



Office of the PPP Arbiter

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**The PPP Arbiter**

**Proposed changes to Procedural Framework  
and Approach Documents**

**A consultation paper**

**7 February 2007**

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## **Role and approach of the Arbiter**

The role of PPP Arbiter was created by the Greater London Authority Act 1999 to give guidance or directions on matters relating to the London Underground PPP Agreements. Although appointed by the Secretary of State for Transport, the Arbiter is independent of Government and of the Parties to the PPP Agreements.

In giving guidance or directions, the PPP Arbiter is under a statutory duty to act in the way he considers best calculated to achieve four objectives:

- to ensure that London Underground has the opportunity to revise its requirements under the PPP Agreements if the proper price exceeds the resources available;
- to promote efficiency and economy in the provision, construction, renewal, or improvement and maintenance of the railway infrastructure;
- to ensure that if a rate of return is incorporated in a PPP Agreement, and taking into account matters specified in the Agreement, a company which is efficient and economic in its performance of the requirements in that PPP Agreement would earn that return; and
- to enable the Infracos to plan the future performance of the PPP Agreements with reasonable certainty.

The Arbiter is also under a duty to take account of any factors which are notified to him by both Parties to an Agreement, or are specified in the relevant PPP Agreement, as ones to which he must have regard.

Following consultation, the Arbiter has adopted the following aim for his work, and that of his Office:

*The aim of the PPP Arbiter and his Office is to give sound and timely guidance and directions on relevant aspects of the PPP Agreements when this is requested, and to work constructively with the Parties to the PPP Agreements in support of their key objective of providing to the public a modern and reliable metro service in a safe, efficient and economic manner.*

*We seek to achieve this by:*

- *working within a clear, transparent and consistent framework;*
- *giving reasoned guidance and directions which are based on well developed analysis shared with the Parties and procedures which achieve predictability in process and outcome;*
- *establishing effective dialogue with the PPP Parties and other stakeholders to facilitate timely response to requests for guidance or direction, while maintaining our independence; and*
- *operating to high standards of accountability in all our actions.*

Further information on the functions, duties and approach of the Arbiter can be found on the Arbiter's website <http://www.ppparbiter.org.uk>.

## 1 Scope of this paper

- 1.1 The Arbiter first published his Procedural Framework for Use in the Giving of Directions and Guidance Under the Greater London Authority Act 1999 and PPP Agreements (his “Procedural Framework”)<sup>1</sup> on 16 July 2004 following a period of consultation.
- 1.2 Within that document there was recognition<sup>2</sup> that it would be revisited after at least one reference had been completed and there had been an opportunity for third parties to comment upon it.
- 1.3 In June 2006 the Arbiter reissued his Procedural Framework and the Procedural Approach document in respect of the annual Metronet Report 2006 to reflect:
- (i) minor amendments to the Procedural Framework, mainly to introduce the concept of the Arbiter’s extranet; and
  - (ii) specific information requirements and a revised timetable in respect of the annual Metronet Report 2006.
- 1.4 The current versions of the suite of Procedural Framework and Approach documents are set out in the table below:

Document	Date
Arbiter’s Procedural Framework	30 June 2006
Procedural approach to the annual Metronet Report 2006	30 June 2006
Procedural approach to Extraordinary Review (including monitoring actual costs and revenues against the Baseline for Net Adverse Effects)	16 July 2004
Procedural approach to the receipt of an unanticipated request for Guidance	16 July 2004
Approach to Periodic Review	[none yet]

- 1.5 Now that the Arbiter has completed three references – one in respect of straddling investment and two in relation to aMR2006 – and has made significant progress on two more concerning the treatment of investment at an Extraordinary Review, the Arbiter considers that it is now appropriate to review the Procedural Framework and associated Approach documents more fully as originally envisaged. Also, in anticipation of Periodic Review (work for which is expected to start in

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<sup>1</sup> See [http://www.ppparbiter.org.uk/files/uploads/g\\_proceduralFrameWork/2006630125636\\_PP%20Arbiter's%20Procedural%20Framework%20\(30\\_06\\_06\)%20DM14895PDF.pdf](http://www.ppparbiter.org.uk/files/uploads/g_proceduralFrameWork/2006630125636_PP%20Arbiter's%20Procedural%20Framework%20(30_06_06)%20DM14895PDF.pdf)

<sup>2</sup> See para 1.9 of the document referenced in footnote 1

earnest in the autumn of 2007) the Arbiter considers that now is the right time to add a further Approach document in relation to Periodic Review.

1.6 The remainder of this document is structured as follows:

- Section 2 describes the areas where the Arbiter proposes to change the Procedural Framework itself;
- Section 3 explains the intention behind the Procedural Approach documents and how they are to be structured going forward;
- Sections 4 and 5 describes the limited changes intended for the Procedural approach to the annual Metronet Report and the Procedural approach to the receipt of an unanticipated request for Guidance;
- Section 6 describes the more significant changes intended for the Procedural approach to Extraordinary Review including the information requirements and proposed timetable;
- Section 7 sets out the outline for the proposed Procedural approach to Periodic Review, particularly in relation to timetable; and
- Section 8 summarises the questions for the PPP Parties set out within this document.

#### **Next steps**

- 1.7 Following publication of this consultation paper there are to be a series of bilateral and group discussions with the PPP Parties culminating in the Arbiter issuing consultation drafts of the full suite of Procedural documents during March.
- 1.8 In parallel with a brief public consultation on the revised documents during March and April, the Arbiter expects to further discuss those draft documents with the intention of finalising and publishing them in April 2007.
- 1.9 PPP Parties are invited to provide written responses to the questions raised in this paper by 7 March 2007.
- 1.10 If a reference is made during the consultation period, the Arbiter would expect to follow a procedure in line with that suggested in this paper.

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## 2 Procedural Framework

2.1 Experience from the references undertaken to date indicates to the Arbitrator that no fundamental changes are needed to the Procedural Framework document. However some areas of tidying up have been identified based on the lessons learned from the annual Metronet Report 2006 and other completed references. These include:

- clarifying the required timing of the Referring Party's (or Parties') and Responding Party's statements of case whilst seeking to avoid sequential submissions in many reference situations given the impact this has on timetable and the workload of a Responding Party;
- clarifying the process for Metronet and London Underground to "join together" in references for guidance;
- incorporating the changes needed to reflect the Approach document for Periodic Review;
- amendments to the drafting relating to Experts such that the concept of Reporters could be applied if appropriate; and
- clarification of required document formats to ensure compatibility with the Arbitrator's Extranet.

2.2 The remainder of this section of this document looks at these areas in more detail.

### **Required timing of the Referring Party's (or Parties') and Responding Party's statements of case**

2.3 Actual application of the Procedural Framework to date has resulted in the following sequence of submissions:

- the Referring Party (in each case to date an Infraco) has triggered the reference by completing a Reference Application Notice;
- in the cases of the references in relation to aMR2006 and the treatment of investment at an Extraordinary Review, the statements of case of the Referring Party have followed the initial Reference Application Notice<sup>3</sup>: in the case of aMR2006 by some two months and in the case of the treatment of investment at an Extraordinary Review by several weeks; and
- following submission of the Infraco's statement of case, London Underground has been given the prescribed 30 days (or longer) to complete its statement of case as part of its Response to Reference.

2.4 As demonstrated in the annual Metronet Report 2006, this sequence has had two effects:

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<sup>3</sup> The default position in the Procedural Framework is that the statement of case should accompany the Reference Application Notice – see Article 2.2 – and “*in exceptional circumstances only...* [the submission of information should be] .. *no later than thirty days from the date of the Reference*”

- it placed a significant burden on London Underground as the Responding Party as there was a significant clarification exercise during the same time period as the preparation of the Response to Reference with both exercises occupying the same resources; and
- it also extended the minimum possible time it might have taken to complete the reference.

2.5 As a consequence the Arbiter seeks to address this by clarifying in the Procedural Framework that:

- the Arbiter expects better adherence to the wording “*in exceptional circumstances only*” in Article 2.2 in relation to a delayed submission of the initial statement of case and “exceptional circumstances” will require considerable justification. To help enable this, the Arbiter intends to clarify the minimum submission requirements for identified forms of reference in the various Approach documents;
- whilst acknowledging that there are some references that are inevitably “sequential” in nature (eg unanticipated references for guidance, references involving cost shocks and those references that may involve confidential matters), the Arbiter considers that some references could have simultaneous submissions in which case the co-joined Referring Party or Responding Party would be expected to provide significant elements of its submission at the same time as the originating Referring Party;
- in the circumstances of simultaneous submissions described above, the Arbiter would envisage as part of the Post-Reference meeting there being an opportunity for all Reference Parties to bring to his attention areas where further information and analysis might be needed from the other Party. One outcome of the Post-Reference meeting would be the Arbiter’s work programme and timetable for all Parties in completing the full submission requirements (which may exceed the initial submission requirements);
- in the circumstances of simultaneous submissions (as in all references) the formal opportunity for each Reference Party to have a right of reply would take place as part of the consultation on draft guidance; and
- in the circumstances where there is to be a sequential submission, the Arbiter will conform the wording in the Framework such that the response time is to be 30 days or such other time period agreed by the Arbiter.

*Question 1: do the PPP Parties agree that the default position should be that references are only initiated once the minimum submission requirements can be met?*

*Question 2: do the PPP Parties agree that there are circumstances where simultaneous submissions are practical? And if so, what are those circumstances?*

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*Question 3: do the PPP Parties agree that there may be benefits, both in terms of workload and resourcing, in requiring simultaneous submissions?*

### **Joined up references for guidance**

2.6 Paragraph 6.5 of Part 2 of Metronet's Schedule 1.9 to the PPP Agreements states<sup>4</sup>:

*"... In the event of a party wishing to refer a matter to the Statutory Arbiter pursuant to Section 230(1)(a), GLA Act (whether for guidance as to the manner in which he would propose to regard any matter if it were referred to him for directions pursuant to paragraph 1 of this Schedule or otherwise), the other party shall join in the reference, but in doing so is to be at liberty to agree, disagree or to express no view on all or any aspects of the reference."*

- 2.7 The Arbiter's understanding of the intent of this drafting is that it is to ensure that all single Party requests for guidance in respect of a Metronet PPP Agreement (for which he may give guidance) become joint requests for guidance (for which he shall give such guidance as he considers appropriate).
- 2.8 In practice, given that this is a contractual provision rather than a statutory provision, this has proved hard for the Arbiter to administer as demonstrated by the recent references relating to the treatment of investment at an Extraordinary Review where there was some initial uncertainty as to whether London Underground would be a joint Referring Party.
- 2.9 As a consequence the Arbiter seeks to address this by clarifying in the Procedural Framework that:
- notwithstanding that the provisions of paragraph 6.5 may not have been correctly applied by the Parties, the Arbiter will treat any reference for guidance received under s230 as a valid reference and will apply the provisions of the Act as drafted;
  - however reflecting the existence of paragraph 6.5 the Arbiter will allow the reference to be amended up until the date of the Post-Reference meeting such that the other Party to the PPP Agreement can join in as a Referring Party. Any similar amendment required after the Post-Reference meeting will necessitate the original reference being withdrawn and reissued; and

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<sup>4</sup> Given that s230(1)(a) of GLAA 1999 refers to a reference made by "all the parties to the PPP agreement acting jointly" (and hence under s230(2)(a), the Arbiter "shall" give such guidance as he considers appropriate), it appears to the Arbiter that there may be an error in this drafting. It makes more sense to the Arbiter for paragraph 6.5 to refer to s230(1)(b) and hence a reference for guidance made by "any party to the PPP agreement" in which case – without the other party joining in – the Arbiter would have the option under s230(2)(b) as to whether he should give any guidance.

- in order to give effect to the proposed amendments above, the Arbiter will ordinarily invite the other Party to a Metronet PPP Agreement to the Post-Reference meeting.

*Question 4: do the Parties to the Metronet PPP Agreements accept that the operation of paragraph 6.5 is a contractual matter and hence an issue for the Parties? And if so, do the Parties agree with the Arbiter's proposed amendments to his Procedural Framework?*

### Periodic Review

2.10 As noted above and given that work on the Periodic Review is likely to commence later this year, the Arbiter considers that now is the right time to add a further Approach document in relation to Periodic Review.

2.11 As with the other Approach documents the Arbiter expects that this document will comprise:

- **preamble:** boilerplate drafting as per the other Approach documents linking the document to the Procedural Framework;
- **contractual background:** describing the circumstances in which the Arbiter can be asked for directions in respect of Periodic Review;
- **interpretation:** setting out the Arbiter's understanding of relevant provisions;
- **approach:** consistent with what is now proposed for the other Approach documents, the Arbiter envisages that this section should comprise:
  - the minimum submission requirements (to the extent that it is possible to define them) such that a reference can be initiated;
  - the required submission requirements such that a reference can be undertaken;
  - the likely analysis; and
  - the envisaged timetable.

Section 7 below sets out the Arbiter's initial thoughts on some of these areas.

**2.12** In addition, Periodic Review introduces issues relating to the financing of the PPP which are not found at Extraordinary Review and as a result the Arbiter may be required to have due regard to the advice of "a financial adviser of international repute".

### Experts and Reporters

2.13 The Arbiter considers that there may be merit in the preparation of information submissions being overseen by 'Reporters'<sup>5</sup> particularly in a broad ranging financially based reference such as Extraordinary Review

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<sup>5</sup> An example of the protocol under which Reporters have operated in a regulatory environment can be found at [http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/reporters\\_protocol\\_issue2\\_010403.pdf/\\$FILE/reporters\\_protocol\\_issue2\\_010403.pdf](http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/reporters_protocol_issue2_010403.pdf/$FILE/reporters_protocol_issue2_010403.pdf)

and/or where there is significant uncertainty in the figures being provided as part of the submission. Reporters would be employed by the Infracore but with reporting lines and a duty of care to all Reference Parties. The role of the Reporter would be to confirm that the information provided as part of a reference proceedings was traceable back to initial assumptions and to give a view on the reasonableness of any assumptions applied, for example giving a view on the likelihood of a proposed approach delivering to the timescale and cost forecast in the submission.

- 2.14 The concept of Reporters was raised in the draft Guidance on the treatment of investment at an Extraordinary Review on which the PPP Parties are currently being consulted and it is via that consultation process that the PPP Parties should express their views on the issue.
- 2.15 In the event that the concept of Reporters is considered to be potentially beneficial, the Arbiter would propose to amend Article 4 to reflect this.

### **Extranet**

- 2.16 In 2005-06 the Arbiter commissioned an Extranet with the intention of using it as a secure document store for the Arbiter, his Advisory Board, Office staff and the Reference Parties. Due to problems primarily relating to documents formats, it has proved hard to upload the necessary documents in a timely fashion and hence the PPP Parties have yet to see the Extranet in operation.
- 2.17 To remedy this going forward the Arbiter intends to:
- make further changes to the Extranet itself to improve its functionality; and
  - be more specific about document formats and naming conventions in Appendix Five to the Procedural Framework.

### 3 Procedural Approach documents

- 3.1 The three Procedural Approach documents that were attached to the original Procedural Framework were structured as follows:
- **preamble:** boilerplate drafting linking the document to the Procedural Framework;
  - **contractual background:** describing the relevant contractual and statutory drafting;
  - **interpretation:** setting out the Arbiter's understanding of relevant provisions; and
  - **approach:** which stepped through the stages of the Procedural Framework and described the timetable, the information needed and the analysis to be performed.
- 3.2 Experience from the Voluntary Submission (which took the place of the annual Metronet Report for 2005) resulted in the Arbiter making significant changes to the original Procedural approach to the annual Metronet Report (dated 16 July 2004) which was subsequently renamed Procedural approach to the annual Metronet Report 2006 and dated 30 June 2006. The main changes were:
- the timetable was clarified and – following representations from Metronet and London Underground – allowed additional time for preparing submissions; and
  - the minimum submission requirements were tabulated in considerably more detail.
- 3.3 Experience from the annual Metronet Report 2006 was that this greater clarity on timetable and submission requirements was helpful but could be taken a step further. As a result the main changes that the Arbiter is proposing to make to the three existing Approach documents is to make it extremely clear what his expectations are for:
- his minimum submission requirements such that a reference can be initiated;
  - his required submission requirements such that a reference can be undertaken;
  - his likely analysis; and
  - the envisaged timetable.
- 3.4 The effect of these changes is intended to make these documents more akin to method statements rather than generic approach documents. However the Arbiter will reserve his right to change them.
- 3.5 In the remaining sections of this paper the Arbiter sets out his current thoughts in these areas.

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## 4 Procedural approach to the annual Metronet Report

- 4.1 Ordinarily the Arbiter would be expecting Metronet to seek an Annual Report for 2007 (aMR2007) on a similar basis to that requested in 2006. However, in light of issues revealed in the annual Metronet Report 2006 and expanded on in the current references on the treatment of investment at an Extraordinary Review, the Arbiter's current expectation is that the annual Metronet Report for 2007 may be subsumed in to an Extraordinary Review, either from the outset or during the Annual Report process.
- 4.2 In the event that an Annual Report for 2007 is started but then overtaken by Extraordinary Review two possibilities arise:
- either the Arbiter would expect to complete the aMR as a stage of Extraordinary Review; or
  - the Reference Parties could withdraw the aMR reference.
- 4.3 In this circumstance the Arbiter's preference would be to complete the aMR2007 as a stage within the Extraordinary Review process itself as – other than in the particular case of the relevance of the Notional Infracost in assessing the efficiency and economy of the supply chain – the reference tests are broadly analogous and hence the aMR is directly relevant when considering Net Adverse Effects.
- 4.4 During the course of 2006 and in the run up to the annual Metronet Report 2006 the Arbiter revised the Procedural approach to the annual Metronet Report by including significantly more detail on the required information requirements and expanding the timetable.
- 4.5 Notwithstanding that aMR2007 might not take place on a stand alone basis, the Arbiter has identified some further changes to the Procedural approach to the annual Metronet Report 2006 to further clarify the information requirements and the timetable as set out below.

### **Annual Metronet Report information requirements and timetable**

- 4.6 The Arbiter considers that the Parties should be able to prepare their statements of case for the annual Metronet Report so that they are able to submit simultaneously and on the timetable originally anticipated in Metronet's finance documents (30 April each year). Alternatively he could set minimum submission requirements for the annual Metronet Report. If he were to do this they would be the latest AAMP and the reconciliation of the AAMP to the Baseline for Net Adverse Effects.
- 4.7 Simultaneous submissions would have the benefit of trimming the timetable by one month. To the extent that either Reference Party considered that there were areas where the other Party's initial submission was inadequate or misleading the Post-Reference meeting would provide an opportunity for that Party to make recommendations for the Arbiter's work programme.

- 4.8 In addition the Arbiter considers that better preparedness on Metronet's part could bring forward the date of the submission of the statements of case to coincide with the actual Reference Application Notice which is due by 30 April in each year. This would be in keeping with the timetable envisaged in Metronet's funding documents.

*Question 5: do the Parties to the Metronet PPP Agreements agree that the annual Metronet Report process should involve simultaneous submissions?*

*Question 6: do the Parties to the Metronet PPP Agreements accept that the timetable for the annual Metronet Report process should be brought in line with Metronet's funding documents and hence accelerated?*

## **5 Procedural approach to the receipt of an unanticipated request for Guidance**

- 5.1 Given the very broad nature of what might be covered by the Procedural approach to the receipt of an unanticipated request for Guidance the Arbiter is not proposing to make any significant changes to this document other than consequential changes due to other amendments described in this document.
- 5.2 The Arbiter would expect most references under this heading would require sequential submissions.
- 5.3 Similarly as it is not possible to be specific on the minimum information requirements the Arbiter would expect that these would be discussed at any Pre and Post-Reference meetings.

*Question 7: do the PPP Parties consider that there are other changes needed to be made to the Procedural approach to the receipt of an unanticipated request for Guidance?*

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## 6 Procedural approach to Extraordinary Review

- 6.1 As a result of both experience learned from recent references and considerable preparatory work in respect of a possible Extraordinary Review, the Arbiter considers that fundamental change is needed to the current Procedural approach to Extraordinary Review document. In the section that follows the Arbiter has expanded on the thoughts set out in his draft Guidance on the treatment of investment at an Extraordinary Review.
- 6.2 At this stage the approach deals only with an Extraordinary Review triggered by an Infraco.

### Overview

- 6.3 In exercising his functions, such as giving directions on an Extraordinary Review, the Arbiter is required to act in the manner he considers best calculated to achieve a number of statutory objectives<sup>6</sup>.
- 6.4 Among these objectives are promoting efficiency and economy and enabling any PPP company to plan the future performance of its PPP Agreement with reasonable certainty. Both of these objectives lead the Arbiter to conclude that an extended timetable for an Extraordinary Review should be avoided if possible, provided that this does not prejudice due process or the objective of giving London Underground an opportunity to review its requirements on affordability grounds.
- 6.5 The Arbiter recognises that an Extraordinary Review could be triggered by an Infraco in a number of different circumstances, ranging from a cost increase resulting from a specific cause (for example, costs arising from a one-off unexpected asset failure or a material increase in input prices) to a situation involving a general re-baselining of an Infraco's programme. The Arbiter's detailed approach (and timetable) for particular cases will need to reflect the circumstances of a particular Extraordinary Review.

### Minimum submission requirements

- 6.6 In all cases, the first step in an Extraordinary Review will be for the Infraco to make a reference to the Arbiter seeking a direction on one or more of the matters set out in paragraph 1.9 of Schedule 1.9 to the PPP Agreements.
- 6.7 In the circumstances of a situation involving a general re-baselining of an Infraco's programme and hence where an Infraco makes the reference for Net Adverse Effects in excess of the Materiality Threshold, the Arbiter would expect the reference to be accompanied by an information pack containing, as a minimum:
- the Infraco's most recent financial model as approved by the Board and presented to its funders;

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<sup>6</sup> Section 231 of the GLA Act.

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- the review of this model and the assumptions underpinning it by the Lenders' Technical Adviser; and
  - any Board papers describing the basis on which the assumptions expressed within the financial model were agreed together with relevant extracts from the minutes of the Board meeting at which the paper was discussed.
- 6.8 This minimum information requirement will enable the Arbiter to reach a view on the areas of the Infraco's business that he will want to examine in more detail. It will also allow him to develop a work programme with the Infraco and London Underground to acquire the additional information required to meet his substantive submission requirements.
- 6.9 The Arbiter would expect this initial information pack to be provided simultaneously to London Underground such that it is also in a position to consider the work programme that it deems necessary in support of its submission.
- 6.10 The Arbiter anticipates that the initial analysis that he undertakes will be used to form the agenda for the Post-Reference meeting, to be held no more than one month after the reference is made. At the Post-Reference meeting, the Arbiter will set out his assessment of the adequacy of the information provided, and propose a work programme to address any gaps. A timetable for the remainder of the reference will also be produced.
- 6.11 The Arbiter recognises that London Underground may have a view on the adequacy and appropriateness of the information submitted with the reference and therefore envisages that it may wish to make representations at or before the Post-Reference meeting on areas that the Arbiter might like to include in his work programme.
- 6.12 The information that the Arbiter will require before he is able to develop draft directions will clearly be dependent on the extent of the Extraordinary Review. However, given that any Metronet reference for Extraordinary Review in the current Review Period is likely to involve a review of all aspects of its programme, rather than one-off factors affecting specific costs, the information requirements will be considerable.
- 6.13 In preparing the Annual Metronet Report 2006, and the draft Guidance on the treatment of investment at an Extraordinary Review, the Arbiter's work programme in respect of information provision has comprised clarification questions to Metronet, supplemented by clarification meetings also attended by London Underground, with written responses from Metronet. Where an Extraordinary Review involves significant re-baselining of an Infraco's overall programme, the Arbiter considers that this may not be the most effective approach. He considers that it is essential that the process of meeting his substantive submission requirements should not extend the Extraordinary Review timetable unduly. He also considers it important that all Parties should have a

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thorough understanding of the basis of the information submitted by the Infraco and used by the Arbiter in giving directions.

- 6.14 In order to meet his substantive submission requirements, the Arbiter would expect to propose a work programme that involves:
- joint working involving the relevant Infraco, London Underground and the Arbiter's Office;
  - information to be provided to the Arbiter on the basis of an agreed specification of deliverables and with a duty of care for these deliverables to the Arbiter and London Underground; and
  - minimising duplication of effort between London Underground and the Arbiter's Office in reviewing information.
- 6.15 The duration of the detailed information collection phase of an Extraordinary Review will be determined by the scale of the data required to meet the substantive submission requirements. However, the Arbiter would not anticipate this phase of the process taking more than three to five months even if the reference is only accompanied by the minimum information identified above.

#### **Transparency of information**

- 6.16 As a general principle, the Arbiter considers that the burden of proof at any Extraordinary Review should be on the Infraco to demonstrate that any increase in costs (or reduction in revenues) was not simply the result of its failure to manage its activities properly (or to get the expected benefit of positive and adverse variances across the programme overall).
- 6.17 As indicated above, in order that all Parties can have confidence in the information supplied at an Extraordinary Review, the Arbiter considers that all information should be shared and where necessary developed collaboratively. All Parties need to understand any limitations or uncertainty in the analysis of costs and performance and the basis on which the Arbiter's decisions have been made.
- 6.18 As discussed in paragraph 2.13, the Arbiter considers that there may be merit in the preparation of information submissions being overseen by 'Reporters'. He would expect to consider the use of Reporters in a particular Extraordinary Review reference at the Post Reference meeting unless arrangements were already in place.

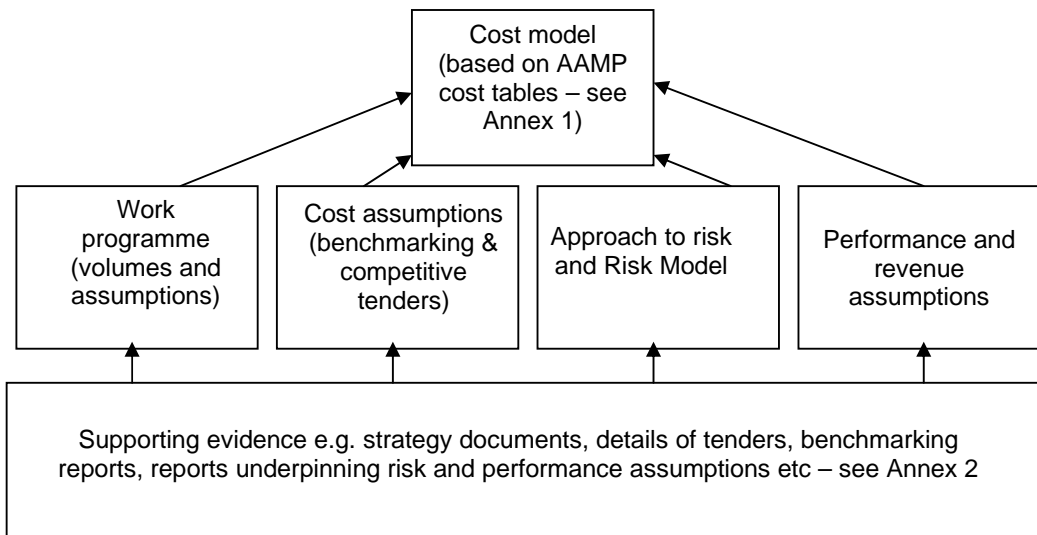
#### **Substantive submission requirements (for a broad based Extraordinary Review)**

- 6.19 In his draft Guidance the Arbiter sets an expectation that the substantive information he would require from Metronet if it makes an Extraordinary Review reference in the current Review Period could include:
- a statement of strategy and objectives for the Infraco as a whole, together with a description of how this overall strategy applies both to the various asset groups and to administration costs;

- for each asset group, data which clearly demonstrate consistency with the strategy objectives, and set out the assumptions for asset management planning and proposed implementation plans, including justification for the approach proposed, volume of work proposed, the basis of cost estimates and an explanation of variances from the contractual baseline;
- evidence of the basis for future assumptions in a form which allows trends in performance, delivery and costs to be compared both between Infracos and over time on a consistent basis;
- any comparisons with external benchmarks of cost and performance used by the Infraco;
- details of significant competitive tenders; and
- detail of risk processes and resulting risk provisions that are incorporated into costs.

6.20 In his final Guidance this section will be updated to include the audited actual costs for the period to date.

6.21 The Arbitrator anticipates a substantive submission will be structured broadly as follows:



### Role of the asset management regime

6.22 In his draft Guidance on the treatment of investment at Extraordinary Review the Arbitrator indicates that he considers that the asset management regime documents, being the AMS, AGS and AAMP, required under the PPP Agreements form the most appropriate start point for a submission. He would expect the figures that form the basis of the AAMP cost tables and the commentary that supports the data to underpin the substantive submission for an Extraordinary Review.

- 6.23 As part of his preparation for Periodic Review the Arbiter has commissioned a report from Halcrow on the asset management regime, the scope of which is to consider the 2006 documents to assess:
- how far they now go towards meeting the requirements of Schedule 3 of the PPP Agreement particularly in terms of the overarching requirement to adopt a whole life approach to asset management;
  - the completeness and consistency of the quantitative information contained within the documents to assess performance, project and unit costs on a consistent basis;
  - the completeness and relevance of the commentary and supporting information to justify apparent performance/cost variance and future projections; and
  - their fit with the variance analysis provided by Metronet as part of its aMR submission. In particular consideration should be given to whether this sort of analysis should be included in future AAMPs.
- 6.24 Halcrow's conclusions relevant to Extraordinary Review submissions are:
- work volumes and associated cost data is limited;
  - similarly variance analysis is also limited;
  - analysis of risk and the Infracos' approach to risk management is not covered in any detail;
  - the documents do not provide a coherent 'big picture' which brings together all of the Infracos plans for delivering the asset management strategy and its business objectives; and
  - while there is significant discussion of processes and the link to Good Industry Practice, the evidence that sits behind this thinking sits outside of the suite of documents.
- 6.25 Whilst recognising their current shortcomings and the fact that they are not intended to comprise a full business plan, the Arbiter remains of the view that these documents are central to an Extraordinary Review submission. The Arbiter considers that a combination of changes to the AAMP documents and the provision of supplementary documents which fill gaps (eg in performance/revenue data and administration and other costs) is the most appropriate way forward.

*Question 8: do the PPP Parties agree that the AMSs, AGSs and AAMPs are central to an Extraordinary Review submission and if so, what changes might usefully be made to these documents to aid consistency and data comparison? How might gaps in the suite of documents best be filled (eg with information routinely prepared for other purposes)?*

#### **Cost model – level of data aggregation**

- 6.26 An Extraordinary Review requires the Arbiter to give a view "in the round" and in his draft Guidance the Arbiter has expressed his views on the level of aggregation that this implies. He considers that the

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appropriate level of aggregation is broadly equivalent to that in the original bids for the PPP Agreements. This implies disaggregation into less than 100 lines of information. The draft Guidance stated that such a level of aggregation is likely to involve identifying and reviewing costs separately for the following different classifications of work:

- major upgrades, such as the Victoria Line Upgrade, that combine significant elements from more than one asset class;
- other major programmes, such as the stations programme;
- steady state investment required to improve or extend the life of existing assets;
- maintenance; and
- other costs such as management and overheads of the Infracos.

6.27 Annex 3 of the draft Guidance contained by way of example the lines of information included in Metronet BCV's PPP Agreement. Annex 1 to this document is a development of that Annex and takes account of the structures used in the AAMPs, guidance given to bidders by London Underground on preparation of prices and a view of the level of detail that is necessary to reach a conclusion on unit costs.

6.28 The data produced by the Infracos for the AAMPs is already in a format similar to this but:

- greater emphasis has been given to maintenance costs;
- costs for works should be presented inclusive of "on-costs";
- risk should be explicitly stated as a single row. For this to be practical the supporting risk model will be required such that the risks to which an Infraco is exposed (and the underlying assumptions) can be evaluated.

6.29 Initial analysis of the structure used by Metronet and Tube Lines in their AAMPs suggests that it should be possible for the Infracos to produce cost information in this way.

*Question 9: the PPP Parties are asked to consider and comment on the revised structure in Annex 1. In particular they are asked to consider whether any further disaggregation of data might be required, whether infrastructure costs might be aggregated in some way, whether a single explicit risk pot is sufficient and whether it is practical for on-costs to be allocated to cost-rows? Details of suggested changes, together with their rationale, should be provided.*

6.30 The AAMP cost breakdown structures currently exclude administration and other costs. Clearly this is an important gap that will need to be addressed. The Arbiter is interested in the way that the joint benchmarking work will address comparisons in this area and what that might say about the cost breakdown structure to be used in this area.

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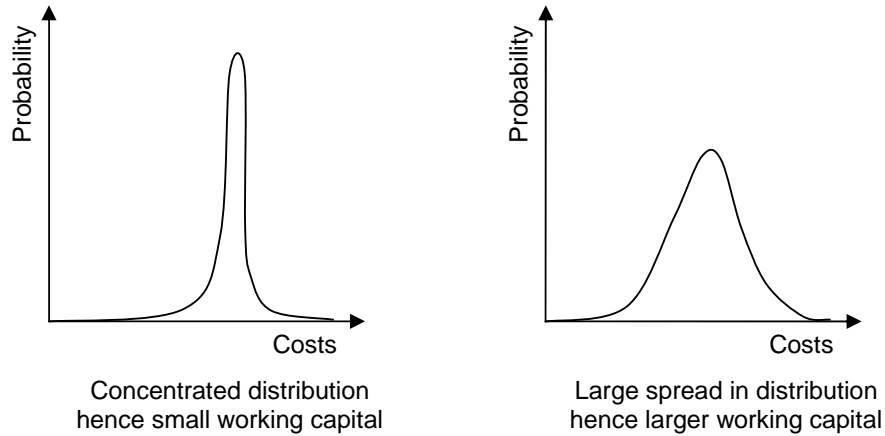
*Question 10: the PPP Parties are requested to consider the level of breakdown appropriate for administration and other costs and present this and their rationale for it in their response.*

- 6.31 The Arbiter will require the cost data to be submitted in a format that can be manipulated (ie as a cost model). He would expect to be able to see all calculations and a direct link from them to the cost, risk and performance assumptions and work volumes that support them.
- 6.32 As depicted in the diagram above, work volumes, risk analysis, cost assumptions and the basis of them are to be separately documented and cross referred where appropriate to the further supporting evidence which is described in Annex 2.
- 6.33 The Arbiter's intention is to work with the PPP Parties to produce a template model that will underpin an Extraordinary Review submission and that can be used for Periodic Review.
- 6.34 Although the intention is to specify substantive submission requirements for a broad based Extraordinary Review quite fully they will be set on the basis that the Arbiter's assessment would be at a reasonably high level of aggregation. As noted in his draft Guidance he would expect to supplement his analysis with a more detailed review of individual projects or work packages, on a sample basis. For example, costs of individual stations might be examined in order that outliers can be identified and factors affecting this considered.
- 6.35 Supplementary information requirements will be set by the Arbiter at the Post-Reference meeting.

#### **Treatment of risk in the cost model**

- 6.36 The draft Guidance indicates that the costs at Extraordinary Review should include an element of programme risk. The Arbiter's proposed approach is that all other risk should be managed in the short term through a working capital buffer allowed for through the phasing of any additional ISC. This provision will be subject to further scrutiny as part of the ongoing monitoring of the initial Extraordinary Review settlement with materialised risk of an efficient and economic nature being considered a Net Adverse Effect and any inefficient and uneconomic costs for the account of Infracore. The obvious exception to this would be a circumstance where the effect of a materialised risk exceeds the working capital amount and triggers a further Extraordinary Review.
- 6.37 The risk provision being made at programme level should be documented as set out in Annex 1 and is to be supplemented by the analysis that has generated it. The Arbiter expects this analysis to be based on probability distributions which are themselves supported by documented assumptions.
- 6.38 The distributions will in part influence the size of the working capital facility. In arriving at an estimate of the appropriate level of buffer the Arbiter would expect to consider the likelihood of costs being significantly in excess of those expected (and hence priced into the ISC). Hence,

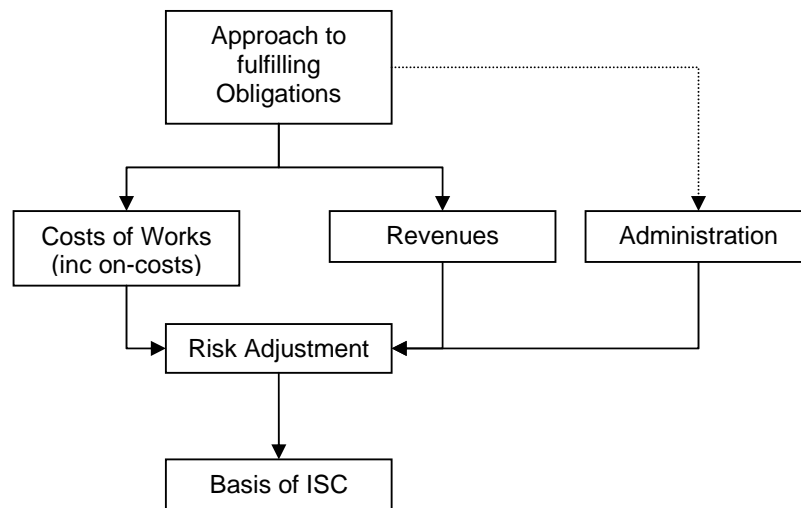
where the probable outcome was closely centred on the expected outcome he would anticipate the working capital being smaller than if the outcomes were more widely spread. This is depicted below:



6.39 The risk model should make the underlying assumptions clear. This should include details on the risks that have been retained for major tendered works and, where historical and/or benchmark costs have been used as the basis for future costs, the treatment of, and adjustments for, risks.

**Further supporting evidence**

6.40 In his draft Guidance the Arbiter set out his approach to assessing work scope and costs diagrammatically as follows:



6.41 He indicated that he considers the rationale behind an approach and analysis used to support a particular course of action fundamental to a consideration of Net Adverse Effects. Annex 2 to this document provides a tabular version of the requirements that were indicated in the draft Guidance.

## Validation of data

- 6.42 The Arbiter considers that an Infraco that is efficient and economic and following Good Industry Practice would be in a position to present data that adheres to its stated policy/strategy positions and that is internally consistent. He also considers that data would be controlled such that consistency is maintained between figures that are used for different purposes.
- 6.43 The substantive requirements for an Extraordinary Review start from an assumption that this will be the case. There is therefore a significant task for Infraco in validating data accuracy and consistency.
- 6.44 The Arbiter has commissioned a report from Ernst & Young on regulatory best practice in setting submission requirements. The report considers the approaches taken by regulators and how they might be applied to the PPP. It concludes that the level of specification of the data as set out in the Arbiter's Procedural Framework is considerably less onerous than is the case elsewhere. It also indicates that regulators tend to require a greater level of data validation than the Arbiter currently stipulates.
- 6.45 Having reviewed this report the Arbiter considers that the existing process of requiring an appropriate person to sign off the submission as true and accurate to the best of their knowledge should be augmented.
- 6.46 In the case of the overall submission the Arbiter would expect to receive a copy of the Board paper recommending the submission be issued to him. As a minimum he would expect this to set out the work that had been undertaken to ensure that the submission is true and accurate.
- 6.47 In the case of the cost model the Arbiter would expect an audit opinion to be provided confirming as a minimum that:
- historical actual data used in the model was consistent with that reported in audited accounts and the most recent AAMP;
  - forecast data was consistent with the assumptions set out in the model and with the forecast in the AAMP; and
  - the model is mathematically correct.

The scope of the opinion should be signed off by the Arbiter and London Underground and be provided for the benefit of the Arbiter and the Reference Parties.

## Analysis

- 6.48 Following receipt of the Infraco's substantive submission and London Underground's representations on it, the Arbiter will proceed to the analysis phase of the Extraordinary Review.
- 6.49 Whether the reference seeks direction on Net Adverse Effects as well as on ISC revisions or not, the Arbiter considers that it would be appropriate to consult on a draft decision on the scale of Net Adverse Effects before considering ISC changes. The Arbiter anticipates this analysis and

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development of draft decision on Net Adverse Effects would take about two months, provided that the information submission had been developed on a transparent basis, involving collaboration with the Arbiter and his staff and advisers.

- 6.50 The Arbiter proposes that the Parties should have 30 days to make representations on the draft decision on Net Adverse Effects. The Arbiter anticipates that both London Underground and the Infraco will wish to comment on his draft decision on the level of Net Adverse Effects. The Arbiter would also expect London Underground to identify any Restated Terms that it wished to propose to address affordability considerations<sup>7</sup> at this stage of the Extraordinary Review process.
- 6.51 Following receipt of representations, the Arbiter would expect to require a further month to consider Notional Infraco Costs (and Revenues) consistent with any Restated Terms, and to prepare draft directions on required ISC changes. He would expect to allow the Parties to have a further 30 days to make representations on these draft directions.
- 6.52 In accordance with the guidance to him in paragraph 3 of Annex 2 to Schedule 1.9 of the PPP Agreements, the Arbiter will follow an open and transparent process for seeking representations on draft directions. This will include seeking representations from the Mayor, Transport for London, Government Ministers and Infraco shareholders and lenders. Given the range of bodies he is guided to consult, he therefore proposes to publish his draft directions on ISC changes.
- 6.53 The Arbiter would expect to publish final directions within a month of receiving these final representations.
- 6.54 An indicative timetable on this basis is set out below. The maximum elapsed time from receipt of a reference is anticipated to be twelve months. The Arbiter proposes within this timetable two separate periods of consultation each lasting one month: the first is with the Parties only on draft decisions on Net Adverse Effects; the second is a public consultation on draft directions.

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<sup>7</sup> Paragraph 14 of Schedule 1.9 to the PPP Agreements

Time for each stage (months)	Stage within Procedural Framework	Description	Notes
-	Reference submission	By reference to paragraph 14 of Part 3 of Schedule 1.9, Infraco refers to Arbiter for direction pursuant to section 229 of GLA Act its contention that it has incurred or will incur Net Adverse Effects during the Review Period in excess of the Materiality Threshold and seeks direction on the change in the ISC which avoids the need to finance these amounts	Statement of case supporting reference submission to include as a minimum: <ul style="list-style-type: none"> <li>• most recent financial model</li> <li>• Lenders' Technical Adviser's report on most recent financial model; and</li> <li>• relevant Board papers.</li> </ul>
1 month	Arbiter's analysis of submission	Arbiter and London Underground review initial submission to determine further information needs and proposed work programme	
-	Post-Reference meeting	Arbiter sets out further information needs and proposed work programme and timetable for the Review	
3 to 5 months	Further information gathering	Arbiter and London Underground work with Infraco to gather and validate the necessary cost and scope information to enable Net Adverse Effects to be quantified. Before the end of this period London Underground to make any further submission that it deems necessary	The Arbiter will develop a template for his analysis that will form part of his Procedural approach
2 months	Arbiter's analysis of Net Adverse Effects	Arbiter undertakes analysis leading to a quantification of Net Adverse Effects, the time profile of costs and the risks associated with the costs	To include assessment of work programme, competitive tendering, benchmarking and risk assessment
-	Draft decision on Net Adverse Effects	Arbiter consults with Reference Parties and relevant stakeholders on his draft decision in respect of his quantification of Net Adverse Effects	Draft decision will be accompanied by confidential technical report
1 month	Responses to consultation	Reference Parties and relevant stakeholders respond to draft decision on Net Adverse Effects	London Underground also indicates whether Net Adverse Effects to be compensated by additional ISC or through descoping
1 month	Arbiter's analysis of required ISC change	Arbiter takes account of representations on draft decision on Net Adverse Effects, including effects of any descoping required by London Underground	Under para 1.9(e)(iii) Infraco may contend that scope changes proposed by London Underground in response to consultation are inappropriate
-	Draft directions	Arbiter publishes draft directions on Net Adverse Effects and ISC changes, including effects of descoping, and any ancillary directions in respect of annual review of costs and revenues	Draft directions will be accompanied by confidential technical report
1 month	Representations on draft directions	Reference Parties, relevant stakeholders and others respond to draft directions	
1 month	Final decisions	Arbiter considers all representations received and prepares final directions in respect of his quantification of Net Adverse Effects, descoping, changes to ISC and ancillary directions	
-	Final directions		

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6.55 Where an Extraordinary Review reference is accompanied by a substantive submission, or where the Extraordinary Review does not involve a review of the whole of an Infraco's activities, the timescales would be reduced accordingly.

**Interim directions**

6.56 The PPP Agreements make provision for the Arbiter to give directions on the interim level of ISC that would be sufficient to enable a Notional Infraco to perform its existing obligations<sup>8</sup>, pending final directions for the Extraordinary Review.

6.57 The Arbiter considers that such a direction will be necessary only in circumstances where an Infraco requires immediate additional funds to allow it to continue fulfilling its obligations while awaiting final direction on the level of ISC that it should receive. Therefore an Infraco should state in the reference for an Extraordinary Review whether it is requesting a direction on the interim level of ISC and the required timing of such a direction. Any such request should be accompanied by a proposed ISC profile and supporting evidence for the increase.

6.58 Where a direction is sought on interim ISC, the Arbiter would propose to carry out only a high level assessment of costs and revenues. In respect of Metronet, he would only expect to conclude that future costs and revenues were inconsistent with those expected of a Notional Infraco where the previous annual Metronet Report had concluded that one or both of the Metronet Infracos were not performing their activities in and overall efficient and economic manner and in accordance with Good Industry Practice, even at the end of the Reference Period. In those circumstances, he would expect that his direction on interim ISC would take account of the need for shareholders to fund costs and revenues which were not efficient and economic or incurred in accordance with Good Industry Practice.

6.59 The Arbiter would expect that any interim ISC direction would only cover the period up to the issue of final directions, although he would also consider an Infraco's funding terms to ensure that it does not breach its funding agreements. The Arbiter notes that the PPP Agreements do not envisage that London Underground has any opportunity to restate its requirements on affordability grounds in the case of interim directions.

6.60 The timetable for giving such directions on interim ISC will clearly be dependent on the circumstances of the request, and the Arbiter will consult with the Parties and stakeholders as appropriate in endeavouring to give timely directions.

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<sup>8</sup> Paragraph 1.8 of Schedule 1.9 to the PPP Agreements

## 7 Periodic Review

7.1 This section of the paper reflects the Arbiter's emerging thoughts on Periodic Review and how they may be reflected in a Procedural Approach document covering:

- remit for the Arbiter;
- necessary timescales;
- basis for submissions; and
- financing issues.

### Remit for the Arbiter

7.2 Neither the PPP Agreements nor the GLA Act provides any certainty that the Arbiter will be involved in Periodic Review. However the Arbiter's assumption is that it is more likely than not that the Parties will, at some point, seek directions from him. This assumption is driven by two reasons:

- experience to date shows that the issues to be faced by the PPP Parties at Periodic Review are complex and – since much money is involved – likely to be contentious; and
- if the Arbiter is to be able to respond to any request for direction – however late in the process it is called – he will need to be prepared.

7.3 For this reason, the Arbiter's business plan assumes that he will be significantly involved in the Periodic Review process from the outset and this is reflected in the remainder of this document.

7.4 The Arbiter firmly believes that it would be beneficial to the process for the PPP Parties to consider now their expected need for the Arbiter's involvement and to confirm this at an early stage.

7.5 The PPP Agreements<sup>9</sup> allow for the PPP Parties to seek directions from the Arbiter in respect of Periodic Review covering:

- the form and structure of the review;
- Base Finance, risk and Eligible Finance;
- whether there is financing impossibility;
- Required Finance;
- ISC requirements;
- Equity Rate of Return for new equity required;
- Prior Net Adverse Effects; and
- Interim ISC.

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<sup>9</sup> Paras 1.2 to 1.10 of Part 1

7.6 For now this paper focuses on the implications of a direction on the ISC requirements (and hence the quantification of the costs of a Notional Infraco) and the financing impacts of that.

### Timescales

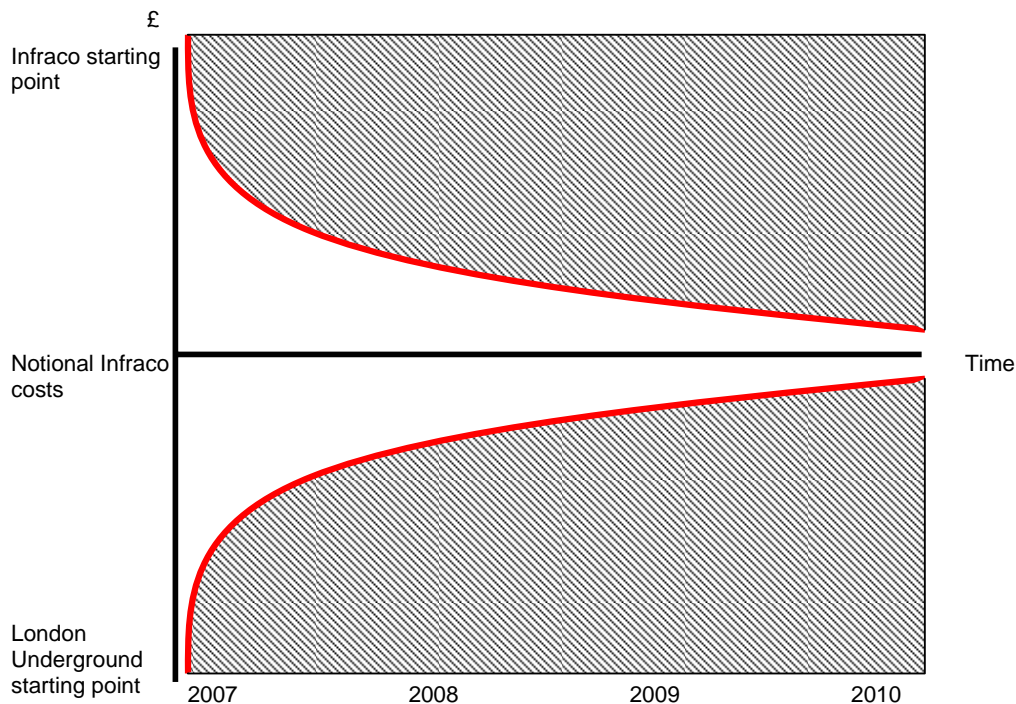
7.7 Previously the Arbiter has raised the issue of staggered Periodic Review dates with Tube Lines' first Review period ending on 30 June 2010 and Metronet's on 3 October 2010. The Arbiter has questioned whether this difference is helpful or otherwise.

7.8 The Arbiter is not aware of any action being taken to change any Periodic Review dates and hence is planning on the basis that the dates will not be aligned.

7.9 In preparing the outline timetable set out below the Arbiter has drawn on the following:

- the requirements of the PPP Agreements;
- London Underground's initial thoughts on timing; and
- the Arbiter and his Office's own experience of bidding for the PPP and similar transactions.

7.10 The outline timetable indicates various checkpoints at which the Parties could review whether the inevitably differing initial views on price are converging. The Arbiter considers that these checkpoints would provide the opportunity to revisit the need for the Arbiter's involvement. This is represented diagrammatically below:



7.11 If at each checkpoint it appears that the PPP Parties are not converging – depicted in the shaded areas in the diagram above – the Arbiter considers that there may be benefit in his involvement.

Time period	Activity	Notes
Spring 2007	<ul style="list-style-type: none"> <li>Arbiter to draft his Procedural Approach</li> </ul>	
Summer 2007	<ul style="list-style-type: none"> <li>PPP Parties to confirm scope of Arbiter involvement</li> <li>Parties and Arbiter to establish detailed submission requirements and formal timetable</li> <li>CSR 2007 settlement which will drive affordability constraint for second Review Period</li> </ul>	First opportunity to fully involve Arbiter
Autumn 2007	<ul style="list-style-type: none"> <li>London Underground to consider scope of second Review Period in light of CSR 2007 settlement</li> <li>London Underground to commence drafting Restated Terms</li> <li>Infracos to prepare 2008/09 consult and confer AAMPs</li> </ul>	Arbiter could assist with unit cost trends
Spring 2008	<ul style="list-style-type: none"> <li>Possible timescale for outcome of anticipated Extraordinary Review</li> <li>Parties agree 2008/09 AAMPs</li> <li>Infracos to provide indicative pricing of draft Restated Terms (and a range of financing options?) using 2008/09 AAMP as key evidence</li> </ul>	
Summer 2008	<ul style="list-style-type: none"> <li>Using outcomes of indicative pricing and elsewhere, London Underground to confirm/revise Restated Terms and actual affordability constraint</li> </ul>	
Autumn/Winter 2008	<ul style="list-style-type: none"> <li>Infracos to formally price Restated Terms and develop a full financial model to be consistent with 2009/10 consult and confer AAMPs being prepared at the same time</li> <li>Benchmarking data needs to be complete by now</li> <li>In parallel Arbiter to be developing Notional Infraco cost model</li> </ul>	Further opportunity to fully involve Arbiter
Spring/Summer 2009	<ul style="list-style-type: none"> <li>PPP Parties to negotiate pricing – to be led by London Underground or Arbiter</li> <li>Arbiter will need to have finalised his Notional Infraco model by now</li> </ul>	Possible formal references at this stage
Autumn 2009	<ul style="list-style-type: none"> <li>Infracos to complete negotiations phase with a Best and Final Offer after further revision to affordability and consideration of financing opportunities to be consistent with 2010/11 consult and confer AAMPs being prepared at the same time</li> </ul>	Last opportunity for formal references
Winter 2009	<ul style="list-style-type: none"> <li>Final negotiation/agreement on costs for second Review Period</li> </ul>	
Spring 2010	<ul style="list-style-type: none"> <li>Infracos finalise funding packages</li> </ul>	
Review Date – final agreement	<ul style="list-style-type: none"> <li>Tube Lines – 30 June 2010</li> <li>Metronet – 3 October 2010</li> </ul>	

*Question 11: the PPP Parties are invited to comment on the outline timetable for Periodic Review in particular in relation to:*

- *Arbiter's involvement; and*
- *Interaction with AAMP timetable.*

### **Basis for submissions**

7.12 Section 6 above sets out in detail the Arbiter's expectations for the detailed submission requirements for a broad based Extraordinary Review. The Arbiter considers that the same requirements would apply for Periodic Review with the following additions:

- further information in respect of risk to reflect the requirement for Infraco to fund any costs up to the new Materiality Threshold;
- consequences of any changes to the contract structure (eg performance regime); and
- financing plans.

7.13 In respect of financing, the Arbiter has identified several issues which the PPP Parties will have to consider:

- whether Infracos will need to refinance Tranche 1 or not; and
- the value for money benefits of residual values/termination payments.

Only once these structural issues are decided will the Arbiter be able to have input on the costs, gearing and sources of further finance.

7.14 The Arbiter expects to develop these concepts with the PPP Parties over the course of the next six months.

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## 8 Consultation questions

Question 1: do the PPP Parties agree that the default position should be that references are only initiated once the minimum submission requirements can be met?

Question 2: do the PPP Parties agree that there are circumstances where simultaneous submissions are practical? And if so, what are those circumstances?

Question 3: do the PPP Parties agree that there may be benefits, both in terms of workload and resourcing, in requiring simultaneous submissions?

Question 4: do the Parties to the Metronet PPP Agreements accept that the operation of paragraph 6.5 is a contractual matter and hence an issue for the Parties? And if so, do the Parties agree with the Arbiter's proposed amendments to his Procedural Framework?

Question 5: do the Parties to the Metronet PPP Agreements agree that the annual Metronet Report process should involve simultaneous submissions?

Question 6: do the Parties to the Metronet PPP Agreements accept that the timetable for the annual Metronet Report process should be brought in line with Metronet's funding documents and hence accelerated?

Question 7: do the PPP Parties consider that there are other changes needed to be made to the Procedural approach to the receipt of an unanticipated request for Guidance?

Question 8: do the PPP Parties agree that the AMSs, AGSs and AAMPs are central to an Extraordinary Review submission and if so, what changes might usefully be made to these documents to aid consistency and data comparison? How might gaps in the suite of documents best be filled (eg with information routinely prepared for other purposes)?

Question 9: the PPP Parties are asked to consider and comment on the revised structure in Annex 1. In particular they are asked to consider whether any further disaggregation of data might be required, whether infrastructure costs might be aggregated in some way, whether a single explicit risk pot is sufficient and whether it is practical for on-costs to be allocated to cost-rows? Details of suggested changes, together with their rationale, should be provided.

Question 10: the PPP Parties are requested to consider the level of breakdown appropriate for administration and other costs and present this and their rationale for it in their response.

Question 11: the PPP Parties are invited to comment on the outline timetable for Periodic Review in particular in relation to:

- Arbiter's involvement; and
- Interaction with AAMP timetable.

## Annex 1

### Proposed Cost Breakdown Structure

1. All rows should be supplied as semi-annual values.
2. On-costs should be incorporated within each cost row rather than stated separately.
3. The basis of on-cost allocation should be clearly stated.

<b>TRAINS</b>	Repeat per Line or rolling stock type
<b>Rolling stock</b>	
Upgrade Refurbishment & Improvements Major examinations by exam type	
Cleaning Inspections Maintenance by exam type	
<b>Signalling and control</b>	
Life extension works Upgrade Refurbishment	
Inspections Preventative maintenance Reactive maintenance	
<b>Depots</b>	
Refurbishment & Improvements	
<b>Other Core PPP</b>	
Special Projects Transition projects	
<b>Other Variations</b>	
Agreed Contract Variations	

<b>STATIONS</b>
<b>Premises &amp; systems</b>
Modernisation Enhanced refurbishment Refurbishment
Inspections Cleaning Preventative maintenance Reactive maintenance Maintenance projects
<b>Lifts</b>
Refurbishment Replacement
Inspections Preventative maintenance Reactive maintenance
<b>Escalators</b>
Refurbishment Replacement
Inspections Preventative maintenance Reactive maintenance
<b>Other Core PPP</b>
Special Projects Transition Projects
<b>Other Variations</b>
Agreed Contract Variations

<b>INFRASTRUCTURE</b>	<b>Repeat per Line</b>
<b>Track</b>	
BTR/ETR Rerailing (split by open, sub-surface and tube) Tube reconditioning Points and crossings Electrical track equipment	
Inspections Preventative maintenance Reactive maintenance	
<b>Bridges &amp; structures</b>	
Renewal	
Inspections Cleaning Preventative maintenance Reactive maintenance	
<b>Earth structures</b>	
Renewal	
Inspections Cleaning Preventative maintenance Reactive maintenance	
<b>Track drainage</b>	
Renewal	
Inspections Cleaning Preventative maintenance Reactive maintenance	
<b>Deep tube tunnels</b>	
Renewal	
Inspections Cleaning Preventative maintenance Reactive maintenance	
<b>Other Core PPP</b>	
Transition projects Special projects	
<b>Other Variations</b>	
Agreed Contract Variations	

<b>ADMINISTRATION</b>
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Planning, Central, Admin, Management Systems, Regulatory Accommodation and Facilities Accounting and Finance Human Resources Information Technology and Management Information Systems Scarce Resources Insurance
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<b>RISK</b>
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Expected risk exposure
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**Annex 2: Further Supporting Evidence**

Question	Supporting evidence	Analyses
<p><b>Approach to fulfilling Obligations:</b></p> <ul style="list-style-type: none"> <li>• Is the work plan appropriate to the Obligations?</li>   <li>• Is the programme appropriate?</li> </ul>	<ul style="list-style-type: none"> <li>• Proposed work programme needs to clearly demonstrate how programme elements have been integrated to make best use of resources including matter such as access time, availability of scarce resources (eg equipment provided by Transplant)</li>   <li>• Chronology of the decision process</li> <li>• Description of approaches and technology considered</li> <li>• Identification of external factors that influenced the decision</li> <li>• Consideration of application of standards</li> <li>• Evidence of consideration of approach taken by other comparable organisations</li> <li>• Rationale for chosen approach by reference to GIP</li> </ul>	<p>Assessment of decision process</p> <p>Comparison of selected approach with GIP and other comparable organisations</p>
<p><b>Notional Infraco costs and revenues:</b></p> <ul style="list-style-type: none"> <li>• <b>Competitive tenders</b> <ul style="list-style-type: none"> <li>– was the procurement strategy appropriate?</li>   <li>– was the tender and award process effective?</li> </ul> </li> </ul>	<p>Statement of overall procurement strategy demonstrating that it has taken account of:</p> <ul style="list-style-type: none"> <li>• most appropriate form of contract;</li> <li>• ability of the market to respond effectively and consideration of how this is likely to change overtime; and</li> <li>• interaction with the approach to delivering Obligations in respects of other assets and constraints on the Infraco</li> </ul> <p>Description of the process demonstrating that the strategy had been followed:</p> <ul style="list-style-type: none"> <li>• advertised to a wide market;</li> <li>• appropriate prequalification criteria fairly applied;</li> <li>• ITT maximises opportunity for competitive bids;</li> <li>• appropriate form of contract;</li> </ul>	<p>The Arbiter would be minded to conclude that the price was consistent with the costs of a Notional Infraco if the actual Infraco is able to demonstrate compliance with these requirements</p>

Question	Supporting evidence	Analyses
	<ul style="list-style-type: none"> <li>• fair and transparent evaluation process; and</li> <li>• application of appropriate corporate governance this being especially important where the contract is awarded to a shareholder.</li> </ul>	
<ul style="list-style-type: none"> <li>• <b>Benchmarking:</b> of processes, engineering level metrics such as MDBF, unit costs, efficiency trends etc</li> </ul>	<p>Evidence that Infracos has benchmarked its own processes and costs against:</p> <ul style="list-style-type: none"> <li>• other Infracos;</li> <li>• other metros;</li> <li>• other rail infrastructure companies in the UK and internationally;</li> <li>• industry databases of unit costs; and</li> <li>• other large scale asset intensive businesses</li> </ul>	<p>Benchmarking data would be used to assess:</p> <ul style="list-style-type: none"> <li>• the processes adopted by Infracos against GIP;</li> <li>• the appropriate level of unit costs; and</li> <li>• levels of efficiency that Infracos would be expected to achieve</li> </ul>
<p><b>Performance and revenue projections</b></p>	<ul style="list-style-type: none"> <li>• Analysis of historic CuPID data and engineering level metrics eg MDBF to underpin performance assumptions</li> </ul>	
<p><b>Risk</b></p>	<ul style="list-style-type: none"> <li>• Documented approach to risk assessment and the risk model</li> <li>• Evidence of risk transfer (eg in competitive tenders)</li> <li>• Analysis of approach to risk in benchmarking</li> </ul>	