

TRANSPORT FOR LONDON

BOARD

SUBJECT: PPP UPDATE

DATE: 10 DECEMBER 2009

1 PURPOSE

- 1.1 The purpose of this paper is to describe the current position regarding the Tube Lines PPP Periodic Review and related issues including:
- (a) Delivery of the Jubilee Line Upgrade (JLU) (with an update on Tube Lines' (TLL's) requirements for access and LU's responses); and
 - (b) Consequential impacts on the Northern Line Upgrade (NLU).
- 1.2 The Board is asked to note this report.
- 1.3 Some areas covered in this paper are subject to confidentiality obligations and therefore detailed questions may need to be addressed in the closed session of the Board meeting.

2 BACKGROUND

- 2.1 The Periodic Review process commenced formally in December 2008 when LU issued Restated Terms and its Affordability Constraints¹ following TfL Board approval on 5 November 2008. The Restated Terms involved pragmatic scope reductions which it was anticipated would result in reductions in price from the current PPP Contract.
- 2.2 On 30 June 2009, TLL submitted its pricing proposals to LU for the second review period (RP2); this showed that TLL's price was well above LU's view of base costs for RP2 of £4.2 billion (2008 prices). It should be noted that LU's view of RP2 costs was based on Initial Ranges Guidance provided by the Arbiter in 2008 with adjustments for reductions in scope, reductions in the risk profile reflected in Restated Terms and changes in economic conditions.
- 2.3 LU engaged with TLL over the summer and came to various agreements over contract terms and scope which led to a marked reduction in TLL's prices, but they were still considered by LU to be unacceptably high. LU's view of RP2 costs remained largely unchanged with scope reductions being offset by identified minor scope omissions. These agreements resulted in further scope reductions from Restated Terms requiring enabling changes to the contract terms.

¹ Restated Terms are part of the Periodic Review process whereby LU gets an opportunity to change the PPP Contract and TLL can revise its pricing for performing the obligations, whether LU changed them or not. Affordability Constraints represent LU's best estimate at the time of the level of payment it expects to be able to afford to pay TLL.

- 2.4 The current position is that, save in relation to the upgrades on all three lines, the parties are close to agreement over scope and performance but in most areas there is no agreement over pricing. The key areas of disagreement are:
- (a) unit rates (and other pricing issues), overheads, central costs and secondment agreements²;
 - (b) the programme for NLU and the extent to which it should have been delivered in RP1;
 - (c) the costs of the upgrades; and
 - (d) access requirements for RP2 relating to upgrades.
- 2.5 On 23 September 2009, LU called upon the PPP Arbiter to set a fair price – he determines financial questions under the PPP Contract in the event that the parties do not agree. The Arbiter intends to publish a draft direction on base costs on around 17 December 2009 together with his views on scope, performance, access and whether the Restated Terms involve a material increase in risk. The outline timetable is attached as Appendix 1.
- 2.6 The parties made further representations to the Arbiter on 17 November 2009 and he intends to hold to his timetable of publishing a draft direction before Christmas in order to ensure that there is time for the RP2 costs to be settled and all consequent contract changes to be captured before June 2010. Key recent developments have been the emerging situation on the JLU and the consequential impacts on NLU. The programme for NLU and the associated access requirements for RP2 have therefore become central issues in the Periodic Review.
- 2.7 In the event that the Arbiter's determination is consistent with LU's view of RP2 costs, there would be no requirement for finance to be raised by TLL. Finance would need to be raised by TLL should the Arbiter's determination exceed LU's view of costs, unless the parties agree to further reductions in the scope of Restated Terms.

3 JUBILEE LINE

- 3.1 The Arbiter in his determination, amongst many other matters, will need to consider whether the delay to the upgrades would have been suffered by TLL had it been efficient and economic along with the impact of any alleged default on the part of LU that may have arisen.
- 3.2 There are also contractual issues to resolve through the normal dispute resolution mechanisms (adjudication, potentially followed by court). As was reported in TfL's accounts, LU has received claims totalling over £400m from TLL in respect of additional costs incurred for station upgrades and JLU/NLU signalling works. There are as yet no active claims seeking an extension of time to the JLU contract date of 31 December 2009. Without an extension of time, TLL will be in contract default and will suffer financial and other consequences.
- 3.3 LU has obligations to Canary Wharf Limited (CWL) arising from its contribution

² The level of payments made to the shareholders by TLL under secondment agreements is one of the reasons why overheads and central costs are an issue – however, the original PPP Contract contains provisions that protect these cash flows in certain circumstances and the Arbiter will need to decide if these circumstances are applicable.

to the cost of the Jubilee Line extension. In the event TLL fails to deliver JLU on time, contract adjustments suffered by TLL under the PPP Contract (unless TLL obtains a contract extension of time) may be utilised to meet LU's obligations to CWL.

- 3.4 TLL has now publically acknowledged the significant delay to the JLU, but LU does not yet have a programme from TLL that demonstrates a credible path towards a revised delivery date. LU has pressed TLL to conduct an independent review; both the "Gaffney" and Serco reports are now complete and both point to an end date well into 2010. Consistent with this, on 23 November 2009, the Daily Telegraph reported the CEO of TLL as stating that the JLU would miss the deadline by almost a year and would cost £100m more in contract adjustments for late delivery and extra costs, which would not be borne by the tax payer.
- 3.5 TLL alleges that LU's approach to closures is impeding delivery of JLU. LU categorically rejects this for the following reasons. LU has at all times complied with the contractual arrangements for access and indeed has granted closures outside of the strict PPP Contract process and timescales, which stipulate a notice period of 222 days. In April 2009, LU granted twelve additional weekends of closures to TLL at short notice on the basis that TLL would complete the JLU by 31 December 2009 and not seek any extension of time to the contract date arising from events prior to the agreement. Since then the JLU programme has continued to slip and TLL has in consequence requested further closures at short notice, in addition to the twelve agreed in April. LU has facilitated additional access on eight weekends since late August, in two instances cancelling its own works on the subsurface network to remove conflicts.
- 3.6 Until Summer 2009, TLL was reporting delivery by the contract date and the current demands for additional access by TLL were neither predicted nor planned. Indeed, TLL assured the Mayor as recently as September 2009, that only five further weekend closures were needed to complete the JLU by 31 December 2009. Currently, TLL is discussing up to twenty eight further weekend or part-weekend closures through to Summer 2010 with LU, in addition to the extra eight closures granted during Autumn 2009.
- 3.7 LU is therefore not accepting any culpability regarding closures. This was agreed and acknowledged by TLL in April 2009 and since then LU has been very accommodating of TLL's further short notice requests. In 2006, when the JLU programme was first shared in detail with LU, it predicted a requirement for around fifty weekend closures. TLL has, to date, required around one hundred and twenty weekend or part-weekend closures, with many more expected. In total, it has submitted over four hundred closure requests under the PPP Access code since late 2006 but has withdrawn or cancelled nearly two hundred as its programme has slipped and its access requirement has changed.
- 3.8 LU is proposing to TLL that a realistic software release schedule should be secured from Thales, the signalling contractor, in order to develop a credible programme and access requirement, against the access potentially available, through to completion. This proposal is consistent with the recommendation of an independent report commissioned by TLL from Serco. Only when a credible programme is received from TLL will LU be in a position to give customers and

businesses visibility of the closures programme and sufficient certainty to enable them to plan accordingly.

- 3.9 TLL has also attributed its difficulties in delivering JLU to the requirements of LU's Standards and LU's management of the assurance process – these matters are the subject of the claim described in paragraph 3.2. The relevant Standards have been applicable since prior to 1999 when the PPP competition commenced; however, these matters were not formally raised by TLL with LU until June 2009. TLL is not in a position to request an extension of the contract date on these grounds as its claim relates to events before April 2009 when it agreed not to seek extensions of time for prior events (as referred to in paragraph 3.5 above).
- 3.10 LU's position is that its requirements have not changed since the PPP commenced and, whatever developments to the signalling system were required, these could have been accommodated within a well managed seven year programme between the start of the PPP Contract in 2002 and the JLU completion date in 2009. LU does not accept that it has mismanaged the assurance process but if TLL believed this to be the case, then it was incumbent on TLL to escalate issues with LU at a time when they were capable of being resolved rather than launching its claim in June 2009, well after the events took place.

4 NORTHERN LINE

- 4.1 The NLU is due to be delivered by TLL by January 2012, with Thales providing the signalling system. The consequential impacts on this upgrade of the delays on the JLU are not yet fully understood. A credible programme for NLU cannot be established until there is a credible programme for JLU. TLL is now seeking a very significant volume of closures to deliver the NLU, in the form of both early line closures and weekends. LU has only recently seen these demands and is engaging with TLL to establish the potential for improved ways of working to minimise disruption to customers. LU has been suggesting to TLL various ways to avoid testing on a live railway, including wider use of simulation and an improved test track.
- 4.2 TLL is also insisting that it requires more than double the access allowance in RP2 that it has had in RP1, suggesting that it intends to undertake extensive and regular closures of both the Northern and Piccadilly lines for Upgrade work, despite assurances given that the lessons from the Jubilee line would be learnt.

5 CONCLUSION AND NEXT STEPS

- 5.1 The costs for RP2, and the issues between TLL and LU, will be determined by the Arbiter and, in relation to claims, initially by adjudication and, potentially, subsequently by the courts.
- 5.2 LU's priority is to secure a credible programme for completion of JLU followed by a credible programme for NLU, with any lessons from the mistakes to date on JLU taken into account in the future and disruption to customers and passengers minimised.

5.3 The commercial consequences of the delay to the upgrades will unfold when the Arbiter gives his draft determination in December 2009 and the signalling upgrade claim is determined by adjudication in early 2010.

6 RECOMMENDATION

6.1 The Board is asked to NOTE the contents of this report.

7 CONTACT

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Tube Lines Periodic Review: outline reference timetable

23 September	Reference received
17 November	Final date for representations from the Parties on costs and associated issues
17 December	<p>Publication of draft directions and draft guidance as follows:</p> <ul style="list-style-type: none"> • material change in risk • costs • performance revenues • access allowances <p>Publication of 'initial thoughts' on the level and profile of the Infrastructure Service Charge, need for base/eligible finance and terms, ability to finance, fixed amounts and RPIX, together with implications for affordability</p>
25 January 2010	Final date for representations on draft directions and draft guidance and responses to initial thoughts consultation
2 March	<p>Publication of final directions and final guidance on:</p> <ul style="list-style-type: none"> • material change in risk • costs • performance revenues • access allowances <p>Publication of draft directions on:</p> <ul style="list-style-type: none"> • the level and profile of the Infrastructure Service Charge • need for base/eligible finance • terms of finance • ability to finance • fixed amounts and RPIX
1 April	Final date for representations on draft directions issued on 2 March

27 April	Publication of final directions on: <ul style="list-style-type: none">• the level and profile of the Infrastructure Service Charge• need for base/eligible finance• terms of finance• ability to finance• fixed amounts and RPIX
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