Subject: The London Underground Public Private Partnership

Report Number:  5

Report to:  Transport Committee

Date:   13 November 2008

Report of:  Executive Director of Secretariat

1. Recommendations

1.1 That the Committee carry out an investigation into the London Underground Public Private Partnerships with terms of reference as outlined at paragraph 3.23

1.2 That the Committee Note the report as a background to putting questions to Terry Morgan, Chief Executive of Tube Lines and Tim O’Toole, Managing Director of London Underground.

2. Background

2.1 On 9 September 2008 the PPP Arbiter announced his initial view of future costs for Tube Lines in the second 7½ years of its agreement with London Underground, which will run from 2010. The Arbiter assessed the costs of the contract over the period in the range of £5.1 - £5.5 billion. In its submission to the Arbiter, London Underground Limited projected costs of £4.1 billion suggesting a potential shortfall in funding in excess of £1 billion.

2.2 In order to respond to this announcement, it was agreed that the Transport Committee’s planned piece of work on the PPP should be brought forward and the PPP Arbiter, Chris Bolt, attended the Committee’s meeting on 16 October. The Managing Director of London Underground, Tim O’Toole, and the Chief Executive of Tube Lines, Terry Morgan, will give evidence at the meeting on 13 November 2008. The following scope is proposed for the inquiry.

3 Issues for consideration

Purpose of the investigation

3.1 It is proposed that the Committee conducts an investigation into London Underground and the Public Private Partnership (PPP) contracts. The timing of the investigation has been driven in part by the Arbiter’s report of 9 September into Tube Lines’ costs, although other aspects of the programme of work to upgrade the Underground network would be considered.
3.2 The purpose of the investigation would be to produce a report which would bring together a range of up-to-date sources of information relating to the tube upgrade so that the current review process and its implications can be more widely and accurately understood. Examination and interpretation by the Committee of the contents of the Arbiter’s recent guidance and responses from Transport for London, the Infraco and Government would mean that potential repercussions for Londoners in terms of the future scope and costs of the upgrades could be set out. Additionally, as evidence builds up as to the advantages and disadvantages of the PPP structure for maintaining and renewing infrastructure and raising finance, the report would give the Committee the opportunity to add its voice to this debate.

3.3 The Committee would seek to draw conclusions and/or make recommendations in relation to:
- the potential funding gap for the second Review Period;
- the availability of performance and financial information;
- progress towards the conclusion of the Periodic Review;
- value for money; and
- mechanisms for raising finance and delivering the upgrades in the longer-term.

The PPP contracts

3.4 The maintenance and renewal of the Tube’s infrastructure requires a vast, hugely expensive and disruptive programme of work that affects large numbers of tax-paying and travelling Londoners every day. London Underground’s contractual relationships with the private sector to deliver the upgrades, and the arrangements for funding and financing, are extraordinarily complex.

3.5 London Underground entered into PPP contracts to upgrade the Underground network with Tube Lines in December 2002 and Metronet in April 2003. Metronet, which went into administration in July 2007 and was transferred into Transport for London control in May 2008, was responsible for the renewal of two thirds of the network. Tube Lines is responsible for maintaining and renewing assets (rolling stock, stations, track, tunnels and signals) on the remaining lines: Jubilee, Northern and Piccadilly.

3.6 The programme of works to be undertaken by the Infrastructure Companies (Infracos) under the 30-year PPP Agreements was designed to deliver the following:
- maintenance of assets, such as rolling stock, signals, track, lifts and escalators;
- renewals and upgrades of infrastructure to reverse historic under-investment, including track reconditioning, station modernisation and “line upgrades” (new trains and/or signalling to increase capacity); and
- an improved understanding of the condition of London Underground’s assets.

3.7 The output-based contracts included financial incentives to secure high levels of performance from the Infracos. Consequently, regular payments made by London Underground to the remaining private sector Infraco include adjustments for bonuses and abatements related to performance. The principal contractual measures are:

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1 On 27 May 2008, the business and the majority of assets and liabilities of Metronet Rail BCV Limited and Metronet Rail SSL Limited transferred to two new, standalone companies within Transport for London.
• Availability: a measure of day-to-day reliability based on whether assets are available for service.
• Capability: a measure of what the assets are capable of delivering in terms of capacity and reduced customer journey time.
• Ambience: a measure of the quality of the travelling environment.

3.8 Contract prices were only fixed for the first of four 7½ year ‘Review Periods’ and the first ‘Periodic Review’ of the payments to Tube Lines is scheduled for 2010.

3.9 In the first 7½ year Review Period, Tube Lines has focused on reliability improvements, station works, upgrading the Jubilee line and the initial stages of its other line upgrades. Its performance is measured against 181 benchmarks set out in its PPP contract. These targets cover the number of trains available on each line for LUL to operate, the ambience of stations, the state of a station facilities (such as ticket machines and train time readers), and the rate at which track, lifts, escalators, and stations are being renewed, refurbished or otherwise modernised.

3.10 Tube Lines anticipates the following improvements over its 30 year Agreement:

- Upgrades of the signalling on all three of its lines to allow increases in capacity and reliability, and reduced journey times:
  - the Jubilee line upgrade will be completed in 2009, which, along with the addition of a seventh car (completed in 2005), could result in some 40% additional capacity;
  - the Northern line upgrade will be completed in 2011 – 30% more capacity; and
  - the Piccadilly line upgrade will be completed in 2014 – up to 20% more capacity.
- Upgrades of all 100 stations on these lines, with an emphasis on improving security, information and the general environment for passengers. 97 will be upgraded by 2010.
- The introduction of a new fleet of trains on the Piccadilly line in 2014 and refurbishment of the fleet on the other two lines.
- Replacement and refurbishment of hundreds of kilometres of track, as well as lifts and escalators.
- Improvements to the general travelling environment for passengers.²

3.11 To date, Tube Lines has upgraded 58 stations, replaced or refurbished over 95km of track and refurbished 62 escalators, as well as installing new lifts to enhance accessibility and improving the cleanliness of the network.³ Tube Lines reports that it has invested £1.9 billion in the upgrade programme so far and anticipates that figure rising to £4.5 billion by the end of the first Review Period in 2010.⁴

Metronet’s collapse

3.12 In May 2007, Metronet admitted that it was expecting an overspend of more than £1 billion.⁵ Metronet made a reference to the Arbiter requesting additional payments from London Underground. However, the Arbiter judged that an efficient and economic Infraco would not

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⁴ Tube Lines, *Five Year Review*, 2008, p. 6
⁵ “Tube contractor pins hopes on review as overshoot hits £1bn”, *The Guardian*, 23 May 2007
have incurred Metronet’s level of overspend and it went into administration on 18 July 2007. The people and assets of the two Metronet companies were transferred into two Transport for London nominee companies to be managed on a stand-alone basis while the long-term structure is agreed.

3.13 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 Metronet sections of the Underground in the long-term.

3.14 The previous London Assembly Transport Committee published a report into performance of the PPP contracts in January 2007 when it had become clear that Metronet was under-performing. The Committee praised Tube Lines for its “clear lines of command [and] ambitious long term spending programme”, and for delivering “substantial improvements to the Underground to time and budget, often exceeding their contractual obligation”. It concluded, “Tube Lines has demonstrated that the PPP can work. Metronet has demonstrated that the PPP can fail.”

3.15 The House of Commons Transport Committee described Tube Lines’ performance as providing “an example of private sector innovation and efficiency”, although it also expressed concerns about the structure of the PPP contracts:

> 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. […] 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.

### The Arbiter’s guidance on Tube Lines costs

3.16 On 14 April 2008, London Underground made a reference to the Arbiter in relation to its PPP Agreement with Tube Lines. London Underground was seeking clarity over costs that Tube Lines would be able to claim in the second 7½ year Review Period, from 1 July 2010 to 30 December 2017. On 9 September, the Arbiter published his assessment of the situation at this stage. A final determination (if required) would not be made until nearer the end of the first Review Period.

3.17 The Arbiter assessed the costs of the contract over the period in the range of £5.1 - £5.5 billion. In its submission to the Arbiter, London Underground Limited projected costs of £4.1 billion suggesting a potential shortfall in funding in excess of £1 billion. The Mayor and Transport for London have argued that the Government should provide additional funding. If TfL is unable to secure additional funding from the Government, increased costs could force London Underground to descope or delay the upgrade work.

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7 London Assembly Transport Committee, A Tale of Two Infracos, January 2007, page 3
9 Ibid, page 32
10 “Arbiter publishes his initial view of future costs for Tube Lines”, Office of the PPP Arbiter press release, 9 September 2008
12 The costs in the Arbiter’s report relate to the original scope for the second Review Period, which was agreed prior to the implementation of the PPP. A final cost determination by the Arbiter would be dependent on decisions by London Underground on the actual scope and timings of work between 2010 and 2017.
3.18 Professor Stephen Glaister said the following in response to the Arbiter’s report:

The PPP was claiming to deliver a programme of work over 30 years. That programme cannot be delivered for what the government thought it would cost originally. The work cannot be done, so the government will have to pay a lot more money. If the programme is not carried out, then we have got a serious problem with capacity on the tube in London."

3.19 RMT general secretary Bob Crow said,

After Metronet’s collapse left the public with a £2 billion extra bill, the alarm bells should be ringing and it is important to understand that 95% of Tube Lines’ colossal liabilities are also underwritten by the public purse.

One way or another there are going to be substantial additional costs if the upgrades are to be delivered, and the obvious question is who will foot that bill.

Subsidy for the Tube has increased 20-fold as a result of the PPP, and Tube Lines has been taking £1 million a week in profits for its shareholders, and now they are asking for £2 billion more than the arbiter thinks their costs should be.

Once more it is clear that the risk involved in the PPP is being borne by the public, not by those who have been draining huge sums in public money out of the industry as profits.

The PPP, like all PFI projects, is a complex scam designed to convert public money into private profit, and these contracts should be brought in-house now.

Tube Lines said, “We continue to believe that we are providing value for money in the work we are currently delivering”.  

The Periodic Review

3.20 The Arbiter’s Guidance is the first stage in agreeing a price for the second Review Period of the Tube Lines PPP contract. London Underground must now decide on the final scope of the contract (Restated Terms) by the end of this year before Tube Lines offers a contract price next summer. If TfL and Tube Lines cannot agree a contract price, the Arbiter will be called upon to determine it. The price must be agreed by summer 2010, when the second Review Period begins.

3.21 London’s Transport Commissioner, Peter Hendy, has expressed concern that the Arbiter’s recent guidance “fails to provide transparency in Tube Lines’ costs in areas such as ‘central costs’ and ‘risk’”, and so does not provide maximum assistance with preparations for the Periodic Review.

Proposed terms of reference

3.22 In order to respond to the Arbiter’s guidance, the Chair of the Transport Committee agreed that the Transport Committee’s planned piece of work on the PPP should be brought forward. As part of this investigation, the PPP Arbiter, Chris Bolt, attended the meeting on 16 October. The Managing Director of London Underground, Tim O’Toole, and the Chief Executive of Tube Lines, Terry Morgan, will attend the Committee’s meeting on 13 November 2008.

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13 “London tube faces £3bn black hole”, Guardian Unlimited, 9 September 2008
14 Ibid
15 “Taxpayers warned about £1bn tube shortfall”, Press Association National Newswire, 9 September 2008
3.23 The proposed terms of reference are:

- To examine the likely scope and cost of the programme of work to maintain and upgrade the Tube network between 2010 and 2017.
- To examine the Periodic Review process and potential outcomes.
- To examine evidence in relation to the value for money provided by the PPP structure.

**Stakeholders**

3.24 The following key stakeholders have been invited to attend Committee sessions to give evidence:

- the PPP Arbiter;
- Tube Lines; and
- London Underground.

3.25 Written submissions would also be welcome from other interested parties.

**Methodology and timetable**

3.26 Key dates and a proposed timetable for completion of the investigation are presented in the table below.

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
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<tbody>
<tr>
<td>The PPP Arbiter gave evidence to Committee</td>
<td>16 October 2008</td>
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<tr>
<td>Scoping report considered</td>
<td>13 November</td>
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<tr>
<td>Tube Lines and London Underground give evidence to the Committee</td>
<td>13 November</td>
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<tr>
<td>Anticipated publication by LU of performance data in relation to the PPP contracts</td>
<td>Autumn</td>
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<tr>
<td>Deadline for TfL to submit its 2009/10 budget to the Mayor</td>
<td>30 November</td>
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<td>Deadline for written submissions</td>
<td>mid-December</td>
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<tr>
<td>Mayor’s draft budget proposals issued for consultation</td>
<td>mid-December</td>
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<tr>
<td>Deadline for London Underground to present Restated Terms to Tube Lines (this will not be published)</td>
<td>31 December</td>
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<tr>
<td>Assembly Plenary with Mayor and TfL</td>
<td>14 January 2009</td>
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<tr>
<td>Potential Transport Committee session on TfL’s Business Plan</td>
<td>20 January</td>
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<tr>
<td>Assembly meeting to consider Mayor’s draft budget proposals</td>
<td>28 January</td>
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<tr>
<td>Assembly to consider and final draft budget</td>
<td>11 February</td>
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<td>Transport Committee meeting agenda to print</td>
<td>27 February</td>
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<tr>
<td>Report considered by Committee</td>
<td>10 March</td>
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3.27 Analysis of the Arbiter’s 9 September report and oral evidence from the Arbiter, Tube Lines and London Underground would form the basis of a report. Written evidence would also be requested from the key stakeholders.

3.28 If, as anticipated, London Underground publishes performance data in relation to the PPP contracts before the report has been finalised, it could be used to inform the Committee’s report.
3.29 Although London Underground’s Restated Terms are due to be presented to Tube Lines by 31 December 2008, they are unlikely to be published at that stage and detailed information about Tube Lines’ obligations for the second Review Period may not be available until the conclusion of the Periodic Review process in mid-2010.

3.30 Transport for London’s new ten-year Business Plan and its budget for 2009/10 are due to be published during November. The Committee is likely to look to discuss the Business Plan with Transport for London at its session on either 13 November or 20 January. Information in the Business Plan relating to anticipated spending on London Underground could be examined at that session and presented as part of the Committee’s PPP report.

3.31 The Assembly’s Plenary session with the Mayor and Transport for London on 14 January would also provide an opportunity for Members to seek further information on the future scope, costs and structure of the Tube upgrades. Relevant evidence resulting from the Plenary session would inform the Transport Committee’s report.

4  Strategy Implications

4.1 Chapter 4C of the Mayor’s Transport Strategy relates to the performance of the London Underground.

5.  Legal Implications

5.1 Section 59 GLA Act 1999 requires the Assembly to keep under review the exercise by the Mayor of his statutory functions.

5.2 Section 54(1) GLA Act enables the Assembly to arrange for any of its functions to be discharged by a committee or sub-committee of the Assembly or by a single member of the Assembly.

6  Financial Implications

6.1 There are no direct financial implications arising from this report.

Background Papers:
- PPP Arbiter, Reference for Guidance from London Underground Ltd, 9 September 2008
- 16 October 2008 Transport Committee meeting minutes

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