6. Brian Harris

Introduction

Unite is the UK & Irelands largest trade union and was formed in May 2007 by a merger of Amicus and the Transport & General Workers Union (TGWU), we have over 2 million members.

We cover every conceivable industrial sector within the UK & Ireland, from the Public Sector including the Health Service (NHS) and Local Government Staff to Private industry including Financial Services (Banking and Insurance), Aerospace Industry, Motor Manufacture/Component Manufacture, the Construction Industry and of course the Transport Industry including Railways, Buses and Ferry organisations.

Public Private Partnership Experience

Unite has dealt many PPP situations within the UK economy from Public Sector building projects such as new hospitals or extensions to existing buildings, however the most relevant experience in relation to this conference is in the PPP contracts for the Maintenance and Infrastructure Renewal of the London Underground Network.

Unite has membership and recognition rights at both the Metronet and Tube Lines the private companies who won these PPP contacts in 2002/2003. Two of the contracts were won by Metronet Rail Ltd the third by Tube Lines.

Unite has held details discussions with both these companies over the future of their PPP contracts in light of the failure of Metronet in July 2007 when it went into PPP Administration. We have submitted written evidence to the UK House of Commons Transport Committee (see appendix 1) and also attended the committee to follow this up with oral evidence.

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1 Brian Harris, Unite Regional Officer, Unite – Amicus Sektion, UK
The conclusion of the Commons Transport committee was a damming report on the abject failure of the Private Sector companies to deliver on their contracts but also recognition from the government that PPP in this instance had failed (see appendix 2).

Unite is currently working with the PPP administrators of the two Metronet contracts in order to return them under a Public Sector banner in the form of nominated company under the control of Transport for London which is the Mayor of London’s Transport Authority.

TFL are the only organisation who has shown a serious interest in taking control of Metronet which is another indication of the failure of the PPP Contract and process.

In conclusion I look forward to participating in the conference and hope that the UK experience from a Trade Union perspective is interesting and can in form the debate in Austria.

Brian Harris – Unite Regional Officer

Attached
APPENDIX 1

Memorandum of Evidence to the Transport Select Committee Inquiry into Public Private Partnership and the London Underground

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 & 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 23rd February 2007 Metronet Rail announced that it had awarded a tranche of six contracts for station upgrades outsi-
de 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.

3. **Health and Safety**

3.1 It must be understood that LU standards of health & 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 & safety advisors.

3.3 In the union’s opinion health & 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 the 5th 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.\(^2\) 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 & 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\(^3\)

\(^2\) Construction News 4th October 2007
\(^3\) Construction News 19th April 2007
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 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 the 4th 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. 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”.

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

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4 Construction News 4th October 2007
5 www.cnplus.co.uk/News/metronets_uncertain_future.html
6 Contract Journal 19th September 2007
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.

5. **Metronet Rail BCV & 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”\(^7\), set against observations that the UK construction industry needs an additional 87,590\(^8\) 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.

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**Bob Rixham**

National Officer – Railways, Buses & Ferries

Unite Amicus Section

October 2007

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\(^7\) Contract Journal 18\(^{th}\) July 2007

\(^8\) Construction Skills Network Report 2007
APPENDIX 2

The extract below is taken from the UK Parliament's Website and is the UK Government Response to the 'House of Commons Transport Committee Second Report - the London Underground and Public-Private Partnership Agreements.'

Unite attended the committee and submitted both written and oral evidence on our experience of working within the PPP Contract.

Web link:
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm

Introduction

This paper sets out the Government's response to the Transport Select Committee's report on London Underground and the Public Private Partnership Agreements (HC 45 published on 25 January 2008). The Government welcomes the interest that the Committee has continued to show in the Underground and the Public Private Partnerships (PPP).

The Underground now carries over a billion passengers every year and is central to the success of London's economy. This is approximately the same number as the entire national rail network in Great Britain, and represents a 65 per cent increase since 1993. Following years of under-investment and neglect, the PPP was implemented to deliver the vital maintenance and capacity upgrades necessary so that the network can cope with this increasing demand and ensure that London has a Tube system that we can all be proud of.

Metronet's collapse was a major disappointment to those with the interests of the travelling public at heart, and the Government is committed to ensuring that all parties learn the appropriate lessons for the future. The Government is also clear that this was predominantly a corporate failure, and that the structural weaknesses of Metronet led to its own downfall.

The Comprehensive Spending Review 2007 settlement for Transport for London, details of which were announced on 6 February,[3] provides the financial framework for the next ten years. This is the first step towards ensuring that the delivery of the maintenance and upgrade of the Underground is placed on a stable, long-term footing. Transport for London is the only party to have tabled a bid for the Metronet contracts and in the short term the contracts are likely to pass to their subsidiaries as an interim measure. The next step is to consider the restructuring of the Metronet contracts and what offers the best solutions for a lasting structure. A Steering Group has been established between the Government, Transport for London and others to develop options for this long-term structure. It is the Steering Group's ambition to report to the Secretary of State and the Mayor jointly by Summer 2008. It is clear that many of the issues identified by the Committee - including risk transfer, information rights and the role of tied supply chains - will form key parts of their deliberations. This report is a welcome and useful contribution to that work.
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)

There are clearly lessons to be learnt from the structure that Metronet adopted, and its inability to operate efficiently and economically in the delivery of the PPP contract requirements. To date Tube Lines appears to have been successful in delivering under a more competitive tendering structure, and belatedly Metronet was moving towards this model.

The Metronet model was perceived as the more traditional model for PPPs and Private Finance Initiatives (PFIs) but, in this case, the role of the executive team in separating the shareholder's interests from the supply chain was not properly developed and the necessary good corporate governance was not in place. In particular it was Metronet's inability to act independently of its shareholders when the deficiencies in its internal arrangements became apparent that was crucial to its collapse. Following the PPP Arbiter’s Annual Report into Metronet in 2006 some action was taken. This included the appointment of Graham Pimlott as an independent non-Executive Chair in January 2007, and the decision not to continue to use Trans4m and award the station modernisation programme through competitive tender to third party contractors. But this was too little, too late to make a material difference to the fate of the company.

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)

The PPP was thoroughly evaluated before the contracts were awarded using the public sector comparator. It was objectively scrutinised by independent observers including the National Audit Office (who reported in December 2000 on the methodology) and Ernst & Young (who provided an independent review for the then Secretary of State).

Tied supply chains can, in certain circumstances, lead to effective delivery. But it is very important that this structure is suitable for the particular contract, and that the role of the partners is very clearly distinguished from their role as contractors. In the case of Metronet this was not apparent, and with hindsight there was a lack of adequate incentives, policing and control within the Metronet consortium. This was noted in the PPP Arbiter’s Annual
Report in 2006 on Metronet which identified that the company was unable to demonstrate the high standards of corporate governance expected, and it could not counter suggestions of a conflict of interest at shareholder level between the competing roles of managing the PPP company and providing services through the supply chain.

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)

The PPP agreements struck a balance between the level of risk transferred to the private sector and that retained in the public sector. Previously a key risk on major enhancements on the Underground was cost overruns and inefficient delivery when the project had been managed by the public sector but delivered by the private sector. In the past the cost overruns and late delivery on the Jubilee and Central line projects of £1.4 billion and £200 million respectively were met by the taxpayer. However, since 2003 London Underground (as part of Transport for London) has gained a record of delivering projects successfully both within and outside the PPP (e.g. the redevelopment of Wembley Park station).

As the National Audit office stated in their report ‘Were they good deals’,[7] the PPP contracts offered nominal returns of up to 20 per cent. This reflected the unique nature of these contracts and was proportionate to the risks being borne. While this rate is higher than other PFI/PPP deals at that time, it was comparable to the expected rate of return on road PFIs, which then came in at around 15 per cent. However this rate of return to the shareholder was not guaranteed. It was dependent on the PPP companies delivering the significant improvements described in the contracts on time and on budget, and that they met their bid levels of performance. The National Audit Office surmised that the likely real rate of returns, at benchmark levels of performance, would be between 10 to 17 per cent. However, these levels of return were also dependent on efficient and economic performance. Under the PPP contracts the costs of inefficient and ineffective work remains with the PPP companies, regardless of the materiality threshold. But as noted by the Committee the effectiveness of this risk transfer within the PPP was based on the continuing solvency of the companies and their ability to pay for uneconomic and inefficient work.

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 Government will always try to negotiate the best and most appropriate deal in any contract. But the greater the level of risk transferred to the private sector, the higher the price this will normally lead to as the lenders reflect this greater risk in the returns on offer. The Underground, in particular, represents a difficult area to clearly allocate and mitigate risk due to a number of challenges. These challenges include the ageing and unknown condition of some of its assets, the difficult and complex environment and the limited working hours available.

Any Government procurement would normally be subject to the appropriate level of scrutiny beforehand, including following the Treasury's Value for Money Assessment Guidance. This process would consider the particular procurement routes and the financial options available, and wider factors such as the strategic benefits, the ability to create a partnership and risk share as part of the value for money evaluations undertaken. Current best practice by the Treasury also now requires a transparent funding competition to be held at the preferred bidder stage. Where the opportunity arises, refinancing can be used to reduce the costs of private sector debt. In the case of Tube Lines it was able to refinance its loans once the PPP contract was complete and this released benefits for both Transport for London and Tube Lines.

The role of lenders in monitoring Metronet's performance was very disappointing, and in particular the failure of the relevant parties to exercise their right to require an Extraordinary Review once it was clear that Metronet had exceeded their materiality threshold. The decision of the parties not to use the right to ask the Arbiter to provide an annual report on Metronet's performance in 2005, involving waiver by Metronet's funders of the right to oblige Metronet to seek such a report, also prevented early scrutiny of the scale of Metronet's difficulties in delivering the contract.

Lenders exposure should, 95 per cent security not withstanding, have been sufficient to incentivise full scrutiny of performance. It is not clear at this stage why Metronet was able to persuade them not to use those rights rigorously. But this is an area that we, together
with Transport for London, London Underground and the Arbiter, will be considering closely as we draw lessons from the experience of Metronet for any future delivery structure.

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)

The Government is fully aware that the involvement of the private sector cannot always guarantee success, nor that they will deliver innovation, efficiency and economy. However there are also examples when the public sector management of major projects, including the Underground in the 1990s, has also been unsuccessful.

It is clear that there is no single procurement model or formula for success in delivering major and complex projects, and the appropriate structure must be adopted in each case. In particular circumstances it is more appropriate that private companies manage projects and provide services, rather than the public sector. As noted by the PPP Arbiter's evidence, the private sector can successfully deliver projects when there are clear outcomes specified in the contract and the company is free to decide the approach that it should take to deliver those outcomes. As the Committee notes, Tube Lines to date has had reasonable success working to the same contract that was applied to Metronet, though with different materiality thresholds.

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)

The materiality threshold was an area that was subject to serious consideration and negotiation within the PPP, and at that time was a unique feature of these contracts.

Within the PPP contracts, the PPP companies were only eligible for efficient and economic costs above the materiality threshold. Costs, such as those down to its own inefficiency will
always be borne by the PPP companies. The level of the materiality threshold will be closely linked to the issues of price and risk transfer. The higher the materiality threshold, the greater risk that costs will be transferred to the private sector. This is likely to lead to a higher price being asked for their services. Any increase in the Tube Lines materiality threshold for the second period would therefore be priced as part of their payments.

However the Government does not agree that the materiality threshold is crucial in all contracts to encourage efficiency and innovation. Many other factors will also play a role in enabling a supplier to deliver efficiently and with innovation. These include specified and agreed outcomes and the freedom to operate without unnecessary constraints or interference.

As the Arbiter discussed with the Committee during his evidence, a higher materiality threshold will potentially focus a company’s attention on cost overruns as they can reach a very high level before they can claim. But this raises the risk that without a suitable mechanism to notify all parties that the increased costs are occurring, they will then reach an unacceptably high level before becoming an issue. Increasing the materiality threshold would therefore only be appropriate if accompanied by adequate monitoring and safeguards.

In the case of Tube Lines, there is a contractual mechanism to seek a direction from the Arbiter when it considers that it has exhausted each £50 million of its £200 million materiality threshold. To date it has not done so. This mechanism should draw attention to the fact that cost overruns are being experienced, and that there is a need for mitigation before the threshold is breached. But it is dependent on the PPP company deciding to exercise it, or their lenders requiring them to implement it. In the second contract period Tube Lines’ materiality threshold will reduce to £50 million, the same as applied to Metronet.

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)

The Government is fully aware that future maintenance costs are central to the planning and commissioning of upgrade work.

A weakness in traditional procurement methods, often a result of funding constraints, is that public bodies would acquire assets on a short-term ‘cost-only’ basis. Any shortcomings in their construction or design, and longer term issues such as higher running or maintenance costs, frequently fell to the public sector.
Good industry practice now requires an approach which considers performance and cost for the whole asset life, including design, construction, maintenance and its eventual replacement. This will be a key consideration in any future arrangement. Whether privately or publicly managed and financed the future structure will need to ensure that it delivers assets that have the best whole life cost, i.e. balancing the cost of design and delivery with the on-going maintenance and operating costs to minimise the total cost of the asset over its entire working life. This enables the delivery of innovative, efficient and economic solutions that meet the operational needs of the Underground. The PPP was built on the basis of whole life decision making, and this approach is one that must be taken forward whichever structure is adopted in the future.

**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)

The Government does not enter any major contract without first fully assessing the level of risk transfer and the appropriate price level for the services being provided. This will be balanced with value for money considerations. Mechanisms such as the public sector comparator are used to ensure that the Government chooses the best value for money deal available. However, it is recognised that this is not an exact science and once the contract is working there will always be other factors and variables that alter the way that the contract performs.

It is inevitable that there will be continued private sector involvement in the improvement and maintenance of the Underground at some level. There are no circumstances in which London Underground would not need to call on appropriate, contracted specialist skills and experience. The key question will be how these are best harnessed within an effective contractual framework. There are a wide range of options being considered within the Steering Group, and these include London Underground having a greater management control than under the PPP arrangements. As noted above it is also essential that any structure allows the enhancement and maintenance of the Underground to be delivered in an innovative, efficient and economic way that provides value for money to both the fare and tax payer, and that the principle of whole life asset management is maintained.

**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 miti-
gated the impact of Metronet’s collapse, if not averted it entirely. However, it is im-
portant 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 per-
formance 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 initia-
ted by a party to the contract. (Paragraph 55)

The issue of independent reporting on the performance of the PPP companies and the
PPP as a whole will form part of the detailed considerations in identifying and taking for-
ward a preferred structure, including the role and function of an arbiter under new arran-
gements.

The Government considers that the statutory appointment of an independent arbiter for the
PPP contracts has had benefits to all stakeholders in the Underground. The Government
also recognises that there are lessons to be learnt from the reporting of Metronet under the
PPP contracts, and in particular from the lack of a Metronet Annual Report for 2005 which
could have indicated problems earlier. But, as recognised by the Committee, it may not
have avoided Metronet’s eventual collapse.

Under a long-term business model, with a 30 year view, we must also consider whether an
automatic annual review is the most appropriate mechanism. The materiality threshold, if
properly monitored and enforced, can be subject to a regular review to determine whether it
is likely to be breached. This breaching could, therefore, be the test of whether the busi-
ness is performing.

The cost of any independent reporting structure must also be weighed up against the bene-
fits in delivering improvements; an alternative option is that of clarifying and confirming
London Underground’s rights for information under the existing contract structure.

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 perfor-
mance of the Infracos. (Paragraph 56)

See answer to Recommendation 11.

11. We recommend that a mechanism be put in place to allow the PPP Arbiter to re-
port 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)

The Government will ask the relevant parties, in particular London Underground and Tube
Lines, to consider the matter of an annual report for Tube Lines, both in 2008 and in future
years. Such a report is not currently part of the PPP, so a mandatory requirement could
only be created through amendment of the contract. This would require Tube Lines’ agreement to change established contractual provisions.

An alternative is a voluntary agreement by the parties asking for guidance in the form of an annual review on whether Tube Lines’ performance was efficient and economic. If both London Underground and Tube Lines agreed to seek such a report from the Arbiter, he would be required (under the terms of the Greater London Authority Act 1999) to prepare it. If only one party requested it, he would have discretion as to whether or not to prepare it. Under any voluntary arrangement it would be possible for either party to withdraw from the reference if they so decided.

London Underground has reported annually on the performance of the PPP since it was implemented, and it is anticipated that this will continue.

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 Government recognises the value that the independent reporting of the Arbiter has brought to the PPP contracts, and this will continue for Tube Lines. No decision has been taken on the long-term arrangements for the Metronet contracts. The Secretary of State's present intention, as set out in the Memorandum of Understanding with Transport for London, is that the role of the PPP Arbiter should continue upon any transfer of the Metronet contracts to Transport for London nominee companies, and that it also remains for the permanent structure. Whatever the new structure of Metronet, the Government considers it should be subject to at least the same level of scrutiny, transparency and reporting as Tube Lines.

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 goldplating 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)

Responsibility for London Underground rests with Transport for London and the Mayor of London under the Greater London Authority Act 1999. London Underground, through the Mayor, must be accountable to London voters in the first instance, and to their own audit and accountability processes to ensure that value for money is achieved on the money spent. Under the terms of the funding provided to Transport for London, they remain accountable to the Secretary of State for Transport and Parliament.
It may be possible under the existing legislation and the PPP framework for the Arbiter to report on the performance of London Underground in relation to the PPP agreement, if that is what the parties sought and where the Arbiter concludes that such reporting is consistent with the duty placed on him by section 231 of the Greater London Authority Act 1999. For example, this could be valid if it could be demonstrated that it was beneficial in helping the PPP contracts to run more efficiently and economically.

The Government disagrees with the proposal that the Arbiter should report more generally on the effectiveness of London Underground within the modernisation of the network outside the PPP regime.

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)

This is an issue that will be examined in the development of the long-term structure.

The Government recognises that in the case of Metronet the contractual mechanisms regarding the Extraordinary Review did not work as well as intended. For Metronet the materiality threshold had clearly been breached but this was not acted upon, and the Government agrees that an earlier commencement would have had benefits, but that it may not have been sufficient to avoid Metronet's eventual PPP administration.

There are certain advantages in the proposal to have reciprocal arrangements to call an Extraordinary Review in any future contractual arrangements. This includes the option of preventing one party having the right to waive an Extraordinary Review when the materiality threshold has been breached.

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)

The Tube Lines PPP contract includes provision that enables them to seek a direction from the Arbiter when they have exceeded each £50 million stage within their materiality threshold of £200 million, during the first period of the PPP contract up to 2010. This enables the Arbiter to assess whether their cost overruns within the PPP contract have been efficient and economic. This should provide a very clear signal of whether Tube Lines is exceeding its projected costs, and whether it is doing so in an efficient and economic way. After 2010 the Tube Lines materiality threshold drops to £50 million, the same as Metronet in Period 1,
therefore it will be important that London Underground and the PPP Arbiter are provided with sufficiently detailed information to understand any movement in Tube Lines' costs.

Clearly the materiality threshold mechanism has potential benefits, and where appropriate the Government will consider including suitable provisions in other contracts. But each contract needs to be assessed separately and will be subject to its own negotiations. As explained earlier, it would be inappropriate for this type of provision to be routinely included in every Government contract.

While it is sensible for the Government to monitor whether a private sector company is performing efficiently and economically within their public sector contracts, the primary responsibility for this duty must continue to remain with the Company's own board, shareholders and funders.

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)

The Government announced to Parliament on 6 February the settlement for Transport for London under the Comprehensive Spending Review 2007. This recognised that Transport for London would need to manage the costs of Metronet in administration and the PPP contracts up to 2017/18, subject to certain conditions as outlined in the Settlement Letter[11] and Memorandum of Understanding. This settlement underlines the Government's commitment to deliver the transport investment central to our continued growth and prosperity.

The Comprehensive Spending Review 2007 settlement included provision regarding the 'Put Option' that was exercised by Metronet's lenders on 5 February 2008. This related to borrowing by the Metronet companies to finance work that had already been undertaken on the maintenance and renewal of the Underground network under the PPP contracts. The Government made £1.7 billion available to Transport for London for it to satisfy the terms of the Put Option. But this was not 'new' money, nor was it a new cost to the taxpayer and it was already reflected in planned public spending. A helpful analogy is to say that this scenario is not dissimilar to someone paying off their mortgage early.

The extent to which Metronet's delivery had slipped behind their spending, and therefore the scale of any long-term costs, will only become clear when London Underground and
Transport for London have been able to review the position that Metronet reached in its works programme, up to its PPP administration on 18 July 2007. As part of the Steering Group's assessment of future structures for the Metronet contracts it is important that we analyse what factors contributed to Metronet's failure. But as Tim O'Toole emphasised in his evidence, there is limited value in over-analysing Metronet's past performance. Our main concern is now learning the lessons from Metronet's failure and moving forward to deliver a structure that provides the necessary improvements for the London Underground in an efficient and economic manner.

It is worth noting that not all of the costs of Metronet's failure will fall on the public purse. Three of Metronet's shareholding companies (Atkins, Bombardier & Balfour Beatty) have already written off £302 million due to the failure of Metronet. We understand that the two remaining shareholders, Thames Water and EDF Energy, have not made any announcements but they are also believed to have written off their equity stakes.

At the start of the PPP contracts, London Underground's asset knowledge was not complete, and future costs could not be properly predicted. The PPP contracts require that all assets whose condition is unknown are surveyed during the first period, however 25 per cent of civil assets are still to be surveyed. Thus the true cost of any required work will not be fully understood until the Periodic Review is completed.

The future structure for the Underground will be based on the most efficient and economic way of delivering the works required by London Underground within its funding constraints. Government has already indicated how much grant it intends to provide Transport for London to 2017/18, subject to certain provisions on further future costs. It is then for Transport for London to allocate this money between modes such as the Underground, Buses, Overground and to deliver Crossrail. Additional funding that is provided by fare revenue, its own prudential borrowing and local taxation is a matter for Transport for London and the Mayor, and not central Government. The Comprehensive Spending Review 2007 settlement gives Transport for London the financial framework needed to manage Metronet's administration, move toward a more stable long-term footing and continue the work to maintain, renew and upgrade the Underground.

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)

The Arbiter has already contributed to the Steering Group's work regarding the future structure for the Underground, and in accordance with the Memorandum of Understanding his views will continue to be solicited as its work progresses. As an independent party, his analysis is a valuable contribution to the work of the Steering Group, and ensures that the scru-
tiny of Metronet within his Annual Report 2006 and Extraordinary Review of Metronet BCV\(^\text{[15]}\) are fully utilised.

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)

The implementation of this recommendation is a matter for London Underground and the PPP Companies, but employee safety is always a top priority for all stakeholders in the Underground.

The Office of Rail Regulation (ORR) is responsible for enforcing health and safety legislation on London Underground. ORR already undertakes work that looks at the safety of contractors on the Underground, including the arrangements for mutual co-operation, by carrying out inspections and investigations and providing advice and guidance on health and safety related matters.

The Government will continue to encourage those organisations with direct responsibility for employee safety to ensure that the highest standards are applied to the network, including the procedures for reporting safety issues. This will remain so in any future arrangements for the Underground. The Committee will have noted the supplementary evidence provided by Tube Lines that indicated that their employees were four times less likely to suffer an injury in their workplace than they were at the time of Transfer. This is backed up by Tube Lines' own surveys that state that in 2005 92 per cent of employees felt safe in their jobs (increased to 95 per cent in the 2007 survey) and 86 per cent felt that health and safety is a top priority within the company (increased to 90 per cent in the 2007 survey).\(^\text{[16]}\)

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)

Passenger safety is of paramount importance to all stakeholders in the Underground. London Underground retains overall responsibility for passenger safety on the network and ORR regulates health and safety on the Underground. As part of its role, ORR is carrying
out additional monitoring of safety during the transition period for the Metronet PPP companies and will investigate and take appropriate action if there is any evidence to suggest deteriorating performance.

The current PPP contracts already incentivise the PPP companies to improve safety. It is a legal requirement that London Underground has appropriate safety management systems and procedures in place to ensure staff and customer safety, and that these have been accepted by ORR. Under the PPP arrangements London Underground monitors the PPP companies’ safety performance, audits their compliance with their own contractual safety cases and London Underground’s own standards, and agrees an annual Safety Improvement Programme.

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. Customer injuries average 1½ persons per 10 million journeys, and the majority of fatalities on the network are due to trespass or suspected suicides, rather than equipment or systems failures. The future arrangements for the Underground will continue to build on this safety record.

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)

The letting of government contracts is subject to procurement law requirements. Within these constraints one of the issues that the Department will continue to consider is the relevant experience of all potential bidders, appropriate to the particular requirement at the time.

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)

There are clearly lessons to be learnt by all parties, including the Government, from the collapse of Metronet and its PPP administration. The Government is determined to learn these lessons and they will be considered by the Steering Group and, where appropriate, taken forward in the new structure for the Underground. But the primary cause of Metronet's demise was its failure to operate efficiently and economically. This was borne out by the independent PPP Arbiter's Annual Report into Metronet in the Autumn of 2006, and was noted in both the Arbiter's and others evidence to the Committee. The Metronet failure was primarily the responsibility of that company and its shareholders, rather than the structure of the PPP. Tube Lines’ performance to date is evidence of private sector innovation and efficiency.
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)

The Government is not a party to the PPP contracts and does not have access to all the relevant and detailed information that such an analysis would require. A number of organisations have also announced their intention to produce reports or already published them into the failure of Metronet. This includes the Committee’s report, the PPP Arbiter (with his Annual Report 2006 and other documents relating to the Metronet Extraordinary Review) and the National Audit Office. Together these will provide a full and wide ranging analysis of the collapse of Metronet. The Government does not believe that another report would add any value to this process.

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)

The Government is fully aware that the involvement of the private sector cannot always guarantee success, nor that they will always deliver innovation, efficiency and economy. However there are also many examples when the public sector management of major projects has also been unsuccessful.

It is clear that there is no single procurement model or formula for success in delivering major and complex projects, and the appropriate structure must be adopted in each case. In particular circumstances it is more appropriate that private companies manage projects and provide services, rather than the public sector. As noted by the PPP Arbiter’s evidence, the private sector can successfully deliver projects when there are clear outcomes specified in the contract and the company is given such flexibility to what approach it should take to deliver those outcomes. As the Committee notes, Tube Lines so far has had success working to the same contract that was applied to Metronet, though with different materiality thresholds.

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)

The Government is working closely with the Mayor and Transport for London to establish the appropriate long-term structure to deliver the essential maintenance and enhancement of the Underground, and the Steering Group will be reporting in the Summer 2008.

The Central and Jubilee line projects taught us that previously London Underground in the 1990s did not have the in house capacity to deliver major enhancements efficiently or effectively. The Metronet experience is a reminder that effective corporate governance is not inherent in private sector companies.

Looking forward, the best value for the taxpayer is likely to continue to come from tasking organisations with what they are best at, within effective governance regimes and with appropriate incentives. It would be wrong to assume that the only option will be to adopt the old, wholly public sector approach and not consider all the relevant alternatives.

1 Written Ministerial Statement by the Secretary of State for Transport on Long term Funding for Transport for London, 6th February 2007; http://www.publications.parliament.uk
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n1

http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n2

3 Metronet Rail news release: Appointment of Graham Pimlott as non-executive Chairman, 14 December 2006; http://www.metronetrail.com
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n3

4 Metronet Rail news release: Metronet awards first six station projects outside of its supply chain, 23 February 2007; http://www.metronetrail.com
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n4

http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n5

http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n6
7 National Audit Office report, 'London Underground PPP: Were they good deals?', June 2004;  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n7#n7

8 Her Majesty's Treasury Value for Money Assessment Guidance, November 2006;  
http://www.hm-treasury.gov.uk  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n8#n8

9 London Underground and the PPP: Data Summary 2006-07 was published instead of the Annual Review 2006-07;  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n9#n9

10 Memorandum of Understanding between the Department for Transport and Transport for London on Metronet, issued on October 4th 2007,  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n10#n10

11 Comprehensive Spending Review 2007, Letter of 4 October 2007 from the Department for Transport to Transport for London,  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n11#n11

12 Atkins 2007 Annual Report & Accounts;  
http://www.atkinsglobal.com  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n12#n12

13 Bombardier Second Quarterly Report, 31 July 2007;  
http://www.bombardier.com  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n13#n13

14 Balfour Beatty Interim Report 2007;  
http://www.balfourbeatty.com  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n14#n14

15 PPP Arbiter's Guidance and Directions;  
http://www.ppparbiter.org.uk/output/page35.asp  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n15#n15

16 Figures for the 2007 survey have been provided by Tube Lines  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n16#n16

17 Community of Metros (CoMET) Benchmarking Report, February 2007  
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n17#n17

18 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 Rail-
way Safety 2005' reported 24 out of 28 respectively;


http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtran/461/46104.htm#n18#n18