

XII. VARIATION AND FLEXIBILITY AND RETENTION OF LUL DECISION-MAKING AUTHORITY

Variation and Flexibility

Section 8.6 of the FAR lists the various ways that change might be introduced during review periods. While the list as to how LUL might introduce change has grown somewhat over the last year, it remains inadequate for LUL to have any comfort that it will have sufficient flexibility to respond effectively to changing requirements and circumstances in any meaningful way.¹⁹⁸

An illustrative example of the impracticalities in the PPP's scheme for flexibility is provided by the Major Enhancements scheme, which provides a framework by which LUL may ask the Infracos to price projects such as line extensions and congestion relief and may elect to look to an alternative provider. Before LUL can proceed with an alternative provider, LUL's responsibility for additional costs and risks to the Infraco arising from the project must be resolved. As Ernst and Young advised, this will entail considering construction interface, commissioning interface, and the costs associated with maintaining the project over the long term.¹⁹⁹ In addition to the potential for delays that will result from this process, the process will create pressure for LUL to reach an agreement with the Infraco as Major Enhancement provider, rather than to look to the market. As Ernst & Young noted, "it will be difficult to resist the desire to maximise profit by the incumbent Infraco when Major Enhancements are planned."²⁰⁰

By way of another example, we consider the problem with requiring Infraco approval or a completion of a dispute resolution process, before LUL can amend certain Infraco obligations in connection with PFI contracts.

Work under PFI contracts is dependent on work under the PPP to an overwhelming degree, as the PFI contracts cover such critical matters as power supply and communications for the Underground network. To that end, enormous effort has apparently been made to predict what work the Infracos will have to undertake to support the PFI contracts, work that LUL would itself be required to undertake should it not cede control of the infrastructure to the private sector Infracos. Failure to do that work can have enormous consequences for the success of the PFIs.

Inevitably, what LUL has predicted the Infracos must do will not dovetail with what will be required in reality for those projects to be successful. If there were no PPP, LUL would be in a position to address a mismatch between predictions and reality swiftly. However, under the PPP, unless the work in question is already required under the PFI contracts or relates to "commercial exploitation," LUL must first agree with the Infracos on a price for the new work,

¹⁹⁸ The inadequacies of the current scheme are illustrated by last minute changes to the list of LUL Specified Rights included in the documents (including a right to require 7 car trains on the Circle line and air conditioning on SSL trains.) The list of Specified Rights changes in every draft, often because LUL's view of what changes should be made on the network evolve. Once the PPP Contract is signed, LUL will have no opportunity over the next 7 ½ years to effectuate any such change.

¹⁹⁹ E&Y Report, pg. 62

²⁰⁰ *Ibid.*, pg. 62.

or await conclusion of a lengthy dispute resolution procedure before imposing the new requirement.

This will create great leverage for the private sector Infracos, leverage that is likely to result in the overall cost of implementing the PFI contracts being materially higher than it would be if LUL retained control over its Infrastructure.

TfL has expressed tremendous concern about the absence of variation rights in the Contract, rights that would provide LUL with a measure of control in the event the Infracos pursue a course that LUL believes is inconsistent with the public interest. LUL pays TfL's comments little regard, by making marginal changes in the document and relying on those changes to suggest that TfL is overstating the risks created by the documents.²⁰¹ It is not possible for TfL to point out to LUL all the instances where the lack of flexibility creates risk and the potential for substantial increased costs to LUL as it pursues its operations and strategies over the next thirty years. The fact is that there is risk being undertaken by LUL in ceding its authority as to how competing work and work generally on the Infrastructure is to proceed. The attempt to "strike a balance between the interests of the parties"²⁰² (between the desire for the Infracos to have autonomy and the needs of LUL as operator of the Underground) does not protect LUL's interests in this regard; it only carves out a few narrow exceptions to the general rule that Infracos will have too much leverage which can be used to increase the true costs to LUL of implementing changes it believes are essential.

The operator of an Underground railway should not subject itself to this kind of risk as a general matter. It is particularly rash to do so when the "benefits" of taking the risks are so illusory.

Lastly, the FAR's suggestion that the features of the PPP in respect of change are less burdensome than those under PFI contracts²⁰³ should be considered. Even putting aside questions as to the accuracy of the assertion, any restrictions that do exist in PFI contracts must be considered in light of the much narrower reach of those contracts. Here, rebuilding and improvement of the entire infrastructure is being delegated, without any effective LUL ability to require the Infracos to change course if that is what LUL believes is in its best interest as Infrastructure Controller and the provider of service to the millions of Underground users.

Retention of Key Decision-Making Authority by LUL

The FAR reports that "There are some decisions which must be for LUL to take, even though they may have financial consequences for Infracos. All decisions relating to service management, operation control, incident management and railway safety are reserved to LUL.

²⁰¹ For example, the FAR states that "TfL have argued that Infracos will be able to delay the implementation of intermediate works by disputing the terms for carrying them out. In fact, intermediate works are in the category of works which have to be implemented on request, with any dispute resolved after the event." FAR, pg. 67. This statement is true only because of a change in the contract documents since TfL expressed its concern. See, e.g., BCV Service Contract, new Section 17.11(c).

²⁰² FAR, pg. 66.

²⁰³ FAR, pg. 71

*Infracos are not compensated for adverse effects – they have to accept this as an inherent part of operating in a railway environment.*²⁰⁴

This is a claim we have often heard in connection with the PPP, the basis for which we have never been able to find in the Contract documents. In fact, we believe the Contract Documents are inconsistent with this claim. For example, Section 16.5 of the Service Contract provides in relevant part that “to the extent that LUL...prevents, hinders, obstructs, delays or interferes with Infraco performing the Infraco Obligations except insofar as it cannot reasonably be avoided or, acting reasonably, it is nevertheless necessary to do so in the exercise of any rights under the Transaction Documents relating to the Infraco Network or making use of the Services...any such act of failure to act shall be an LUL Breach and clause 16.7 [which entitles the Infraco to full compensation for the cost and risk associated with the matter] shall apply accordingly.”

If LUL must compensate the Infraco if LUL discretionary actions hinder the Infraco’s work efforts, it is hard to see how the FAR can claim that all decisions relating to service management, operation control, incident management and railway safety are reserved to it, without corresponding compensation to the Infracos.

Similarly, the absolute limitation on LUL’s rights to increase weekend and off-peak service²⁰⁵ belies this claim. There may be a legitimate reason for a limitation of this type (though the one given in the FAR is not a good one²⁰⁶); however, it cannot be argued in the face of this limitation that LUL has reserved to itself all decisions relating to service management.

Any remaining doubt in connection with this claim is removed when the costs-plus implications of the Extraordinary Review process are considered. If LUL actions cause the Infracos to incur more costs, LUL may well be liable to meet those costs by operation of these provisions.

What the FAR should say if it is to be accurate is that, to the extent that LUL has not already agreed to express limitations on its discretion by virtue of the Contract Documents, LUL must make service decisions around Infraco needs, subject only to unavoidable decisions, or risk being obliged to reimburse Infraco for its excess costs attributable to those decisions. The FAR should then identify the limitations on LUL discretion that have been pre-agreed. Lastly, the effect of Extraordinary Review on the Infraco’s entitlement to reimbursement for costs arising out of LUL’s unavoidable decision should be discussed. A general discussion of decreased flexibility does not paint a sufficient picture of what LUL will face under PPP.

The FAR should also compare the protection afforded to the Infracos against cost increases, to the far more limited protection provided to LUL should the way the Infracos elect to manage their work adversely affect LUL’s operating costs. An Infraco may not cause a *material*

²⁰⁴ FAR, pg. 20. Emphasis added.

²⁰⁵ FAR, pg. 71

²⁰⁶ The FAR argues that the Infracos must be entitled to withhold 10% of the trains during off-peak hours so that some maintenance can be done during the day. This does not explain the absolute limitation being applicable to all hours of the weekends. LUL could have accommodated the Infracos in a manner which preserved its flexibility and still gave the Infraco comfort that there would be enough time to get maintenance work done.

increase in LUL's overall cost of operating the Underground, with various significant exceptions. While it is not clear that there is any right on the part of LUL to recover anything from Infraco should Infraco breach this obligation, note that, under Section 16.5 of the Service Contract, LUL is liable for the *first pound* that it unnecessarily causes an Infraco to incur as it exercises its rights. The Infracos do not need to worry until they have caused a "material increase" in the whole cost of running the Underground.