPP agreement to be renegotiated, what are you offering? What are you going to ask for in order to make sure that we get value for money for the second seven and a half year review period?

**Mr Morgan:** In terms of 2010, work has already started. Chris Bolt made reference earlier to the need to benchmark.

**Q140 Chairman:** I understand that, but I need to know what it is that you will be asking for which you believe you can deliver, which will be value for money and which will be part of that negotiation.

**Mr Morgan:** The big project is that we will have done a great deal of work on the Jubilee line and we will have done a great deal of work on the Northern line by the time we come to the Periodic Review. The big issues around the Periodic Review I think is a number of issues. One is with regard to Piccadilly, a huge project to upgrade, both the signalling and to purchase a new fleet for 2004<sup>1</sup>, so that has to be sorted and settled and moved forward before the Periodic Review. Clearly the Periodic Review is important in terms of confirming that. Secondly, bearing in mind that this contract is in embryonic stage and negotiations started in the 1990s, the agenda has changed enormously since.

**Q141 Chairman:** That is exactly what we are asking you.

**Mr Morgan:** So the expectations around the environmental debate is something we expect to see built within the Periodic Review work that we will be asked to bid for. We have in the detail obviously gone through enormous learning curves about how we think, and London Underground think, we could make this deal more efficient. So again we have been sharing views. For example, concerns have been expressed about engineering overruns, how we can

make that more effective. We have talked about how, in terms of when we go in to do some work, do we actually minimise disruption to the public, so again lots of discussions around more innovative ways of trying to get greater access to do the work, but at the same time to ensure that we can actually get the programmes completed on time. So we are fully engaged with London Underground on coming up with ideas to improve the work we can do –

**Q142 Chairman:** You are assuming that this will in its turn be a fixed price contract?

**Mr Morgan:** Our view is that we had a 30 year franchise and that the Periodic Review is all about agreeing the scope of work, pricing and the performance objectives that we are setting for the second review period. That is our approach to it.

**Q143 Chairman:** Why then do you think, finally, that there is this slight confusion in the minds of others that the contracts are not necessarily fixed price? What clarity of view, Mr Morgan, is it that you have got that is withheld from others?

**Mr Morgan:** The area that creates uncertainty about whether this is a fixed price contract is where there is a dispute, and where there are huge amounts of money around that dispute the consequences of that dispute can make it such that that ability to maintain a fixed price approach, knowing that there is then a dispute in place which might be quite substantial brings huge risk.

**Q144 Chairman:** Yet there is a very clear Arbiter with a responsibility and clear arbitration machinery?

**Mr Morgan:** You are right. The Arbiter, though, does not handle disputes. There is an arbitration procedure which deals with disputes, but it takes time. That is the issue.

**Q145 Chairman:** So the problem is not that you cannot ask for more money, it is not that you cannot demonstrate that you are worth more money, the problem is you have to take some time to produce the evidence and argue it?

**Mr Morgan:** That is part of it, but I equally have to say that delivering the projects on time gives you a huge advantage in terms of at least taking away the debate about whether things were delivered on time. When you have a time issue and a cost issue, it becomes very complicated.

**Chairman:** Mr Morgan, you have, as always, been very tolerant and helpful. Thank you for coming.

*Witness:* **Mr Roger Evans**, Assembly Member, Chairman of the London Assembly Transport Committee, gave evidence.

**Q146 Chairman:** I have to adjourn the Committee in one minute because there will be a vote so I hope, Mr Evans, you will not regard this as a personal comment if we all get up and walk out.

**Mr Evans:** It will not be the first time.

**Q147 Chairman:** I can assure you we will return. Perhaps you would be kind enough, while we are waiting for the magic moment, to tell us your full name and station in life?

**Mr Evans:** Yes. Good afternoon and thank you for the invitation to join you today. My name is Roger Evans. I am a Member of the London Assembly, the

<sup>1</sup> Note by witness: should be 2014

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Member for Havering and Redbridge, which is known to most people as Ilford and Romford in north-east London, but I am with you today because I am chairman of the London Assembly's Cross-Party Transport Committee, I should point out the evidence I will give you will be agreed cross-party, rather than my own political views.

**Chairman:** Thank you very much for that. The Committee is suspended, preferably for ten minutes, depending on how quickly Members can get back.

*The Committee suspended from 4.36 pm to 4.49 pm for a division in the House.*

**Q148 Chairman:** Mr Evans, you were about to tell us?

**Mr Evans:** Yes. I have a full introduction here, which I will not burden you with as you have already got our notes, but there are three key points which my committee asked me to emphasise. The first one is that we have heard from the Arbiter today about the tension over the continuing of the Extraordinary Review. We feel the Review should continue and I am pleased to hear that it will report on 12 November<sup>2</sup>. I think there may be some lessons we can learn from this, and certainly it will be useful to have a clearer valuation around the Metronet contracts. Secondly, we feel—and we have said this in our report at the start of 2007—that Tube Lines has shown that PPP can work and Metronet has shown us some of the problems which can stop it working. I think because of that we would not want to see the whole thing wound up.

**Q149 Chairman:** You would or you would not?

**Mr Evans:** We would not, no. Finally, as a plea on behalf of my voters almost, we do not feel that Londoners should pick up the tab for this. Figures like £2 billion are being bandied around here. Obviously there is only a couple of ways that we could pay for that through the transport budget, either by raising fares (which we have seen increase over the last few years anyway) or by cutting projects to find the money, and that would not be a suitable thing to do either given the state of transport that we have in London.

**Q150 Chairman:** What do you think of the performance of London Underground in fulfilling their responsibilities in the partnerships?

**Mr Evans:** I think London Underground's approach has been perhaps unnecessarily adversarial towards the PPP companies. Of course, you have to remember that we started with a situation where Transport for London went through litigation to try to prevent this being imposed. Our committee did not take a view. We wanted to look at what was actually going to be provided rather than have an arcane debate about the mechanism, but this having been imposed I think we feel London Underground could have worked better with the PPP companies.

**Q151 Chairman:** In what way? To work better is a lovely phrase, but they are all very professional. Mr O'Toole, it seems to me, has not only got an extraordinarily good track record but has shown himself capable of dealing with all sorts of highly complex situations. He has been lumbered with an arrangement that he did not negotiate. He was directly responsible for it, but not directly involved in it.

**Mr Evans:** Mr O'Toole is a very high quality public sector manager and we are very pleased with his performance, but if you look at the situation around station refurbishments, for example, there has been a lot of wrangling about what should go into a station refurbishment. The way the companies dealt with it were different. Metronet seemed to get drawn into long, drawn out arguments, which led to delays, and we have a situation where we have been left behind.

**Q152 Chairman:** But that can hardly be laid at the door of LUL, can it really, to be honest? Part of the problem with any customer/supplier argument surely is the customers will always go for what they want and the supplier will presumably have to decide whether or not they can do it for the price?

**Mr Evans:** Yes, and the customer has a responsibility to make it very clear what they want from the outset. Our experience is that maybe something had been added to the specifications and minds have changed halfway through them. I think Tube Lines' approach was only just to say, "We'll do what you want and argue about the price afterwards," and maybe that has been a bit more of a successful approach.

**Q153 Clive Efford:** Could you say what the role of your committee is in scrutinising what is happening on the Underground?

**Mr Evans:** Yes, certainly. We have an entirely scrutineer role. We have no executive responsibility over what happens. The executive responsibility is exercised by the Mayor, who is the chairman for Transport for London through the board and the Commissioner there. We have no power to have our recommendations taken on by Transport for London, although in fact they do take them on when they wish to and when they feel that something we have done is useful for them.

**Q154 Clive Efford:** Is there a mechanism in place for your committee to be made aware of serious deficiencies in the performance of a contractor on the Underground?

**Mr Evans:** No, there is no mechanism in place to do that. What we do receive are the minutes of the board of Transport for London and the panels that comprise that board, so we might see indications from that that a contractor was failing or that something was wrong, but it is very much up to us to go through the material that is put in front of us. There is no formal mechanism to tell us.

<sup>2</sup> Note by witness: should be 18 January 2008

**Q155 Clive Efford:** So we have got a virtually bankrupt contractor rattling around on the Underground, running two-thirds of it, and you do not know anything about it until it hits the buffers?

**Mr Evans:** I think that is a fair summary of the situation. I look back at my officers to see if they have anything else to say, but that is a fair summary.

**Q156 Clive Efford:** So I cannot accuse you of sleeping on the job while all this was going on?

**Mr Evans:** No. I think that would be unfair. If we had a responsibility, or if there was a reporting mechanism built in, then that would be the case, but Transport for London view our committee in some ways as being adversarial towards them and it is often a case of chasing information rather than having it provided.

**Clive Efford:** A bit like the way the Government views this Committee!

**Chairman:** Surely not! That must be a misconception on your part!

**Q157 Chairman:** Do you think it likely that there will be interest from other private sector companies to purchase Metronet?

**Mr Evans:** We had the Arbiter in front of us last month to talk to us about the work he is doing and I think the feeling is that if there is value in the contracts there may be interest from the private sector, but we need to actually see how the administrator's valuation comes out first. It may be that the contract is seen to lack value to such an extent and be such a bad deal that the only –

**Q158 Chairman:** Most people would regard the sort of investment they have put in and the sort of return they have got as being not bad value. I think we ought to be quite clear that we are not talking about a company having failed because it was not given a very considerable amount of leeway to make money, are we?

**Mr Evans:** No, we are not, and when I talk about the value of the contracts I am talking about a snapshot now. Would you want to come in and pick these contracts up with a margin of hundreds of millions of pounds of debt attached to them? Possibly London Underground may, according to the Arbiter, owe money to the contractors, possibly not. You have heard the range of figures talked about. So it is difficult to say in those circumstances whether someone would want to take them over. I have to say my view is they do not look very attractive.

**Q159 Clive Efford:** If there was a private sector company or consortium interested, should there be a restriction on the scale of the operation they take over in the future, or do you think it should be on the same lines as the previous PPPs?

**Mr Evans:** One of the problems that Metronet had, as opposed to Tube Lines, was the size of the task they faced. This is nine out of the 12 underground lines, probably about two-thirds of the system underneath one heading, and that has magnified a

lot of the difficulties they have had. I think anyone would agree that it would be better managed in smaller chunks in future, yes.

**Q160 Clive Efford:** So what is your interpretation of s.210 of the GLA Act, which seems to forbid the public sector from operating an Infraco?

**Mr Evans:** I am not a lawyer and I did not write the Act, but my understanding is that there is the possibility that contracts could be effectively undesignated so they were no longer PPP contracts, and that would enable the public sector to operate the Act. We had a question time session with the Mayor this morning and I asked him about this. He told us he felt the Secretary of State would be amenable to that happening.

**Q161 Clive Efford:** How should the £900 million loan that TfL has made to Metronet's administrators be financed?

**Mr Evans:** Ideally, that and any other bills that are picked up from this should be financed from the national Government's coffers rather than through Transport for London.

**Q162 Clive Efford:** You are not aware of any changes TfL has made to its forward programme as a result of having to find this money?

**Mr Evans:** They have assured us that their programme of works has not been altered. I think the Mayor has said the station refurbishment programme may fall back in order to do this, but nothing else has been sacrificed.

**Q163 Graham Stringer:** Have you had any indication of the Government's position on the costs due to the failure of Metronet?

**Mr Evans:** No.

**Q164 Mrs Ellman:** There has been this major financial and operational collapse and you say there is no reason why you should have known about it. What other powers do you think you should have had or you would like so that you might be in a position of knowing in the future?

**Mr Evans:** I think a power we would like to have as a committee generally is to be able to vet and approve the Mayor's transport strategy for London, which is a huge area and would take into account a lot of issues which are important to Londoners. But remember we are a scrutiny committee, we are not a part of the executive here, although we occupy the same building as them. I think you said earlier it is not your job to micro-manage the Underground. I do not think it is our job to do it either.

**Q165 Chairman:** Mr O'Toole, I think, told you that £17 million a week was being paid for the loan to both Metronet and Infracos. Can I just get it plain in my own mind exactly what it is you are saying? You believe that even though that was an arrangement which was entered into by Transport for London, even though it is directly involved in a London infrastructure project it should be paid from the national purse?

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**Mr Evans:** We believe the PPP is something which was imposed on London in opposition to the views of the Mayor, who was elected at the time and Londoners should not pick up the cost.

**Q166 Chairman:** Is your committee of the opinion it should not have been imposed and that we should still have them all within national control? Is that the position of the committee?

**Mr Evans:** No, the position of the committee was that we would wait to see what actually developed and how it worked at the time. Obviously, I have a committee which does not just involve the three major parties, we have Greens and people formerly known as UKIP as well, so there is quite a wide range of views there.

**Q167 Chairman:** Full of life's rich pattern. All I am asking you is what you view your responsibility as. You say you are a scrutiny committee. That is what we are, but we are also part of the Parliament which decides how much money is going to be spent on which particular heading at least once a year, sometimes twice if we are feeling violently enthusiastic! All I am saying to you is, are you really saying to us, "We didn't have anything to do with it. We're just scrutinising it, but on the whole we think you ought to pay for any gap there is because it's not us, Guv, it's the people next door"? I only ask. I just would like to have it on the record.

**Mr Evans:** Yes, it is a fair question, and certainly I believe that because this was imposed on London then the Government that imposed it should be the people who pick the bill up.

**Q168 Chairman:** And your committee would have opposed the imposition of this arrangement?

**Mr Evans:** No, we did not. We could have made a statement at the time.

**Q169 Chairman:** You did not oppose it at the time, but now you think you should have done and you want the cash?

**Mr Evans:** No, I think the committee's position was correct at the time. We did not agree to it being imposed either. We said we would monitor what was

going on because that was our role. Please remember as well that we do not have that role of walking downstairs and seeing what is going on.

**Chairman:** You have been kind enough to explain that to us, Mr Evans, and it is because you are a scrutiny committee and because you are asking awkward questions and because, presumably, one of the things you scrutinise is where the Hell that amount of money is coming from each week. It is very important for us to know who is paying for it. It is boring, but you know that is what elected Members do.

**Q170 Graham Stringer:** You were listening to Mr Bolt's evidence earlier on?

**Mr Evans:** Yes.

**Q171 Graham Stringer:** Do you have an answer to the question I asked Mr Bolt about what you believe the cost to the taxpayer (whichever taxpayer) has been the failure of Metronet?

**Mr Evans:** That is an interesting question and it is one I was discussing with colleagues earlier on. There is that notional £500 million that was possibly spent on legal advisers and auditors, maybe. That is the figure we have seen in the press. I cannot sit here and substantiate it because I was not a party to that.. You might also add, of course, the cost of the legal challenge to the scheme and the work that was done on both sides during that process, and possible costs of delays bringing the PPP in because of that challenge. But then you might also look at the PPP and say, "Perhaps there are some things where we've saved money here, based on what could have happened before." One of the big problems has been the quality of the asset register that London Underground had and it does appear in hindsight no one really knew exactly what they were taking on.

**Q172 Graham Stringer:** So you do not have an answer to the question of taking the baseline being the public sector case?

**Mr Evans:** No, I do not have a ballpark figure for that. I think it would be very difficult to calculate.

**Chairman:** It is very nice to have heard you, Mr Evans. We do wish you the greatest luck with your scrutiny. Thank you for coming.

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## Wednesday 7 November 2007

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Clive Efford  
Mrs Louise Ellman  
Mr Philip Hollobone

Mr John Leech  
Mr Lee Scott  
Graham Stringer

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*Witness: Mr Graham Pimlott, former Chairman, Metronet, gave evidence.*

**Chairman:** Good afternoon. I am very grateful to you for coming this afternoon. Members having an interest to declare. Mr Efford.

**Clive Efford:** A member of Unite.

**Chairman:** Mr Stringer.

**Graham Stringer:** A member of Unite.

**Chairman:** Gwyneth Dunwoody, ASLEF. Mrs Ellman.

**Mrs Ellman:** A member of Unite.

**Q173 Chairman:** Can I welcome you most warmly. I would be very grateful, sir, if you would be kind enough to identify yourself for the record. I am going to ask you if you want to say one or two words before we begin. The house rules are very simple: the microphone in front of you records but does not project, so perhaps you would be kind enough to remember that.

**Mr Pimlott:** Thank you very much Chairman. My name is Graham Pimlott. I was the non-executive Chairman of Metronet from 9 January this year to 31 July this year. In relation to your kind offer to make an introductory statement, I do not think I shall, thank you.

**Q174 Chairman:** So you do not mind if we go straight ahead?

**Mr Pimlott:** Fine.

**Q175 Chairman:** We understand, of course, the situation that you face but could you tell us what you think is the reason why the Metronet combination failed?

**Mr Pimlott:** At the expense of being somewhat simplistic, it ran out of cash and the reason it ran out of cash was that it had spent too much money and the banks were no longer prepared to advance it any more money, and if one were to pick one area which had caused the most difficulty it was the stations project.

**Q176 Chairman:** Was that because they were inefficient and did not do their sums properly before they started, or what was your estimate for the reason?

**Mr Pimlott:** I do not think it is easy to say precisely what the reason was; indeed, I think that the Extraordinary Review was going to help everybody to assess that. It is undoubted that there was inefficiency; however, there was also some difficulty in interpreting what the area of the contract relating to the stations truly meant.

**Q177 Chairman:** In what sense?

**Mr Pimlott:** In the sense that when it was put together it was assumed that there were three homogenous groups of stations, which would get a different sort of treatment. As it turned out, certainly from Metronet's point of view, the stations were much more unique than that and the clients' requirements were much different to those which had been bid.

**Q178 Chairman:** What you are really saying is that the contract management was bad because that was not estimated correctly and the information available was not precise at the beginning of the contract?

**Mr Pimlott:** I would not go so far as to say contract management—contract creation maybe, yes. I think if the specification had been much clearer at the start a lot of the problems would have been avoided.

**Q179 Chairman:** How much of the overspend, do you think, or the problems were connected directly with the structure of Metronet and how much with the management?

**Mr Pimlott:** By structure of Metronet we are talking about the shareholder being supplier and shareholder and the tied contracts; is that the point? I think that there is no doubt that in the case of the stations the contractual arrangements with the shareholders was a very negative factor from Metronet's point of view. Metronet had a contract with Trans4m, which was a contract that gave Metronet very little in the way of leverage over Trans4m. It had to actually pay money when bills were presented and it did not have the ability to withhold it, for example for performance failure. That, together with the difficulties which Trans4m had in getting the contract specified and then carried out was extremely damaging. On the other hand, if you look at the Bombardier contract, certainly at the time I left the contract that was working perfectly well as a tied contract, and if you ask me to indicate the difference I think it is that the Bombardier contract was a true output contract; it had to achieve certain milestones and it got paid when it achieved them. Whereas the stations contract, in my view, was not a true output contract, it was more like a building contract.

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**Q180 Chairman:** Then why did the management not perceive that right at the beginning because it was in their interests to sign a contract which was going to enable them to make a profit and to produce the results at the proper time, was it not?

**Mr Pimlott:** I am afraid I honestly cannot tell you what happened at the beginning, I was not around in 2003.

**Q181 Chairman:** Let me put it another way. Was the tied supply chain responsible for increasing the costs?

**Mr Pimlott:** The poor management on the station contract was to some extent responsible for increasing the costs, yes.

**Q182 Chairman:** In your role as the independent Chairman were you able to distinguish between the roles of shareholder and supplier?

**Mr Pimlott:** We did increasingly do that. When I first arrived in January I think it was more difficult to see the difference around the board table, but over a period of time, as we renegotiated the track contract and got into a substantial renegotiation of the Trans4m position it became much easier for people to understand whether they were acting as a board member or as a contractor.

**Q183 Chairman:** Do you think it is unfair to suggest that Metronet was simply set up by shareholding companies to guarantee that they retained the lion's share of the work and as protection against most of the liability in the event of the failure of Metronet?

**Mr Pimlott:** I think you would have to ask the shareholders that; I cannot comment on that.

**Q184 Chairman:** You have no indication of that? You certainly were not there at the beginning but you came in and all the papers were available to you and you presumably read deeply before you took over responsibility.

**Mr Pimlott:** Every indication I had was not that. I do not believe that the shareholders deliberately set it up in order to achieve that; I actually believe that what happened was one particular area of contracting which got out of hand.

**Q185 Chairman:** So they were not crooked, they were incompetent?

**Mr Pimlott:** If that is the way you would like to put it.

**Q186 Chairman:** No, I am just asking; I am interested. Why would you sign a contract that did not work if you had had access to proper professional support?

**Mr Pimlott:** I think they believed that Trans4m would be a perfectly effective vehicle for carrying out the stations contract and indeed some of the other contracts, the civils contract. Metronet was set up as a very light company, it did not have a big staffing—indeed, the majority of the project management and indeed all the project management on those

contracts was to be done in Trans4m. I think they genuinely thought they would achieve that; as it happens they did not.

**Chairman:** Mrs Ellman.

**Q187 Mrs Ellman:** But the facts are, are they not, that Metronet was not really taking very much risk. Its shareholders were tied up with the contracts that were let out and there was public liability for debt. Do you think if there had been a bit more risk to the shareholders the outcome might have been different to what has happened?

**Mr Pimlott:** All I can tell you is that the shareholders did not behave as if they were taking no risk and I think to each of them, especially to some of the smaller ones, the loss of whatever it was—£70 million—was a significant loss. If they had had more skin in the game would they have behaved differently? I honestly do not think so. I think Trans4m got itself into a state where the four parties all had slightly different interests and they found it very difficult to sort that out.

**Q188 Mrs Ellman:** So do you think that the shareholders were faced with adequate risk to incentivise them?

**Mr Pimlott:** What is adequate? I think they had risk and they were conscious of that risk and I think they behaved as if they really did not want to lose their money.

**Q189 Mrs Ellman:** Why then was the report that should have been requested from the arbiter not actually made?

**Mr Pimlott:** I cannot give you a direct answer to that because I was not there at the time. My understanding is that Metronet understood that it was experiencing some difficulties and wanted to try to sort those difficulties out with London Underground before subjecting itself to a public examination.

**Q190 Mrs Ellman:** Yet the delay in seeing that report did delay identifying some of the problems, did it not?

**Mr Pimlott:** I am not sure whether it delayed identifying some of the problems because I think that Metronet was aware of the problems. I have to say I do believe that the 2006 report shone a very useful light on those problems and did actually bring some momentum to resolving some of those problems. So you could say that if the same was true of 2005 it would have had that effect.

**Q191 Mrs Ellman:** Do you think with hindsight that Metronet should have been required to seek that report?

**Mr Pimlott:** I think it could have done no harm, frankly, to have had that report.

**Q192 Mrs Ellman:** You say no harm but in the light of what has happened could it not have done some good, in not just identifying the problems but dealing with them?

**Mr Pimlott:** With the benefit of hindsight obviously it would have been much better to have had that report earlier.

**Q193 Mrs Ellman:** So if we were looking at what lessons to draw from what has happened would you say that there should have been a requirement to seek that report?

**Mr Pimlott:** I am just expressing an opinion but my opinion is that any sort of external supervision is a good thing.

**Q194 Mrs Ellman:** In this particular case would it have been a very good thing in the public interest?

**Mr Pimlott:** I am not sure about that. Part of the difficulty of all of this is how much liability was incurred at any given moment and the stations project accelerated its expenditure quite significantly in 2006 and 2007—and I think maybe even 2005, 2006 and 2007—but I am not sure how much of that would have been captured in the 2005 annual report. They would have obviously seen the start of the problem but I am not quite sure how big a problem it would have been at that time.

**Q195 Mrs Ellman:** But the outcome of what has happened has been a failure and administration, has it not? So surely we should all have been in a position to look at what might have been done differently?

**Mr Pimlott:** All I am saying is I do not know how severe the position would have been and whether the arbiter would have been able to express as trenchant views in 2005 as he did in 2006?

**Q196 Mrs Ellman:** You have said to us on a number of occasions this afternoon that you could not answer certain points or you could not give an opinion because you were not there at the time and that is factually correct—you were not, you took up your position later. In view of that who was actually responsible for what has happened? Is anybody responsible for the failure?

**Mr Pimlott:** A series of people have been responsible.

**Q197 Mrs Ellman:** Is there no liability to any individual or to a structure or to a decision-maker? Surely it cannot be that when there has been a failure on this scale because there is somebody else in the hot seat then nobody is held responsible? Do you think that is a reasonable position?

**Mr Pimlott:** It seems to me in this case that what has happened is that one or two things have gone wrong and ultimately badly wrong over a period of time and different people have had different positions both within the shareholders, within Metronet and within the contractors during that period of time, and each of them must clearly bear some responsibility for that part of the journey when they were in charge.

**Q198 Mrs Ellman:** But you would not draw any conclusions at the moment about how things might have been done differently? Was it the structure, was it the individuals; was it the failure of adequate supervision?

**Mr Pimlott:** If I were asked to choose between those two things, which are rather black and white choices, I think the structure clearly, with hindsight, was very difficult, to have on the stations project a tied supply chain where Metronet had little or no ability to influence what was going on in the project manager underneath it, was extremely difficult to change or to do anything about.

**Q199 Mrs Ellman:** Who should have been looking at that? Who should have been identifying that problem?

**Mr Pimlott:** I think the problem was known. It was a problem known to the arbiter, it was known to London Underground, it was known to Metronet and it was known to the shareholders. The arbiter and London Underground and Metronet and the shareholders were over a period of time trying to do something about it but they did not get it done fast enough.

**Q200 Chairman:** Could we go back a bit? Why would anybody sign a contract that was so imprecise they did not know what they were committing themselves to or know that they were required to do an estimate? That they were not at all clear that they were able to flexibly plan to do the work that they estimated, even if they got the estimates wrong? It is not really surprising that the banks did not love you, is it, really—not you personally—because the company did not seem to have a very good idea of what they were doing. In fact some might say, if they were being cruel, that they had no idea what they were doing.

**Mr Pimlott:** When the contract was first entered into clearly people thought they knew what they were going to have to do. As it turned out that was not how it happened.

**Chairman:** Mr Efford.

**Q201 Clive Efford:** You said that the problem was with the stations project; you said that the clients' requirements were different from the bid. When did you first become aware of that?

**Mr Pimlott:** My understanding is that they first became aware of that in probably 2004/05.

**Q202 Clive Efford:** And you also said that the root of the problem is that the banks refused to loan any more money to the company. Was that the sole reason that they gave at the time, this failure in this area of the stations project? If we were to have the banks in front of us and asked them the question would they point to that as being the serious black hole in your finances?

**Mr Pimlott:** I think the banks would say probably two things. The first thing they would say is that it was important for them, before lending more money, that an economic model was shown to them in which they had confidence that the project would

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work, and they would say that model 68, which is the one produced in March, was not a model in which they were confident. But probably the final thing was when they were effectively told that advancing further money may not attract the 95 % guarantee.

**Q203 Clive Efford:** Just remind me, the question about when you became aware of the problems with the contracts on the stations, when did you first become aware of that?

**Mr Pimlott:** As I have said before, I was not there. I can tell you from what I have heard.

**Q204 Clive Efford:** That is not good enough actually, is it? This is something that would have been under review by your board constantly and you would have had some idea of when these problems came to light. It is not really good enough to sit there and say, "Not me, guv! It all happened before I took over in the chair," is it?

**Mr Pimlott:** I said to you earlier on that I believe it was first known in 2004/2005.

**Q205 Clive Efford:** So why, then, did you wait until 2006 to ask for an Extraordinary Review?

**Mr Pimlott:** I believe that the board's decision in the first instance was to attempt to agree a way out of the problem with London Underground, and in 2005 I believe—

**Q206 Chairman:** To go back and ask for some more money because they had not got it right in the first place.

**Mr Pimlott:** I suppose two things, really. First of all, to try to reach much greater agreement on what it was that was supposed to have been done under the contract; and secondly—

**Q207 Chairman:** Only at that point, after the banks were breathing down . . . Is it not slightly odd to have a board where people were not keeping a constant eye on what their bankers were going to say to them? Bankers are singularly unimaginative people, it seems to me, and they do tend to draw your attention to the fact that they do not like what you are doing.

**Mr Pimlott:** I do not think the banks were particularly concerned about what was going on until 2006.

**Q208 Chairman:** So they were quite happy, even though there were clear signs in 2005 that it was going wrong, and you do not think they worried about it until it actually became manifest that it was a much, much larger sum than anybody had expected?

**Mr Pimlott:** I do not think it was as obvious in 2005 that the sum was going to be the size it was.

**Q209 Clive Efford:** When you started in April 2005 presumably you had a huge report put on your desk saying, "We are in a mess."

**Mr Pimlott:** Sorry, I started in January 2007.

**Q210 Clive Efford:** I am sorry, I have misread my notes; yes, you did. Presumably you had a big report put on your desk about what was going on in the company?

**Mr Pimlott:** By the time I arrived the position was very clearly in difficulties. Both London Underground and the board were very well aware that there was going to be a large overshoot.

**Q211 Chairman:** Would you say then, having looked into what has gone on, that the approach of Metronet in trying to agree every detail of every station project before they actually started any work contributed to the financial problems that the company finished up with?

**Mr Pimlott:** Yes, it must have contributed to it but why did they do it? They did it because at the end of the project they were not getting sign-off on what they had done, so they decided that the only way to get sign-off was to agree up front what it was they were supposed to do.

**Q212 Clive Efford:** What then would you say were the key differences between what was happening with Metronet in terms of its contractual relationship with London Underground and that of Tube Lines, that does not seem to have fallen into the same problems?

**Mr Pimlott:** I suppose there are a couple of things to say. My understanding is that Tube Lines have had nothing like the same over expenditure as we have, but they have had over expenditure, if I understand what you have been told. However, it does seem to me—and I cannot explain it to you because I have not been part of Tube Lines or sitting in discussions between Tube Lines and London Underground—there is no doubt at all that Tube Lines managed to find a better way of working on the stations project.

**Q213 Clive Efford:** Could you give us an estimate at all of just exactly what the cost to Londoners is going to be of the failure of Metronet?

**Mr Pimlott:** I am afraid I could not possibly give you that.

**Q214 Chairman:** Not even vaguely?

**Mr Pimlott:** No, I could not.

**Chairman:** Mr Scott.

**Q215 Mr Scott:** Thank you, Chairman. 95 % of Metronet's debt was guaranteed by London Underground. Did that mean that the banks were less worried about the mounting debt than they might otherwise have been?

**Mr Pimlott:** You would have to ask them but they might have been; it is a perfectly reasonable possibility.

**Q216 Mr Scott:** You said earlier that different people were to blame at different times. So nobody was overseeing this and nobody can take responsibility; it is for everyone and "Not me, guv!"?

**Mr Pimlott:** If you want to identify people responsible then clearly those who were in the know throughout were, in general terms, the shareholders, and those who were on the board of Metronet and at different times each had opportunities to do things about it. At the same time there were issues between Metronet and London Underground.

**Chairman:** Mr Stringer, finally.

**Q217 Graham Stringer:** It has been said that there is only one person alive who understood the PPP and the difficulties of the PPP contract, so I hope you will bear with me when I ask what I think is a simple question. You said previously that the client requirement was different from the bid. My experience of the building trade is that contractors go, “Whoopie!” when clients change their requirements and they make a lot of money out of the changes. Why did that not happen? What happened when it was clear that the client requirement was different?

**Mr Pimlott:** There were three entities in this chain; there were the actual contractors, there was Trans4m, which is the project manager, and there was Metronet, which was on top of the whole piece. My understanding is that both Trans4m and Metronet were trying very hard to pin down what these requirements were, as you would expect any project management entity to do. What you are saying here is would the contractors have been happy to have been given more work? I am sure they would have been happy to be given more work and I am sure they were.

**Q218 Graham Stringer:** I suppose what I am really trying to get at is when it was quite clear that the work that was expected was different to the work that was bid for, what happened? Was it possible within this very complicated contract to go back and say, “We want more money?” or were you constricted, even though it was a different request, to what had been bid for?

**Mr Pimlott:** I think one of the issues was that there were two very different views of what would happen in those circumstances. As I understand it, the view of London Underground was that the work had been bid for and therefore if more work was done the contractors would have to swallow it, and the view of the contractors was that if more work had been done and it was done efficiently, economically and in accordance with good industry practice, they would be paid for it. That difference of opinion, in my view, when applied to the facts, was the reason for doing the Extraordinary Review.

**Q219 Graham Stringer:** So it was known from the beginning that it would be different, and the conversations that should have taken place between the clients, the contractors, all the way up to the Metronet board did not take place and everybody said, “It will be all right on the night.”

**Mr Pimlott:** No, there were discussions going on all the time, suggestions as to how the contract could be changed, amended, clarified, etcetera, but there was no agreement.

**Q220 Graham Stringer:** There was no resolution?

**Mr Pimlott:** There was no resolution.

**Q221 Graham Stringer:** The work carried on without a resolution of the basics; was that not irresponsible? Mr Efford asked what is the cost, and it seems to me that the cost to the public sector is about three billion. Was that not irresponsible?

**Mr Pimlott:** A lot of that money has not yet been spent and of course it does not need to be spent.

**Q222 Graham Stringer:** My estimate might be wrong, it might be right, but the question I was asking is: is it not irresponsible to carry on when both sides are not agreed on what should be done?

**Mr Pimlott:** I think it would have been better had there been an earlier Extraordinary Review, yes, and then the matter would have been solved.

**Q223 Graham Stringer:** You do not know why there was not an earlier Extraordinary Review?

**Mr Pimlott:** My understanding is that the board of Metronet decided that they would try to negotiate with London Underground a solution, which did not come about, rather than go through an Extraordinary Review.

**Q224 Graham Stringer:** So the money kept being spent and the contractors kept doing the work, not knowing what they were doing, which brings me back to Mrs Dunwoody’s first question really about risk. Let me tell you what it looks like—and I will use slightly different words from Mrs Dunwoody—there is £250 million of equity at risk, 5% of the debt at risk, so what the partners try and do is to push all that money into the contractors so that the money stays with them and the risk that was there in the equity and the debt disappears. That, in straightforward, simple English language, looks corrupt. Is that a fair representation of what went on? It looks even more corrupt when the companies doing the work, who are owned by Metronet, do not even have a contract that they are agreed for what they should be doing. You can understand why I am perplexed by the process.

**Mr Pimlott:** Whether it is corrupt or not is a question entirely of motivation. As I said earlier on, I saw no evidence at all that that was the motivation for what was going on. I saw people trying very hard to actually come to some understanding of what it was they were supposed to do and how they were supposed to do it, and they failed.

**Q225 Graham Stringer:** If you had your own money at risk and you were asked to do a job and you did not know what you were doing, would you carry on doing it and put all your own money at risk?

**Mr Pimlott:** We asked London Underground many times to be allowed not to carry on doing it, but the problem with stopping doing it unilaterally is that the contract could well have been forfeited.

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**Q226 Graham Stringer:** That does bring me back to what I do not understand, but surely you were not obliged under the contract to carry on if it was the position of Metronet and the contractors that the contracts had been fundamentally altered?

**Mr Pimlott:** All I can say is that the view that the board took was that they should try to do what they were being asked to do by their customer and they should try to resolve the issues that they had.

**Q227 Graham Stringer:** As the Chairman did you test the hypothesis that I have put to you, that actually there was a flow of risk capital into safe contractor companies; did you look at that flow of capital and see, “Yes, the shareholders have looked after themselves here.” Did you test that?

**Mr Pimlott:** I do not know quite what you mean by “test it” but on several occasions I tried to stop any more money going down that particular route and got threatened with litigation.

**Q228 Graham Stringer:** So you were worried that what I said it looks like was actually happening; that these companies were feathering their own nests?

**Mr Pimlott:** I would not put it quite the way you have put it. The way they would put it to me is that they have done the work and they wish to be paid for it.

**Q229 Graham Stringer:** A final question: what was the compensation package to the directors of Metronet?

**Mr Pimlott:** I think you would be better putting that question to the administrator because that is the person who has agreed the package. I do not know.

**Q230 Graham Stringer:** You simply do not know?

**Mr Pimlott:** No, I left before any of that happened.  
**Chairman:** Thank you very much for coming this afternoon. It has all been almost illuminating. Thank you very much. My next set of witnesses, please.

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*Witnesses:* **Mr Alan Bloom**, PPP Administrator, Ernst and Young, Metronet Administrators and **Mr Tim O’Toole**, Managing Director, London Underground, gave evidence.

**Q231 Chairman:** Good afternoon gentlemen. I think both of you know the house rules—speak up, please. Would you tell us who you are, firstly, and tell us if you would like to say something to begin?

**Mr O’Toole:** I am Tim O’Toole; I am the Managing Director of London Underground. You have our filing and I see you have taken a note of our Press release so I will not try your patience with a further opening statement, other than to note that our growth continues. We moved over a billion people last year and we look like we will hit 1.1 billion this year, so the criticality of this subject and the rebuilding of the Underground has only gotten greater. Thank you.

**Mr Bloom:** Alan Bloom, I am a partner in Ernst and Young and one of the joint PPP administrators of Metronet.

**Q232 Chairman:** Did you want to say anything, Mr Bloom?

**Mr Bloom:** No, thank you.

**Q233 Chairman:** Can I just ask you what your assessment is of the reasons why Metronet was not able successfully to operate its PPP Agreements? Mr O’Toole, you have loomed quite large this afternoon—not personally but your organisation has been accused of not being very precise, so why do you think that Metronet could not operate its PPP Agreements?

**Mr O’Toole:** I think that Metronet failed because of a unique flaw in its structure. I think that Metronet as a company had very little control over what was going on. I think the shareholders and the suppliers working through Trans4m largely controlled matters and that while the PPP created incentives for performance I think the incentives that were driving

the subcontractors’ performance were obviously much stronger and more powerful and as a result Metronet failed.

**Q234 Chairman:** Do you want to expand on that? Are you confident that London Underground made very clear at every point of this contract exactly what it was that they were putting out to tender and exactly what they wanted out of it?

**Mr O’Toole:** No the structure, especially on the stations side—and as an output contract supposedly its attractiveness is the lack of a need to specify but an output is to be delivered. In the stations area you had three categories: modernisation, which was a complete remake, an enhanced refurbishment and a refurbishment. The middle category was really made up right near the end, as I understand it, of the negotiations because they were trying to take some stations out of the modernisation programme because it was all too expensive. There was not clear definition in all respects. Moreover, while there would be a listing of kinds of work these people were going in to work on very, very old buildings—when you open up ceilings and you open up walls you often discover some surprises that are not pleasant. Moreover, I do not think there was a full appreciation of the difficulty in getting all this done in engineering hours at night. As a result both Metronet and Tube Lines struggled early on with us, with squabbles over scope and the like, but we worked through them and it is why, if you talk to Tube Lines, they will say as they do stations now they are able to do them at the cost they expected to do them but in the beginning they could not. One of the changes was working through some of these ambiguities with us, but one of the other changes was to take control of it in a much more direct way. If you talk to Tube Lines you will find that they have

gotten rid of hiring contractors to oversee it for them and they are managing it directly. The reason is that in the face of this kind of ambiguity subcontractors will completely clean you out and they will hit you with claims forever and you do not have the ability to move that risk down to them. So Tube Lines has grabbed control of it. In Metronet's structure they were completely unable to do that because there was no one in control; that was the fundamental problem—there was no one with an iron fist who could force one subcontractor to do something or fire some subcontractor who was not performing, and so the cost just kept accumulating. It is interesting when they talk about they could not get agreement with us; I think the record will show that most of their problems with agreement were between subcontractor and Metronet—the decision never got to us. So it was this kind of self-perpetuating, armies standing around and nothing getting done.

**Q235 Chairman:** How soon did it become clear to you that there was a very real problem?

**Mr O'Toole:** Very early on. It started in 2003 obviously and then by 2004 we were quite struck by the fact that there was a lack of delivery, especially on the station side, from Metronet. But what was so confounding to us, going into 2004/05—and this is one thing that has been missed from some of the commentary in prior testimony—at that time Metronet was projecting an under spend, not an overspend. They were projecting under spends of £70 million to £90 million per infraco, and at the time this did not make any sense to us because usually delay means costs going up, and that was why we kept pushing them for more information and more information and if you look at my prior testimony here and all the testimony I gave before the GLA it was that constant demand for more information that was one that we were making because the situation did not make sense to us.

**Q236 Chairman:** Have you made a lot of changes at Metronet since administration began in July?

**Mr O'Toole:** We are somewhat limited by administration. We do not have control of it, obviously, the administrator does. It is one of the reasons we are so anxious to get it out of administration so that we can get in there and understand all the numbers and make changes. Some of the most dramatic changes have been forced on us because the stations programme, Trans4m, which we have heard a lot about, terminated their arrangement and so the entire stations programme has slowed down dramatically as we have tried to deal with that. There are a number of new people in management at Metronet now, but I think the more dramatic change will not come until we have direct control.

**Q237 Chairman:** Five members of Metronet's executive team are out on the stones, including Andrew Lezala. Was it their handling of the company that contributed to its failure?

**Mr O'Toole:** I think the issue about those executives moving on has more to do with that they were not figuring in our plans for delivering a solution for the future. I said before I testified that I think if Jack Welch—

**Q238 Chairman:** That is a nice American way of saying there was no room for them and they were not any good, is that what you are saying?

**Mr O'Toole:** As I said before, if Jack Welch had been running this company it still would have failed. The structure guaranteed failure, in my opinion.

**Q239 Chairman:** Terry Morgan has said that he “would not wish to have the Metronet supply chain running in Tube Lines” because it would be “an impediment to the effectiveness of the business”; is that right?

**Mr O'Toole:** I agree with Terry Morgan.

**Chairman:** Mrs Ellman.

**Q240 Mrs Ellman:** Mr O'Toole, you said that a major problem was lack of information and you kept seeking it, but looking back on this what could have changed in that structure to make sure that the information was given when it was requested, if you had problems being identified?

**Mr O'Toole:** I think there should have been much clearer specification in the PPP as to transparency and giving us access to information. I think there has been a concern on the part of all the infracos that more information to LU would mean that LU would meddle more, would want to take control, and I think further if you consider the political climate when we took over, with the things that the Mayor has said and what Bob Kiley, the former Commissioner, had said, there was a real concern that information would be used in ways other than to manage the contract for purposes of maybe rhetorical argument. So there was a real concern about sharing information and I think that hurt us; it hurt us coming to grips with these problems quickly enough.

**Q241 Mrs Ellman:** Why do you think that there has been this catastrophic problem at Metronet but not at Tube Lines?

**Mr O'Toole:** I think Tube Lines was in control, it had a management structure where they at least—even if we do not have the information they understand it and they have very, very strong control over the delivery of their programmes. I think Metronet's problem was, as we subsequently learned, I do not think they had the information—the information was in Trans4m and other places down the supply chain. To think that in 2005 they are still projecting under spends, they did not see what was going on; it was not until Andrew Lezala came in and they had re-baselined all their costs and in 2006 suddenly said, “Oh! We have a problem here, could you please give us £1.2 billion to solve this?” That happened in February and that is when the scales fell from everyone's eyes.

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**Q242 Mrs Ellman:** Why was the request for the Extraordinary Review withdrawn?

**Mr O'Toole:** It was withdrawn because we see no value in it. The Extraordinary Review is based on a Metronet cost model, it is based on some analysis taken from Metronet delivery about delivering work that is not going to be done and that it would be impossible for them to deliver. We face right now the following things we have to do: we have to get this company out of administration; while the administration is going on we have to renegotiate with current suppliers; we then have to deliver a new structure for a company; we have to prepare for a periodic review for Tube Lines; and we also have to manage the delivery of all these programmes at a time when delivery is almost going vertical at LU. Participating further in a proceeding that was not going to tell us anything seemed a complete waste of time and, quite frankly, from our point of view, was vexatious.

**Q243 Mrs Ellman:** How then would there be a fair assessment of the value of the Metronet company?

**Mr O'Toole:** You mean how would we understand what went wrong?

**Q244 Mrs Ellman:** How would you assess, yes, and its value now?

**Mr O'Toole:** The challenge for us all right now is to determine what the cost to complete of this work is. What Metronet's costs to complete would have been if all its arguments had been accepted might be interesting to some people but it is not really relevant to the future. We will not know what this cost is until we get in there, take it apart and decide on the vehicle that will deliver it in the future, then we will have a firm estimate of "what this is going to cost us".

**Q245 Mrs Ellman:** And you do not think that an Extraordinary Review would identify any of this?

**Mr O'Toole:** No, I do not think it was identifying it. Actually you have the facts in front of you and they are not very helpful. They tell you that the arbiter has said that net adverse effects, that is the bill that might have come back to us, somewhere between £130 million and £470 million, or some numbers like that. Assume what you want, let us say that the number is £470 million, some of that would have been things they did not bid, some of it would have been work that would have to be delivered through their supply chain, and that was what it was going to cost them. We are not going to deliver the work that way, so that number does not actually help me go forward. That was my problem of continuing with the Extraordinary Review.

**Q246 Mrs Ellman:** Is the government putting any pressure on you not to let this go to Transport for London?

**Mr Bloom:** None whatsoever.

**Q247 Mrs Ellman:** Not in any way?

**Mr Bloom:** Not in any way.

**Q248 Mrs Ellman:** Is it being suggested to you that there should be more private sector involvement?

**Mr Bloom:** Never. Not at any point, and we have had liaison with the government; but not at any stage.

**Q249 Mrs Ellman:** What sort of liaison have you had with them?

**Mr Bloom:** Briefing meetings, update meetings, what is happening in the administration, timing key events, that sort of thing; basically us talking to them about what is going on.

**Q250 Mrs Ellman:** Have there been any attempts to secure private sector interest?

**Mr Bloom:** Let me explain to you what we did under our duties and responsibilities. We have two duties, two responsibilities legally. The first is to transfer the undertaking and the second, ironically, in the legislation, is to keep the railway going. In fact we take those responsibilities the other way around, so it is absolutely critical that we start by concerning ourselves with keeping the railway going and in doing that we work very closely with Metronet staff and obviously London Underground as well. We then move on to our responsibility to transfer the undertaking and in doing that we have one customer, we have a regulator and we have an approval process for anybody that wants to take this on. So we engaged Rothchild's to do a valuation for us on the basis of what we believed we had to sell. What we had to sell was a PPP contract with all the issues connected with it that you have heard described by Mr O'Toole and the former Chairman, and that is all we had to sell. We were also advised that the guarantee of the bank debt that had been available to Metronet's bankers prior to administration, something like that would not be available to funders going forward. So all we could do was to present what we had available, first of all to Rothchild's for evaluation process and second of all in looking at that valuation they talked to a lot of market participants. By market participants I mean bankers, I mean people who are in that industry, people who might be potential bidders, people who are already in the industry generally. Really just to add some colour and flavour to when they do the numerical work on the valuation, does that stack up with what the market place is telling you? And the market place has told us and the valuation tells us that an active medium to long-term marketing campaign for the business would have been fruitless. We would not have generated any external—if I can call it that way—interest in what we had to sell.

**Chairman:** I am not altogether surprised, I must admit.

**Q251 Mrs Ellman:** What did the Rothchild's valuation say?

**Mr Bloom:** It is very confidential; I have a bidder sitting next to me.

**Q252 Chairman:** Whether or not it has any commercial value must have been told to you.

**Mr Bloom:** Certainly it is our view that the creditors and the shareholders have not been disadvantaged by there not being an active marketing campaign.

**Q253 Chairman:** That is an interesting remark! What do you mean by that, Mr Bloom? I am always fascinated by double negatives!

**Mr Bloom:** A double negative is appropriate here because they have not been advantaged but they have not been disadvantaged.

**Q254 Chairman:** So, what do you mean, Mr Bloom? I do not have the advantage of your professional training. What do you mean, Mr Bloom?

**Mr Bloom:** What I mean is that if we had continued the marketing process we would not have generated any interest in acquiring what we had to sell.

**Q255 Chairman:** So you are selling not very much to somebody who knows a lot about it and if you had gone on you do not think you would have done any better than you will do in the situation you are in now; yes?

**Mr Bloom:** Correct, and we only had six months in which to do it because our funding line was only a six-month line.

**Q256 Mrs Ellman:** Has government been pressing you to make a decision quickly?

**Mr Bloom:** I do not think specifically government has; I think everybody has been encouraging us, which we have indeed been doing, to work towards a solution as early as we possibly can.

**Q257 Mrs Ellman:** Has government as well as other bodies encouraged you to move quickly?

**Mr Bloom:** No, they have expressed no more than anybody else the desire for the thing to be resolved as quickly as possible.

**Chairman:** Mr Scott.

**Q258 Mr Scott:** Mr O'Toole, do you think that the structure of the PPP Agreements was flawed in principle as a model for upgrading London Underground?

**Mr O'Toole:** I think that this story is about the flaw in Metronet's structure. Obviously I am on record that there is lots about the PPP I do not like but I do not think it drove this failure other than the fact that it did not have anything in it that gave us earlier visibility of what was going on, although given that they were projecting that this situation did not exist in the earlier period I am not sure, even if we had moved, in we would have been able to divine the truth of the matter.

**Q259 Mr Scott:** So you do not think that the current Mayor of London's opposition to the PPP is justified?

**Mr O'Toole:** I'm like the Mayor. I ran a railway back home and I like to control everything—who does not when they are running something? The fact that I cannot point at something and make it happen but instead have to go into a negotiation to make something happen can be very, very frustrating. But I do not deny the fact that the project delivery we have now in Tube Lines has been quite impressive and we certainly enjoyed some of the positive reaction of the public, like at Wembley Park and others, as a result of that delivery. So it would be disingenuous of me to say that nothing good has come out.

**Chairman:** Mr Efford.

**Q260 Clive Efford:** Mr O'Toole, how did we manage to allow Metronet get so far behind in delivering on its obligations?

**Mr O'Toole:** It is a constant frustration. We do not think that we did not manage it; we like to think that we struggled very hard to understand what was going on and to deal with it. If I can go back to the record of what actually happened? In 2005 they are falling behind but they are projecting under spend still; they said, "We are going to catch up; we are going to change things around." None of this made any sense to us and we struggled and struggled and struggled. We went to the arbiter, we asked him to use his plenary authority to get more information. I note that a lot of people have referred to this issue of, "If you had had this annual review in 2005 maybe you would have found all this out before?"—Graham Pimlott pointed that out. I have to say that I reject that; I do not think that that squares with the facts.

**Q261 Clive Efford:** Can I just stop you there and can I just press you on that point because the arbiter has said to us that he was of the view that had that review gone ahead these things would have come to light much earlier, but you do not agree with him?

**Mr O'Toole:** No.

**Q262 Clive Efford:** So why would you have gone to him?

**Mr O'Toole:** He is the only one who had plenary authority to get information out of them; we did not have that power. He is the only one who could have gone down the supply chain, and so we asked him if he would do just that. I have brought an excerpt from his 2004/05 annual report and here is what he said, if I could quote him? He says at paragraph 5.13: "A process of the PPP parties providing routine information returns has been established and the arbiter is now able to monitor operational, project"—

**Q263 Chairman:** Slower please, Mr O'Toole, we are taking a record.

**Mr O'Toole:** He concludes: "This fulfils my objective of ensuring that I have early warning of any potential Extraordinary Review." We found this stunning. We filed a challenge to this say, "We certainly do not have this."

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**Q264 Clive Efford:** When was this?

**Mr O'Toole:** This was in 2005. "We do not have the ability to see any such information, could you please share with us this information you say you are getting that would allow you to see an Extraordinary Review on the horizon," and he chose not to give it to us.

**Q265 Clive Efford:** What was his response?

**Mr O'Toole:** He simply said, "My statement on information availability was published on January 19, you can go and read it."

**Q266 Clive Efford:** When he was before us and we were asking him questions—and I will go back to the statement—he was quite clear that had that review gone ahead in 2005 that these things would have come to light. So why did you not have the review?

**Mr O'Toole:** For this reason. Everyone is looking back at this review as if, "Here is this thing that would have been an exposé." The annual review, which by the way does not apply to Tube Lines, is not something that was put in to protect the public; the annual review structure was put in by Metronet to protect Metronet. Their concept was—and they took this out of the regulatory industry with the water business—they wanted to be able to review their company a little bit each year so that they could take pieces off the board and by the time it got to the periodic review they would have findings that everything was Economic and Efficient and they could already be sure of what the outcome was. We were very, very sceptical of this proceeding, very worried about it. In 2005 they are projecting under spends; we have no information and we are about to go into a proceeding with the arbiter and he is not giving us further information, where they are going to be able to take pieces off the board. We saw this working to our disadvantage. So what did we do? We said that we would work with Metronet and said, "Why do we not take this year to work on turning around your performance and working with you in developing information so that when we go into one of these annual reviews we could participate in a knowledgeable way." But we did not give them a year's pass. We worked with the arbiter and then we had a kind of a pretend run-through of an annual review. The idea was to take the lawyers out of it, use the accountants and engineers and hopefully extract the information we lacked. Through that kind of run-through annual review before the arbiter what happened? A lot of squabbles over procedures, process—"They do not want to produce numbers they only want to talk about their glide path to getting better." Exactly what would have happened if we had had the real annual review because at that time there were not any numbers that said there was a problem; that did not happen until 2006 and it did not happen because of the annual review, it happened because they announced it in a re-base lining exercise in February that was revealed to us. So this kind of looking backwards at, "This annual review would have told us everything," I do not think there is anything in the record to support that.

**Q267 Clive Efford:** If we can just recap, what you are saying in response to what the arbiter has said to us is that had he been requested by you and Metronet to go ahead with that review in 2005 he would have selectively written the review so that the information you needed was not included in it.

**Mr O'Toole:** At that time we did not know what he would do because no one had ever been through one of these proceedings. What we do know is that he said at that time, publicly in his own report, "I have sufficient information and I will know if an Extraordinary Review is on the horizon."

**Q268 Clive Efford:** I am still not clear. If you believed that the arbiter had information that would assist you in assessing the position of Metronet why would you not go ahead with that review anyway?

**Mr O'Toole:** Because we did not think we were going to get it through that proceeding; that proceeding was not designed to give us information, it was designed to help Metronet get through a periodic review and we had never been one before and we were very, very sceptical. Think of it this way: would you want to have a law suit with someone where they held all the evidence, good and bad, and you had none? That was the situation we were in in 2005, and so we wanted first to improve our own situation in terms of what we understood before we were going to allow them to get a free pass on the review of their work.

**Q269 Clive Efford:** I think we have gone as far as we can on that, but the only thing I would ask you on that is, are you saying that the arbiter then is Metronet's animal and not an independent?

**Mr O'Toole:** No, I am saying that given the information the arbiter apparently had then—and he was not worried about the Extraordinary Review in 2005—and our lack of information, and given what happened in the run through annual review we actually did do, I am very sceptical that any of this would have come out prior to Metronet bringing in a new CEO and doing the re-base lining of their costs.

**Q270 Chairman:** Because they did not have the information? The point is that you said very clearly that it was not clear to you but you rather suspect that it was not clear to them either. Is that what you are saying?

**Mr O'Toole:** One of the reasons I say that is, in 2006 when this bombshell went off the first thing we did was immediately send in outside auditors to begin an audit of their general administrative expenses to see if we could understand what was there. What we got out of that was nothing—zero. We at the time thought it was because they were stiff-arming us, obfuscating, etcetera, but now in hindsight, given more exposure of the company, we do not think Metronet had the numbers, we think they were down in the supply chains.

**Q271 Clive Efford:** So was it the lack of that detailed knowledge that led to you not using corrective notices?

**Mr O'Toole:** That is an interesting point because we were so desperate to find new ways of manipulating this contract to take control of this that we did use a corrective action notice on the stations programme, which you have heard is the big problem. Our thinking was, if we file this corrective action notice we know they cannot comply with it, they are never going to catch up, it would allow us then to step in and take control. What did they do? They went to court and they got it blocked and we were told by the court, "No, you are limited under this contract for sitting there and collecting your abatements; you are not allowed to use a corrective action notice in this situation." So I think your instinct is the right one but unfortunately it did not work for us. That case is still under appeal right now.

**Q272 Clive Efford:** Why has this year's London Underground report on the performance of the infracros been delayed?

**Mr O'Toole:** The reason is we normally publish it right at the period where they were on the brink of falling over. At that time there was a lot of discussion back and forth about "LU is causing this to happen, LU has engineered this, etcetera," and we thought a report that was going to take very, very hard shots at them right at this time could be misinterpreted later, so we thought better we just stand back and let this happen, which we thought it would and, sure enough, within a week or two they fell over. At that point it really did not help us to publish anything because now we are worried about stability; we are worried about people not showing up for work, not doing things in depots, so firing more insults at them really was not going to do anything for us. What we have done is we have compiled all the statistics that would normally be issued and we are making those available to people.

**Q273 Clive Efford:** Lastly, to Mr Bloom, do you have an estimate of the cost to Londoners of the failure to Metronet?

**Mr Bloom:** No.

**Q274 Chairman:** Was that a no?

**Mr Bloom:** Yes, it was a no.

**Chairman:** I just want to be quite clear. Mr Leech.

**Q275 Mr Leech:** Mr O'Toole, you are quoted as saying, I think yesterday, that you are pleased that Transport for London is the only bidder. What makes you think that Transport for London can do a better job and what would Transport for London do differently to make sure that it works?

**Mr O'Toole:** Of course our responsibility is the safety of the public and to provide a service, so we have to make sure that we can control this situation to guarantee that that happens and no one is better suited to do that than us, through this very difficult transition. I think that is where you start. No one else could look after the public like we could or has our motivation and that is primarily why I am pleased to be in control. What will we do to be more efficient? It is going to be like any of the contracts we let, we are going to have to examine what the options

are; we are going to be negotiating with government as to the right delivery vehicle going forward and, hopefully, we will deliver a much more transparent, straightforward way of delivering this work.

**Q276 Mr Leech:** Do you think you could do a better job than Tube Lines do as well?

**Mr O'Toole:** I think on a lot of the project work we will be hiring companies like Tube Lines or Tube Lines shareholders because the public sector never does that kind of work in-house, you are always going to be using the private sector to some extent. I would hope that we are certainly able to deliver work on time and on budget as they have with their projects.

**Q277 Mr Leech:** The Mayor of London is on record as saying that in the year following your appointment London Underground got rid of a large number of the "dullards and knuckleheads", I believe is the term he used, who had delivered very poorly for the tube network. How many staff actually left London Underground and how is it that within the industry people still say that middle management of London Underground is tied up in red tape, unnecessary bureaucracy and restrictive practices of all sorts. Is that a fair comment, firstly?

**Mr O'Toole:** I am actually quite proud of the performance of London Underground in the last four years. I think we have done some things at times that reach the extraordinary—certainly it was true in 2005. I think we have improved customer service, I think the fact that we are carrying more people than ever before and have turned out more transport, that is more kilometres have been run than ever before on a creaking system, is quite an accomplishment. Attendance is at a ten-year high, etcetera, so there is a lot of good to point to. I think it is natural that people point to the public sector, particularly one that is the client, and complaints about bureaucracy and complaints about delay because that is the nature of the claims they are later able to file. We have a long way to go, we are not as efficient as I would like.

**Q278 Mr Leech:** Are they fair criticisms, though, in your opinion?

**Mr O'Toole:** You always have to believe they are fair criticisms because you can always do better.

**Chairman:** Mr Hollobone.

**Q279 Mr Hollobone:** With regard to TfL's bid for the contract, has the administrator accepted the bid?

**Mr Bloom:** We have not formally accepted because it is the only bid we have had. It was a long document, there are a number of things in it which were not that easy to accept—it was not that they were controversial but they needed discussion—and frankly we thought that rather than sit there endlessly and debate whether we could accept a clause or not we would issue a note to Transport for London and London Underground basically saying, "It is our intention to proceed along these lines," and that is what we are doing.

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**Q280 Mr Hollobone:** What are the necessary steps to achieve TfL's planned takeover?

**Mr Bloom:** Are you asking me?

**Q281 Mr Hollobone:** Both of you.

**Mr O'Toole:** The primary thing is that we have to get state aid clearance from Brussels so that we can go forward with the transaction and then it is just a question of designating what is being done with all the liabilities, taking this to court and getting clearance and having it just be transferred to us.

**Mr Bloom:** It is only the word "just" that I would take issue with, but, yes, those are the main components.

**Q282 Mr Hollobone:** Between the two of you, what is the likely timetable, in which Londoners would be extremely interested?

**Mr Bloom:** We are working off a timetable still of middle of January, which was our original intention. At the moment there is no reason to believe that we are off line for the middle of January. There is an enormous amount to do and the next four weeks, frankly, are critical to that in doing the very things that Mr O'Toole has been talking about, effectively reaching agreement one way or the other with the significant creditors, putting a transfer scheme forward and making an application to court, and the timeline between now and the middle of January, clearly with Christmas and New Year in the middle and courts shut and that sort of thing, is tight—tight but still achievable.

**Q283 Mr Hollobone:** With regard to the future scale of the capital investment in the network, presumably your assessment of how much of that can be carried on, assuming you are successful in the bid, is going on at the same time as the bid process is going through. So when can Londoners expect confirmation from yourselves that the scale of future capital investment is as Metronet had envisaged, or if there will be changes to it?

**Mr O'Toole:** The Mayor has set a target and I hope I can comply with it, of late spring—as he put it, a few months to get in there and truly understand it. There will also partly be a function of course about the vehicle chosen to do the work and thereby the price, and that is something that will involve negotiations and discussions with the Mayor, with government and with other stakeholders before we know exactly how all this work can be done.

**Q284 Mr Hollobone:** Are you confident that there will not be any scaling back of the capital investment programme that was originally envisaged?

**Mr O'Toole:** No, I am not confident.

**Q285 Mr Hollobone:** How would you assess your degree of confidence? What is the likelihood that the capital investment programme is going to have to be scaled down?

**Mr O'Toole:** Everyone will do everything to protect the line upgrades because to not deliver that is simply unthinkable. This system, as I said, is bursting at the seams and it is becoming ever more

important to London and it has to be renewed. We already know as a result of Trans4m just cancelling and walking off that the stations programme has kind of sat down. We are trying to continue the work that is on site right now so that at least there is not a compounding of waste, but the starting of new jobs has definitely fallen behind the original schedule, so at a minimum some of that work is going to be pushed into the future—at a minimum. When we get into further analysis of the costs and what can be done and when, the sorts of things you have to worry about is the completion of stations programme, completing the tunnel cooling programme, which we have quite an aggressive one, which we think it is necessary to London are going to be looked at, and the accessibility programme and the congestion relief programme. A lot of these are outside the PPP but they are all things that have to be delivered if you are going to truly improve the network the way it needs to be improved, and those are going to be some very tough choices that will be faced in the future.

**Q286 Mr Hollobone:** This announcement about the future scale of the programme going forward, is that going to be made before or after the Mayoral elections?

**Mr O'Toole:** We are going to tell people things when we know them but I suspect this is not going to be a big bang which will change the shape of this—it is going to be around timing. Some of the station work that we thought was going to happen in 2008 might happen in 2009; it is going to be when we can deliver this. This was years in the planning and to re-plan it all in a matter of months is a tall order.

**Chairman:** Mr Stringer.

**Q287 Graham Stringer:** What was Trans4m's motivation not to give information to the Metronet board?

**Mr O'Toole:** You would have to ask them. Plainly somebody was making money.

**Q288 Graham Stringer:** Precisely. A lot of money has gone through the system. But you are very clear that the Metronet structure was what was wrong and not the PPP, which was a slightly surprising answer but a very clear answer. So you must have thought why would Trans4m would wreck the whole process by not passing on information about the contractual difficulties. Why were they not doing that?

**Mr O'Toole:** I do not know that it was a conscious plan; I think it was just structural ineptitude. Think of it, you are redoing a station in the middle of the night, you have a tiler, you have an electrician, you have somebody who has to do some other electrical work down for you on the platforms, you might have somebody who has to come in and lay CMS. If no one is in control and yet they all make money when they show up, the fact that they are frustrated, "I have to be here tonight, you cannot work," that person is perfectly happy to go home, file his bill and show up the next day, and this kind of inefficiency, if you do not have someone with an absolute iron fist running things, can go on for quite a long time. If

that information is not getting up to Metronet—and by the way they lacked the corporate power to do anything about it anyway—this goes on. But I would direct your attention to this fact; this thing fell apart amazingly quickly. When you think of how long this was planned, how big these companies were, for this to have gone pear-shaped this fast is stunning.

**Q289 Graham Stringer:** Mr Bloom, were you here for the previous witness?

**Mr Bloom:** Yes.

**Q290 Graham Stringer:** What is your assessment of what went wrong? It seems to me that the owners of Metronet were trying to get rid of their liability and they were taking the money back as contractors, they were losing their risk in debt and they were losing their risk in the equity by paying themselves lots of money. Do you think that is a fair assessment?

**Mr Bloom:** To be honest, I have not really spent too much time worrying about the past. Our involvement was a week or two at best before administration. We have really had our hands absolutely filled in fulfilling our objectives. I have heard lots of speculation, I have heard lots of informed views, but I have not spent any time at all trying to establish why it was the way it was because it really does not satisfy either of our purposes, and it is not really our role to do that.

**Q291 Graham Stringer:** You heard me ask about the compensation package to the directors of Metronet. Can you tell the Committee what that was?

**Mr Bloom:** I can certainly do that. We have made no payments for loss of office to any of the five parties. What we have done as part of the transition when we took over the responsibility of the administration, in order to retain some of the executives—in fact all of the executives—we offered them a certain amount of, if you like, retention, loyalty payment, which only worked for as long as they stayed with the company and we wanted them to stay with the company, but we have not paid them anything at all for breach of contract, as is normal in these cases, and their claims will rank in the estate.

**Q292 Graham Stringer:** I understand that it is not your job to analyse the past but I would have thought that if there had been corruption you would have looked at that; is that not the case?

**Mr Bloom:** No, it is not the case; it is not our job to look at that.

**Q293 Graham Stringer:** You said very clearly that you did not know what the cost was to the public sector. Why is that? Is it not a very simple sum to do when you are going through it that 95 % of Metronet's debts go to Transport for London? That is part of the costs, is it not?

**Mr Bloom:** I imagine there is a hell of a lot of components to what the cost would be but to evaluate what each of those would be is a very difficult thing to add up. It certainly would not be our job to add up all those different components.

**Q294 Graham Stringer:** It looks as though Mr O'Toole has added them up.

**Mr O'Toole:** I actually I do not think that is the way to look at it. The debt always had to be paid by us, that is the way it worked. We paid them an ISC—an infrastructure service charge—over 30 years and they would use that money to pay the debts. We were always on the hook for the debt; this is not a new problem. The issue is how much of that debt did not deliver work that now has to be delivered by somebody else and that is the cost to us. So it is not the 1.8 billion or whatever.

**Q295 Chairman:** So it is paying twice.

**Mr O'Toole:** Exactly, and that is what we will not know until we figure out what it is and what is going to cost us, which will be a function that the delivery vehicle shows.

**Q296 Graham Stringer:** Do you have any envelope idea of how much it is going to cost? You must have an idea of how many stations have been done and how many have not been done and how much it is going to cost in the future?

**Mr O'Toole:** We are struggling with it and the reason why I am equivocating is because our source of information is all from Metronet and we have learned that relying on it is not anything we can do, so we really need to get in there and get control of it ourselves before we come up with some numbers that I would want to be quoted on.

**Q297 Graham Stringer:** You are covering the costs of the current administration?

**Mr O'Toole:** That is correct.

**Q298 Graham Stringer:** How much is that over and above what you expected to pay?

**Mr O'Toole:** It is running at around 15 a week, is that right?

**Mr Bloom:** I can tell you. It is running at £13 million<sup>3</sup>—that is not in addition but the net figure after taking account of the ISC that we are entitled to get from our customer anyhow—is £13 million and that is the deficit funding by virtue of not having any bankers more and TfL being our banker.

**Q299 Graham Stringer:** So that is the extra amount?

**Mr Bloom:** Yes, the amount that we do not have from our bankers any more.

**Q300 Graham Stringer:** That will go on until at least January?

**Mr Bloom:** That is due to terminate on 18 January at the moment.

**Q301 Graham Stringer:** Just to clarify one of your previous answers, Mr O'Toole, you said that some things may slip into 2009, so basically there is going

<sup>3</sup> Note by witness: The figure of approximately £13 million relates to the costs of running the Metronet business not the professional fees, which are a small fraction of this and are being reviewed by TfL / LU on a regular basis.

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to be no long-term impact on the programme. It might be delayed in parts but the programme is going to be completed?

**Mr O'Toole:** I think delay is an impact as well because I think one of the problems of neglecting the Underground is they kept improving a little bit of it while allowing the rest of it to degrade, while it is being used at a furious rate. So I think the whole thing does have to be lifted up quickly, so I consider delay a very serious cost.

**Q302 Graham Stringer:** Can you give an estimate to that cost?

**Mr O'Toole:** No, as I said, I would be disingenuous if I were to say that the station programme will not be delayed, it almost certainly will—the delay is already built into this whole administrative process and takeover. So there is definitely going to be a shift in when stations can be delivered and we are talking about tens, if not scores of stations.

**Q303 Graham Stringer:** £13 million a week plus an undetermined large capital sum for stations paying effectively to be refurbished twice, when you get one refurbishment, how are you going to fund that?

**Mr O'Toole:** I have funding from only two sources. It is not really complicated. I have fares and I have a grant from the government and I have to live within that envelope.

**Q304 Graham Stringer:** So has the government said that they will stump up any more cash?

**Mr O'Toole:** Of course we are in the middle of a funding round and there are a lot of pieces moving around like Crossrail and delivery of other improvements in the transport sector—

**Q305 Graham Stringer:** Mr O'Toole, I have been in negotiations like that and the government will say yes and no to certain areas; have they said yes or no to the extra costs associated with this?

**Mr O'Toole:** They have been—how shall I put this?—very constructive about some of the ways we can deal with this but neither of us knows right now what that cost is. They have not signed a blank check.

**Q306 Graham Stringer:** So they have indicated that they will put some contribution towards the double payments?

**Mr O'Toole:** They have indicated that they are going to work with us to make sure that the Tube gets rebuilt.

**Q307 Graham Stringer:** That is not quite the point I was making.

**Mr O'Toole:** Until this comes out it is unclear exactly what either of us is describing.

**Q308 Graham Stringer:** What I am trying to get to is the Government is saying, “No, we are not putting any extra money in, we are not paying for that when we go through the different components”, so the passenger will pay, will they not?

**Mr O'Toole:** Keep in mind something that I think is being missed here, and that is the PPP and the money that the Government has put towards it is not the only money the Government gives us. The needs of London Underground are huge and they go well beyond the PPP. We have to build a new power system, the new radio system, all the congestion relief projects, so that when you rebuild Victoria Station that is a separate grant. Working out this problem is within the context of that larger grant and that is why I said some of the things that could be delayed are things like tunnel cooling. That is not within the PPP but that is within my total grant. We are going to have to look at the whole programme to see what we can deliver when.

**Q309 Graham Stringer:** So other parts of the programme might be affected?

**Mr O'Toole:** I cannot sit here looking at a catastrophe of this dimension and say, “Don't worry, it is not going to cost anyone anything”.

**Q310 Mrs Ellman:** I would like to clarify the issue of delay on the programme. If we take the promised improvements that Metronet were supposed to deliver, what is the likely delay in getting those delivered, if indeed they are delivered at all?

**Mr O'Toole:** If by “promised improvements” you mean all of the stations delivered when they were scheduled to be delivered under the original schedule given under the PPP, it is almost certain that there will be substantial delay.

**Q311 Mrs Ellman:** How much delay?

**Mr O'Toole:** Until we know what our delivery capability is it is hard for me to say. We are talking at least 50-60 stations scheduled have already had to be changed.

**Q312 Mrs Ellman:** In terms of the bigger picture as well, when would the public be likely to know what is going to happen on the Underground?

**Mr O'Toole:** As I said earlier, it is the Mayor's ambition, and I hope I can meet it, to know after the first few months of our being in there, so sometime in the spring or late spring we will have a better idea of what it all looks like.

**Q313 Chairman:** What about the transparency of all these arrangements, Mr O'Toole? How is the public going to know what is going on?

**Mr O'Toole:** They will certainly be represented by the Government when working with us in choosing how this will be done, but in many respects I suppose it is not unlike any of the large substantial contracts that TfL signs. It is subject to audit, inspection and scrutiny before the GLA and others.

**Q314 Chairman:** It did not stop us getting into one hell of a mess, did it, up to now? How are we going to know what you are agreeing both with the Government and anyone else that you are employing?

**Mr O'Toole:** I suppose the way you always know it. The NAO will be in there, you will have me before you and we will be publishing our own reports.

**Q315 Chairman:** I think we should have a word with Sir Anthony. Mr Bloom, you made a very careful statement earlier on about the shareholders and you tell us now you do not know what the total cost is going to be to the taxpayer, but in effect you are selling a shell company, are you not? Are you confident that the shareholders will have something to benefit from this arrangement?

*Witnesses:* **Ruth Kelly MP**, Secretary of State for Transport, **Mr Paul Collins**, Head of Regional Transport London and South East, and **Ms Lucy Chadwick**, Director of Regional and Local Transport Delivery Directorate, Department for Transport, gave evidence.

**Q317 Chairman:** I am sorry to have kept you waiting, Secretary of State. Would you be kind enough to introduce yourself for the record.

**Ruth Kelly:** Ruth Kelly, Secretary of State for Transport.

**Mr Collins:** Paul Collins, Head of the London Transport team in DfT.

**Ms Chadwick:** Lucy Chadwick, Director of Regional and Local Transport Delivery in DfT.

**Q318 Chairman:** Thank you very much. Did you want to say something to us, Secretary of State?

**Ruth Kelly:** I will say something very briefly if I may, Chairman. I would like to start by saying how much I welcome the Committee's consideration of PPP contracts and in particular the background to the failure of Metronet. Metronet's failure has cost its shareholders significant sums and damaged the reputation of those companies involved. Importantly, Metronet's failure let down Tube travellers, London Underground and taxpayers. This is clearly a very serious matter, however day-to-day safe running of the Tube has not been materially affected. It remains essential that we continue to improve the Tube and minimise the risk of additional costs falling to the taxpayer or passenger and find a way forward that delivers the best value for money. It is of great importance to us that we fully understand why Metronet failed so that we learn the appropriate lessons for the future. I am completely committed to doing that and this Committee's hearings and its conclusions will, of course, be important in that process.

**Q319 Chairman:** Oh, that is extremely kind of you, Secretary of State. Do you still think that the PPP was a good way of getting value for money as a means of upgrading the Underground?

**Ruth Kelly:** I certainly think a PPP structure can deliver good value for money.

**Q320 Chairman:** Why?

**Ruth Kelly:** The reason for that is you just have to look at the experience of Tube Lines' operation at the moment, which is, I think, clearly delivering economically and efficiently. It certainly delivered the outputs that were specified in the contract on time and to budget. There were, of course, particular

**Mr Bloom:** Am I confident that they will have something to benefit?

**Q316 Chairman:** Yes.

**Mr Bloom:** No, I am very confident that they will not have something to benefit from this arrangement because we are not selling the company, we will be transferring the assets that are required to run the Metronet business and I do not expect that there will be any value for the shareholders arising from that.

**Chairman:** Gentlemen, you have been very helpful indeed. We are very grateful to you both. Thank you very much.

issues both about Metronet, its shareholders and the corporate governance associated with Metronet, which I think was largely responsible for its eventual demise, but I would agree with others, such as Chris Bolt, who I know you have had in front of the Committee, and I believe Tim O'Toole who also has said that in theory at least the PPP can deliver very good outcomes and good value for money for the taxpayer.

**Q321 Chairman:** What about a different system of financing the improvements, would that not have proved better at getting value for money?

**Ruth Kelly:** It is certainly the case that a different system could have delivered line upgrades and improvements for passengers. The issue for us is what is the best value for money way of delivering those improvements and, as I understand it, looking back through the files, there were very rigorous processes of testing. I know that this Committee in the past has been interested in the amount of money spent on consultants and so forth, but clearly it was the view of those who looked very closely at the contracts and were involved in that scrutiny decision, including the NAO, that the PPP could deliver value for money and a public sector comparator, which again I know has been the subject of controversy, was tested against the PPP design.

**Q322 Chairman:** I think the difficulty we are in here, Secretary of State, is that we have been told very plainly by practically everybody involved that the company did not know what it was doing, did not know what it was actually tendering for, spent all its time arguing with the people who were employing it as to what it was really genuinely expected to produce, and at the end of it sank gently to its knees. I am fascinated that you think that is a demonstration either of efficiency or of value for money.

**Ruth Kelly:** I do not think it is a demonstration of efficiency or value for money.

**Q323 Chairman:** So you think it was simply this particular company, although you are aware the difference between the two bids was the one that is

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still staggering on had a much more restricted remit, was run differently and was required to do much less than the Metronet contract.

**Ruth Kelly:** It is certainly the case that they had one infrastructure company rather than two.

**Q324 Chairman:** No, no, I am talking about the extent of what they were required to do. These are totally different types of contracts, are they not, one very large, one not so large, one quite clear about a limited remit, one with a remit it was unable to agree even with its own members.

**Ruth Kelly:** There are very, very clear differences in structure between the two companies, and I think—

**Q325 Chairman:** Good. So we are agreed that it is rather too simple to say the PPP would automatically have been efficient because the smaller of the two companies has managed to survive so far.

**Ruth Kelly:** It is clearly the case that it would not automatically deliver value for money because Metronet has not worked economically and efficiently, even if Tube Lines' performance suggests that it is delivery for both taxpayers and passengers. The issue is why is it that it did not deliver economically and efficiently, and I think there are a number of reasons why that was the case, including the particular structure of tied supply chains which Metronet operated, but also a number of other issues.

**Q326 Chairman:** Well, Transport for London says that effective project management and the most basic controls were lacking but, after all, they went along with a lot of this for a long, long time because they said that they had not got the adequate information. Do you think that is a very good record for trusting TfL's estimate of the private sector's superior ability in these fields?

**Ruth Kelly:** I think London Underground and TfL have improved enormously over the past number of years and the leadership that has been provided by Tim O'Toole has been very important in that. There are a few things that London Underground—

**Q327 Chairman:** With respect, we are not actually talking about how much better they are than when they started off. I am saying if this company got itself into this situation with one of its major suppliers where it let it go on for some considerable time because it said it did not have sufficient, accurate information to judge delivery, are we now to accept that they are so well-equipped and so efficient that they can estimate what the private sector can provide at this point?

**Ruth Kelly:** I think they are in a very good position to do that working closely with the Government, but actually there are a number of—

**Q328 Chairman:** Why? Does the Government have sources of judging the internal workings of private companies that were not available to TfL?

**Ruth Kelly:** A lot has become apparent since the operation and the Metronet contracts started to work and they were put into practice. Clearly there

was an issue about information flows, but that was not the only issue. There was an issue about the structure of the company, which I think was very important.

**Q329 Chairman:** With the greatest respect, Secretary of State, at what point did either the Department or TfL raise the structure? If, in fact, they so determined that the structure of the companies was inadequate, would it not have been a good idea, since they were expecting this same inadequate and badly organised company to produce results, to have asked them rather earlier on?

**Ruth Kelly:** I think this was an issue that came to the fore quite early on in the process, the question is why Metronet did not act to put it right. I think that Metronet, with the appropriate leadership in place, could itself have identified the problems and sought to put them right. There are also issues to do with the materiality threshold, which I know the Committee has been interested in, and the point at which the process of using an extraordinary review and going to the arbiter kicked in. When this contract was set up it was assumed that the incentives were right whereby if a cost increase materialised which was greater than £50 million Metronet would have sufficient incentive to turn to the arbiter to express his opinion about the extent of the cost overruns and what they were in line, as it were, to receive. That did not happen. I think there is a very clear issue here that we need to think carefully about for the future, which is why was it that those cost overruns were allowed to occur without anybody being absolutely clear about whose responsibility it was to deal with it.

**Q330 Chairman:** I think we have taken very clear evidence that no-one either within Metronet or their opposite numbers in TfL were aware of what was happening and, indeed, we have taken evidence that, in fact, Metronet were actually projecting an under-spend. Their information was so accurate that until the point within 12 months of their collapse they actually thought they were not spending as much money as they should.

**Ruth Kelly:** Well, as far as—

**Q331 Chairman:** Could I ask, the Department presumably does not take responsibility for auditing private companies in this situation.

**Ruth Kelly:** Nor should it.

**Q332 Chairman:** TfL tell us they were not in any way privy to the information that would have enabled them to take this decision. I ask you again, what makes you think that this could not happen again and what makes you think that your Department is in any position where it would be capable of assessing the standing of a private company should it be put into the same situation again?

**Ruth Kelly:** For the benefit of the Committee, can I just say that I think issues were spotted early in this process. What we have to identify—

**Q333 Chairman:** What is your definition in this case of “early”, Secretary of State?

**Ruth Kelly:** For example, by December 2005, so two years after the start date, there was clear concern over station delivery which led London Underground to issue a regulatory notice. They tried to follow this with a corrective action notice in June 2006. In the summer of 2006—

**Q334 Chairman:** A corrective notice that they were not allowed to continue with.

**Ruth Kelly:** Indeed. By summer 2006 it was clear that Metronet were not properly stress testing the lines, which was obvious to everybody was a significant failure. By November, the arbiter had estimated that there was a cost overrun of around 750 million, a figure which in due course proved to underestimate the amount that Metronet presented in the extraordinary review.

**Q335 Chairman:** You think this was an adequate early warning system that enabled everyone involved in these contracts to know exactly what was happening—

**Ruth Kelly:** No, I do not.

**Q336 Chairman:** --- within the timescale in which they could cheerfully have put them right?

**Ruth Kelly:** I do not. I do not think the incentives were sharp enough and I think there are lessons to be learned for the future, I could not be clearer about that. The point I am making is that there were signs early in the process, maybe not early enough, but the incentives clearly were not sufficient in the round for action to be taken early enough.

**Q337 Chairman:** Incentives for whom?

**Ruth Kelly:** Incentives, for instance, for Metronet to get its own house in order, for Metronet to produce an annual report and go to the arbiter when there were cost overruns. The lenders, it seemed, were not policing the contracts effectively. There are issues across the board that we need to look at here. It is not possible to isolate one of them and say everything is down to that particular item.

**Q338 Chairman:** It seems to have been quite an interesting co-operative effort. We are constantly hearing this very interesting point that nobody is actually to blame because everybody was involved in it at every level and some of them, unfortunately, have since left.

**Ruth Kelly:** I do not agree. I think the primary responsibility was Metronet's. There was a clear failure of corporate governance. There was the tied supply chain that did not distinguish clearly enough between the board members in their capacity as shareholders and the supply contractors.

**Q339 Chairman:** So the structure was wrong, the administration was wrong and Transport for London were wrong in not picking it up early enough.

**Ruth Kelly:** With hindsight, I think it is possible to see that a combination of factors coming together led eventually to Metronet's demise. There are important lessons for us to learn, both through this process of administration and beyond, about what an appropriate future vehicle would be for delivering these upgrades.

**Q340 Chairman:** But not sufficiently tough lessons that we would disclaim any use of this existing machinery in the future?

**Ruth Kelly:** We need to work through it together with the Mayor and TfL.

**Q341 Chairman:** We need to work through it, at some cost to the taxpayer.

**Ruth Kelly:** There are always going to be costs in trying to get the best value for money for the taxpayer.

**Chairman:** I am sure everybody will bring you back to that.

**Q342 Mr Hollobone:** There are indeed important lessons to be learned but, as the Chairman has alluded to, there is also a big bill to be picked up. On top of the liability for Metronet's debts of some £2 billion, Transport for London has made available a £900 million loan facility to the administrators to cover the costs of administration, which we have just heard are now running at £13 million a week, so the total additional cost to the public is now some £3 billion. Is central Government going to pick up the bill?

**Ruth Kelly:** First of all, I do not accept that characterisation as to the cost to the taxpayer. If, Chairman, you will let me expand on the reasons why. First of all, I think it is very important to distinguish between the various costs. There are some costs that would have arisen in any event because we know more about the state of the assets than we did when these contracts were let. We inherited, as I am sure the Committee know, a Tube network with a long history of under-investment. There was a great deal of uncertainty about the state of those assets which over time we are gradually gaining more information about. It has become apparent through this process that an efficient and economic company would have incurred costs delivering what we wanted to be delivered in any event, no matter what the delivery vehicle was.

**Q343 Chairman:** I think Mr Hollobone, Secretary of State, if I may interrupt you rather rudely, is referring to the information we have been given today about actual costs.

**Ruth Kelly:** Right. If I could just point to the arbiter's interim report which said an efficient and effective company would have incurred costs in any event of between 370 and just over a billion pounds, so I think that accounts for some of the amounts that you put in front of me just now. There are also some of the costs incurred by Metronet itself because it was acting inefficiently. We do not yet know the precise quantity of those costs, although I think they will become apparent in due course, but we do know

that Metronet's shareholders, for example, already have written down £300 million off their books to account for some of that. That has been incurred by Metronet shareholders and acknowledged explicitly as a cost to their shareholders. There is some cost which has been incurred because Metronet has gone into administration and the cost of paying for the administrator and the cost potentially of any lost outputs. That does not equate with the loan facilities. Quite how much that will be and how much excess there is from Metronet's inefficient and ineffective operation is something that will be determined during the course of the administration process and will become apparent in due course, but it is nothing like the figure you are quoting.

**Q344 Chairman:** I think Mr Hollobone was telling you the figures we have been given this afternoon, not on a speculative basis but by the person who is doing the administration.

**Ruth Kelly:** It is certainly the case that Metronet have put in claims of up to £2 billion. It is also the case that—

**Q345 Chairman:** These are the administrator's costs, not Metronet's costs.

**Ruth Kelly:** Someone has to run the Tube and whoever is running it will incur a cost, so what we are interested in is the additional cost.

**Q346 Chairman:** It was the size of the cost that you were being asked about.

**Mr Collins:** It might be helpful just to explain that some of the additional costs that will be running here will be replacing the costs that Metronet would have been drawing down from their own borrowing. To some extent what TfL will be doing in terms of the funding facility for the administrator is covering the costs that would have been incurred by borrowing and these were already factored in.

**Chairman:** I think we will come back to that in a moment.

**Q347 Mr Hollobone:** What the passengers on the Tube network want to know is, is there any comfort from central Government that they will be picking up some of the bill, or is all the pain going to be on future fare increases? The passengers always want to know the extent to which the capital investment programme on the Tube network is going to be delayed or axed as a result of the Metronet debacle. I would be interested in the Secretary of State's view.

**Ruth Kelly:** First of all, I think it is clear that there will be a short-term cost and impact on delivery. It is not clear how that will play out in the longer run because if we secure really good value for money for the taxpayer in a vehicle that replaces the current PPP in due course that will be an opportunity for gaining extra efficiencies. Clearly there will be some cost to the taxpayer, it is not clear how big it will be but it is nothing like the figures that you were quoting. It is also the case that all of these issues were explored between myself and the Mayor in the run-up to the Comprehensive Spending Review and we were clear that the amount of money provided to

London as a settlement was appropriate to cover both the costs of Crossrail and made appropriate accommodation for Metronet as well as delivering for Londoners in other respects. Obviously within that envelope the Mayor and TfL will have to make choices about priorities, but I think it was an appropriate long-term funding settlement.

**Q348 Clive Efford:** Are you concerned that now Metronet's portion of the London Underground is going to be run by Transport for London we are going to lose the rigour of the private sector from the upgrading of the Underground?

**Ruth Kelly:** No. I think it is entirely appropriate that TfL should have bid for Metronet from administration. Clearly there is a process to be gone through, it is ultimately for the administrator to decide what the best way of exiting administration is but, as we have just been discussing, there are costs to administration and the sooner we get it out of administration the better for Londoners. There are issues beyond that about what the appropriate long-term arrangements are for delivering the upgrade of the lines, the station refurbishments, the track renewal and so forth that needs to be done.

**Q349 Clive Efford:** So what will be the Government's long-term role in the future management of this contract on the Underground?

**Ruth Kelly:** These are primarily issues for the Mayor and TfL but clearly, because we have got a strong interest as a government in what happens to London and good value for money, the Mayor and I have agreed to work closely on delivering the best value for money option for the taxpayer.

**Q350 Clive Efford:** Is there any prospect of the Government forcing us to go through another tendering process like the PPP?

**Ruth Kelly:** We are not in the business of forcing anyone, we are in the business of getting the best value for money for the taxpayer. What we need to do is work through the options and see exactly what the best delivery vehicle is. I am completely open-minded about the outcome of that.

**Q351 Clive Efford:** The Mayor for London has clearly got a position on the PPP which is a matter of public record. Is there any prospect of that position being challenged in the future with the difficulties we had with the Government in the past over the PPP and the Mayor?

**Ruth Kelly:** We are working in partnership. We both want to secure the best value for money outcome for the taxpayer and I am convinced this process will help us do that. I am completely open-minded about what the eventual outcome will be.

**Q352 Clive Efford:** Secretary of State, I accept that both the Mayor and the Government would want to get the best value for money for the London Underground, but the point is, is there any prospect at any date in the future of the Government imposing a tendering process on TfL against the will of the Mayor?

**Ruth Kelly:** We are not in the business of imposing anything on anyone. I think both the Mayor and I accept there will be private sector involvement in the future, and it is right that there should be, including an element of risk transfer. Quite what the appropriate way of doing that is, as I say, I am open-minded, we need to do the work, we need to understand the state of the assets, we need to understand the cost to the taxpayer and see what interest there is. There is a process to be gone through.

**Q353 Clive Efford:** There is always scope for private sector involvement, and Mr O'Toole gave us evidence earlier on pointing out that the expertise to carry out some of the contractual work is not in the public sector so, therefore, you would have to involve the private sector. What we are talking about here is an overarching contract for the whole of this section of the Underground and for running of the rolling stock and maintenance of the track and signals. Is there any prospect of such a contract of that kind being forced on the Mayor against the will of the Mayor in the future by the Government?

**Ruth Kelly:** I am certainly not going to prejudge the outcome of this joint piece of work. In principle, there is an argument for asking the private sector to deliver in the most innovative and efficient manner it can against certain outputs which are, as it were, specified in a contract. That can work, it does work for Tube Lines and it could work again. Whether that is the best value for money option given what we now know, I do not know and I do not want to prejudge that one.

**Q354 Clive Efford:** Can I push you again on one point. Every step that is taken in terms of the future management of the Underground will be taken with the full agreement of the Mayor, is that right?

**Ruth Kelly:** There is a process to be gone through. We are working co-operatively and jointly on this trying to find the best value for money option. It would be ridiculous for me to sit here and speculate about the relationship between the Secretary of State and the Mayor over the coming years. We work closely together.

**Q355 Clive Efford:** But it will not be the Mayor on his own determining the future structure of the contracts?

**Ruth Kelly:** The Mayor has agreed that we should work jointly on this because there are significant benefits to be derived and it is important for London to get this right, and that is something I am entirely happy with.

**Q356 Clive Efford:** Are you concerned that there will be a reduction in the transparency of the PPP agreements with Transport for London effectively acting as both the client and the contractor?

**Ruth Kelly:** If you are talking about this interim period where TfL are so far the only bidder to bid for the Metronet companies direct from administration, if that results in the contracts moving to TfL I think that is an entirely appropriate outcome but that

decision has clearly got to be taken by the administrator. It is right too that in the longer term we think about what the best structure is for doing the work.

**Q357 Clive Efford:** Just going back to the situation we are now in with Metronet, do you think that a review of the powers of the arbiter might be necessary in order to give him step-in rights to prevent this situation coming about again?

**Ruth Kelly:** There is an issue about what information was produced when and at what point in the process. It was unfortunate, with hindsight, that an annual report was not produced earlier in the process, and I think the arbiter has been pretty clear that had that happened he would have had information earlier and action may well have been taken earlier with less cost to the taxpayer. Whether that needs a formal power for the arbiter, potentially implying primary legislation which could have an impact on Tube Lines and their contracts, I do not think that is an obvious conclusion, there may be other ways of achieving the same outcomes.

**Q358 Clive Efford:** Can I clarify the role of the arbiter. When we asked questions of Mr O'Toole earlier on he indicated that the arbiter was not forthcoming with all the information that was available to him that may have assisted London Underground in having a better idea of what the situation was. Is it your understanding that the arbiter is duty bound to publish all of the information that is available to him in order to make everyone aware of the situation on the Underground?

**Ruth Kelly:** I think the arbiter certainly intends to share the results of his work and he has made that absolutely clear in public as well as in private, both to us and to TfL.

**Q359 Clive Efford:** So there is no circumstance in which the arbiter would have information that he would not share with London Underground or the Government?

**Ruth Kelly:** I am not privy to those conversations, so I do not know if there is information that London Underground is—

**Q360 Chairman:** Mr Collins, is it likely that the arbiter had access to accurate information at an early point but did not feel it part of his duties to convey that to Transport for London?

**Mr Collins:** Mr O'Toole's answer earlier on about the reassurance that was given suggests that the arbiter was satisfied with the level and nature of the information that he held in relation to Metronet.

**Q361 Chairman:** So either he knew it was going badly wrong and did not choose to tell anybody or he did not know.

**Mr Collins:** I think the conclusion to draw from that is that he might not have known; in fact, he probably did not know. The question would have been whether or not these issues would have emerged in the annual review in 2005. For example,

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confirmation that information was not being made available to him sufficiently robustly and in appropriate form. If that was in fact the case that break in the knowledge and information chain might have been useful to explore at an earlier stage.

**Q362 Clive Efford:** The suggestion is that Metronet really determined the information that was available to the arbiter which diminished the role of the arbiter. Is that correct?

**Mr Collins:** The arbiter had particular powers to go and request information from the infrastructure companies, they would provide it to him and he would take a view on the robustness of the information given to him.

**Q363 Clive Efford:** Given this situation that has come about, are you confident that the arbiter has sufficient powers to avoid these circumstances coming about again?

**Mr Collins:** I think that is clearly an area that we, with the other parties, will want to look at very carefully. The information flows here, as other witnesses have testified, have not been sufficiently clear at a sufficiently early stage in some instances and that is something we will want to take stock of.

**Q364 Clive Efford:** Given the circumstances, Secretary of State, are you confident that the London Underground is safe and running efficiently at this moment in time?

**Ruth Kelly:** Yes.

**Q365 Clive Efford:** Who is that due to?

**Ruth Kelly:** London Underground is responsible ultimately for the safe operation of the Tube, but the administrator in the current process puts safety at the top of his list of objectives and priorities.

**Q366 Graham Stringer:** You said that you wanted to understand what has happened, how are you going to do that?

**Ruth Kelly:** Partly this Committee's hearings have been very important in that process of examining the evidence from witnesses. What we want to do now is work with the arbiter, understand the information which he has obtained and, as we have been saying, he has made very clear his intention of sharing that with us. If TfL is successful in bidding for the contracts from administration then clearly we will want to work with them in due course to understand much better the state of the assets and what any potential cost overruns have been and the cost to the taxpayer, all of that information that would normally be produced in due course. It is also the case that we will want to understand the information flows, work with the different parties to the contract to see what information was produced when and whether that could have been better, think about the combination of a low materiality threshold, £50 million materiality threshold, and why that did not bite earlier and why it was that costs were allowed to overrun and they did and the implications of that in the future, think about the combination of that with the level of risk transfer and ask the question, and

there are fundamental issues to think about here, as to why the incentives were not there or did not seem to bite hard enough on Metronet's shareholders earlier.

**Q367 Graham Stringer:** We are operating in public, Secretary of State, and there is some information we are unable to achieve, partly because it is not there at the present time. By and large the Department for Transport does not operate in public, but would it not be better to have a public inquiry?

**Ruth Kelly:** Having looked at the transcripts of the evidence that has been provided it is pretty clear to me that there are lessons to be learnt here. The important thing now is to make sure those lessons are incorporated in the work that we do in the future and obtain the best value for money going forward.

**Q368 Graham Stringer:** Secretary of State, this is a scandal. We have heard this afternoon that £13 million of public money is being paid out every week on top of what would otherwise have been—

**Ruth Kelly:** That is not true.

**Q369 Graham Stringer:** That is what the administrator told us.

**Ruth Kelly:** On top of what otherwise would have been paid out?

**Q370 Graham Stringer:** On top of what otherwise would have been paid out.

**Ruth Kelly:** 30 or 13?

**Q371 Graham Stringer:** £13 million a week up until at least January. We have heard that tube station renovations have been paid for and they have not been renovated, that is the extra 1.2 billion cost. That is public money down the drain. No public figure is responsible for it. The Mayor of London is not responsible, you are not responsible, the Chancellor of the Exchequer is not responsible. Do you not think we have at least a responsibility to get this out in the air and have a public inquiry?

**Ruth Kelly:** Certainly we have a responsibility to air the issues and I think this is part of that process. In due course it will become apparent precisely what the cost to the taxpayer has been and whether that is recoverable in a new delivery vehicle, having learnt the lessons and having more information about the state of the assets.

**Q372 Graham Stringer:** Would it not be better if it became apparent in public in one inquiry where people could go? One of the things that was said to us by Mr O'Toole was lots of people have made money out of this. This is not just something that has gone wrong, something that was not foreseen, there looks like real corruption has gone on. The shareholders of Metronet were paying themselves via the construction companies, they were funnelling money through, there was no control on that by Transport. This is a scandal, Secretary of State. It is not just that lessons will be learnt in private, do you not think we should have a public inquiry?

**Ruth Kelly:** I have no evidence to suggest there was corruption. If others have evidence then they should produce it to the appropriate authorities. What I do have very clearly before me is a situation in which the corporate governance structures were not appropriate, where there was a lack of financial control in the Metronet company, where there was not a clear separation between the shareholders and the contractors, and where they were in a contractual relationship with a project management company which, as it were, entrenched those relationships rather than it meant they got on top of delivering value for money. Those are issues which I think have meant there will be some cost to the taxpayer, but the size of that cost is not at all clear to me. In due course that will become apparent but it is not of the size and significance of the figures that Mr Hollobone has been quoting. We also have to bear in mind that if you look at the history of projects of this size and nature, the public sector does not have a very good track record, or did not in the past, of delivering projects of this size. The Jubilee Line, for instance, was 30% over cost, a very significant cost to the taxpayer. All the time we have to ask ourselves the question what is the most efficient and best value for money way of delivering projects of this scale.

**Q373 Graham Stringer:** It is a bit of a red herring, if you do not mind me saying, that a project that finished in 2000 was overspent. We have here a company, Metronet, basically funnelling cash into its own shareholders as contractors. That might strike you as a poor governance arrangement, it seems to me corrupt. There is nobody publicly accountable, that is the appalling thing about PPPs because at the end of the day there is no individual to whom you can say, "You set that up. You are for the high jump". Secretary of State, given that, do you not think that there should be a public inquiry?

**Ruth Kelly:** Well, there were clearly failures, I accept absolutely there were failures in Metronet's governance but, having said that, Metronet was delivering improvements on the Tube network for passengers and for London. It may not have been at the rate at which we would have expected or assumed.

**Q374 Graham Stringer:** They were providing regenerated, renovated stations one for the price of two. This was not a good deal, was it?

**Ruth Kelly:** I think it is too early to say.

**Q375 Graham Stringer:** In terms of the costs there are clearly extra costs. When you said earlier that you provided enough money for Transport for London as a global sum, did that include an assessment of any sort of the extra costs from this financial catastrophe of Metronet?

**Ruth Kelly:** Obviously there was a negotiation between the Government and the Mayor about the appropriate settlement for London. I do not think it would be wise for me to reveal the details of those negotiations.

**Q376 Graham Stringer:** Why not?

**Ruth Kelly:** Having said that, there was clearly an assumption that extra money would be needed for Crossrail and to fund the short-term impact of Metronet's failure. What the consequence is for the longer term is much more uncertain and there will be further opportunities to look at that.

**Q377 Graham Stringer:** You have put extra cash in for the immediate loss?

**Ruth Kelly:** We took that into account in the overall settlement and it was something that the Mayor agreed was appropriate.

**Q378 Graham Stringer:** In plain English does that mean extra cash in the short term?

**Ruth Kelly:** There are huge sums that go to London, as I know, Mr Stringer, you are aware, very significant sums.

**Q379 Graham Stringer:** I am, this is a different argument. This is making sure those vast sums are worked efficiently which were not used very effectively as they have been in this case.

**Ruth Kelly:** Indeed, and I think we have given an appropriate settlement which will allow the Mayor to prioritise within that and in an appropriate way, but also recognise that there will have been an impact from Metronet's failure.

**Q380 Graham Stringer:** Would you expect fares to go up because of this?

**Ruth Kelly:** Those are issues for the Mayor. I should not comment on what is likely to happen to fares, but that was not part of the intention.

**Ms Chadwick:** Certainly not.

**Q381 Chairman:** The slight hazard, of course, is that there are only two sources of finances, as we have been told. One is the fare box and one is, after all, public money.

**Ruth Kelly:** There is also the shareholders' money and potentially the lenders' money.

**Q382 Chairman:** I think possibly you should study some of our evidence a little more closely, Secretary of State, before you make quite such a confident assertion because it does seem to some of us that the only people who have done reasonably well out of this are the companies which manage to collapse gently at the point where they had not committed or produced the results they had been paid for and which left the taxpayer and the ratepayer to pick up the bill and start again.

**Ruth Kelly:** I do not think Metronet did comfortably from this deal.

**Q383 Chairman:** You are astonishingly self-controlled. You do not think they did comfortably?

**Ruth Kelly:** I think, Chairman, you used the word "comfortably". If you look at what has happened to the individual shareholders, there were five, three of those have already produced their end of year

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results. Balfour Beatty, Atkins and Bombardier together have written down £300 million. Thames Water and EdF have still to produce final accounts.

**Q384 Chairman:** I am not sure where this argument is going, Secretary of State. Are we sorry for them?

**Ruth Kelly:** No, I am just saying that they did bear some of the cost of this directly.

**Q385 Chairman:** It is nice they bore some of the cost, yes.

**Ruth Kelly:** At least some of the cost and, not only that, I do not think anyone should underestimate the impact on their reputations.

**Q386 Chairman:** Would you mean people might feel that taking on a contract they could not fulfil, that they did not understand, they did not estimate properly and then failing to do it might not do them a lot of good?

**Ruth Kelly:** Indeed.

**Chairman:** Is that what you are saying? How astonishing.

**Q387 Mrs Ellman:** Your last comments, Secretary of State, suggest that you are not unduly concerned about the situation where the shareholders benefited from a very large number of contracts and yet the total result has been a failure for the public?

**Ruth Kelly:** No, I am concerned about the tied supply structure and the fact that the corporate governance structure was not acting effectively, there was not an independent chairman of the board until January of this year, for example. I am concerned that the incentives did not seem to be right. All I am saying is that the Metronet company ultimately went into administration and it is clear already from their accounts that they have written down between them £300 million and there may be more to come—I do not know about that—but clearly there was some transfer of risk and they have felt the pain, not only financially but reputationally as well.

**Q388 Mrs Ellman:** You would not agree that what has happened is a scandal?

**Ruth Kelly:** I think it is a terrible failure.

**Q389 Mrs Ellman:** But not a scandal?

**Ruth Kelly:** It is a terrible failure of Metronet.

**Q390 Chairman:** No-one is to blame, it is not a scandal, “It was not me, gov”.

**Ruth Kelly:** I do not agree with that at all. I said right at the start this was a very serious matter that Metronet had let down the passengers, had let down the taxpayer and had not delivered appropriately for Londoners. I think this is a very serious issue. I think there are lessons that can be learnt from it and it is very important that we do that.

**Q391 Clive Efford:** Very briefly, given the scale of the problem that we have got here, if these companies have suffered by reputation, does that mean you would not look favourably on any contracts that they were involved in for public sector work in the future?

**Ruth Kelly:** One of the issues that we look at is the competence and delivery record of individual companies—

**Q392 Clive Efford:** That is a “yes” then?

**Ruth Kelly:**—and of course those issues would be taken into account.

**Q393 Mr Leech:** What practical steps is the Department for Transport going to take to make sure this does not happen again?

**Ruth Kelly:** We are learning the lessons and I think it is very clear—and I have identified the areas that we are examining for this Committee—that in due course when the Committee produces its recommendations we will take those into account and respond fully to those too. The process going forward really now is one for the administrator and to get these contracts out of administration is our primary focus and then to work with TfL and the Mayor to determine the best delivery vehicle going forward.

**Ms Chadwick:** In terms of achieving that administration requires state aid clearances, et cetera. A lot of the effort is in terms of making sure the state aid clearances underpin some of that and there is a great deal of work that is going on across the Department in terms of ensuring this is undertaken smoothly.

**Chairman:** One would hope so. The Secretary of State has just told us she does not think there is a problem with the PPP theory, it is simply this particular company which does not seem to have done very well. You will understand that some members of this Committee might regard that with a certain amount of disbelief. Anyway, Secretary of State, you have been, as always, very articulate and we are always pleased to see you. Thank you very much indeed.

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# Written evidence

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## Memorandum from Chris Bolt, the PPP Arbiter (PPP 01)

### THE ROLE OF THE PPP ARBITER

1. The functions and duties of the PPP Arbiter were established by the Greater London Authority Act 1999 (GLA Act). The PPP Arbiter's role is principally to ensure that any differences between the PPP Parties about the price to be paid to the Infracos for carrying out obligations under the PPP Agreements can be resolved independently, with certainty and in a timely way.

2. Although the Arbiter can be asked for guidance or directions at any time, it was expected that he would exercise formal functions in three main circumstances:

- in giving an annual “definitive statement” on the performance of the two Metronet infracos;
- at the Periodic Review of the Agreements which takes place every 7½ years; and
- at an Extraordinary Review of the terms of a PPP Agreement if there were material changes in costs and revenues within a Review Period.

3. The PPP Agreements establish the concept of a “Notional Infraco”—an entity which has the same obligations as Infraco, which carries out its activities in an overall efficient and economic manner and in accordance with Good Industry Practice, and has certain other specified characteristics. A key part of the Arbiter's role is therefore to assess what constitutes Good Industry Practice and the level of performance and cost which would be efficient and economic.

4. Chris Bolt was appointed as the first Arbiter on 31 December 2002, and his appointment now runs to 30 December 2010. He is supported by a small permanent staff. As he is appointed as an individual, and is personally responsible for the exercise of his statutory functions, he has also appointed an Advisory Board to provide independent and expert challenge to his decisions and procedures. Although he is not required by statute to do so, he has published each year a Business Plan and the Annual Report and Accounts setting out the work programme of his Office and the resources used.<sup>1</sup>

### ACTIVITIES TO DATE

5. The Arbiter's initial focus was on two main workstreams:

- developing clear and transparent procedures for handling references, which have been published—after consultation—as a “Procedural Framework for Use in the Giving of Directions and Guidance” together with a series of more detailed supporting documents relating to different types of reference; and
- initiating a programme, jointly with the PPP Parties, to develop a basis for assessing the key concepts of efficiency and economy and of Good Industry Practice; this has included developing a framework for benchmarking between the infracos, initial work on international benchmarking and specific studies on aspects of good practice in asset management, procurement etc.

6. The two Metronet Agreements provide for an annual reference to the Arbiter for guidance in the form of a definitive statement as to whether “Infraco has performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice” or not (the “annual Metronet Report”). It was expected that the first report would be prepared in 2005, covering the two year period from Transfer in April 2003. Preparing for this reference was an early priority for the Arbiter and his Office.

7. In the event, it was agreed by Metronet and London Underground not to seek this independent report from the Arbiter in 2005, and Metronet secured a waiver from their funders to permit this.<sup>2</sup> Although Metronet and London Underground agreed to undertake, with the Arbiter, some preparatory work for the 2006 report, which enabled some issues such as the presentation of variance analysis to be taken forward, a significant consequence of this decision was that the emerging overspend in Metronet was not fully analysed for a further 12 months.

8. Five references were made to the Arbiter for guidance in the year 2006–07:

- a reference from Tube Lines for guidance on the treatment of investment which straddles a Periodic Review;
- references from Metronet BCV and Metronet SSL for the 2006 annual report; and
- references from Metronet BCV and Metronet SSL for guidance on the treatment of investment at an Extraordinary Review.

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<sup>1</sup> These are published on the Arbiter website, at <http://www.ppparbiter.org.uk/output/page19.asp?DocTypeID=4>.

<sup>2</sup> Although the annual report is specifically referred to in the PPP Agreements, the reference is discretionary. However, Metronet's funding agreements make it mandatory that such a reference is made by 30 April in each year from 2005.

9. These references were handled in accordance with the Procedural Framework. The final guidance in each case has been published.

10. Of particular significance was the annual Metronet Report 2006, published on 16 November 2006. This concluded that neither of the two Metronet infracos had performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice in the first three years of the contract. The report made some specific criticisms of the supply chain arrangements which Metronet put in place at Transfer, and of Metronet's governance. The Arbiter also expressed surprise at the lack of detailed information on important aspects of Metronet's activities.

11. The report also identified a significant overspend, at that stage estimated at about £750 million for the two infracos combined, for the first 7½ year Review Period. To the extent that an Extraordinary Review concluded that these additional costs were efficiently incurred, all but £100 million would be borne by London Underground (either through additional Infrastructure Service Charge (ISC) or through a reduction in obligations); costs inefficiently incurred would be borne by the relevant infraco.<sup>3</sup> Given this scale of overspend, the Arbiter considered that it was important to clarify the responsibility for cost overruns through an Extraordinary Review.

12. The Arbiter had discussed with Metronet the possibility of their making a reference for direction on Eligible Costs and ISC (essentially a determination of the increase in efficient and economic costs and revenues above the contractual baseline) alongside the 2006 annual report, but in the event Metronet did not make that reference.

13. Initially, Metronet considered that it was preferable to negotiate a settlement with London Underground, rather than use the contractual processes. Anticipating the possibility of an Extraordinary Review, Metronet made a further reference to the Arbiter for guidance on the treatment of seven specific investments at an Extraordinary Review on 14 November 2007, and the Arbiter's final guidance was published on 13 March 2007. Although London Underground and the Mayor were publicly urging Metronet to call an Extraordinary Review from February 2007, the Arbiter did not receive a reference until June 2007.

#### METRONET EXTRAORDINARY REVIEW

14. Metronet BCV made a reference to the Arbiter for an Extraordinary Review of its PPP Agreement on 28 June 2007. This sought three separate directions: on the form and structure of the Extraordinary Review, on Net Adverse Effects and the consequent increase in ISC for the full 7½ year Review Period, and on an interim increase in ISC ("Interim ISC") while the Extraordinary Review was being conducted.

15. Draft directions on Interim ISC, covering a 12 month period to 28 June 2008, were published on 16 July 2007. These directions allowed Metronet BCV only £121 million of the £551 million interim funding the company had sought. On 18 July, both Metronet BCV and Metronet SSL entered PPP Administration.

16. To allow the Administrators time to develop their plans for Metronet, and reflecting the availability of alternative interim funding, the Arbiter suspended on 30 July the previously announced timetable for the Extraordinary Review which covered the publication of final directions on Interim ISC and holding a post-reference meeting to establish the timetable for the full Review. However, he also said that he was continuing work on analysing submissions from Metronet BCV and London Underground.

17. The Administrators of Metronet have told the Arbiter that they do not currently envisage withdrawing the reference, and indeed are considering whether to make a reference for an Extraordinary Review of Metronet SSL's Agreement. Because the Metronet BCV reference remains on the table, the Arbiter is under a statutory obligation to give directions. On 21 September, he published his Initial Thoughts on both the level of efficient costs and revenues for Metronet BCV, and the potential implications for Metronet SSL, and on the form and structure of the whole Extraordinary Review. He has asked for representations by 12 October.

18. The Arbiter's current proposals in respect of Metronet BCV envisage draft directions on Net Adverse Effects being published on 12 November, with final directions on 14 December. Draft and final directions on the resulting changes in ISC will follow, with the process being completed in January 2008, unless additional time is required to assess the impact of changes in Infraco Obligations on affordability or practicability grounds.

<sup>3</sup> Changes in the efficient level of costs and revenues are referred to in the Agreements as Net Adverse Effects. Net Adverse Effects in excess of a Materiality Threshold are borne by London Underground. The Materiality Threshold is £50 million indexed in each Review Period for the Metronet infracos, and £200 million indexed for Tube Lines in the first Review Period and £50 million in subsequent Review Periods.

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## THE PERIODIC REVIEW

19. The Arbiter is continuing his preparations for the first Periodic Review of the contracts, due to be completed in 2010. The current focus is on the format of cost and performance information to be provided, and the internal and external benchmarks which will assist in evaluation of infraco projections. The Arbiter's office now chairs the Joint Benchmarking Steering Group, and the Arbiter chairs regular meetings with Metronet, Tube Lines and London Underground to review overall progress.

20. The current programme for the Periodic Review envisages that the business plan currently being developed by each infraco will provide the basis for an initial assessment by London Underground of affordability in the second Review Period (2010–17/18) and by the Arbiter of efficiency and economy. The results will allow an updated business plan to be developed at the end of 2008 as the basis for detailed negotiations between infracos and London Underground, and any directions by the Arbiter, during 2009. New pricing and financing arrangements need to be in place by the start of the second Review Period (1 July 2010 for Tube Lines, 4 October 2010 for Metronet).

## ISSUES RELEVANT TO THE CURRENT INQUIRY

21. Under the terms of the PPP Agreements, the infracos are incentivised to deliver improvements in three main output measures: capability (in terms of capacity and journey times); availability (performance of trains on the day); and ambience (of both stations and trains). They are also required to deliver a station improvement programme in line with dates specified in the Agreements. The infracos are under an obligation to demonstrate an efficient and economic whole-life cost approach to asset management, by reference to Good Industry Practice.

22. Since Transfer, performance of the Infracos on the availability measure (train performance “on the day”) has generally been better than the level in the two years before Transfer, although the improvement has been different for different lines. Delivery of the stations programme has also varied between the infracos, with Tube Lines delivering on time, but Metronet delivering substantially later than the contractual dates. Tube Lines is also projecting costs in the first Review Period broadly in line with bid, in contrast to the overspend under the two Metronet Agreements.

23. Although the Arbiter has no role in establishing the obligations to be delivered under the PPP Agreements, or in monitoring and enforcing delivery of those obligations, his guidance and directions are central to delivery of value for money under those Agreements (as recognised by the National Audit Office in their report on the PPP).

24. The Arbiter identified in his guidance on investment which straddles a Periodic Review, issued in November 2006, some weaknesses in the PPP Agreements in giving adequate incentive to the infracos to innovate where this increased costs in the short term but brought longer term benefits. Recent events have also highlighted some areas where the PPP Agreements may not be fully effective in promoting value for money. These include the arrangements for updating and reviewing business plans, provisions relating to the triggering of an Extraordinary Review, and the provisions for handling delay in the delivery of obligations. There are also questions about the effectiveness of lenders in using their powers under the funding agreements to hold Metronet to account.

25. It also seems clear that there have been differences of understanding between Metronet and London Underground about the allocation of different risks under the contract. In particular, the cost consequences of increases in the scope of work required to deliver obligations are mostly borne by London Underground; only the (low) Materiality Threshold and the cost consequences of delivering inefficiently are borne by Metronet. Thus, even where sums were omitted from the original bid, or disputes about contractual requirements have been won by London Underground (such as whether Low Loss Conductor Rail for the Victoria Line was an original obligation or not), London Underground still has to bear the efficient increase in costs.

26. Quantification of risk will be particularly important in assessing the value for money of different options for the future structure of Metronet, in particular if this involves a comparison of public and private sector ownership models. Experience in developing the Public Sector Comparator (PSC) at the time of the original contract award may be particularly relevant. It should also be borne in mind that the PSC for SSL was assessed as being between £500–£1000 million more expensive than the Metronet bid for the first 7½ years.<sup>4</sup>

27. Uncertainties surrounding the future structure and ownership of Metronet (in both the short and longer term) make it particularly difficult to plan effectively for the Periodic Review, in particular given the expectation that comparisons between the three infracos would be a primary source of information for the Arbiter. However, the Arbiter remains of the view that the basic structure of the PPP Agreement remains sound, and that maintaining an output-based contract is important for delivering value for money in the longer term.

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<sup>4</sup> Present value over 7½ years. Source: *Final Assessment Report*, 2 February 2002, Table 20.1.

## THE FUNCTIONS AND DUTIES OF THE PPP ARBITER

1. The role of the PPP Arbitrator was established by the Greater London Authority Act 1999 (GLA Act). Under the terms of the GLA Act, the Arbitrator is independent of Government and of the PPP Parties and can only be dismissed by the Secretary of State on grounds of incapacity or misbehaviour, or for unreasonable delay in the discharge of his functions.

2. The PPP Arbitrator has two principal statutory functions:

- to give directions on matters specified in the PPP Agreements, when asked to do so by one of the Parties to a PPP Agreement; and
- to give guidance on any matter relating to a PPP Agreement, when asked to do so by either (or both) of the Parties to a PPP Agreement.

3. When the Arbitrator is asked for guidance by one Party only, he has discretion about whether to give guidance. Where he is asked for directions, or is asked for guidance by both Parties to an Agreement, his is required to give such direction or guidance.

4. In addition the PPP Arbitrator also has further powers “for the purposes of the proper discharge of the functions” conferred on him by the GLA Act. For example the PPP Arbitrator may do “all such things as he considers appropriate for or in connection with the giving of a direction or guidance and . . . do such other things as he considers necessary or expedient . . . for purposes preparatory or ancillary to the giving of directions or guidance generally . . . notwithstanding that there is no matter in relation to which a direction or guidance is required”.

5. The PPP Arbitrator’s function in respect of directions is limited by the terms of the PPP Agreements: if there is no specific provision in a PPP Agreement for the PPP Arbitrator’s involvement then disputes are dealt with through contractual dispute resolution. Even on matters within his remit, he is only brought in if one of the Parties seek a direction from him. The PPP Arbitrator therefore has no unilateral power to change, or propose to change, provisions in the PPP Agreements. Even where he has made a direction on a disputed matter within his remit, the Parties may, under the provisions of the GLA Act, jointly agree to set it aside.

6. In exercising his functions, the Arbitrator is under a statutory duty to act in the way he considers is best calculated to achieve four objectives:

- to ensure that London Underground has the opportunity to revise its requirements under the PPP Agreements if the proper price exceeds the resources available;
- to promote efficiency and economy in the provision, construction, renewal, or improvement and maintenance of the railway infrastructure;
- to ensure that if a rate of return is incorporated in a PPP Agreement, and taking into account matters specified in the Agreement, a company which is efficient and economic in its performance of the requirements in that PPP Agreement would earn that return; and
- to enable the Infracos to plan the future performance of the PPP Agreements with reasonable certainty.

The Arbitrator is also under a duty to take account of any factors which are notified to him by both Parties to an Agreement, or are specified in the relevant PPP Agreement, as ones to which he must have regard.

*September 2007*

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### Supplementary memorandum from the PPP Arbitrator (PPP 01a)

#### INTRODUCTION

1. This submission supplements my initial submission of 27 September 2007 and my oral evidence given on 17 October. It addresses in particular the information available to me in 2005 about the performance of Metronet, and explains further why I consider that some of the subsequent problems could have been mitigated had I been asked to prepare an Annual Report on Metronet in 2005.

2. Such a report would have identified:

- the scale of the shortfall in delivery by Metronet, in particular on the stations and track programmes;
- the emerging projected overspend, which by late 2005 already exceeded the Materiality Threshold for Metronet BCV; and
- weaknesses in financial and risk management, and in management of the supply chain.

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 ROUTINE MONITORING INFORMATION

3. I set out my initial requirements for routine information from the PPP Parties in January 2004.<sup>5</sup> These requirements included:

- information to enable me to gain a high level understanding of the Infracos' actual and forecast costs and revenues (specifically, the financial models that the Infracos were required to provide to their lenders);
- additional information to provide updates of progress on capital works; and
- information regarding the performance of the Infracos under the PPP performance regime.

In addition, I required the Infracos to provide me with the monthly reports prepared for their Boards and, in the case of Metronet, the reports produced for each of the main supply chain contracts.

4. During 2004–05 the provision of these items became routine, with information provided to me by the Infracos and London Underground on a 4-weekly cycle, as reported in the my 2004-05 Annual Report.<sup>6</sup> That Report included a high level review of Infraco performance which demonstrated, for example, that Metronet had not delivered into service any of the eight stations due to be completed by 31 March 2005. Additional detail was provided in London Underground's own report,<sup>7</sup> which concluded that "there has been some progress in the delivery of renewals but again this is inconsistent and significant parts of the capital programme are late, particularly for Metronet."

## PREPARATION FOR 2005 METRONET REPORT

5. Metronet's PPP Agreements include an explicit provision for each Infraco to seek a "definitive statement" as to whether the Infraco has performed its activities to date "in an overall efficient and economic manner and in accordance with Good Industry Practice" or not, in each year apart from the first contract year. If, as originally expected, the contract had been signed before 31 March 2003, the first report by the Arbiter would therefore have covered the period to 31 March 2004; in the event, the contract was not signed until 4 April 2003, meaning that the first expected report would cover the period from Transfer to 31 March 2005.

6. The PPP Agreement does not itself require Metronet to make a reference for the annual report. However, under the terms of its agreements with lenders, a waiver is required if the reference is not made by 30 April in each year.

7. Given the original expectation was for a report to be produced in 2004, I proposed to Metronet that a "practice run" should be undertaken in 2004 to allow procedures and data availability to be tested in preparation for the 2005 reference. However, I was told by Metronet on 6 April 2004 that the Holdings Board (which principally comprised the shareholder representatives, then under the chairmanship of John Weight) had decided not to cooperate with this exercise as it would be "unhelpful in terms of our longer term objectives of improving Metronet as a business".

8. Preparations for the 2005 report continued through 2004, and on 30 March 2005 I wrote to Metronet setting out my proposed approach. This followed confirmation on 23 February 2005 from the then Chief Financial Officer that, subject to confirmation at the March 2005 Holdings Board meeting, it was "highly likely" that the reference would seek directions on Eligible Costs and Eligible Infrastructure Service Charge in addition to the definitive statement. Such a reference would therefore have required me to put a precise figure on the extent to which cost overruns (and revenue shortfalls) to date had been efficient and economic.

9. However, on 6 April 2005, I was invited to meet Tim O'Toole and John Weight and was told that they had agreed that Metronet should not make a reference at all. John Weight subsequently confirmed this in writing, attaching a letter to him from Tim O'Toole dated 4 April which set out London Underground's view that "the time and effort required of the contract parties to give [the reference] proper engagement would be better directed to normalising the relationship between us in terms of provision of information, AMS/AAMP<sup>8</sup> development, MPD<sup>9</sup> submissions and commercial resolution of outstanding issues."

10. Despite John Weight resigning as Executive Chairman of Metronet within a week of this meeting, the decision not to make the reference stood. Metronet confirmed to me in May 2005 that it had received the necessary waiver from its lenders.

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<sup>5</sup> Routine Provision of Information to the PPP Arbiter: Initial Requirements, 19 January 2004, at [http://www.ppparbiter.org.uk/files/uploads/g—proceduralFrameWork/200621015756—Provision%20of%20Information%20to%20the%20Arbiter%20-%20Initial%20Requirements%20\(19—01—04\)%20DM6520v1.PDF](http://www.ppparbiter.org.uk/files/uploads/g—proceduralFrameWork/200621015756—Provision%20of%20Information%20to%20the%20Arbiter%20-%20Initial%20Requirements%20(19—01—04)%20DM6520v1.PDF)

<sup>6</sup> The PPP Arbiter: Annual Report and Accounts 2004-05, 2 August 2005, at [http://www.ppparbiter.org.uk/files/uploads/a—annualReports/2006210163231—The%20PPP%20Arbiter's%20Annual%20Report%20&%20Accounts%202004—05%20\(02—08—05\)%20DM11266v1.PDF](http://www.ppparbiter.org.uk/files/uploads/a—annualReports/2006210163231—The%20PPP%20Arbiter's%20Annual%20Report%20&%20Accounts%202004—05%20(02—08—05)%20DM11266v1.PDF)

<sup>7</sup> London Underground and the PPP: the second year 2004/2005: Report for financial year ending 31 March 2005, 27 July 2005, at <http://www.tfl.gov.uk/assets/downloads/LULPPP-Financial-Report-04-05.pdf>

<sup>8</sup> Asset Management Strategy and Annual Asset Management Plan.

<sup>9</sup> London Underground's Master Projects Database.

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**WORK ACTUALLY UNDERTAKEN IN 2005**

11. In place of the Annual Report reference, Metronet and London Underground agreed to work together during 2005, with my involvement, to prepare for a reference in 2006. I wrote to John Weight on 12 April (the day before his resignation), setting out my view that the agreed work programme should deliver “all the information required, not only by LUL but also by myself, to make an effective assessment of economy and efficiency in line with contractual provisions.” My expectation was therefore that there would be a full “practice run”, reviewing the whole of Metronet’s activities and financial information.

12. In the event, the exercise was more limited than this, and concentrated on agreeing the basis for identifying variances in financial projections and reviewing some extracts from the expected 2006 reference submission. Nonetheless, on the basis of this work which was undertaken jointly with London Underground, it became clear by November 2005 that the apparent underspend in the 2005 Annual Asset Management Plan actually represented an overspend above bid levels when contractual variations were taken into account. The increase was well above the Materiality Threshold in the case of Metronet BCV. It was also clear that there were weaknesses in Metronet’s financial and risk management, and in its management of the supply chain.

13. Had a reference been made for an Annual Report in 2005, it therefore remains my view that this would have identified many of the weaknesses that were set out in the 2006 report. In particular, a 2005 report would have made it clear at an early stage to shareholders and lenders that some of the costs to date had not been incurred by Metronet in an efficient and economic manner, and were not therefore recoverable from London Underground, and that early action was therefore essential if financial difficulties were to be avoided.

November 2007

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**Memorandum from T Martin Blaiklock (PPP 02)**
**INTRODUCTION:**

The Committee has asked for comment as to whether:

- the PPP is producing real benefits for Tube passengers;
- ensures the maintenance of the highest safety standards;
- provides value-for-money for the tax-payer; and
- spreads the associated risk fairly between the public and private sectors.

Professionally, I am not qualified to provide an opinion on any of the above, although I have my own subjective views as to value-for-money and the allocation of risks.

I can, however, provide a professional view with respect to the Committee’s final question, viz. “the likely impact of Metronet Rail BCV and SSL going into PPP Administration”, as below. My comments focus solely on the financial impacts of this event.

Finally, I should mention that I appeared as a Witness before the Committee on my own account in the February 2002 Inquiry into the London Underground PPP.

**COMMENTARY:**

1. The underlying financial structure of the Metronet BCV and SSL PPPs combined following Financial Close in 2003 was:

Equity:	Atkins	=	£70mn
	Balfour Beatty	=	£70mn
	Bombardier	=	£70mn
	EdF (ie French state)	=	£70mn
	Thames Water (RWE)	=	£70mn
Senior Debt:	Commercial bank loans	=	£1,000mn
	EIB	=	£600mn
Bonds:	Index-linked (AMBAC wrapped): BCV	=	£165mn
	Index-linked (AMBAC wrapped): SSL	=	£165mn
	Fixed rate (FSA wrapped): BCV	=	£350mn
	Fixed rate (FSA wrapped): SSL	=	£350mn
	<b>TOTAL</b>	=	<b>£2,980mn</b>

[Source: NAO and *Infrastructure Journal*]

2. From the above it can be deduced that the debt-equity ratio in the funding was 88.3% debt and 11.7% equity, ie “highly geared”.

Many UK PPP's, where the PPP Concessionaire receives payment from Government measured against the "availability" of the PPP assets for the provision of a public service, have similarly high debt/equity ratios. However, the Underground PPP comprises many additional inherent risks, which other PPP's do not embrace, eg the construction risks associated with the need to keep the Underground operational throughout the period.

Clearly, then, this particular PPP was too highly geared at the outset [cf. Eurotunnel!!].

3. In effect, the Metronet BCV and SSL PPP's were financed equally and in parallel, ie to cover estimated capital investment costs for the first 7.5 years of the PPP of approx. £1.5 billion for both PPP's individually. Against this one has to put the claims by Metronet under the Extraordinary Review of around £1 billion additional funding for each of these PPP's, ie cost over-runs of 60-70%, when only 5 years of the first 7.5 years have been completed and much work remains yet to be done!! An unqualified disaster!!

4. There are five possible parties financially impacted by the Administration of the Metronet PPP:

- The Government, representing the Taxpayer;
- LUL/TfL
- The shareholders of Metronet;
- The lenders to Metronet; and
- The suppliers contracted to Metronet.

5. "THE GOVERNMENT, REPRESENTING THE TAXPAYER":

Although the terms and conditions of the Metronet loans/bonds are not in the public domain, it has been widely reported (eg Euromoney, etc) that TfL received a "Letter of Comfort" from Government that, in the event of Termination of either PPP concession, the Government would ensure that lenders/bondholders received back at least 95% of their outstanding debt. Indeed, for some of the bonds, this lifebelt may have been even as high as 98% of the outstanding debt.

Additionally, the Government has all along assumed that the LUL PPP debt was "on balance sheet" and, therefore, part of Government debt (ref. PwC comment Q120, PAC Report on "London Underground PPPs", HC 446 2003-04).

Hence, if the lenders to Metronet called in their debt in this event of Termination, Government/TfL would have to pay up. This might create a cash-flow issue for HM Treasury to an amount of £3 billion, but this is relatively small in the overall scenario of UK Government finance.

What might be the incentive for the lenders to enforce Termination? Possibly, very little, as the margins they currently receive on Metronet debt might be better than they would otherwise get on direct loans to Government for effectively the same security.

Hence, HM Treasury may be irritated and embarrassed by the Metronet Administration—since they promoted and were instrumental in concluding the LUL PPPs in the first place—but little more.

There is, however, some cost to the public purse and, hence, Taxpayers, as the Metronet Underground contractual commitments and responsibilities will have to be transferred back to, and restructured by, TfL, without too much disruption to the travelling public. This will take time and money. Without detailed knowledge of such deals, it is impossible to estimate the cost for this.

Finally, in addition to this cost one needs to add the incremental costs of undertaking the PPP in the first place over a conventional contracting and funding structure. For Metronet BCV and SSL this could be estimated as around £300 million, two-thirds of the £430 million the PPPs cost overall to implement [ref. A. Darling, Trans Ctee 10 Sept 2003, Q35-40]

6. LUL/TfL:

Given that Government underpins LUL PPP debt, LUL/TfL's prime "cost" under this Administration will be for restructuring and re-resourcing Metronet operations, as quickly as possible. The extent and complexity of this problem is unknown. Hopefully, the new basis for undertaking BCV and SSL work will be simpler than the previous PPP structure!

7. METRONET SHAREHOLDERS:

The shareholders invested £350 million of equity in the PPP. Most of them, it is assumed, have written off their investment in the current circumstances of Administration. This gives an actual loss of £250 million (£350 million, less Corporation Tax at 30%).

On the other hand, it is understood that some of the contracts placed by Metronet for Underground construction and rehabilitation were placed with individual shareholder companies. Given that it is quite possible that Metronet BCV and SSL have awarded overall at least £2 billion, if not £3 billion—plus even more if their claims to the PPP Arbitrator are substantiated,—of such contracts, many of them to themselves

at supposedly 20-25% profit margin, it is most likely that overall the shareholders may not have lost any money on the PPP at all (eg 20% of £2 billion is £400 mn.)!! It will be just that they—the shareholders—have made less money on the PPP than they originally hoped! They also might be somewhat ashamed of their role in this debacle!

What will be interesting will be whether the Government/TfL will recognise the components of any loans that might have been used to pay for Metronet subcontracts, including those to shareholders, for work which was not properly approved by TfL as being under the PPP. This could leave lenders somewhat exposed, as Government might not underpin the repayment!! In such circumstances, recourse to Metronet shareholders might have little value, unfortunately, as their exposure to Metronet will, most probably, be limited to their original investment.

#### 8. METRONET LENDERS:

As mentioned earlier, the lenders are largely protected by the “Letter of Comfort” to TfL from Government.

The only uncertainty is, as mentioned above, some contracts funded under these loans may not be recognised by TfL/Government as valid for funding under the PPP, leaving lenders exposed.

It should also be mentioned, however, that under the PPP structure in this case lenders and bondholders had limited incentive to monitor closely Metronet and its contracting practices, not least because lenders received 95–98% of their debt back, paid by Government, in the event of Termination of the PPP. Indeed, it is understood in the City/PPP community that, if lenders had not received such Government support when the PPP funding was being arranged, then they would not have provided the debt in the first place!

It is also said that the lenders received such generous up-front negotiation fees that any potential 2–5% loss on Termination was offset against these fees!

As mentioned before, therefore, the lenders may be just as happy to see their PPP debt stretch out to maturity, as the terms are better than they might otherwise get in the market. Further, the hassle and cost of renegotiating the bond finance could be very expensive and complex (ref. the British Energy restructuring in 2004).

Overall, the lenders may not be too unhappy, but they may be somewhat embarrassed to be a stakeholder in this debacle!!

#### 9. SUPPLIERS CONTRACTED TO METRONET:

Suppliers to Metronet will wish to ensure payment, whether or not their contracts were officially approved or not. Those contracts, however, awarded by Metronet to its shareholders, will indubitably be scrutinised in some detail by TfL, et al., before any payment is effected. In the end, it will be a question of commercial negotiation: part of the cost to TfL of restructuring the PPP.

Details of these contracts are not in the public domain, but a major contract could be for rolling stock with Bombardier of Canada, which could stretch over many years. This could represent the biggest stumbling block to smooth restructuring.

10. Finally, one might question, given the absence of major losers apart from Taxpayers, who else might have gained or lost out?

One group, in particular, have gained! The lawyers and financial advisers who created the PPP edifice on this occasion!! They orchestrated the birth and death of this PPP, and will be needed again for the re-birth too!!

#### CONCLUSION:

In the end, the losses which have been generated by this PPP saga have fallen, as always, at the feet of the Taxpayer. Whilst much of the public focus of blame will be on Metronet and its management of this PPP, Government cannot absolve themselves of responsibility for these losses to the Taxpayer either, as it was, in particular, HM Treasury, who were promoting this PPP against much widespread advice. Such complex PPPs should be avoided, whatever the forecast “value for money” may be!

*August 2007*

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## Memorandum from London TravelWatch (PPP 03)

### 1. INTRODUCTION

London TravelWatch is the official body set up by Parliament to provide a voice for London's travelling public, including the users of all forms of public transport. Our role is to speak up for transport users in discussions with policy-makers and the media; to consult with the transport industry, its regulators and funders on matters affecting users; to investigate complaints users have been unable to resolve with service providers; and to monitor trends in service quality. Our aim is to press in all that we do for a better travel experience all those living, working or visiting London and its region.

### 2. THE INQUIRY

London TravelWatch welcomes the House of Commons Transport Committee's new inquiry, which will build on its previous work in this area to consider whether the PPP is:

- producing real benefits for Underground passengers
- ensuring the maintenance of the highest standards of safety
- providing value-for-money for the taxpayer
- spreading the associated risk fairly between the public and private sectors.

The inquiry will also consider the likely impact of Metronet Rail BCV (Bakerloo, Central and Victoria) and SSL (Sub-surface lines) going into administration.

This submission concentrates on the first three of the inquiry's objectives: benefiting London Underground (LU) passengers, ensuring safety and providing value for money. We also express views on the impact on LU's users of Metronet going into administration. We recognise the apportionment of risk between the public and private sectors to be a delicate issue, but make no judgements on this aspect except in so far as it influences the level, cost and quality of service experienced by users.

### 3. GENERAL PRINCIPLES OF THE PPP

London TravelWatch supports the objective of the PPP to guarantee the flow of investment into the Underground, after many years of inconsistency and fluctuation. We consider it of the utmost importance that the periodic reviews at 7.5 year intervals should not be allowed to become vehicles for under-funded price rises and for the scope of investment plans to be cancelled or reduced in scope. This concern is given added importance by the slippage that has occurred in parts of the investment schedule, and by Metronet going into administration, each of which phenomena increases the opportunity for cuts to be made in previously agreed investment programmes.

We were initially concerned that animosity to the principle of the PPP would adversely affect relationships between LU and the PPP contractors. We are therefore encouraged by the determination of LU's top management to work constructively for the success of the PPP in the interests of Underground users, whatever may have been the political debate over its introduction.

We are, however, concerned that—despite assurances that the infracos (Tube Lines and Metronet) would get on top of the problems, once the period of climbing the “learning curve” had passed—placing contracts for looking after 70% of the LU network with a single organisation was too much. Tube Lines, with only 30% of the business, has shown itself to be more capable of delivering projects on time and to budget, although its slowness to rise to the challenge of improving performance on the Northern line has been disappointing.

### 4. PRODUCING BENEFITS FOR UNDERGROUND PASSENGERS

London TravelWatch is concerned that the PPP is not delivering improvements as quickly as had been expected, or indeed contracted for, in particular by Metronet. Tube Lines' website provides specific information which shows its programme of station investment to be on schedule, although the reliability of the Northern line was initially poor. We are encouraged that LU recognises the importance of pressing the infracos on the delivery of renewal projects, but share its frustration when delays continue. Metronet made several unfulfilled promises to get work back on schedule, before it eventually brought in assistance in the form of external contractors early in 2007.

As the PPP is largely “behind the scenes” project, delivered when trains are not running and stations are closed, we have not experienced a large postbag of casework directly connected to the performance of the infracos. But we can cite two examples from our case load which relate to aspects of the PPP:

- Several appeals which have reached us were concerned with aspects of station upgrading, including the length of time a station has to be closed for renovation to be completed, and with closures of lifts and escalators for reconstruction or refurbishment.

- A further example relates to the rolling stock replacement programme for the Circle, Metropolitan and Hammersmith & City lines, for which a single type of train has been ordered. This is viewed as a retrograde step by long-distance Metropolitan line commuters, for whom the smaller seats (including a higher proportion of inward-facing seating) and greater provision for standing passengers will be inferior both to the present dedicated rolling stock and to trains on equivalent routes on the National Rail network. We anticipate that there may be strong adverse reaction to the new trains when they come into service. We found the attitude of the PPP contractor to be somewhat inflexible, and unduly resistant to considering the option of building two versions of the new trains (for use on different lines) although no additional costs would have been incurred if they had been ordered at the same time.

Delays to journeys caused by weekend line closures and by over-running engineering work are of particular concern to Underground users. Passengers are prepared to accept the inevitability of some disruption to weekend travel where major engineering work is essential to bring lines up to modern standards, but we believe that the boundaries of this tolerance have sometimes been reached. LU must do all it can ensure that alternative parallel routes are not both closed at the same time, whether these are other Underground lines or parts of the National Rail network.

London TravelWatch has consistently been concerned at the failure of PPP contractors to reduce the number of engineering overruns, ie the incidence of work not completed on time with consequential delay in reopening lines or stations to traffic. We do not fully accept the explanation that, for example, discovering a broken rail towards the end of a night's engineering work is "unavoidable". The closure on a Monday morning in July of the northbound Victoria Line platform at Victoria, one of London's busiest platforms, because of excessive dust caused left over from weekend engineering works was a further example of poor work by Metronet which impacted severely on thousands of passengers.

A problem during 2006 was the imposition of speed restrictions in hot weather resulting from Metronet's failure adequately to de-stress rails, which caused slower running and therefore fewer trains and resultant overcrowding on the Piccadilly, District, Metropolitan, Circle and Hammersmith & City lines. And the reopening of Queensway station after its renovation was delayed. LU has reported some concern at the quality and timeliness of Tube Lines' track project work, due to an insufficiency of experienced staff. In each of these cases, better planning of engineering tasks is called for.

We are concerned lest attempts to make up for delays occurring during the first 7.5 year period of the 30-year PPP increase the incidence of line closures later on. The balance between full and partial closures, ie between short bursts of intensive activity necessitating complete closures of sections of line or extended periods of weekend and night-time activity, may need to be re-examined. The balance of advantage, from the users' perspective, is not always clear cut.

## 5. MAINTAINING SYSTEM SAFETY

The members and officers of London TravelWatch are not safety experts. Nevertheless, we have become aware in the course of site visits with each of the infracos of an apparent difference in their safety cultures, with Tube Lines taking a more diligent approach to managing workplace safety than Metronet.

Following the derailment on the Central line in July 2007 which was caused by a badly-stored roll of plastic sheeting becoming dislodged in a tunnel, we expressed our grave concern at what appeared to be a further serious failure by Metronet and/or its sub contractors. This was not the first occasion when that organisation had been warned about the safety implications of apparent poor workmanship.

## 6. ENSURING VALUE-FOR-MONEY IN COMMISSIONING WORK

One of the main reasons for Metronet's failure to deliver station upgrades on time was its tied supply chain, in which work was allocated to members of its consortium of shareholders without open competition. This meant that the programme fell seriously behind schedule, and raised questions about whether the contracts were being let on the best value for money terms.

We are pleased that the Metronet management team eventually persuaded its board to let third party contractors bid for the work. Tube Lines, in contrast, invited outside tenders from the outset, with the result that it had stronger influence and control over performance, and largely avoided slippage. Upgrades are more likely to be delivered on time with a flexible supply chain, so Metronet's change of practice is good news for Underground passengers desperate to see the improvements delivered.

## 7. IMPACT OF METRONET GOING INTO ADMINISTRATION

A likely impact of the financial collapse of Metronet is that there will be a substantial element of cost to be picked up. London TravelWatch considers that the shareholders in Metronet should bear the bulk of any cost overruns, as those shareholders entered into the PPP agreements voluntarily and as the independent PPP Arbiter has ruled that Metronet had not always been acting efficiently or economically. But London TravelWatch believes that the Government should consider funding the extra costs that the Arbiter has

agreed may be owed to Metronet, that were not changes of specification, as it was the Government that required LU to enter into these PPP agreements against the better judgement of the Mayor and Transport for London.

A relevant comparator in preparing for the post-Metronet future is that of the changes wrought by Network Rail to the policies of its predecessor Railtrack. Network Rail has achieved considerable success in reducing its cost base and improving the maintenance of the national rail network by bringing this task back in-house, allowing external contractors to concentrate exclusively on investment in renewals and network development. Such an option might be explored by LU as part of its future strategy, provided that this does not jeopardise the guarantee of future funding needed to secure the delivery of the entire PPP project.

## 8. CONCLUSIONS

London TravelWatch believes that the PPP was always going to be an extremely challenging proposition to deliver. Whatever the rights or wrongs of the way in which it was carried out, it has attempted to tackle the historic problem that has faced London Underground and its passengers—namely the need for long term commitment to fund investment in the system, which had previously been cursed with a stop-start cycle of capital funding governed by the fiscal requirements of the Government of the day. It would seriously detriment the interests of London's transport users if the administration of Metronet was to put in jeopardy the commitment to continuing investment that the PPP has sought to guarantee. But, that said, there are undoubtedly ways in which the performance of the PPP could be improved for the benefit of passengers, and we await the Select Committee's conclusions with interest.

Note: This paper was prepared before the PPP Arbiter's recent publication of further preliminary findings in his Extraordinary Review of Metronet's contract performance.

September 2007

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### Memorandum from Tube Lines (PPP 04)

#### OVERVIEW

Tube Lines' achievements, in the years since the PPP contracts commenced, show clear and demonstrable progress in the improvement of the underground network, reliable and consistent improvement in day to day performance, completion of upgrade projects on time and on budget, clear benefits for passengers and value for money for taxpayers whilst maintaining high standards of safety.

#### 1. About Tube Lines

1.1 Tube Lines is the infrastructure and asset management company responsible for maintaining and upgrading the Jubilee, Northern and Piccadilly lines, under a 30 year partnership with London Underground, which commenced on 31 December 2002.

1.2 Tube Lines is responsible for the following:

<i>Asset</i>	<i>Actual</i>	<i>Percentage of total</i>
Track	320 km	30%
Trains	255	42%
Stations	100	39%
Escalators	227	55%
Lifts	79	73%
OTHER		
Employees	3,500	
Passengers (per weekday)	1,941,000	39%

#### 2. Progress to date and benefits to passengers

2.1 Tube Lines has delivered real benefits to passengers over the last five years.

2.2 Availability, cited by the Committee during its previous inquiry as the most important factor for Tube travellers, has improved significantly over the last five years. Lost customer hours, the main measure of delay, has halved since transfer. On the Piccadilly line, delays have been cut by up to 70% and on the Jubilee line, the figure is 30%. Both are performing ahead of internal targets and ahead of the commitments we made to London Underground (LU). The Northern line remains our most complex set of assets and at transfer, was in a worse state than anticipated. Performance deteriorated over our first year, but we have more than

recovered this, although it still falls short of the target we set ourselves. Through increased investment, we are tackling the problems of the Northern line. 80% of these are currently fleet-related but we are close to signing an amendment to the PFI contract we inherited with Alstom, the fleet maintainer, aimed at improving maintenance and performance.

2.3 The PPP has brought about much greater monitoring and scrutiny of performance than was ever the case before transfer. However, it is clear that current performance levels are better than the period pre-transfer.

2.4 All of our major capital investment projects have been completed on schedule, bringing significant benefits to passengers. Some projects have cost more than anticipated (see 2.6) but overall, we have been able to remain within our planned budget.

2.5 In early 2006, we completed a major project to add an additional car to every Jubilee line train and introduce four new trains. This project, which increased passenger capacity on the line by 17%, was completed, ahead of budget, two days early.

2.6 We have modernised or refurbished all 47 of the stations required to be upgraded to date under our contract and are halfway through our station modernisation programme. Each upgrade brings enhanced security and information for passengers and a cleaner, brighter environment: this is done through the installation of additional CCTV cameras and passenger help points, new indicator boards, upgraded facilities and a comprehensive redecoration. However, this programme has been significantly more complex and costly than anticipated at transfer, principally resulting from the interpretation of scope. We had to manage the balance between the ambitions of London Underground and the specification we had committed to deliver (see 5.4).

2.7 We have refurbished 52 escalators to date. We have also replaced or refurbished over 90 km of track (out of 320 km), which allows passengers to experience a smoother ride, helped to reduce incidents of track failure by 44% and also reduced noise from the railway for residents living in the vicinity of the track. A programme of 10 km of track replacement and refurbishment carried out intensively over 40 weekends on the Northern line has resulted in a large body of work completed 2-3 years early. This programme has also resulted in a reduction in track and signal failures on the Northern line by approximately 15%.

2.8 We have taken a number of initiatives to improve the travelling environment for passengers on the trains. We never knowingly put a train into service with graffiti on and we have made significant improvements to the cleaning regimes. Our ambience scores, the contractual figures used for measuring the quality of the travelling environment, have risen significantly since transfer and are ahead of internal targets and the LU benchmark.

2.9 We completed an upgrade to Wembley Park in 2006, to expand the station in order to accommodate the demands of the new stadium. The upgrade was completed on time for the scheduled opening of the stadium in spring 2006, although the stadium itself opened a year late. Other achievements have been signalling work to support the Piccadilly line extension to Heathrow Terminal 5 and the installation of lifts at a number of stations to provide step free access. This additional work is currently valued at approximately £300 million.

2.10 More significant improvements for passengers will come with the line upgrades, which will deliver further improvements to reliability, increased capacity and a reduction in journey times. Upgrades to all three lines are running on schedule; the Jubilee line will be completed in 2009, the Northern in 2011 and the Piccadilly in 2014. A new fleet of trains will also be introduced on the Piccadilly line in 2014.

2.11 The Committee's previous inquiry expressed a concern that some work might have to be delayed until the second review period. Tube Lines' progress to date means that there will be no such delays.

### 3. *Innovation and change*

3.1 A key factor behind Tube Lines' success is the importance attached within the company to innovation, change and new ways of working.

3.2 We have made significant investment in training and development. £10 million has been invested in a state-of-the-art training centre in Stratford to allow all of our training programmes to be provided under one roof. We have introduced a suite of leadership development programmes and other competency schemes for employees at all levels throughout the business. We have also enlarged the size of our graduate and apprentice schemes. All of this is underpinned by informal coaching and mentoring opportunities for employees. The aim of these initiatives is partly to ensure that we have the skills and competencies required in the business and can ensure that we are not adversely affected by skills shortages in the industry. Just as importantly, these initiatives are designed to provide motivation and encouragement to employees to come up with ideas themselves for innovations and changes. A number of the initiatives later in this section have been developed by employees on the frontline.

3.3 We have also been innovative in our employment relations policies. We concluded the first ever two year pay deal on the Underground in 2004—previously there had only been one year deals—and reached a further two year deal in 2006. We have launched a profit share scheme from which all employees benefit and we have also put in place various schemes to recognise individual contributions made by employees.

3.4 We have been able to monitor the positive effect which these changes have had on our employees through our biennial survey. The last one, carried out in 2005, showed increases in employee motivation of 13% and employee satisfaction of 19%, to levels above the UK norm. These levels of improvement in satisfaction and motivation are almost unprecedented within UK industry. The next survey is taking place in autumn 2007.

3.5 By employing new methods of planning, innovative shift patterns and improved welfare facilities for site operatives, we have been able to reduce the time taken to reduce escalator refurbishments from 26 weeks to as little as eight weeks. This has a clear passenger benefit in that escalators are out of passenger service for less time.

3.6 By applying best industry practice we have been able to make the process of station modernisations more efficient. Where before and at transfer, each upgrade could take over two years, we are now able to complete this type of work in as little as four months. This also has passenger benefits in that the amount of time they have to travel through a half-refurbished station is now reduced. In addition, we are now able to work on 15 stations at a time, whereas before, only two or three could be worked on at any one time. We have also reduced the cost of each upgrade by 40% since we began our programme. This improvement was critical as we needed to bring rigorous cost control to the work on stations where this had been lacking in the past.

3.7 We have invested in a number of processes and equipment to make maintenance more efficient. We have, for example, introduced a new “Tubevac” machine, which is like a giant vacuum cleaning machine and is used to replace compacted ballast which causes trains to bump, increasing rail and wheel wear. The machine enables us to increase productivity by 300%. In the past, the same work was done by people shovelling ballast by hand; teams of 12 typically completed a third of the work which the machine can achieve each night. Another device which is being rolled out across the network is allowing our teams to get on site almost immediately after the current is turned off rather than having to wait for valuable minutes for clearance to access the track as in the past. This will mean that more work can be completed each night, during engineering hours. We believe this has the potential of saving tens of millions of pounds per annum.

3.8 We have also taken a number of steps to put more emphasis on preventative maintenance rather than simply waiting for infrastructure to fail, as happened in the past. We have introduced a new “smart step” which can be used to gauge, in advance, when an escalator is in danger of breaking down. We have also introduced a new computerised enterprise system to record the history and geography of our assets, to make it easier to anticipate when a repair will be needed.

#### 4. *Safety*

4.1 Safety is at the heart of Tube Lines’ business and in everything we do, we seek to ensure the highest standards of safety for the travelling public. We operate under London Underground’s safety case, which has been accepted by the Health and Safety Executive, and it is our policy to comply with not just the letter, but the spirit of all health and safety and railway legislation and codes of practice. All safety training is approved by London Underground and is consistent with the training provided to all others who work on the underground, regardless of their employer.

4.2 Since transfer, we have improved our regime to detect potential incidents. This means that potential issues are identified at a much earlier stage and that there is a much better preventative safety mechanism in place than ever before. The lost time injury rate has fallen by 80% over the last four years.<sup>10</sup>

4.3 Tube Lines is committed to the safety and welfare of our own employees and contractors. We believe that all accidents are preventable and are committed to continuous improvement and learning from past events to identify and mitigate potential risks. We are a member of CIRAS, which operates the industry’s nationwide confidential helpline on safety issues, and any employee who has any safety concerns about his or her work is encouraged to ring the helpline.

4.4 We have introduced a number of initiatives to enhance safety. We operate a “beacon site scheme” where individual work sites can gain accreditation for operating the highest standards of health and safety and act as a beacon of good practice for other sites to follow. The idea is to incentivise individual site teams to aim for excellence and set the standards for others to follow. We have also devised a new track gauge which is able to detect track wear and tear much more effectively and comprehensively than in the past.

4.5 We are very proud of our safety record to date and are confident that we can and will continue to improve even further.

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<sup>10</sup> The lost time injury rate is one of the standard measures used to measure our safety performance. It is a normalised rate based upon the number of employees absent from work for more than three days.

## 5. *Risk transfer*

5.1 Tube Lines believes that risk has effectively been transferred to the private sector under the PPP.

5.2 Our performance regime incentivises good performance and penalises poor performance. On availability, cited by the Committee during its previous inquiry as the most important factor for Tube travellers, the abatements for poor performance are greater than the bonuses received for good performance. In addition, the financial penalties for late completion of station and line upgrades are significant.

5.3 The contract is structured so that we suffer the financial consequences for all asset problems, not just those caused by our own maintenance, but those resulting from inherited problems and other factors. For example, we incurred a financial impact of £7 million in relation to the Camden Town derailment in late 2003, even though the cause was a historic design failure and Tube Lines was completely exonerated; we invested £20 million on a refurbishment of part of the Piccadilly line fleet, to make good years of make-do-and-mend prior to transfer; and we have spent an extra £20 million on the Northern line to rectify inherited conditions.

5.4 This is a fixed price contract. We bid for the work on the basis of what we believed the cost of the maintenance and upgrade programme would be. Where we have found projects to be more complex than expected, we have had to take on the additional cost ourselves. For example, at Arsenal station, we had, unexpectedly, to replace the existing roof with a new one. This was done at Tube Lines' own cost; that is to say, the risk lay with the private sector. We have only received supplementary funds from London Underground a) when we have been instructed to carry out additional work, such as the expansion of Wembley Park, referred to above; and b) when LU have widened the scope of projects or changed the standards by which we are expected to perform and deliver our programme of work. There have been occasions on which we and LU have disagreed over the cost of scope extension, but the PPP dispute process has worked effectively on these occasions to resolve these issues.

5.5 Most of our contract is output-based. This means that we have a set of broad, passenger-facing targets, which are principally around reducing journey times and improving the condition of the infrastructure and it is down to us to design the programme appropriate to delivering this. This means that the risk is transferred to us for the whole lifespan of the assets. The exception to this is the stations programme, where the nature of the upgrade was much more closely defined in the contract by LU and consequently is largely input specified.

5.6 In recent years, there has been an increasing tendency to offer work to alternative providers through conventional contracts. The disadvantage to the taxpayer of this approach, particularly if it results in the descopeing of work from the PPP contract, is that the risk is transferred away from us and back into the public sector.

## 6. *Value for money*

6.1 Tube Lines believes that the PPP model for upgrading the Underground does constitute value for money.

6.2 Without the PPP, the current, unprecedented levels of investment would not be sustainable. Investment levels are running at about 3–4 times that seen at the time of transfer. Prior to that, there had been decades of under-investment.

6.3 The PPP is enabling upgrades which had been put off for years to be completed. The addition of the extra car to the Jubilee line fleet, completed in late 2005, and the current Jubilee line signal upgrade are being carried out now only because they had to be descopeed from the original extension project in the late 1990s. The problem was that annualised budgets meant that upgrade programmes were cut back when funding streams ran out and what upgrades were completed were usually over budget and heavily descopeed.

6.4 Underpinning the PPP is an approach known as whole life asset management. This means that we design, build, maintain and manage the entire infrastructure—we are responsible for everything that happens to our assets, throughout the entirety of their lifespan. This, combined with the security of long term funding, means that:

- we can take a long term and holistic approach to planning and strike the right balance in terms of funding and personnel towards maintenance and upgrade activities; and
- our projects can be delivered much quicker as we can go through the scoping, design and construction phase without having to lose time to secure new money or tender for new suppliers as might have happened in the past.

The relationship between projects and maintenance, and achieving the right whole life balance between them, is at the heart of this approach.

6.5 The output-based components of our contract are able to be delivered much more efficiently than the input-based components, where our programme is subject to significant outside intervention. Should there be a move towards a more input-based structure, the capital investment programme would become more

complex to deliver, and there would be more unhelpful intervention, leading to additional costs. The fact that the risk would be transferred back to the public sector means that these additional costs would have to be met by the taxpayer.

6.6 The PPP has led to the recruitment of world class project management and engineering expertise, with strong track records of delivering programmes on schedule and to budget.

6.7 The innovations detailed above can be linked both to the influx of talent and to the long term and output-based nature of our contract: we had to make changes to create a viable, efficient business, fit to look after the infrastructure for 30 years. A conventional contractor would not have had to do this. These innovations have in turn generated cost savings which could be shared with the public purse through the periodic review process in 2010. Should part of the work undertaken under the PPP be returned in-house, there would be a risk of a return to the resistance to change and entrenched attitudes which militated against innovation before transfer.

6.8 Tube Lines' business model is based on a competitive supply chain. All sub-contracted work goes out to the best value provider, offering the best quality. This ensures efficient, value for money work.

6.9 At the heart of Tube Lines' business model has been a drive to reduce dependency on consultants and sub-contractors throughout the business. Prior to transfer, numerous consultants were engaged to undertake specialist roles, at significant cost to the taxpayer. Tube Lines embarked on a process of in-sourcing these roles. A further drive has been to cut out principal contractors on station and track upgrade work and to engage sub-contractors directly. This model is similar to Network Rail's drive to bring work in-house. It also provides significant value for money benefits.

## 7. Summary and conclusions

7.1 Tube Lines has achieved significant progress to date.

7.2 This has been underpinned by significant business and technical innovations.

7.4 Tube Lines is proud of its improving safety record.

7.5 Tube Lines believes that the PPP does offer value for money to the taxpayer and effective risk transfer to the private sector.

7.6 We would be delighted to give oral evidence to the Committee or organise a visit for Members to see at first hand the work undertaken by Tube Lines.

*October 2007*

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## Supplementary memorandum from Tube Lines (PPP 04a)

### 1. INTRODUCTION

1.1 This memorandum is designed to supplement the oral evidence given on 7 November and to provide some further information on safety and communications within Tube Lines, in response to some of the concerns raised by the witnesses from the trade unions.

### 2. SAFETY IS A TOP PRIORITY

2.1 Safety is our highest priority at Tube Lines and we are totally committed to guaranteeing the safety of both passengers and our employees. Safety is at the heart of all of the work which we do on the railway, we have a dedicated health and safety sub-committee of the Board chaired by the Chief Executive, and safety is also the first item discussed at every Board meeting and every Executive team meeting.

2.2 The network has become safer in recent years. For example, the number of broken rails has been cut by 90% in the last three years and the number of technical SPADs (signals passed at danger resulting from faults with the signalling equipment) has halved over the same period. The number of open/unresolved regulatory notices issued by London Underground around safety concerns has gone down from over 290 at the time of transfer to just four at present.

2.3 The railway has become a safer place for our people to work. They are four times less likely to suffer an injury in the workplace than they were at the time of transfer.<sup>11</sup>

2.4 Furthermore, our employees feel that safety is taken seriously. In our 2005 employee survey, 92% said they felt safe in their jobs and 86% felt that health and safety is a top priority within the company.

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<sup>11</sup> Figures based on lost time injury rate recorded by Tube Lines.

### 3. A UNITED APPROACH BETWEEN LONDON UNDERGROUND AND TUBE LINES

3.1 There is a united approach to safety across the network. There is no fragmentation.

3.2 We, like all organisations working on the Underground, operate under LU's Safety Certificate and Authorisation (commonly known as the safety case), which is approved by the Health and Safety Executive. Our main safety standards are either set by London Underground (LU) or approved by them. The safety training provided to our employees is identical to that provided to LU employees.

3.3 Contrary to a suggestion made at the oral evidence session, representatives from Tube Lines do attend LU's principal monthly Health and Safety Executive Committee. There is a monthly safety standards partnership meeting involving ourselves, LU (and also Metronet), a six monthly meeting involving all parties and the HMRI and a three monthly joint forum with the unions.

3.4 Details of all significant incidents and lessons learnt are shared between LU and the infracos. In addition, all parties can track the progress of investigation reports into safety incidents.

### 4. A UNITED APPROACH BETWEEN TUBE LINES AND OUR SUB-CONTRACTORS

4.1 The same safety regime operates for everyone working on a Tube Lines site, whether they are an employee or a contractor. All contractors undertake the same safety training as our employees. A Tube Lines Health and Safety Manual is provided to all contractors as well as employees, setting out the safety standards which operate on Tube Lines sites. All contractors and employees receive a site briefing every night, prior to starting work, and major upgrade sites run a brief induction programme for operatives working on the project, before the programme begins. These briefings are identical for employees and contractors.

4.2 Tube Lines monitors the safety performance of its contractors rigorously. A senior employee is allocated to scrutinise each contractor, to ensure that safety standards are maintained and lessons learnt are shared. The performance of major contractors is regularly audited and there is also a league table of contractors to encourage competition and drive up standards. Any under-performers are required to undertake a stringent programme of corrective action. We also have a team of health and safety advisers who make unannounced visits to work sites to ensure that safety standards are maintained and contractors feel safe on the job.

### 5. THE SAFETY CONCERNS OF OUR EMPLOYEES ARE TAKEN SERIOUSLY

5.1 Any employee who feels unsafe in doing their job or a particular task has a legitimate right to refuse to undertake that particular task and for this decision to be respected by their manager.

5.2 Employees can raise concerns about safety in a number of formal and informal ways, including the following:

- through their manager;
- by logging a call with our 24/7 fault reporting centre;
- by placing a call with CIRAS, the rail industry's independent confidential reporting hotline;
- through their industrial relations channels;
- through their monthly team briefings; or
- to the chief executive, through the employee magazine or the monthly breakfast session which is open to all employees.

Indeed we encourage employees to raise any safety concerns which they have so that we can do more to prevent incidents rather than simply respond to them.

5.3 When employees raise concerns, they are dealt with in various ways. Some incidents are dealt with locally, by the line manager. All calls referred to the fault report centre are formally documented with actions drawn up to prevent similar safety incidents taking place in the future. The number of incidents each week is reported to the Executive team meetings and the most serious discussed in some detail at those sessions. If incidents are reported to CIRAS, the relevant team within Tube Lines puts together a response plan together with CIRAS, and this is then reported back to the employee who raised the concern, whose confidentiality is respected throughout the process.

5.4 In addition, the Health, Safety and Environment Committee, which is a sub-committee of the Board, meets monthly to review all major safety issues which have occurred over the previous month and take a strategic overview of lessons which need to be learnt.

5.5 Employees' safety concerns are taken very seriously and are dealt with rapidly: calls reported to our fault report centre are addressed within minutes or hours and the safety issues considered at the weekly Executive meeting are all those which have occurred in the previous seven days.

5.6 Employees are informed of the various ways in which they can report safety concerns at their induction and then at their basic safety training course, which they complete when they join and are required to repeat every two years. In addition, we run a more advanced safety training course for frontline employees which is accredited to NVQ Level 1. 80% of eligible employees have taken and passed this and the remainder will complete the course by the end of 2007.

## 6. INTERNAL COMMUNICATIONS

6.1 There was a suggestion in the oral evidence session that communication around the company is poor and that employees are uncertain on how safety issues are addressed. This is emphatically not the case.

6.2 As noted above, regular safety training keeps employees informed on how they can report safety concerns. Our regular employee communications outlets keep people informed on the way in which safety is managed, any new initiatives and changes to the way in which safety is addressed. These include a weekly newsletter, a monthly magazine, a monthly team briefing centred around a monthly performance report which has details of safety performance and any key incidents, an intranet and other ad hoc communications.

6.3 In addition, there are regular safety campaigns focused around topical issues (such as avoiding injuries caused by winter weather) which serve to reinforce safety messages and remind employees on how to raise concerns.

6.4 Our survey suggests that employees are satisfied with the communications they receive about what is happening within the company. In 2005, 72% said they were satisfied with communications—a rise of almost 30% from the 2003 survey. 80% of employees said they read the various communications which are issued. In addition, we have received a number of awards for excellence in internal communications.

## 7. COMMUNICATIONS WITH THE UNIONS

7.1 The forums which we have for communicating directly with our employees are complemented by those which we have with the unions. We place great store by having a constructive working relationship with the unions at all levels and we are keen to give them every opportunity to raise any concerns they have with safety and deal with them appropriately.

7.2 In addition to the three monthly forum with the unions involving LU and Metronet, Tube Lines has its own Health and Safety Forum with the unions, chaired by the Director of Health, Safety and the Environment, at which lessons learnt from incidents around the business are discussed. There are other health and safety forums at local level. All of this is in addition to all of the other more general lines of communications between the business and the unions, which include:

- a six monthly review between the chief executive and all of the union general secretaries to discuss key business issues;
- quarterly company council meetings involving local representatives, national officers and Tube Lines managers;
- local forums in various areas of the business; and
- informal contacts at various levels of the business.

7.3 We seek to involve the union representatives as much as possible in what we do. They participate in investigation reports, following safety incidents. We also seek to engage them in new initiatives and in the development of projects, to get their buy-in and ensure any concerns they have are dealt with at an early stage. Finally, we give our representatives release from normal duties to carry out union activities.

## 8. CONCLUSION

8.1 In all that we do, we are committed to continuous improvement, but we do believe that we have made huge strides in safety since transfer and that we have successfully engaged employees in the progress we have made.

*October 2007*

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## Memorandum from ASLEF (PPP 05)

### ABOUT ASLEF

ASLEF is Britain's trade union for train drivers. Its 18,500+ members are employed in the Train Operating Companies, the Freight Companies, London Underground and some Light Rapid Transport.

The union's day to day direction is overseen by its Executive Committee. Each of its 8 regions has a District Organiser and Committee, while the main negotiations with employers are undertaken by Company Council Representatives.

### SUMMARY

ASLEF believes that the PPP is and will be a failure. Both companies at the forefront of the PPP, Tube Lines and Metronet, have failed to deliver on their promises, as many predicted. The public, London Underground (LUL) and the Government have, and will, bear the consequences of an initiative widely condemned from its outset. ASLEF thus remains of the view that the LUL should be run as a not for profit service.

Although there have been some minor achievements, since the transfer to the PPP, these have been undermined by substantial unacceptable failures. Furthermore, it is viable to propose that these minor successes could also have been achieved by a publicly run LUL.

The recent collapse of Metronet illustrates all that can, and in this case has, gone wrong with the PPP. However, Metronet has not just failed in the business sense—ie it has gone bankrupt. Both Metronet and Tube Lines have failed to improve LUL in a variety of ways to an unprecedented scale.

The financial cost of the PPP to the public has been vast and the Government is now locked into a 30 year legal agreement which involves funding LUL at an average of £1 billion a year till 2009. Furthermore, despite Metronet and Tube Lines' failures, in the last few years they have raked in huge profits.

In terms of the LUL's performance since the PPP, it is widely acknowledged to have not matched up to the vast sums of money which have been invested in the network and has in fact been worse than what was promised.

The fragmentation caused by the PPP has led to a lack of accountability and responsibility. This has in turn caused disruption for passengers and confusion for drivers and their unions, as they are often not sure who they are supposed to address their issues to.

With regards to the maintenance and refurbishment of stations, aside from some minor success, the work which Metronet and Tube Lines (in particular their work on the Northern Line) have been responsible for is unacceptable. Furthermore, the majority has been over budget and has taken far longer than promised.

The results on safety since the implementation of the PPP are likewise unsatisfactory. Although safety is not significantly worse than before the PPP, incidents such as derailments have increased.

The recent collapse of Metronet is merely the pinnacle of an initiative which has failed on all fronts and one which is likely to have wider consequences to the public and possibly workers, through loss of guaranteed jobs, conditions and pensions. ASLEF thus concludes that the Government must push through the necessary legislation as soon as possible to put an end to the PPP.

### BACKGROUND

On 7 February 2002 the Secretary of State for Transport announced approval of a decision by the board of London Regional Transport to enter into three Public Private Partnerships (PPPs) for the infrastructure of the London Underground.

As a result, in July 2003 London Underground Limited (LUL) was transferred to Transport for London (TfL) which was set up in July 2000 and reports to the London Mayor. Two companies, Metronet and Tube Lines acquired three separate infrastructure companies (Infracos), previously wholly owned subsidiaries of LUL, covering all 12 London Underground lines, as follows:

- BCV Infraco—Bakerloo, Central, Victoria and Waterloo & City lines (run by Metronet);
- JNP Infraco—Jubilee, Northern and Piccadilly lines (run by Tube Lines); and
- SSL Infraco—District, Circle, Metropolitan, Hammersmith & City and East London lines (run by Metronet).

Although Tube Lines are still functioning, Metronet, who were responsible for two thirds of the underground, went into administration in July 2007. Since this is a recent development it is not yet known what the cost of this might be for the public.

Between 2000 and 2003 the LUL trade unions—RMT, TSSA and ASLEF—organised a large scale campaign against the PPP. The unions' lack of faith in the PPP was shared by transport users, transport specialists, Transport for London (TfL), the London Mayor, the National Audit Office and private

consultancy firms, who all expressed substantial concerns regarding the financial viability of the PPP and/or that it would ultimately not work. Nevertheless, the Government chose to ignore these observations and it has since been proved wrong to a high degree.

As early as February 2002 the House of Commons Transport, Local Government and the Regions Select Committee report warned that “it is inevitable that the PPP will lead to significant and expensive disputes over the contracts and between staff and employers . . . The initial forecasts that the PPP would provide a saving of £4.5 billion over public sector management were inadequate and flawed.”

A month later, the Committee in its report, “London Underground—The Public Private Partnership: Follow Up” concluded that “evidence we have taken to date shows that the basis on which the decision has been taken is flawed. The shifting sands of the rationale for and the assessment of, the PPP have led to a process that has lost all credibility in the eyes of the public and professionals in the field. Parliament must now have the opportunity to have an unfettered debate on the decision to proceed with the PPP.”

The lack of financial viability of the PPP was also outlined by the National Audit Office, who stated that that the Government “had not established the value for money of the PPP”.

In February 2002 the Mayor of London correctly predicted that “The PPP will saddle the travelling public and council-tax-payers of London with huge and unquantified liabilities while replicating the key mistakes of rail privatisation on the Underground”.

Notably, distinguished private consultancy firm Deloitte and Touche also expressed a lack of faith in the financial viability of the project and stated that “neither the 30 year nor the seven-and-a-half year [value for money test] provides a satisfactory basis for establishing value for money”. They also said that “highly material adjustments to the [Public Sector Comparator] are judgmental, volatile or statistically simplistic”.

### 1. *Financial Issues*

The PPP has had disastrous financial implications for all parties involved, without even taking into account the recent collapse of Metronet.

The Government has spent a fortune subsidising the PPP and has locked itself into an initiative which does not cap its contributions. On the other hand, the companies involved have limits on the amounts they will contribute and although the underground’s performance remains poor they have raked in huge profits.

The House of Commons Transport Committee’s first report on the PPP found that “disregarding the costs of the Jubilee Line extension, central Government expenditure in constant terms has increased from £44.1m in 1997–98 to £1,048 million in the current financial year (2004–05); an increase of 2,276%—over twenty fold”.<sup>12</sup> This is a shocking figure and, without even considering the potential costs to the Government that the collapse of Metronet might lead to, illustrates the extent to which the PPP is not a financially viable initiative.

Nevertheless, Metronet and Tube Lines have made vast profits along the way. Between 2003–04 and 2005–06 Metronet BCV, Metronet SSL and Tube Lines made pre-tax profits of £286 million and by July 2006 had been paid £3.3 billion in performance-adjusted Infrastructure Service Charge.

Aside from the possible costs involved with the collapse of Metronet, there is also the fact that despite the determined opposition of London’s elected Mayor and Assembly, the PPP contracts have locked the Government into a 30-year legal agreement which involves funding LUL at an average of more than £1 billion a year up till 2009–10.<sup>13</sup> On the other hand, there is no significant binding agreements in place for the companies involved with in the PPP and in fact, “members of the consortia can sell their share in the Underground relatively freely” whilst “the taxpayer is committed to continued funding of the PPP whatever changes in ownership occur”.<sup>14</sup> Put simply, the Government has effectively signed a blank cheque to the companies involved in the PPP which will last for 30 years

Whilst it has been claimed that since the implementation of the PPP the performance of LUL has improved, this “could hardly be otherwise” given the sums involved, as a 2005 TfL report explained.<sup>12</sup>

### 2. *Performance*

In relation to the performance of the LU since the PPP, as explained in the previous section, it clearly does not equate to the levels of investment on the LU. Furthermore it is likely that any minor improvement in the performance of the LU could have been carried out by a publicly run initiative and almost certainly at a vastly lower cost.

<sup>12</sup> House of Commons Transport Select Committee report on the Performance of London Underground (March 2005).

<sup>13</sup> London Assembly Transport Committee—A Tale of Two Infracos, The Transport Committee’s Review of the PPP, (2007).

<sup>14</sup> London Underground and the PPP: the third year 2005–06 (TfL Report).

The overall poor performance of LU has been acknowledged by an array of bodies and institutions, including the House of Commons Committee on Transport, who in 2005 reported:

“All the Infracos needed to do to meet their availability benchmarks was to perform only a little worse than in the past. On most lines, they did not even manage that.”<sup>15</sup>

The 2005 TfL report describes how, “in short, performance is not good enough and is less than what was promised”. The report goes on to say, “the Infracos and their shareholders are earning significant sums through the PPP, but the volume of real work on the railway is not consistent with the payments being made”.

### 3. *Poor Communication*

PPP has resulted in, what TfL describe as, “a plethora of different arrangements with private partners all responsible for different bits of the infrastructure”.<sup>16</sup> This has led to poor communication between Infracos and their employees. Indeed, ASLEF LUL organisers have repeatedly complained that since the PPP there have been a number of personnel changes in LUL Human Resources Management that have disrupted the continuity of working relationships between ASLEF and LUL and often drivers “don’t know who they should be addressing union issues to”. ASLEF LUL activists have also described how since the implementation of the Company Plan in 1992, LUL has gone full circle and returned to a line based management structure. This has led to disputes at local level, for example, at Arnos Grove depot, Acton Town depot, North Greenwich depot and line based disputes, for example on the District Line and East London Line.

Put simply, the PPP has meant that it is much more difficult to sort out problems faced by our members. As all the infrastructure is controlled by the PPP firms, getting even the smallest thing done, like getting a mess room painted, takes an unacceptable amount of time and effort.

One of the worst examples was the defective tripcocks on the Northern Line two years ago. The infrastructure is controlled by Tube Lines, the trains are owned by Alstom and no one would take responsibility for sorting out the problem until ASLEF members refused to drive on safety grounds.

At the very least, the infraco management and LUL need to ensure that all employees know that no matter who is employing them, the same standards of training are required for the same tasks. There must also be consistency in their personnel and line managers.

The array of companies involved in the PPP has also led to their being a lack of communication and accountability. As the London Assembly Transport committee commented in their 2007 report, “the management of the preferred supplier contracting arrangements employed by Metronet has failed to impose this discipline”. A clear line of responsibility and accountability needs to be established between the work being done on the ground and those charged with overseeing this work.<sup>17</sup>

### 4. *Maintenance and Upgrades*

Despite some minor achievements, on the whole, the maintenance and upgrading of the underground is widely recognised to be extremely disappointing and in the vast majority of cases it has been both over budget and behind schedule. As the most recent LU report on PPP states:

“After three years we are now 10% of the way through these PPP contracts, but basic day-to-day maintenance of the trains, tracks and signalling systems is still not good enough and must improve.”<sup>18</sup>

In addition, following the signing of the deals, work to improve the Tube started in 2003, two years later than planned.<sup>19</sup> Station maintenance and upgrades has been so poor that both Tube Lines and Metronet have been issued Corrective Action Notices (CAN) for their repeated failures to deliver their station renewal programmes.

#### a. *Tube Lines*

Although Tube Lines have achieved some successes on their station refurbishment programmes, such as their work on the Piccadilly Line around Heathrow which was completed in time and within budget, these have been exceptions to the rule.

Tube Lines have failed in their main task, to sort out the Northern Line and bring it up to an acceptable standard. As LUL put it, “Tube Lines have failed to maintain the Northern line to the standards we and the PPP contracts demand”.<sup>20</sup> In fact, even by the third year the Northern Line “remained significantly

<sup>15</sup> House of Commons Transport Select Committee report on the Performance of London Underground (March 2005).

<sup>16</sup> London Underground and the PPP: the third year 2005/06 (TfL Report).

<sup>17</sup> London Assembly Transport Committee—A Tale of Two Infracos, The Transport Committee’s Review of the PPP, (2007).

<sup>18</sup> Press Release: London Underground publishes third Annual PPP Report (24 July 2006).

<sup>19</sup> London Underground : Are the Public Private Partnerships likely to work successfully?, 2003–04 (National Audit Office).

<sup>20</sup> Press Release: London Underground publishes third Annual PPP Report (24 July 2006).

worse than benchmark”.<sup>21</sup> Performance of the Northern Line was such that in December LUL issued Tube Lines with a CAN, “which requires Tube Lines to restore Northern line performance to at least the contract benchmark in the fourth year”.<sup>22</sup>

#### b. Metronet

Metronet’s refurbishment and upgrading performance is also widely acknowledged to have been unacceptable—far worse than Tube Lines’.

Before Metronet’s collapse, its station renewal programme was way behind schedule, with only 14 out of a scheduled 35 delivered, all of which were late.<sup>23</sup> Furthermore, Metronet failed to properly prepare sections of the District and Metropolitan line track ahead of warmer summer temperatures, which resulted in a series of disruptive speed restrictions. There were also disruptive incidents on the Victoria and Central Lines.

The same TfL report goes on to say that the upgrade of the Waterloo and City Line “is an acid-test of Metronet’s capability to manage major projects”. The Waterloo and City Line re-opened over a week late on 11 September 2006, which led to fines. In addition, the line has since been closed twice due to dust, caused by engineering works, which caused visibility problems for drivers.

Metronet’s performance was a failure to the point that TfL effectively stated that there was no point in Metronet carrying out anymore upgrades. TfL stated:

“Unless existing assets are maintained to a higher standard that yields a more stable operating environment, the coming line upgrades will be hopelessly disruptive . . . . If the existing network is failing at the same time as we are installing the new system and addressing the inevitable design deficiencies, we shall face even worse levels of disruption.”<sup>24</sup>

#### 5. Safety

Since the transfer to the PPP safety on the LUL has got worse and there have been a number of serious derailments (Chancery Lane, 25 January 2003—Hammersmith, 17 October 2003—Camden Town, 19 October 2003—White City, 11 May 2004).<sup>25</sup> Furthermore, derailments in recent years have increased from 4, in 2002–03, to 9, in 2004–05.

ASLEF believes this is at least in part due to the infracos, whose priority is not safety but profits and have thus in all likelihood put pressure on LUL managers to adhere to this notion.

Indeed, the Chancery Lane derailment, for instance was, according to the London Assembly, an “accident waiting to happen” and raised serious concerns about the management of LUL and the lack of full-time maintenance staff and the limited availability of qualified experts able to respond

More specifically the London Assembly’s inquiry into the incident criticised LUL for failing to tackle a problem relating to faulty bracket bolts and accuses officials of taking action “more in line with maintaining a service than solving the underlying problem”.<sup>26</sup>

John Biggs, Chairman of the committee’s Chancery Lane hearings, said:

“The Chancery Lane incident has raised very real concerns about the safe management of the system, about Tube management structures and about the corporate response of LUL to the incident.”

#### 6. Metronet—Who Will Pay?

Aside from Metronet’s collapse illustrating the detrimental financial and logistical costs of what happens when the PPP goes wrong, it also exemplifies the personal loss associated. Indeed, the bankrupt company’s administrators have failed to provide guarantees that there will be no job losses, pension cuts or forced transfers.

#### CONCLUSION

It is clear that the PPP and the and the resulting fragmentation of the Tube’s maintenance has in many instances resulted in a deterioration in services, value for money for passengers and possibly workers’ pay and conditions. ASLEF thus believes that necessary improvement on the LUL will only be achieved by dissolving the PPP.

<sup>21</sup> London Underground and the PPP: the third year 2005–06 (TfL Report).

<sup>22</sup> Press Release: London Underground publishes third Annual PPP Report (24 July 2006).

<sup>23</sup> Press Release: London Underground publishes third Annual PPP Report (24 July 2006).

<sup>24</sup> London Underground and the PPP: the third year 2005–06 (TfL Report).

<sup>25</sup> London Underground and the PPP: the third year 2005–06 (TfL Report).

<sup>26</sup> An accident waiting to happen?, A Transport Committee investigation into the Chancery Lane derailment (2003).

Gordon Brown insisted that the PPP was the way forward for LUL despite the opposition of Mayor Ken Livingstone, amongst many others. ASLEF believes that private capital is driven by entirely different concerns than public investment. One is about making money; the other is about providing service. PPP is a failure to reconcile two opposites. It is time it was ended on LUL

#### THE ONLY SOLUTION—A PUBLIC UTILITY THAT IS PUBLICLY OWNED

European metros prove that well-funded publicly owned networks deliver world class public transport. ASLEF believes that London needs the following:

##### *An integrated, publicly owned, publicly accountable underground*

Keeping LU as a vertically integrated network is essential—the experience of rail privatisation proves this. The tube, like any other metro, cannot make a commercial profit, so its economic nature means it is best served by remaining wholly in the public sector. The social, economic and environmental benefits provided by the network are best delivered through the elected London Authority, where responsibility and accountability are best placed. The Mayor and the GLA should decide on how the Tube should be funded—whether the PPP or another method based on the best value and the best structure for safety and efficiency

##### *Cheaper more flexible finance*

TfL should be given powers to issue bonds over seven year investment periods. This would allow the Mayor and the GLA the flexibility in the short-term to access direct funding to address the investment backlog and specific maintenance and renewals, in the medium term to relieve congestion through the construction of new lines and over the longer term to reintroduce passenger subsidies

##### *It can be done*

In June 1998 Treasury rules were updated so that public borrowing would not automatically be included in the Public Sector Borrowing Requirement (PSBR), providing that the borrowing is for investment and not current expenditure

There is no obstacle and many good reasons why the existing public subsidy cannot instead be used to back a cheaper bond option. The bond option could be further enhanced by a combination of fare revenues and congestion charges.

*September 2007*

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#### **Memorandum from the Office of Rail Regulation (ORR) (PPP 06)**

1. This memorandum sets out our role and responsibilities as the independent safety and economic regulator of Britain's railways in matters relevant to the Committee's inquiry into the performance of London Underground, including whether safe operation has been affected by the introduction of the public-private partnerships (PPP).

#### THE ROLE OF ORR

2. We are the integrated safety and economic regulator for the railway industry. This includes the health and safety of the travelling public as well as those who work on the railways. We have very limited economic regulatory functions in respect of London Underground Ltd (LUL), other than as competition authority under UK and European competition law, and this memorandum concentrates on our health and safety responsibilities.

3. The rail division of the Health and Safety Executive (HM Railway Inspectorate (HMRI) and rail safety policy) and the economic regulator of the mainline railway merged in April 2006 when the Railways Act 2005 transferred responsibility for railway safety from HSC/E to ORR. We administer and enforce the Health and Safety at Work etc Act 1974 and regulations made under it, such as the Railways and Other Guided Transport Systems (Safety) Regulations 2006 (ROGS), and provide the railway industry with advice and guidance on health and safety issues.

4. ROGS replaced several sets of safety regulations including the Railway (Safety Case) Regulations 2000. Duty holders no longer have to submit a detailed safety case to us. Instead, ROGS require most transport operators to obtain from us a safety certificate (to run train services) or safety authorisation (to manage infrastructure).

5. To obtain a certificate or authorisation, an operator must provide evidence that their safety management system is capable of ensuring their operation is safe. This includes evidence about how the duty holder: sets and meets safety standards and targets; assesses and controls all types of risk (including new risk); ensures the competence of staff under their control, including contractors; and investigates and learns from accidents and incidents.

#### SAFETY CERTIFICATE AND AUTHORISATION FOR LONDON UNDERGROUND LIMITED (LUL)

6. On 15 March 2007, ORR awarded London Underground Limited (LUL) a safety certificate and safety authorisation. (LUL requires both because it also manages the infrastructure it operates on.) The award of a safety certificate and authorisation does not guarantee safety, but indicates that ORR is satisfied that an effective safety management system is in place. ORR seeks further assurance that the operator's safety management system remains effective through a programme of inspection.

7. Responsibility for adhering to the terms of the certificate and authorisation, and therefore maintaining safety, rests with the duty holder (in this case, LUL). Under ROGS, LUL's contractors (for example, the infrastructure companies or "Infracos") must co-operate with LUL in a way that allows LUL to meet the terms of its certificate and authorisation.

8. Duty holders are required to update their safety certificate and/or authorisation to ensure that it continues to be capable of ensuring safe operation. They must do this every five years or if a substantial change to operations that would affect safety is made. So, at the latest, LUL will need to obtain an updated certificate and authorisation by 14 March 2012.

#### SAFETY ON THE LUL NETWORK UNDER PPP

9. LUL continues to provide good levels of passenger and worker safety. As with all railways, there is the potential for derailments and other serious incidents.

##### *Derailments*

10. Our inspectors have investigated four train derailments on the running lines since the introduction of the PPP in early 2003. In our view the PPP had no relevance to any of these incidents. (A fifth, at Mile End in July 2007, is still under investigation.) The derailments at Hammersmith in 2003 and 2004 related to track and train maintenance respectively. The derailments at Camden Town (2003) and White City (2004) related to the design and replacement of points. The number and causes of derailments appears to have been unaffected by the introduction of the PPP.

##### *Signals passed at danger (SPADs)*

11. SPADs on LUL are regarded as low risk due to the mechanical train protection systems that are used on the network to stop a train if it passes a signal at danger. Since the PPP the number of "category B" SPADs caused by equipment failure or malfunction has risen slightly, after an initial fall. However, this reflects a long-term trend caused by ageing signalling assets and more intensive usage as train frequency has risen. We do not believe that the PPP has contributed to the increase. PPP incentives have resulted in some localised improvements and initiatives to reduce the number of SPADs

##### *Track maintenance and renewals*

12. The quality of track has implications for train safety, and was implicated in the 2003 Hammersmith derailment. The PPP Infracos took time to develop their priorities for maintaining and renewing track and this meant that some of the most pressing renewals work was not done as quickly as it should have been. In April 2006 we took enforcement action to require Metronet SSL to maintain the District Line to an appropriate standard. The Infracos are now developing track strategies that will deliver a better-maintained railway.

##### *Broken rails*

13. Undetected broken rails can derail trains, as at Hammersmith in 2003. The number of broken rails across the LUL network was rising when the PPP was introduced. After an initial rise, the number of broken rails has fallen during the PPP, following concerted action by the Infracos. Improved detection methods and more frequent testing means that rail defects are now more likely to be detected before they become rail breaks.

*Rolling stock maintenance*

14. The number of rolling stock incidents has been falling and reliability has improved under the PPP. The Infracos inherited some deferred maintenance, and they have acted positively to manage and rectify the situation. While the effect of Metronet's decision to transfer rolling stock maintenance to Bombardier remains to be seen, we see no indication that the PPP has had a detrimental effect on rolling stock maintenance.

## HEALTH AND SAFETY INTERVENTIONS

15. We recognise that the PPP arrangements for controlling risk need to be tested and verified as robust, particularly at a time when more people than ever are using the LUL network. Our programme of inspection and investigation work aims to identify strengths and weaknesses in the management of the greatest safety risks. When Metronet entered administration we swiftly carried out additional inspections to ensure that Metronet continued to be able to safely maintain track, signals and rolling stock.

## CONCLUSION

16. Overall safety on LUL continues to improve. We have no evidence that the PPP has had, or is having, a detrimental effect on safety performance. We will continue to monitor the safety performance of both LUL and its Infracos. The table overleaf summarises performance against key indicators.

**Summary of reported incidents on LUL, 2001–06**

	<i>Derailments</i>	<i>Broken rails</i>	<i>Category B SPADs</i>
2001	1	29	180
2002	1	26	143
2003	6	32	143
2004	4	51	221
2005	4	45	166
2006	2	29	171

*October 2007*

**Memorandum from London First (PPP 07)**

London First is a business membership organisation whose mission is to make London the best city in the world in which to do business. London First delivers its activities with the support of 300 of the capital's major businesses, representing approximately a quarter of London's GDP, from key sectors such as financial, professional services, property, ICT, creative industries, hospitality and retail. We also represent the interests of all of London's higher education institutions as well as many of the further education colleges.

## EXECUTIVE SUMMARY OF LONDON FIRST POSITION:

- London's success is critical to UK prosperity and dependent on sustained investment in the Tube system.
- Investment in the next major phase of capacity increase must be safeguarded.
- Reliability on the worse performing lines must be improved.
- The needs of the business community must be considered when planning the extensive upgrade works.
- Contracts that replace Metronet BCV and Metronet SSL must secure the forward programme.

## LONDON'S SUCCESS IS CRITICAL TO UK PROSPERITY AND DEPENDENT ON SUSTAINED INVESTMENT IN THE TUBE SYSTEM

1. London is the most highly productive region in the UK, with GVA per head (on a workplace basis) 53% above the national average (ONS, GLA 2007). Increasing employment in the central business cluster adds not only the value of these extra jobs, but increases the productivity of existing workers—the agglomeration effect. With 12.4% of the UK population, London produced 20% of GDP growth between 1994 and 2004. London also contributes up to £20 billion more in taxes than it receives from the Exchequer (Oxford Economic Forecasting November 2005).

2. The strength of London's economy—and that of the UK—depends on its success as a world city. Foreign-owned companies are responsible for 14% of employment in London. The attractiveness of London for foreign investment also benefits the rest of the UK. A survey of inward investors in 2002 showed almost 60% of companies surveyed planned to expand their operations to other parts of the UK. Between 2000 and 2004 London was responsible for 39% of export growth. With the UK increasingly in deficit as a net importer of goods, the export success of key service sectors in London allows the country as a whole to buy goods from across the world.

3. London's continued productivity and prosperity depend on two key factors—investment in transport and its ability to continue to attract and retain highly skilled individuals. This continual growth is not constrained by domestic growth parameters but, instead, potentially linked to the growth of the global economy. It can also, however, take place in one of the other global economic centres.

4. Around three million people rely on the Tube every day. London's employers, workers, visitors and customers depend on it to keep the capital moving. For businesses, a safe, clean reliable Tube is a necessity. Sustaining the tube modernisation programme, and finding the funding to do so, is crucial to the future prosperity of London. The PPP has allowed investment to be committed on a scale not seen before; while substantial progress has been made, that commitment must not be allowed to falter.

#### INVESTMENT IN THE NEXT MAJOR PHASE OF CAPACITY INCREASE MUST BE SAFEGUARDED

5. There is no dispute about the forecasts for the growth of population in London. Whereas the new homes needed to house 900,000 more people by 2025 will be spread around London, with the majority to the east, new jobs will be heavily concentrated in financial and business services in the central areas. The effect will be a huge increase in transport demand on an already overloaded system. We welcome the Government's commitment to funding of Crossrail, but understand that the scheme's earliest opening date is 2017. On current plans, overcrowding on rail and Tube lines will double by 2016, which will in turn cause greater delays and breakdown.

6. This is not just a problem for over-stretched transport operators and disgruntled commuters. It is a threat to the growth and competitiveness of London's—and the UK's—economy. Whereas population increase is likely to happen anyway, the potential for 440,000 new jobs in financial and business services will not be realised if transport into the central areas is full. This sector cannot grow without increased transport capacity, including Phase 2 of the tube modernisation programme.

7. Phase 2 of the tube upgrade programme will need to increase capacity to accommodate growth and reduce overcrowding. Most of the 28.5% planned increase in capacity is due in this phase, including upgrading the Northern, Victoria, Metropolitan and Piccadilly Lines. In addition, Phase 2 will need to:

- Put in place high visibility safety and security measures.
- See the upgrade of stations such as Victoria.
- Introduce a tunnel cooling system, which may be essential if the planned capacity increases are to be realised.

Given the back-end loading of Phase 1 of the PPP and provision for inflation, there will need to be a substantial increase for Phase 2 in cash terms.

#### RELIABILITY ON THE WORSE PERFORMING LINES MUST BE IMPROVED

8. While it is not possible at present to anticipate negotiations over roll-forward of the PPP contracts from 2010, Phase 2 will need to cover renewing outworn assets in order to maintain and improve reliability. Lost Customer Hours—a key PPP measure of availability—saw an improvement across the network of less than half a percent last year.<sup>27</sup>

#### THE NEEDS OF THE BUSINESS COMMUNITY MUST BE CONSIDERED WHEN PLANNING THE EXTENSIVE UPGRADE WORKS

9. We welcome the work London Underground (LU) has done in the life of the PPP contracts to improve dialogue with the business community and exchange long-term, strategic discussions around essential tube closures. The Tube User Forum offers the regular opportunity to provide for and predict business needs, and thereby minimise the negative effect of closures on London's economy.

<sup>27</sup> 2006–07 compared to 2005–06—Network LCH (LU) [unpublished].

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**CONTRACTS THAT REPLACE METRONET BCV AND METRONET SSL MUST SECURE THE FORWARD PROGRAMME**

10. We believe Metronet Rail BCV & SSL must emerge from administration at the earliest possible moment, and mid-January 2008 at the latest. On that basis, there are good arguments for Transport for London (TfL) taking on Metronet's assets in the short term, and perhaps in the longer term for LU bringing day-to-day maintenance in-house and contracting out packages of upgrading work. However, this model must be backed up by sufficient expertise in systems integration and contract management in order to be successful, as the upgrading work will itself be vulnerable to changes in funding.

11. The greatest value of the PPP is that it commits LU to a programme. For Tube Lines this is fixed until 2010, and while the terms of its roll forward for another 7½ years will be subject to negotiation, once the contract is signed the programme will be fixed. TfL may be able to parcel up upgrading contracts so as to lock in the forward programme, but this could require a large number of long-term contracts to be let at once. If contract-letting is phased over several years there exists the scope for delaying work, for example to make good a funding gap. Such a delay must not be exploited to the detriment of the vital modernisation programme currently enabled by the Tube PPP.

12. LU's project management capacity must avoid a scenario in which the upgrade programme becomes subject to the kind of spending pressures seen in the 1990s, when over-spends on the Jubilee line extension were clawed back from funding intended for the core Tube network. Whatever form the PPP contracts take, they must lock in the forward programme and consign to history the years of underinvestment that have plagued London's Tube.

*October 2007*

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**Further memorandum from London First (PPP 07a)**

London First is a business membership organisation whose mission is to make London the best city in the world in which to do business. London First delivers its activities with the support of 300 of the capital's major businesses, representing approximately a quarter of London's GDP, from key sectors such as financial, professional services, property, ICT, creative industries, hospitality and retail. We also represent the interests of all of London's higher education institutions as well as many of the further education colleges.

**AS TRANSPORT FOR LONDON TAKES METRONET'S CONTRACT IN-HOUSE, TRANSPARENCY MUST BE MAINTAINED**

Our original submission argues that the contracts replacing Metronet BCV and Metronet SSL must secure the forward programme. The most important issue is outcome. Outcome here signifies those improvements brought on by the modernisation programme that impact on tube passengers: capacity, reliability and ambience enhancement. The schedule of improvements set out by the original PPP must be adhered to as closely as possible.

However, we are anxious that as Transport for London (TfL) takes Metronet's contracts in-house, transparency is maintained. This means that there should be an effective client-contractor split within TfL, with transparent reporting of performance data, in order that outcome and input performance can be properly tracked and compared against customer priorities. As Phase 2 of the original PPP approaches—and with it most of the planned increase in capacity across the network—this clarity will help set the plans for modernisation against their delivery.

*November 2007*

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**Memorandum from the Department for Transport (PPP 08)**
**INTRODUCTION**

1. By the mid-1990s it was widely recognised that the Underground had suffered from decades of underinvestment and that the continued uncertainties about future funding levels had badly affected the reliability of passenger services. London Underground (LU) also had a poor record of delivering major infrastructure projects and maintenance programmes on time and on budget. There were substantial cost overruns on the Jubilee line extension and the Central line upgrade (both in excess of 30%) and on a number of other smaller renewal programmes.<sup>28</sup> Neither major project was completed on time nor delivered the expected improvements in journey times.

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<sup>28</sup> London Underground Public Private Partnership Final Assessment Report published on 7 February 2002, updated on 3 May 2002.

2. To address this, the 1997 Labour Party manifesto proposed a new public private partnership (PPP) to improve the Underground, safeguard its commitment to the public interest and guarantee value for money for taxpayers and passengers. In March 1998 the Government signalled its commitment to substantial extra investment in the Underground and announced that LU would be restructured to deliver two key aims:

- Keeping LU as a single unified body in the public sector with responsibility for operating passenger services; and
- Utilising the private sector's capacity in a PPP to overcome the investment backlog, and maintain and modernise infrastructure.

3. LU considered a number of alternative structures during development of the PPP before concluding that the best practical and value for money option was to split the network into three infrastructure companies each with responsibility for a number of individual lines. This structure, together with the partnership approach and proposed performance regime underpinning it, was supported in general by the industry.

4. In 2002 the Government gave an unprecedented statement of intent to provide long term funding to the Underground, averaging more than £1.1 billion a year up to 2009–10. The PPP, together with this funding, was designed to enable LU to deliver earlier a modern system that will provide passengers with a better and more reliable service, and enable the network to meet future passenger demand.

#### THE PPP CONTRACTS

5. Under the 30-year PPP agreements the private sector companies maintain, renew and upgrade the Underground's infrastructure while LU remains responsible for delivering passenger services. The PPP companies have specific obligations to deliver certain projects (eg station refurbishments and line upgrades) by particular dates and a more general obligation to maintain assets in accordance with the principles of whole-life cost management. This requires them to fully consider the future cost of maintaining the asset throughout its working life, as well as its initial purchase and installation cost.

6. The PPP also includes a performance payment regime which provides incentives for the companies to perform better than the benchmark measures set out in the contracts, while abatements (financial penalties) are imposed for below benchmark performance. Payments to the PPP companies reflects their performance in three key measures:

- Availability; which reflects whether the assets (trains, track etc) are working and available for LU to deliver passenger services. It is measured in delays to passengers (lost customer hours), weighted depending on location and time of the delay;
- Capability; which is a long-term measure of a line's capacity, ie its ability to move more people and reduce passenger journey time. Most improvement under this will be seen when the line upgrades, which are currently underway and are planned to be delivered from 2009 onwards; and
- Ambience; which indicates the quality of the passenger environment, including cleanliness, information and general condition of the stations and trains.

#### DELIVERING REAL BENEFITS FOR PASSENGERS

7. The PPP is delivering benefits in performance against the background of continuing growth in demand and an unprecedented level of works being carried out on the network. The Underground is carrying more passengers than ever; over 1 billion journeys were made in 2006–07, 21% above the 832 million passengers carried in 1997–98. Between 1997–98 and 2006–07 LU has increased the annual train kilometres run by 12½%, to nearly 70 million and over 94% of scheduled services were run in 2006–07. LU's customer satisfaction last year was also at the highest level since 1990–91.

8. Availability is currently a key indicator of PPP performance until the line upgrades are delivered. To date there has been a wide disparity of performance between the Underground lines, reflecting the variation in the condition of the assets, but also the performance of the PPP companies.

9. The latest availability performance figures<sup>29</sup> show that of the three lines that Tube Lines are responsible for under their PPP agreement, two (the Piccadilly and Jubilee lines) are performing significantly better than the benchmark measure. The Northern line continues to present a challenge with performance so far this year running at 18% worse than the benchmark figure. To address this performance Tube Lines and LU have accelerated the track renewal programme and are looking at ways to improve the train fleet's reliability.

10. Of the nine lines which are the responsibility of Metronet under its two PPP agreements, six (the Bakerloo, Circle, East London, Hammersmith & City, Metropolitan and Waterloo & City) are performing better than the required benchmark figure. The major improvement in performance on the Waterloo & City line reflects the benefits of the upgrade completed last year.

<sup>29</sup> London Underground Managing Director's Performance Reports.

11. Performance on the three remaining lines is running worse than the benchmark figure; 15% in the case of the Central, 17% on the District and on the Victoria it is particularly disappointing, running at 61% worse than benchmark.

12. Long term improvements within the PPP contracts include:

- Stations: 247 stations programmed to be modernised or refurbished by 2010–11, with work on 91 stations completed.<sup>30</sup> This included major improvements to Wembley Park station by Tube Lines, which was completed on time and within budget, delivering a 70% increase in capacity and enabling the station to handle 37,500 passengers per hour;
- Track: Over 115 km of track (14% of the network) has been renewed, with delivery on some lines ahead of schedule;
- Waterloo & City line: A fifth train is now in service during the peak periods, providing a 20% increase in capacity. A £40 million upgrade has seen improved reliability and a reduction in average journey times;
- Jubilee line: Four new trains are now available and a seventh carriage has been added to all trains, bringing about a 17% increase in capacity. Work on a new signalling system is ahead of the contract date for delivery in 2009;
- Piccadilly line: The extension to Heathrow Terminal 5 is on schedule to be completed by March 2008;
- Northern line: Work on a new signalling system is ahead of the contract date and should be completed before the Olympics;
- Victoria line: The first new trains are being tested, while work on the signalling and power upgrades is broadly on schedule;
- District line: 55 trains have been refurbished to date. A refurbished train is being returned to service every two weeks and all trains should be completed by 2009.

## SAFETY

13. Passenger safety is of paramount importance. The Underground is a very safe mode of transport and its safety record compares favourably with other Metro systems of a similar age, particularly in key areas such as derailments, collisions and platform-train interfaces.<sup>31</sup> Customer injuries average 1.5 persons per 10 million journeys, and the majority of fatalities on the network are due to trespass or suspected suicides.<sup>32</sup>

14. LU retains overall responsibility for passenger safety on the network and the Office of Rail Regulation, through Her Majesty's Railways Inspectorate (HMRI), regulates health and safety on the Underground. It is a legal requirement that LU has appropriate safety management systems and procedures in place to ensure staff and customer safety which have been accepted by HMRI. Under the PPP arrangements LU monitors the PPP companies' safety performance, audits their compliance with their contractual safety cases and LU's own standards, and agrees an annual Safety Improvement Programme.

15. LU's Safety Action Tracking System records progress against the Safety Improvement Programme. For the fourth year in succession there has been an improvement in the proportion of actions completed on time and in 2006–07 all three PPP companies achieved improved levels of compliance with their contractual Safety Cases than the previous year.

16. The table below provides figures for derailments, broken rails and signals passed at danger (SPADs) since 2001.<sup>33</sup>

Year	2001	2002	2003	2004	2005	2006	2007 <sup>34</sup>
Train Derailments <sup>35</sup>	1	1	6	4	4	2	1
Broken Rails	29	26	32	51	45	29	9
Category B SPADs <sup>36</sup>	180	143	143	221	166	171	158

17. The number of train derailments of all types has fallen since 2003. Within these figures the number of passenger train derailments while in service remains very low. These incidents have averaged at just over one per year over the last 15 years or so, but LU recently went 37 months between such incidents.<sup>37</sup>

<sup>30</sup> 61 stations have been delivered into service and accepted by LU. A further 30 have been declared complete by the PPP companies.

<sup>31</sup> Community of Metros (CoMET) *Benchmarking Report*, February 2007.

<sup>32</sup> Office of Rail Regulation's "Railway Safety Statistical Report 2006" reported 19 suicides and trespasser deaths out of 22 fatalities on the network, their "Annual Report on Railway Safety 2005" reported 24 out of 28 respectively.

<sup>33</sup> Figures provided by Her Majesty's Rail Inspectorate.

<sup>34</sup> 2007 figures, provided by LU, are for provisional up to the end of September.

<sup>35</sup> Includes passenger trains both in service and those withdrawn, and other trains (ie engineering).

<sup>36</sup> Category B, or technical SPADs are caused by signalling failure, errors by technical staff or train system faults.

<sup>37</sup> Central line derailments at White City on 11 May 2004 and Mile End on 5 July 2007.

18. The figures for broken rails reflect the ageing nature of LU's track and the increase in both volume of trains and passengers. The PPP, through improved rail inspection technology, asset maintenance and fault detection has led to an increase in the number of broken rails detected before they represent a safety hazard to passengers. The reduction since 2005 is encouraging and reflects the PPP companies accelerated track renewal programme, at about four times the historic average.

19. The increase in signals passed at danger (SPADs) reflects a combination of the failure of ageing signalling equipment and greater emphasis on reporting incidents. However, the presence of LU's safety protection systems fitted throughout the network means that the risk of a collision following a SPAD is extremely low. Again the signal system upgrades planned for the majority of lines will address this issue.

#### VALUE FOR MONEY

20. Ensuring value for money for taxpayers and passengers was a key consideration when both the Department and LU concluded that a PPP structure was the best option. In addition to the value for money assessment carried out by LU, the Government commissioned independent advice that confirmed that LU's value for money analysis was robust.<sup>38</sup> The Committee of Public Accounts report<sup>39</sup> noted that the key principles in the Treasury's Value for Money Guidance had been adopted for the PPP, and that when both the Department and LU assessed the PPP they had considered wider, non-quantitative factors alongside the Public Sector Comparator. This included considering the strategic benefits, the ability to create a partnership and the risk share between public and private sectors.

21. The PPP contracts include a number of mechanisms for ensuring that value for money is secured over the long term:

- an outcome based performance and payment regime that links payments to the delivery of services at a price agreed with LU;
- an obligation on the companies to demonstrate an efficient and economic whole-life cost approach to asset management;
- the use of an independent Arbiter, established by statute, with powers to determine an efficient and economic price for services where LU and the companies are unable to agree a price. The Arbiter provides an important assurance of value for money in the PPP agreements that allows for possible changes to the scope of the work, the re-specifying of requirements, and re-pricing of services as part of the Periodic Review which occurs every 7½ years. Revisions to the price at these breakpoints in the agreements will need to meet the tests of efficiency and economy; and
- under both Metronet agreements the Arbiter can be asked to undertake an annual performance review to show the extent that the company is meeting the criteria of efficiency and economy and Good Industry Practice, contained in the PPP agreements.

22. The PPP also allows LU to procure additional works outside the contracts from alternative suppliers that enables LU to benchmark prices and test the price competitiveness of the PPP companies.

#### RISK SHARING

23. When signed the PPP agreements struck a balance between the level of risk transferred to the private sector and that retained in the public sector. The table below<sup>40</sup> sets out how the key risks were allocated under the PPP agreements.

24. The PPP agreements are outcome based and expose the companies to risk of performance payment abatements if the contractual targets are not achieved. The targets demand enhancements by fixed dates, ie the Jubilee line requires a 48% increase in capacity and 22% reduction in journey times by November 2009 compared to when the contracts were signed. The risk for the PPP companies is that failure to deliver the line upgrades and enhanced performance by the contract deadlines will mean a step-change in abatements. This will be exacerbated if the cost of the upgrade exceeds the budget provided in their bid through the PPP Company's own inefficient and uneconomic performance.

25. Where risk more properly sits with the public sector then this has been retained by LU, such as passenger fare revenue, which can be subject to variations beyond the PPP companies' control.

26. Other risks have been shared, such as where the asset condition was unknown at the time of PPP procurement (known as grey assets). The National Audit Office<sup>41</sup> acknowledged that in these circumstances seeking to transfer too much risk would be likely to lead the PPP companies to over-compensate on grounds of uncertainty. This would have caused them to build in bigger contingency provisions within their bids, leading to a higher price that would not have represented value for money for the taxpayer.

<sup>38</sup> London Underground PPPs; Value for Money Review. Independent Review by Ernst & Young for the Secretary of State for Transport, Local Government and the Regions, published on 5 February 2002.

<sup>39</sup> House of Commons Committee of Public Accounts "London Underground Public Private Partnerships" Seventeenth Report of Session 2004-05, published on 31 March 2005.

<sup>40</sup> Reproduced from the National Audit Office Report "London Underground: Are the Public Private Partnerships likely to work successfully?", published on 17 June 2004.

<sup>41</sup> The National Audit Office report "London Underground PPP: Were they good deals?", published on 17 June 2004.

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 ALLOCATION OF KEY RISKS UNDER THE PPP
 

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	<i>Risk</i>	<i>LUL</i>	<i>PPP Co</i>	<i>Shared</i>
Revenue	From passenger demand	E		
	From meeting performance targets		E	
Safety	In passenger operation eg driving at the appropriate speed; change in safety law	E		
	In provision of assets that are “fit for purpose” with As Low as Reasonably Practical Risk		E	
Costs	Of Infrastructure work eg design and construction of new trains		E	
	Of operations eg cost of drivers	E		
	Of inflation (indexed)			E
	Of rectifying the health of unclassified “grey assets” eg deep tunnels			E

NOTE: Net cost/revenue overruns are capped at £200 million for Tube Lines in the first 7½ year period and £50 million for each of the two Metronet contracts if they are acting in an “efficient and economic” way.

## METRONET IN PPP ADMINISTRATION

27. The PPP Administration of Metronet should not in itself affect passenger services on the Underground. The GLA Act 1999 provides that PPP Administration must encompass both the protection of creditors’ requirements and keeping passenger services running safely and effectively, until the PPP company is transferred out of PPP administration.

28. LU have made clear that the overriding priority continues to be the provision of a safe and reliable Underground service for passengers, with the continuance of Metronet’s maintenance and renewal activities pending transfer to a new company.<sup>42</sup> To date, LU have reported no safety concerns arising from the Metronet PPP Administration.

29. The PPP Arbiter’s Annual Review of Metronet’s performance for the three years to 31 March 2006<sup>43</sup> identified areas of weakness and potential for costs considerably higher than those provided under the contracts. On 21 June 2007 Metronet requested that the independent PPP Arbiter conduct an Extraordinary Review (ER) of its BCV contract. ER is a contractual mechanism that, among other things, enables the PPP companies to seek additional payment to meet cost overruns ahead of a periodic review. The ER process involves the Arbiter making a judgement about the costs that an economic and efficient PPP company would have incurred in delivering the same outputs as the Metronet company.

30. To allow a PPP company to perform its obligations pending the completion of an ER, the Arbiter can also award an “interim” payment. Metronet accordingly sought an interim award of £551 million from the Arbiter who, on 16 July published a draft Direction which provisionally concluded that an efficient and economic company in Metronet’s circumstances would be entitled to an interim award of £121 million.<sup>44</sup> Metronet concluded on 18 July that such an award would be insufficient to keep the company afloat, and Transport for London (TfL) proceeded to serve the Mayor’s petition for PPP Administration of both Metronet companies.

31. On September 2007, the Arbiter published his Initial Thoughts on the ER.<sup>45</sup> The Arbiter’s provisional view, based on representations from LU and Metronet, was that aspects of Metronet’s operations were not efficient and economic (eg deficiencies in the supply chain and governance arrangements) and that the costs associated with these would not be allowable.<sup>46</sup> This suggests that it was failures in the management of the Metronet companies that were to blame for a large proportion of the cost overruns that led to their collapse.

32. It is for the PPP Administrators, working with LU, TfL and the Mayor, to identify the best outcome from the PPP Administration process. However, we share TfL’s objective that the Metronet contracts should be transferred out of PPP Administration in the minimum time necessary. We are working closely with TfL, LU and the PPP Administrators to understand the full implications of any potential solutions and deliver a long-term outcome which:

- secures the best achievable value for money;
- is affordable;

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<sup>42</sup> TfL press release, “Mayor and London Underground act to ensure smooth transition for Metronet lines”, 18 July 2007.

<sup>43</sup> Office of the PPP Arbiter “Annual Metronet Report 2006”, published on 16 November 2006.

<sup>44</sup> The PPP Arbiter “Interim level of ISC pending a direction on ISC at Extraordinary Review, Draft Directions”, 16 July 2007.

<sup>45</sup> The PPP Arbiter “Directions on Form and structure of Extraordinary Review and Net Adverse Effects and Infrastructure Service Charge at Extraordinary Review, Initial Thoughts”, 21 September 2007.

<sup>46</sup> The Arbiter’s Initial Thoughts said that allowable costs were likely to be in the region of £140 million and £470 million for BCV and £230 and £600 for SSL.

- addresses lessons to be learned; and
- enables the most effective possible transfer of risk into the private sector.

*October 2007*

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### **Supplementary memorandum from the Department for Transport (PPP 08a)**

#### **METRONET—THE COST TO THE PUBLIC PURSE**

Following my appearance before you at the Transport Select Committee hearing on Metronet on 7 November, I wanted to clarify some points about the cost of the collapse of Metronet.

At the hearing it was suggested that the combination of Metronet's debts and the administrator's loan facility represented a net impact on the public purse of about £3 billion. This is emphatically not the case.

As Metronet's contracts were "on balance sheet", public expenditure figures take into account external borrowing, and following the reclassification of Metronet and Tube Lines in September this by the Office of National Statistics, the existing debt scores directly against Public Sector Net Debt (PSND). The entry into administration does not, of itself, change the public expenditure treatment of Metronet's existing debt, and so does not represent a net impact on the public purse.

What administration does is to change the way in which funds are provided for the work that is being carried out. A number of Committee members suggested that the £13 million a week that Metronet, in administration, requires on top of their ISC payments is new and unplanned spending, totalling the £900 million loan facility that has been provided to the administrator. This is not correct.

First, the current rate of spend by the administrator is falling well short of exhausting the six month, £900 million, loan facility provided by TfL.

Second, much of this funding simply replaces planned cashflows that Metronet would, outside administration, have borrowed. As described above, this borrowing would have scored in PSND as public expenditure, and so the new form of funding does not represent an increase in planned public expenditure. It is also not wasted spending as it ensures that Metronet can continue to keep the tubes running and maintain safety standards.

We do recognise that some of the £13 million per week spending does reflect the additional cost of administration. In addition, some of the work may be more expensive than previously anticipated owing to remaining inefficient and uneconomic activity by Metronet; but the Administrator and LUL are working together to rectify these areas. This is why securing an early exit from administration, an objective all share, will help minimise these costs.

That said, it is clear from the work of the PPP Arbiter to date that the cost of delivering PPP outputs under the two Metronet contracts in the first period would have been higher than expected at the time of their bid. The Arbiter's view is that a proportion of these would have been faced by a company operating economically and efficiently.

It is also clear from the Arbiter's work that Metronet had delivered less, in terms of outputs, than expected at the time of the bid. There was clearly uneconomic and inefficient behaviour and notable failings of their internal financial controls and corporate governance.

These costs will impact Metronet's shareholders. As I said when giving evidence, three of Metronet's shareholders have already written down over £300 million as a result of Metronet's failure.

What we do not yet know is the true extent to which Metronet's delivery had slipped behind their spending. That will take London Underground some time to establish, when and if they take control of the Metronet assets from administration. The extent to which these costs exceed shareholder's equity losses will have implications for the public purse. My view is that in the short term there will be costs. As Tim O'Toole stressed, our capacity to recover lost outputs will then link directly to the decisions we take about the best delivery vehicle for the longer term.

We will continue to work to learn the lesson's of Metronet's failure and I look forward to reading the Transport Select Committee's views on these matters.

*November 2007*

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### Memorandum from the National Union of Rail, Maritime and Transport Workers (RMT) (PPP 09)

1. The National Union of Rail, Maritime and Transport Workers (RMT) welcomes the opportunity to contribute to the Transport Select Committee inquiry in the Public Private Partnership (PPP) and the London Underground. With over 10,000 members employed across both operational and engineering functions on the London Underground, RMT is the largest of the Tube trade unions.

#### *Risk transfer*

2. Before the transfer of engineering functions to Metronet and Tube Lines a series of organisations including the rail unions, the Transport, Local Government and Regions Select Committee, the Mayor of London, Transport for London, the Industrial Society and the Capital Transport Campaign all issued warnings, on a series of grounds including safety, value for money and contractual complexity, against proceeding with the Public Private Partnership. Regrettably, all of these warnings were completely ignored by Government.

3. In June 2004 the National Audit Office published their London Underground PPP: Were they good deals? report which indicated that in the event of termination or administration, 95% of the money loaned by banks and other institutions to the Infracos would be reimbursed by the public purse. Indeed, the NAO noted that whilst negotiating the PPP contracts the Department for Transport and London Underground conceded to the lenders demand that a 90% payback in the event of termination was too low a figure given the market perceptions of the political risks associated with the scheme. The pay-back figure was therefore increased to 95%.

4. That the public purse is still responsible for the 95% of Metronet's debt was confirmed in the following exchange at City Hall during Mayor's Question Time on 18 July 2007. The Mayor was accompanied on 18 July by Transport Commissioner Peter Hendy, TfL Managing Director Tim O'Toole and TfL Managing Director of Finance Steve Allen.

Bob Neil (AM): *There was also a piece in The Guardian, I think, yesterday suggesting that there might be some potential liability on either TfL or LUL as its subsidiary, for a considerable chunk of Metronet's debts. It was based on the Standard and Poor's report. Is there anything in that?*

Tim O'Toole (Managing Director, London Underground Ltd): *The Metronet debt is guaranteed by us.*

Bob Neil (AM): *I think The Guardian was suggesting that in 2004 Standard and Poor's had suggested that TfL or the subsidiary could be liable for up to 95% of the debt. That is correct is it?*

Steve Allen (Managing Director of Finance, Transport for London): *That is correct. That is a feature of the PPP contracts.*

5. RMT's view is that the decision taken by the Department for Transport and the then management of London Underground to allow clauses to be written into the PPP contracts which allows for 95% of Infraco debt, now standing at £1.6 billion,<sup>47</sup> to be guaranteed by the public purse represents, in our view, a dereliction of public duty. It also confirms the long held RMT view that the privatisation of both the national rail network and the London Underground has led to a wholly inadequate level of risk being held by the private sector. It is simply unacceptable that private sector interests are routinely issued letters of comfort or guarantees in the event of project failure. RMT believes that if lenders and/or operators are willing to make profits out of essential public services they should also be prepared to bear the financial risk.

#### *Private sector failure*

6. The collapse of Metronet comes as no real surprise to the RMT. From transfer in 2003 to administration in 2007 our representatives and activists employed by BCV and SSL were reporting to us poor project management, chaotic financial control and the de-skilling of their work. Two thirds of the PPP scheme—Metronet BCV and Metronet SSL—is now financially and operationally in ruins and essential upgrades are in jeopardy. In the run-up to the 2012 Olympic and Paralympic Games, London cannot afford another failure on this scale.

7. Since the collapse of Metronet, several claims have been made that the performance of Tube Lines demonstrates that it is simply the performance of Metronet and not the PPP itself which has proved to be a failure. RMT fully accepts that the performance of the project and engineering managers at Tube Lines has been better than that at Metronet; it could hardly have failed to be so.

8. However, the financial environment created by the PPP, and enjoyed by Tube Lines brings into serious question whether the scheme can be considered in any respect to be value for money.

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<sup>47</sup> GLA press release 11 September 2007.

9. Your Committee explained in the March 2005 report: “The performance of London Underground” “improvements in facilities and performance are not in proportion to the huge sums of money flowing through the PPP”. The report further highlighted that “disregarding the costs of the Jubilee Line extension, central government expenditure in constant terms has increased from £44.1m in 1997–98 to £1,048 in the current financial year (2004–05): an increase of 2,276%”.

10. In addition to serious value for money concerns, successive Transport for London reports about the performance of London Underground and the PPP brings into some question the claims about the success of Tube Lines.

11. The July 2005–06 TfL report London Underground and the PPP indicates that in relation to lost customer hours, Tube Lines performance on the Northern Line was 28% worse than benchmark and 35% worse than bid.<sup>48</sup> The report further reported that Tube Lines had been issued with a Corrective Action Notice due to persistent poor availability performance on the Northern Line.

12. The press release launching the 2005–06 report acknowledged that some progress had been made by Tube Lines, particularly in relation to renewals. However, TfL Managing Director Tim O’Toole said “Tube Lines have failed to maintain the Northern Line to the standards we and the PPP contracts demand”.

13. The Committee will also remember that 1.8 million customer hours were lost on the Northern Line in October 2005 due to repeated tripcock failures. Efforts to resolve the problem were compromised by the multiple interfaces which existed between Alstom, who hold the 25 year PFI contract to maintain the Northern Line rolling stock, Tube Lines and Transport for London.

#### *Administration and beyond*

14. Metronet entered administration on 18 July 2007. RMT’s view on what should happen for the future is clear and has been repeatedly put to both this Committee and Government since the PPP was first mooted. All engineering functions that were transferred to Metronet BCV and Metronet SSL in April 2003 should be returned to public ownership under London Underground.

15. RMT is squarely against any attempt to re-let the contracts to the private sector and believe that the PPP Arbiter’s initial findings that Metronet could recover up to £1.07 billion are an attempt to make the company a more attractive proposition for potential private sector bidders. On the contrary we support TfL’s bid to take over the Metronet contracts and trust that the administrator is able to process the transfer of contracts back to the public sector as soon as is possible. Support for public sector control is overwhelming. An ICM poll of published on 4 September found that 76% of those asked wanted London Underground to carry out the maintenance of trains, track, signals and stations. Only 13% of those asked favoured maintenance being undertaken by a private sector company.<sup>49</sup>

16. Returning contracts to LUL would deliver an integrated and accountable management structure. When, in October 2003, Network Rail made their decision to bring maintenance functions on the national network in-house, they identified that benefits would include the consistent application of high standards of rail maintenance across the network, significant efficiency savings and improvements to track-side safety standards. Therefore, in order to deliver similar benefits on the London Underground, reduce fragmentation and deal with unnecessary operational and safety interfaces RMT would also want to see Tube Lines contracts returned to public control. This would also help to deliver savings associated with economies of scale and enable LUL to roll out a network wide procurement programme.

17. Finally, returning contracts to the public sector will also deliver security to the Tube Lines and Metronet work-forces, transferred against their will to the private sector in 2002 and 2003. The work-force has seen their final salary pension schemes closed to new entrants and has in addition staved off repeated attempts to transfer fleet engineers and depot managers to Bombardier.

18. In terms of funding, there is little doubt that the previous “feast and famine” nature of funding which LUL had to endure led some industry insiders to look to the PPP as a guarantee of funding over a protracted period of time. Key to the transfer of engineering functions back to public ownership will be securing stable, long-term investment from Government. The precise nature of the framework is a matter for discussion between the DfT and TfL. However, RMT would expect funding arrangements to deliver an investment stream that would enable LUL to effectively plan the urgently required major upgrade and renewal of the London Underground, which the PPP has self-evidently failed to deliver.

#### *Industrial Action*

19. The Committee will be aware that RMT members employed by Metronet took lawful industrial action on 3 September 2007 to secure unequivocal guarantees on job security, transfers and pensions. The action followed a strike ballot which saw a 51% turnout and a 93% yes vote.

20. The strike action was suspended late on 4 September after the RMT received assurances from the employer that met our concerns, these were as follows.

<sup>48</sup> Figures do not include the 1.8 million lost customer hours caused by the tripcock failures.

<sup>49</sup> ICM poll, commissioned by RMT. 1,028 Londoners were questioned between 1 and 26 August 2007.

21. On pensions the original proposal on fund rescue was withdrawn and assurances received that a full scheme rescue was to be placed before the TfL pension trustees' board on 5 September. Following the scheme rescue being put in place, the pension entitlements for the Metronet members of the TfL pension fund will operate entirely as normal as if the administration had not taken place.

22. On streamlining, confirmation that there would be no streamlining or transfer of employees from Metronet during administration. A written commitment that if, in the post administration period, any subsequent streamlining proposals were raised, the Code of Practice will be applied and a new consultation process will commence. Any issues of concern regarding the application of the Code of Practice to be resolved through the existing machinery of negotiation.

23. On Bombardier transfers, confirmation that no transfers would happen during the period of administration. Assurances that the Code of Practice will be applied for the implementation of any transfers post administration and that a new consultation process will commence.

### *Conclusion*

24. RMT welcomes the opportunity to contribute to the Transport Committee's inquiry into the Public Private Partnership and the London Underground. Our key contributions to your inquiry are;

- The PPP has proved to be an unpopular and expensive failure
- The transfer of risk to the private sector has been wholly inadequate and replicates the experience on the national rail network
- The administrator should move quickly to return maintenance functions to the public sector under a responsible and accountable management structure
- Returning the contracts to public ownership will provide the current workforce the security and stability required to deliver the upgrade of the London Underground
- Support for public ownership is overwhelming
- A funding framework should be established that delivers sustained investment levels necessary for the urgently needed upgrade of the Underground

*October 2007*

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## **Memorandum from Unite Amicus Section (PPP 10)**

### 1. INTRODUCTION

1.1 Unite Amicus Section is the UK's second largest trade union with 1.2 million members across the private and public sectors. Our members work in a range of industries including transport, manufacturing, financial services, print, media, construction and not for profit sectors, local government, education and the health service. The union has just completed a merger with the TGWU to form the UK's largest union of over 2 million members.

1.2 At a time when investment in the UK's rail network is at an unprecedented level, Unite Amicus Section welcomes the decision by the Transport Select Committee to conduct a far reaching inquiry into the effect of PPP on the London Underground (LU).

1.3 Unite Amicus Section members are involved in all aspects of maintenance on the London Underground and are employed currently within both the defined public and private sector.

1.4 Our members are responsible for maintenance and repair of key elements of LU infrastructure including signaling, escalators, station lighting and electrics and communications equipment. In addition our members are also employed in the maintenance of the train fleets.

### 2. BENEFITS FOR TUBE PASSENGERS

2.1 Unite Amicus Section believe that whilst PPP has accelerated the financial investment of funds into the ongoing refurbishment of the LU network, it has not delivered within the timescale stated in the original contract.

2.2 This fact is evident when we consider that on the 23 February 2007 Metronet Rail announced that it had awarded a tranche of six contracts for station upgrades outside of its tied supply chain. This was the first time Metronet Rail had moved out of its own supply chain and is clear and concise evidence that its own structure was failing to deliver on time and on budget.

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### 3. HEALTH AND SAFETY

3.1 It must be understood that LU standards of health and safety have historically been over and above any statutory or legal requirements. Unite Amicus Section have concerns that the involvement of the private sector has increased the propensity for profit margins to become the primary motive behind relevant decision making.

3.2 Furthermore Unite Amicus Section is concerned that the increasingly complex networks of responsibility are diluting the direct involvement of experienced LU health and safety advisors.

3.3 In the union's opinion health and safety on the LU is now alarmingly fragmented. There is minimal interaction between safety committees that exist within LU and the private sector.

3.4 In the union's experience it is becoming increasingly difficult for operatives to address safety issues. This becomes more relevant when it is understood that many sites are in effect "multi-user", engaging operatives from not only the defined public and private sectors but also sub-contractors.

3.5 The risks involved in such a fragmented and overly complex supply chain were brought into sharp focus on the morning of 5 July 2007 when a Central Line train hit an object in the tunnel between Mile End and Bethnal Green. On investigation it was discovered that operatives from one of Metronet's shareholder partners Balfour Beatty had left a roll of industrial plastic sheeting too close to the track.<sup>50</sup> Clearly objective evidence does not exist to suggest that such an oversight is solely a result of private sector involvement in the LU, but there is sufficient anecdotal evidence to confirm that the structure that is currently in place does nothing to facilitate "joined up thinking".

3.6 The health and safety issues of the fragmented supply chain were further highlighted in March 2007 when 12 electricians were thrown off the Hainault station site after it was discovered they were doing a full shift on their day jobs before working on the LU in the evening.<sup>51</sup>

### 4. RISK AND "VALUE FOR MONEY"

4.1 Unite Amicus Section believes that the very fact that Metronet Rail has now gone into PPP administration and is, in effect, being funded by Transport for London (TfL), provides objective evidence that on this occasion PPP has certainly not been "value for money" especially for London tax payers. Not least when it is widely reported that TfL is paying Metronet £17 million<sup>52</sup> a week (roughly double the normal rate under their 2003 agreement) to keep the contractor and the railway operating during administration.

4.2 It should be noted that as recently as 4 October it was being reported that the PPP Arbiter, Chris Bolt, had still to determine the exact amount Metronet was owed by LU for the first seven and a half years of its tube contracts, in order to have some idea of the complexity of the issues. A perspective of the scale can be seen when information suggests that this figure could be anywhere between £370 million and £1.1 billion.<sup>53</sup> The fact that the figure is so wide ranging doesn't exactly create the impression of prudent financial management.

4.3 This ambiguity was further highlighted in a recent statement from Tube Lines. When questioned as to whether they would consider a bid for Metronet they stated that, "We need more transparency about what is being sold before we would consider making a bid".<sup>54</sup>

4.4 Unite Amicus Section firmly believes that across the majority of the rail network there is little or no competition. The union believes that the private sector is taking only a marginal amount of the risks involved in both running and investing in the network. In this respect London Underground is no different.

4.5 The private sector that has been brought into the LU network is entirely confident in the fact that the Government cannot allow any part of the infrastructure to fail and therefore has a limited commitment in terms of long term investment in the industry. In effect the private sector can "go bust" but the network must continue to operate, funded by the taxpayer.

4.6 The very fact that other private sector stakeholders are awaiting the publication of Metronet's valuation by investment bank Rothschild provides sufficient evidence that the private sector are unwilling to take any of the potential risks involved in undertaking its work.

4.7 Given the very nature of the private sector this should not be surprising. Equally it should not be surprising that the private sector enters those parts of the industry where it can extract the largest profit margins whilst avoiding any unnecessary obligation to invest in the long term growth and expansion of the LU network.

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<sup>50</sup> *Construction News* 4 October 2007.

<sup>51</sup> *Construction News* 19 April 2007.

<sup>52</sup> *Construction News* 4 October 2007.

<sup>53</sup> [www.cnplus.co.uk/News/metronets\\_uncertain\\_future.html](http://www.cnplus.co.uk/News/metronets_uncertain_future.html)

<sup>54</sup> *Contract Journal* 19 September 2007.

## 5. METRONET RAIL BCV AND SSL IN PPP ADMINISTRATION

5.1 The consequences of Metronet entering into PPP administration are significant, not least for increasing the financial burden on the taxpayer as outlined above.

5.2 The situation that has been allowed to develop calls into question the long term planned infrastructure improvements on the LU network. It will also act as a deterrent in sourcing long term financial investment.

5.3 Historically maintenance staff employed by the LU in the public sector were prepared to accept remuneration less than they could expect in the private sector for the additional benefit of stable and direct employment. The increasing role of the private sector has in part increased job insecurity.

5.4 The uncertainty that Metronet's administration has caused is creating the potential for skilled operatives to leave the LU network and seek stable employment elsewhere in the sector or in the wider construction and contracting industry, where demand for their skills is set to increase at least into the medium term. Headlines such as, "Metronet workers poised to walk out over late pay",<sup>55</sup> set against observations that the UK construction industry needs an additional 87,590<sup>56</sup> workers every year until 2011 to meet increasing demand, does not bode well for LU recruitment and retention policies.

5.5 Anecdotal evidence suggests that as specialist operatives, such as signaling technicians, leave the network the cost of employing them in the future through any kind of third party agency arrangement will inevitably increase the overall wage bill in the long term.

5.6 Despite reassurances from Metronet that the terms of PPP administration ensure that staff, suppliers and third party creditors will continue to be paid Unite Amicus Section believes that there will be the inevitable haemorrhaging of staff and suppliers that will further undermine the long term improvements to the LU infrastructure network.

*October 2007*

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### Memorandum from the London Assembly Transport Committee (PPP 11)

#### 1. INTRODUCTION

1.1 The London Assembly Transport Committee has followed the progress of the PPP contracts since their inception. It conducted two in-depth reviews of performance: "The PPP: Two Years In" and "A Tale of Two Infracos". It has recently questioned in detail the key players in the PPP Administration of Metronet.

1.2 The Committee has set up a webpage with all the latest information it has gathered on the PPP Administration, and its previous work: [http://www.london.gov.uk/assembly/scrutiny/transport\\_ppp.jsp](http://www.london.gov.uk/assembly/scrutiny/transport_ppp.jsp)

1.3 This paper outlines the conclusions and recommendations that the Committee made in its previous reports, and summarises the information from its recent hearings about the PPP Administration.

#### 2. PREVIOUS PERFORMANCE REVIEWS

*Initial findings—June 2005*

2.1 "The PPP: Two Years In", the Committee's first look at the performance of the PPP contracts, found that Infraco performance was inconsistent and varied. Whilst there were some improvements compared with pre-PPP performance, for example on availability of trains, much of the performance was well below target. Given the inadequacies of the Tube prior to the PPP, as well as the large sums of money made available through the contracts, the Committee was disappointed at the progress that had been made.

2.2 The Committee identified several problems that raised concerns for the future of the contracts. The rate of asset renewal, which rapidly accelerates after the first 7½ year period, was behind schedule after only two years and subsequently scaled down. Asset renewal is the upgrading of major infrastructure, for example, signalling, lifts, escalators and track. For the planned renewal of lifts and escalators in the first 7½ year period, Metronet revised its figures from 58% to 44%, and Tube Lines from 65% to 51%.<sup>57</sup>

2.3 Part of the problem arose from the asset knowledge base being so poor prior to the contracts being awarded and the work began: the actual state of the Tube was relatively unknown. Therefore the targets for many projects had to be revised, particularly for track and signalling work, and these have potentially the greatest impact on passengers.

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<sup>55</sup> *Contract Journal* 18 July 2007.

<sup>56</sup> Construction Skills Network Report 2007.

<sup>57</sup> "The PPP: Two Years In", London Assembly Transport Committee, 2005, para 2.15.

2.4 There were also early signs of poor project management. The rate of engineering overruns was far too high, 278 in the first two years. This had a frequent impact on the morning rush hour. Overnight and weekend work has been built into the PPP to minimise disruption to the network. However, the marked increase of overruns since the Infracos took over responsibility had the opposite effect. Metronet's former Executive Chair, John Weight, described his company's performance as "unacceptable"<sup>58</sup> to the Committee and resigned shortly afterwards.

2.5 The Committee also expressed its concerns over the station refurbishment programme. Metronet's performance was particularly bad. Its station renewal programme was 15 weeks behind schedule after two years.<sup>59</sup>

2.6 The Northern Line, Tube Lines' responsibility, performed particularly poorly for the first two years of the PPP. It had by far the most signal and point-related failures and track delays of any line, and its train availability was almost 40% below the agreed benchmark. The Northern Line's performance was so poor, that Tube Lines suggested full line/branch closures to accelerate the rate of renewal of the track and signalling. Ultimately this was deemed unnecessary, however, as performance on the line improved overall.

#### *Emerging themes—January 2007*

2.7 The Committee's second performance review of the PPP returned to many of these themes. Four years into the contracts and a sharp dividing line between the performances of Tube Lines and Metronet seemed to be emerging. The Committee concluded "Tube Lines has demonstrated that the PPP can work. Metronet has demonstrated that the PPP can fail".<sup>60</sup>

2.8 Though there were exceptions, Tube Lines management and delivering was generally impressive, and Metronet's was poor. Tube Lines completed its station renewal programme for the first 7½ years ahead of schedule and the Piccadilly Line performed 70% in excess of basic standards. Overall Metronet remained behind in its station renewal programme, though it did improve its rate of completion.

2.9 The Northern Line, under Tube Lines' management, continued to perform poorly and the Committee found that these were due to a Private Finance Initiative (PFI) contract with Alstom agreed prior to the PPP. The Committee found: "Its terms and conditions are considerably less robust than those set on other maintenance contracts in the PPP".<sup>61</sup> The Committee understood that Tube Lines were renegotiating this contract with Alstom in order to overcome these problems.

2.10 Many of Metronet's lines, such as the Bakerloo and Victoria Lines performed well below basic standards with frequent delays. There were inconsistencies in aspects of performance between different lines, such as the performance of fleets that were of the same age. For example, the Bakerloo Line had twice as many failures as the Victoria Line, despite the fact that the fleets are the same age. Work to prepare District and Circle Line track for summer conditions had not been adequately done, despite repeated warnings from London Underground.

2.11 The Committee identified differences in the way that the two Infracos managed their contracts. Tube Lines aggressively pursued its targets through competitive tendering processes and additional spending, and demonstrated impressive results whilst making a healthy profit. Metronet appeared to be blighted by a poor management structure and a lack of market discipline. Much of their work was done by their own shareholders, without competitive tendering. There appeared to be a lack of incentive or a corporate structure to ensure work was done on time and to budget.

2.12 The Committee found that both Infracos had difficulties over differences of opinion with London Underground over scoping and design for station refurbishments. Final costs were well over what had been forecast and projects were subject to long delays. Tube Lines' approach was to undertake the work that London Underground requested. At the completion of the project, Tube Lines used the arbitration process to negotiate over what they saw as differences to what had been initially agreed and reclaim additional costs. By contrast, Metronet did not start work on stations until all differences had been resolved, leading to lengthy delays. Tube Lines demonstrated that it was able to learn from early difficulties, Metronet did not.

2.12 In November 2006, the PPP Arbiter delivered his first annual report on Metronet and discussed it with the Committee.<sup>62</sup> He found that Metronet was not operating in an efficient or economic manner and often not to Good Industry Practice (for example, the work done to prepare the District and Circle lines for summer weather). He also discovered a pattern that appeared to show that Metronet was paying its shareholder-suppliers for work that had not been done.

2.13 The Chair and Chief Executive of the company were appointed from within its composite companies and therefore had a lack of independent oversight. The Committee strongly criticised the poor management structure of Metronet: "A clear line of responsibility and accountability needs to be established between the work done on the ground and those charged with overseeing that work".<sup>63</sup>

<sup>58</sup> *Ibid*, para 3.6.

<sup>59</sup> *Ibid*, para 2.17.

<sup>60</sup> "A Tale of Two Infracos", London Assembly Transport Committee, 2007, p 3.

<sup>61</sup> *Ibid*, para 3.48

<sup>62</sup> Available at: [http://www.ppparbiter.org.uk/files/uploads/n\\_guidance/2006112012398LaMR%202006%20final%20guidance.PDF](http://www.ppparbiter.org.uk/files/uploads/n_guidance/2006112012398LaMR%202006%20final%20guidance.PDF)

<sup>63</sup> *Ibid*, para 3.31.

2.14 The Committee made a number of recommendations to improve Metronet's corporate structure. The Committee had previously endorsed the PPP Arbiter's call for a non-executive Chair, which Metronet heeded. The Committee went further and called for Metronet's board to have a majority of independent members to ensure any casting vote was an objective one. It also recommended that Metronet should contract out its station and track work on a competitive basis.

2.15 The Committee considered the implications of a possible Extraordinary Review. It emphasised that Londoners should not have to bear any additional costs if London Underground was found liable for any of the additional funding claimed by Metronet. Finally, the Committee recommended that the Government prepare for the possibility of stripping Metronet of some of its responsibilities on the basis that the management of nine out of the 12 lines was too much for any company to take on within the PPP contracts.

### 3. THE PPP ADMINISTRATION AND THE EXTRAORDINARY REVIEW

3.1 On 11 September, the Committee discussed the PPP Administration with Alan Bloom, joint PPP Administrator, Tim O'Toole, Managing Director of London Underground and Chris Bolt, the PPP Arbiter. The Committee's key findings from the meeting can be found on the Committee FAQs: [http://www.london.gov.uk/assembly/scrutiny/transport\\_ppp\\_faq.jsp](http://www.london.gov.uk/assembly/scrutiny/transport_ppp_faq.jsp)

3.2 The Committee has also written to the Administrators for additional information in the light of emerging findings from the Administrators and Arbiter. A detailed breakdown of the drawdowns made on the loan facility are contained in the letter entitled "Further information on the funding costs of the Administration", found under the "related documents" section.

3.3 The Committee recently wrote to the Administrators (letter dated 24 September which can be found under "related documents" on the website above) seeking further clarification of how the valuation of the companies would fully take account of the Arbiter's recent "initial thoughts" on the Extraordinary Review. In these, the Arbiter had stated that Metronet BCV could be due an increase in the Infrastructure Service Charge (ISC) of between £140 million and £470 million. The Arbiter also found that Metronet SSL could be due an increase in the ISC of between £290 million and £650 million.

3.4 Such an increase in the income of the companies would appear to have an impact on their value and therefore whether they are attractive to potential buyers. The Administrator told the Committee that Metronet's PPP contracts were its main asset. It appears that an increase in the ISC, as proposed by the Arbiter, would increase the value of these assets. London Underground has stated that it does not believe the contracts will be marketable and that it would therefore like to take the management of the contracts in-house.

3.5 The Chairman of the London Assembly Transport Committee would be happy to attend one of the Select Committee's meetings on this topic to discuss these issues further.

*October 2007*

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## **Memorandum from Transport for London (TfL) (PPP 12)**

### 1. INTRODUCTION

1.1 Transport for London (TfL) welcomes the opportunity to comment on the Committee's inquiry into the London Underground Public Private Partnership (PPP). Our response sets out an account of the performance of the PPP since its contract commencement in 2003 and provides some commentary on the recent PPP administration of two of the infrastructure companies, Metronet Rail BCV Limited and Metronet Rail SSL Limited (the Metronet Infracos).

### 2. BACKGROUND

2.1 TfL was created in 2000 as the integrated body responsible for the Capital's transport system. The primary role of TfL, which is a functional body of the Greater London Authority, is to implement the Mayor of London's Transport Strategy and manage transport services across the Capital. London Underground (LU) became part of TfL in 2003 and is responsible for operating the LU rail network. It owns (in part or whole) 250 stations and operates services on 12 lines.

2.2 Today LU is carrying more passengers than ever before. On 8 December 2006, approximately 4 million passenger journeys were made, the highest number in LU's 144-year history; and in 2006-07 more than 1 billion journeys were made—the highest ever annual number of passenger journeys. Last year also saw the highest ever level of service with 69.8 million train kilometres operated. At the same time the pace of the investment programme continues to increase and is now much in evidence across the Underground network.

2.3 With London's economic growth gathering pace we anticipate Tube demand to grow by around 25% over the next decade. The benefits of growth will only be experienced if investment is sustained. The direct customer benefit of PPP capacity increases is £12.5 billion with additional benefits to the economy of London as a whole of £20 billion over the contract life of the PPP.

2.4 As the Committee is aware, despite TfL's concerns about the PPP structure, the Government adopted this as its preferred solution for investing in the Tube. These concerns are a matter of public record and will not be repeated again here. TfL has committed to make the best of the position it inherited.

2.5 Under the 30-year PPP contracts, the Infracos are responsible for the maintenance, renewal and upgrade of LU's assets—its rolling stock, stations, track, tunnels and signals. LU continues to have ultimate responsibility for safety and is responsible for the delivery of all Tube services. LU manages the PPP contracts, demanding strong performance from Metronet and Tube Lines on behalf of the Mayor and the Government and ultimately the millions who rely on the Tube each day.

2.6 Imperfect as it is, and despite the high profile failings, the PPP has delivered tangible benefits from the investment in the first four years.

### 3. METRONET ADMINISTRATION

3.1 On 18 July 2007 both Metronet Infracos entered PPP Administration. Metronet's performance had been an escalating concern for LU with the performance disparity between Metronet and Tube Lines becoming ever greater since 2003. In November 2006, the PPP Arbiter published his first Annual Metronet Report. LU's concerns about Metronet's performance were borne out by the Arbiter's findings, which were that "neither Metronet BCV nor Metronet SSL has carried out its activities, over the period from 4 April 2003 to 31 March 2006 as a whole in an efficient and economic manner and in accordance with Good Industry Practice". This conclusion was a major factor in TfL calling for Metronet to seek an Extraordinary Review in February 2007 as the only solution for getting clarity on the cost overruns issue.

3.2 In June, Metronet requested an Extraordinary Review of the BCV contract, claiming an additional £992 million of cost overruns. Metronet further requested that £551 million of the £992 million be paid in the current period, prior to the conclusion of the Extraordinary Review because of its then current liquidity position. The Arbiter issued a draft direction on the latter request on 16 July to the effect that the Infrastructure Service Charge should increase by only £121 million based on his initial assessment of the appropriate level for the next 12 months for a company performing in an economic and efficient manner in line with Good Industry Practice, but no payment should be made before January 2008 by which time the Arbiter may well have reached a definitive position on all the evidence. TfL maintains that the Arbiter's initial decision assumed facts favourable to Metronet and does not represent a likely outcome based on all the evidence.

3.3 In the days following this draft finding, both Metronet Infracos determined that they would not be able to meet its obligations as they fell due and the directors of each Metronet Infraco requested that the Mayor applied for the Metronet Infracos to be placed into PPP Administration under the provisions of the GLA Act, which status was granted on 18 July.

Three of the most serious of Metronet's failings are set out below.

3.4 First, their basic maintenance performance, which reduced Metronet's expected revenues. In 2006–07 all but two Metronet lines (apart from the Central and Waterloo & City lines), showed deterioration on 2005–06 availability performance (lost customer hours). Performance in lost customer hours across half the Metronet lines were below Metronet's bid expectation.

3.5 Metronet failed to heed the numerous warnings from LU over basic maintenance. Since 2003, LU had repeatedly called on both Tube Lines and Metronet to focus on basic asset maintenance and reliability in order for the system to withstand the stress brought on by upgrade works. The Victoria line for example has suffered from insufficient attention to maintenance and this has resulted in one of the most reliable LU lines becoming one of the worst performing.

3.6 As a result of Metronet's spiralling performance problems, in 2006–07 both Metronet Infracos incurred sizeable financial penalties for their performance against contractual measures (£22.4 million in total). Since the start of the contracts, the two Metronet companies have incurred net abatements of £23.9 million compared to a bid expectation of net bonuses totalling £83.5 million for this stage in the contract. Therefore total Metronet performance adjustments are over £107 million worse than their original plan.

3.7 The second major failing was Metronet's inability to plan and execute works effectively, as evidenced by their high-profile track failures eg in summer 2006 when they did not prepare the tracks for the summer heat, leading to speed restrictions. This was one of Metronet's most prominent failings which contributed to LU taking the extreme step of issuing an Emergency Direction to Metronet in order to get this and other matters resolved.

3.8 In addition, Metronet's performance in delivering its station programme was seriously behind schedule and substantially over budget by the end of 2006–07. In both 2004–05 and 2005–06, Metronet BCV failed to complete any of the stations projects due by the original contract date. Only two of the seven projects due in 2006–07 were completed in the year. For the sub-surface contract, whilst eight stations were completed in 2005–06, they were on average 34 weeks late, and the seven stations delivered in 2006–07 were on average 28 weeks late.

3.9 Thirdly, there were significant structural issues in Metronet's management, that were the root cause of the above and that prevented Metronet from recovering its situation. Metronet's contracting strategy for stations and civils (through the conglomerate "Trans4m") had been the source of criticism for some time due to the lack of competitive pricing and Metronet's subsequent inability or unwillingness to apply the appropriate pressure when programme milestones were missed and costs escalated. Another fault in the contracting strategy, for example, in relation to track and trains, was that the payment provisions did not adequately incentivise performance—in some instances, fixed payments were made which were neither linked to performance nor achievement of milestones. With a myriad of sub-contractors and shareholders involved in the Trans4m organisation and supply chain, effective project management was vital, and fatally lacking. TfL believes that this was one of the fundamental factors behind the companies' cost overruns and ultimate collapse. Metronet was not in charge of delivery of its obligations in any conventional sense, and it lacked even the most basic financial controls and information to address the situation.

The key events leading to Metronet's insolvency are set out in Appendix 1.

3.10 Moving forward, the Mayor and the Government are now considering options for ensuring delivery of the commitments set out in the PPP contracts. TfL believes that it is in the best interests of all parties for Metronet to exit administration as soon as possible. TfL believes that this is the best way to maintain the continued safe operation of the Tube network and to mitigate possible performance and financial risks. To achieve this goal, on 24 August TfL lodged with the PPP Administrators a formal Expression of Interest for bidding for the assets of the Metronet Infracos in order that TfL may take control of the operations of the Underground. This would ensure stability for the day-to-day running of the Tube and the ongoing upgrade programme, whilst options for the long-term commercial structure are carefully considered.

#### 4. OVERALL PERFORMANCE OF THE PPP

4.1 The Committee noted in its report of March 2005 that "it would be wrong to claim that the PPP had produced no benefits for the Tube". This remains the case. Despite the failings of Metronet and the many frustrations in managing such complex contracts, the PPP has delivered an improvement in the Underground. Since the Committee last considered the Tube PPP and in the last year in particular, the fruits of the investment programme have begun to be seen by passengers and at the same time as there has been a dramatic increase in passenger numbers.

4.2 61 stations have been completed ("delivered into service") and a further 30 have been declared complete by the Infraco and are under review by LU. In the last year, works to provide step free access at Brixton have been completed, new escalators at North Greenwich have been installed in time to support the opening of the O<sup>2</sup> venue, and the new station at Wembley Park proved a showcase, coping admirably with its first FA cup final in May 2007. Over 40 km of track were renewed during the year, the first new Victoria line train arrived on the line for testing and three-quarters of the District line train fleet has been refurbished.

4.3 It has been well-documented that Tube Lines has been more successful at delivering its investment programme to date. The station programme is on schedule and the Jubilee line 7-car project, adding 17% more capacity to the line, was delivered on time and on budget. This has been followed up by tangible progress on the Jubilee and Northern line upgrades and an improvement in Piccadilly line performance. Some elements of the infrastructure renewal plan are running ahead of schedule. While Tube Lines has been significantly more successful than Metronet, its performance record is not unblemished. In particular, performance of the Northern line has been of concern, leading LU, in December 2005, to issue a Corrective Action Notice (CAN) to Tube Lines. Since issue of the CAN performance on the Northern line has seen some improvement.

#### 5. CONCLUSION

5.1 The PPP was not the vehicle of TfL's choosing for the upgrading of London Underground. Imperfect as it is, and despite the failings and frustrations, it has provided a vital investment stream for the Underground.

5.2 The performance of Tube Lines tells us that the PPP contracts are not unworkable and we believe that Metronet's collapse was predominantly due to that organisation's fundamental flaws rather than failure of the PPP contract per se.

5.3 As the Committee noted in its last report, ensuring competition within the PPP is crucial in ensuring it can deliver the improvements originally envisaged. Lack of competitive pricing and inadequate contractual incentives within Metronet's own supply-chain was one of the critical factors leading to the cost overruns and ultimate collapse of the two Metronet companies. This will be an important lesson for the future.

5.4 TfL's first goal in the Administration process which started on 18 July was the continued safe and reliable operation of the Tube network. This has been achieved. TfL expects to submit a formal bid for the assets of the two Metronet companies in order to ensure stability for the day-to-day running of the Tube and mitigation of performance and cost risks. This period will enable the Mayor and the Government to consider options for taking forward the PPP contracts.

5.5 Tackling the legacy of under-investment is a complex and long-term task which has only just started. It is critical that at this time, when it would be easy to be distracted by the details of the arrangements that will succeed the Metronet Infracos, that the bigger picture is not forgotten. The ultimate goal, and the overriding concern of all of those who rely on it everyday, is the investment in and modernisation of the Tube. Regardless of the vehicle used to achieve this, it is vital that funding for the programme is sustained and that all stakeholders continue to support the aim of a renewed Underground system. Without this commitment, London will not be able to sustain population and job growth to the detriment not only of the Capital but the rest of the UK.

## APPENDIX 1

The following is a timeline of events leading to Metronet entering administration.

1. On 29 June 2007 Metronet Rail BCV Limited ("MRBCV") filed for an Extraordinary Review with the PPP Arbiter, claiming additional costs for which it sought reimbursement of £992 million. As part of that filing, MRBCV asked for an Interim Adjustment to the Infrastructure Service Charge of £400 million, which was later increased to £551 million. MRBCV requested the interim relief because its lenders had suspended further funding, its shareholders had declined to contribute further resources and its cash reserves and future payments from LU were insufficient to meet its obligations, according to its projections.

2. On 16 July, the PPP arbiter issued a draft determination on MRBCV's request for interim relief that provisionally awarded £121 million, payable beginning January 2008 and subject to various conditions regarding solvency of MRBCV. The interim increase in the Infrastructure Service Charge and the conditions for and timing of its payment in the draft determination left MRBCV with insufficient resources to discharge its contractual obligations.

3. The Metronet Infracos are subject to a special insolvency regime known as PPP administration introduced by sections 220 to 224 of the Greater London Authority Act 1999 ("GLA Act"). This special regime allows the Mayor to apply for a PPP administration order. Under a PPP administration order, the court directs one or more named insolvency practitioners (each known as a PPP administrator) to manage the affairs, business and property of the Metronet Infracos for the achievement of the purposes of the PPP administration order as set out in the GLA Act 1999 and in a manner which protects the respective interests of the members and creditors of the Metronet Infracos. The purposes of a PPP administration order are:

- the transfer to another company or (as respects different parts of its undertaking) two or more companies, as a going concern, of so much of the company's undertaking as it is necessary to transfer in order to ensure that the activities may be properly carried on; and
- the carrying on of those relevant activities pending the making of the transfer.

4. Letters were received by LU from the Directors of both Metronet Infracos on 17 July 2007 confirming that, as a result of the PPP Arbiter's draft directions in respect of MRBCV's claim for an interim adjustment to the Infrastructure Service Charge and following discussions between the companies, their lenders and shareholders, both Metronet Infracos had concluded that they were or were likely to become unable to pay their debts. On that basis both Metronet Infracos invited the Mayor to petition for the appointment of a PPP Administrator to both Metronet Infracos.

5. A Mayoral Approval Form ("MAF") was signed by the Mayor on 17 July 2007. The MAF recorded the Mayor's directions concerning the presentation of a petition and the provision of a loan facility and indemnity to the PPP administrators. Following the Mayor's direction, petitions for PPP administration of the Metronet Infracos were submitted by TfL to the High Court at 8:00 am Wednesday 18 July 2007. Orders were granted by Mr Justice Lightman appointing three partners and one director from Ernst & Young LLP as the PPP administrators.

*October 2007*

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### Memorandum from the Confederation of British Industry (CBI) (PPP 13)

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. Our membership ranges from multinational organisations through to SME and trade associations. CBI London's priority is to help shape policy with the aim of strengthening London as a place to do business and maintaining its competitive edge, and transport plays a central role in this.

Business is a funder and user of public transport in the capital. Carrying over three million passengers a day, the underground network is fundamental for business. The tube modernisation programme is vital to the economic well being of London. We continue to urge the government to demonstrate strong commitment to the modernisation of the underground network: In the latest CBI/KPMG London Business Survey of business leaders in the capital, 96% said the tube modernisation programme is vital for the capital.

The tube PPP has paved the way for the largest improvement programme the tube has ever seen—to modernise a system that has suffered from decades of under-investment. And some real improvements are being felt on the ground: in the London Business Survey over a quarter said the service was good or excellent, up from 12% in the previous year. However, there is clearly further room for improvement.

Tube Lines's performance clearly shows that the PPP approach can bring substantial improvements to the Underground on time and on budget.

For example some of their key achievements are:

- adding an extra car to every Jubilee line train at the end of 2005, adding 17% extra capacity
- replacing or refurbished over 90km of track
- providing upgrades to 47 stations.
- virtually eliminating graffiti
- installing new lifts to make a number of stations fully accessible
- deploying innovative methods to speed up escalator installations.

More generally, PPPs have brought substantial benefits to British public services. They provide financial and professional benefits which cannot be brought by government alone, and will become increasingly important in the future as public spending becomes more constrained.

For nearly two decades, and particularly since 1997, the Private Finance Initiative has been used to deliver a range of public facilities, including prisons, schools, hospitals and infrastructure projects. PFI has enabled a significant investment in the UK's public assets and projects are delivered on time and to budget. The vast majority of these are successful.

The collapse of Metronet should not be used as a premise to undermine the model of PPPs. Rather, the priority should be to complete the administration process, review the contracts and re-let them to another provider, preserving the principle that the risk should be shared between government and the provider. The modernisation of the underground is vital to business and enhancing London's reputation as a world class city.

*October 2007*

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