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Down the Tube

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Financing the London Underground is rapidly turning into a case study on how not to sell a deal to the private sector.

Despite contradictory reports commissioned by London Mayor Ken Livingstone and the government, and the appointment of New York Metro's Robert Kiley as head of Transport for London (LU's governing body), a potentially mediocre PPP solution is still going ahead.

There are but a few points on which all involved in this political debate agree.

It is not possible for the Tube to finance itself through fare revenues alone (currently meeting only 71% of expenditure). Further, in addition to investment in the infrastructure, there must also be a reappraisal of its management. This was highlighted by the considerable problems encountered in the recent jubilee line extension, which in the words of the Industrial Society's report, ?commands little confidence'.

Opinions on the shape and form that this investment should take have ranged from complete privatisation, as suggested by former mayoral candidate for the Conservatives, Steven Norris, to full public ownership and accountability, as advocated by Ken Livingstone.

The PPP currently being progressed under the direction of the government is a middle road, aiming to increase efficiency of infrastructure and maintenance through the use of the private sector, whilst retaining the public accountability to passengers pledged by John Prescott. The infrastructure of the underground network is to be split into three, and run by several Infracos (infrastructure companies). The shortlist of bidders has been completed and, with best and final offers due in this month, it is expected that the winners will be announced at the beginning of next year.

The Linc Consortium, comprised of Bombardier, John Mowlem, Fluor Daniel, Alcatel and Anglia Water and the Metronet Consortium, including Adtranz, WS Atkins, Balfour Beatty, Seeboard and Thames Water are both competing for the SSL and BCV contracts, (Sub Surface Lines and Bakerloo, Central, Waterloo & City, Victoria Lines respectively). This has been complicated recently by the announcement of Bombardier (LINC) taking over Adtranz (Metronet), leading to one company effectively bidding against itself. The two bidders for the JNP Infraco (Jubilee Northern Piccadilly Lines) are TubeLines, made up of Bechtel, Amey, Halcrow, Hyder and Jarvis and the TubeRail consortia comprised of Halliburton Brown & Root, Alstom, Amec and Carillon. Surface Line Groups, the TubeLines consortia without Hyder, is also up against Linc and Metronet for SSL.

All bidders have had to submit their best and final offers with fully committed financial plans. It is understood that financing will see a higher equity content than is normal in PFI deals and will also include long term bank debt and credit enhanced bonds.

While a PPP solution will cost the government little in the short term, the underlying question is the cost, in financial, organisational and safety terms over the 30-year duration of the Infraco franchises.

The Industrial Society's report highlights some of these potential concerns. In particular, it challenges the Public Sector Comparator (PSC), drawn up in the government commissioned report by PricewaterhouseCoopers and used to demonstrate efficiency savings of the PPP. Other related risks it points to include the possibility of projected savings due to redundancies, potential ability of Infracos to hold back investment, lack of competition preventing them to do this and inability of them to cope with unexpected cost overrun.

The report also claims it would be difficult to monitor safety on a fragmented infrastructure. Chris Deacon of the PPP department in London Underground, however, has stated that no plans will go ahead unless meeting the strictest of safety targets. Moreover, he points to the fact that the fundamental difference between the plans for the tube and other privatised systems, including overland rail, is that accountability for safety remains in the public sector. A review of procedures by the Health and Safety Executive (HSE) is currently underway.

With respect to the prior concerns raised by the Industrial Society and others, the question remains, given the level of investment needed, whether there are any viable alternatives to the PPP.

Financing through bonds is the method associated with Livingstone's camp and there are two broad options within this field that are attracting speculation. The first is that of government backed bonds, such as those issued in order to rescue the channel tunnel in 1998 but this was a one-off agreement after the event, specifically not designed to set a precedent. The second would be a plan similar to that of the New York Metro's revamp in the 1980s through a major bond financed investment program.

However, this was possible through circumstances that are, as stated in the Industrial Society report, ? symptomatic of decisive constitutional differences between the two cities, with respective tax raising powers. A further difference between the cities is that the US bond market is tax-exempt.' Moreover, a member of the government's PricewaterhouseCoopers team pointed out that this placed New York taxpayers at a huge risk.

PricewaterhouseCoopers has dismissed the Industrial Society report as inaccurate, stating that the authors were not familiar enough with the deal. On the case of bonds, it was conceded that an ability of Transport for London to issue bonds might well be of benefit for future Underground projects. For the moment, however, this is a theoretical debate.

Securitisation solely against future fare revenues may be worth consideration but would, according to Mike Wilkins of Standard and Poors, throw up complicated legal and administrative issues surrounding ownership of assets. Congestion charges have also been cited as a resource which, in combination with fare revenues, could be used to service a debt but these will not come into effect for at least two years.

The government's agenda states that the PPP will be in motion by next spring.

But it is unlikely that the voices of opposition will fade. Should either Kiley or the National Audit Office find any concrete problems in their upcoming investigations, then there could be a more high profile review of alternatives, or at least a substantial re-think of the terms and conditions that PPP should take.