

SCHEDULE 1.9

The Statutory Arbiter and Reviews

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Part 1: The Statutory Arbiter

1. *Statutory Arbiter's jurisdiction*

Agreed jurisdiction

1.1 The parties agree that:

- (a) either of them may:-
 - (i) at any time and from time to time during a Review Process (or at any time where relevant in connection with an actual or potential Extraordinary Review, subsequent Periodic Review or application pursuant to paragraph 1.9(aa)) refer any of the matters referred to in sub-paragraphs 1.2 to 1.10 below to the Statutory Arbiter for direction pursuant to section 229 of the GLA Act; or
 - (ii) at any time and from time to time, refer any of the matters referred to in sub-paragraphs 1.1A to 1.10 below to the Statutory Arbiter for guidance pursuant to section 230 of the GLA Act;
- (b) any matter that may be referred to the Statutory Arbiter shall not be referred to the Dispute Resolution Agreement, save to the extent that either express contrary provision is made or the matter relates to a failure by either party to comply with any direction which takes effect as a term of the contract issued by the Statutory Arbiter.

Arbiter Reports

1.1A This paragraph refers to a definitive statement following the end of each Contract Year (other than the first) as to whether, if the Statutory Arbiter had been issuing his statement pursuant to paragraph 1.5(c) then but by reference to the facts subsisting at the end of the Contract Year concerned, it would have been in terms of sub paragraph (i) or sub paragraph (ii) of that paragraph and, in either case, a report to the parties on the reasons for the conclusions reached.

Form and structure of review

1.2 This paragraph refers to the form and structure of the way in which (or any aspect of the way in which) the parties should proceed concerning a Periodic Review or an Extraordinary Review to give effect to and facilitate the intent of Part 2 or Part 3 of Schedule 1.9 including (without limitation):

- (a) information to be exchanged between the parties including provision for LUL to revise its Affordability Constraints;
- (b) following any direction as to financing impossibility pursuant to paragraph 1.4 (a) below;

- (c) in relation to obtaining a current credit rating for Infraco as contemplated by paragraph 6.3, the procedure for a joint application by the parties for a credit rating and information to be supplied to credit rating agencies;
- (d) procedures in relation to any election that LUL may make pursuant to paragraph 4.2(b) below;
- (e) procedures for iterations that enable the LUL Options to be utilised in refining the balance between Restated Terms, Affordability Constraints and financing constraints in a manner that makes provision for LUL to propose and Infraco to respond by service of notices equivalent to those required pursuant to paragraphs 2 and 3 in respect of the Restated Terms and Affordability Constraints as originally proposed;
- (f) in relation to any aspect of the appointment or role of the financial advisor referred to in paragraphs 6, 9 and 11 below;
- (g) the dates that are to be the End Date and the Last Financing Date ;
- (h) any contention that it would be advantageous for:
 - (i) the Review Process to continue beyond the Review Date; and/or
 - (ii) to revise the End Date; and/or
 - (iii) to revise the Last Financing Date (subject to the limits in the definition of that term);
- (i) following any direction confirming that there has been a material adverse change and/or temporary market disruption which has prevented Infraco procuring the Required Finance prior to the Last Financing Date; and
- (j) in relation to an Extraordinary Review, the timetable to which the parties should provide one another with the notices that are equivalent (mutatis mutandis) to those that are required pursuant to paragraphs 2 and 3 below and the timetable for the financing programme to be implemented by Infraco in accordance with paragraph 8 below (if applicable).

Base finance, risk and eligible finance

1.3 This paragraph refers to any contention by Infraco that:

- (a) Base Finance is required at a Periodic Review; and/or
- (b) new or varied obligations contained in the Restated Terms proposed by LUL at a Periodic Review or at an Extraordinary Review (which for the avoidance of doubt shall include the variation of any of the limits and cover (including deductibles) of insurance in accordance with paragraph 4 of Schedule 5.19 (Insurance) of the Contract and/or clause 10.1 of the Insurance Agreement) or the Affordability Constraints:

- (i) involve an increase in risk (including but not limited to an increase in technical risk in meeting the Restated Terms (and regardless of any costs or contingencies in respect thereof taken into account pursuant to paragraph 7) and including also an increase in risk of non-payment by LUL resulting from a change in the payment profile that LUL may specify as part of the Restated Terms) for Infraco that is material in the context of Infraco's overall activities pursuant to the Contract or in the context of the risk of failure to pay ISC; and/or
- (ii) are such that a Notional Infraco would require Eligible Finance for performance of the Restated Terms from the Review Date.

1.3A This paragraph refers to any contention:-

- (a) by LUL that it ought to be permitted to exercise an option in the terms of paragraph 8.3(c) or paragraph 10.2(d) and Annex 4 to subscribe or procure subscribers for any amounts of Eligible Equity or Base Equity that the parties have agreed or the Statutory Arbiter has directed pursuant to paragraph 1.5 is required and in respect of which either Infraco has elected pursuant to paragraph 8.3(a) not to procure subscribers or in respect of which the financial adviser referred to in paragraph 9 has advised that he is not reasonably confident that Infraco has the requisite financing ability;
- (b) by either party as to division, if any, of the amounts to be subscribed pursuant to any such option into equity and shareholder subordinated debt components;
- (c) by either party as to the steps that each or either of them are to take so as to enable the options referred to in paragraph (a) above to be exercised and the subscriptions to be made and received as contemplated by the relevant provisions of this schedule 1.9.

1.3B This paragraph refers to any contention by LUL that it ought to be permitted to exercise an option in the terms of paragraph 10.2(e) to attach an economic return to the Special Share.

Financing Impossibility

1.4 This paragraph refers to any contention:-

- (a) by Infraco in its notice pursuant to paragraph 3.1(a) below that a Notional Infraco would be incapable of financing performance of the Restated Terms on any basis;
- (b) at any time after the Advice Date and prior to the Last Financing Date, that a Notional Infraco with the ISC agreed or directed pursuant to paragraph 1.5 would be incapable of procuring the Required Finance for any reason (including concerning the credit rating of Transport for London) other than a reason to which paragraph 1.4(c) relates; and

- (c) at any time after the date on which the ISC is agreed or directed pursuant to paragraph 1.5, that a Notional Infraco with that ISC would be incapable of procuring the Required Finance due to a subsequent material adverse change or due to temporary market disruption.

Required Finance

1.4A This paragraph refers to any contention as to:

- (a) the amount or any other characteristics of Required Finance; and
- (b) the amount of any finance required for standby or liquidity facilities or for the purposes of financing Net Adverse Effects less than the Materiality Threshold as it would be prudent for a Notional Infraco to have.

ISC requirements

1.5 This paragraph refers to:

- (aa) any revision to the Fixed Amounts so as to result in fifty per cent. (50%) of any Refinancing Benefits not previously shared with LUL pursuant to this provision accruing to LUL as and when arising by means of a reduction in the level of ISC that would otherwise have been payable to Infraco following the Review Date (and so that LUL's share of any Refinancing Benefits that have arisen in a prior Review Period (and have not previously been shared) shall be deemed to have arisen at the Review Date), but excluding any Refinancing Benefits that are attributable to: -

- (i) Infraco's prior operational (rather than financial) efficiency gains; or
- (ii) tax efficiencies within Infraco (rather than a reduction in financing costs) which ought to accrue wholly to Infraco consistently with Infraco's general assumption of tax risk under this Agreement;

- (a) the best estimate (that is, the most likely outcome) of amounts and times of payment and receipt of each of the cashflows:

- (i) as referred to in paragraph 7 below; or
- (ii) as subsequently adjusted pursuant to the exercise of an LUL Option referred to in paragraph 10 below;

on the basis (in relation to paragraph 7.2(b)) that the aggregate of all the amounts allowed in respect of the operating and capital costs of a Notional Infraco after the Review Date shall be the best estimate of such amounts as would be agreed to by a Notional Infraco when entering into a contract after a competitive tendering process in respect of the relevant activities having regard to:

- (x) the risks associated with individual activities (including the risk of cost overruns and ISC Adjustments);
 - (y) the risk that a Notional Infraco may have to undertake activities which it has not expected to have to carry out; and
 - (z) the probability that in the management of a portfolio of activities, the actual cost of some individual activities will exceed the costs allowed, and the actual costs of other individual activities will be less than the costs allowed;
- (b) the ISC to be paid by LUL from the next Review Date on the basis set out in paragraph 7.4 below and such that the negative cashflows (as directed pursuant to paragraph (a) above) are funded by the positive cashflows (as directed pursuant to paragraph (a) above) without the need to draw on other finance;
- (c) consideration as to whether, and a definitive statement to the parties at the same time as any direction is given pursuant to sub-paragraphs (a) and (b) above (and so in anticipation of the position at the Review Date) in terms that either:-
- (i) Infraco has performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice; or
 - (ii) Infraco has not performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice

and, in either case, with a report to the parties on the reasons for the conclusion reached;

- (d) a statement of the amounts allowed by way of fixed amounts and the timing of their payment in respect of any Base Finance, and/or Eligible Finance as the Statutory Arbiter may have directed in the current Review is required pursuant to this paragraph and paragraph 7 below, in the form of a revised version of Annex 3 of this Schedule 1.9 (Fixed Amounts) as new terms of the Contract pursuant to section 229(4) of the GLA Act; and
- (e) any contention by the parties that the ISC set by the Statutory Arbiter should be subsequently adjusted as set out in paragraph 9 below following the completion of the financing programme set out in paragraph 8 below.

Equity Rate of Return

1.6 This paragraph refers to any contention that the Equity Rate of Return in respect of any Base Equity or Eligible Equity ought to be adjusted to a higher or lower rate of return to allow for:

- (a) any change to the general perception of Infraco's risk in carrying out its original requirements under the Contract, to the extent any perceived increase

or decrease in risk is not provided for in the operating or capital costs taken into account pursuant to paragraph 7 in particular having regard to the extent to which that change in the perception of risk may be reflected in contingent obligations imposed on those providing Base Equity or Eligible Equity to invest further sums in the Infraco which will not be remunerated other than by way of the fixed amounts allowed in respect of the Equity Rate of Return;

- (b) any change to the risk that Infraco will be carrying in its future performance of the Contract as a result of the Restated Terms, to the extent that any perceived increase or decrease in risk is not provided for in the operating or capital costs taken into account pursuant to paragraph 7, in particular having regard to the extent to which that change in the perception of risk may be reflected in contingent obligations imposed on those providing Base Equity or Eligible Equity to invest further sums in the Infraco which will not be remunerated other than by way of the fixed amounts allowed in respect of the Equity Rate of Return;
- (c) any change in the consensus view of the market risk premium over the appropriate risk free rate between the premium as at the Transfer Date (which is agreed to be 4.4 per cent. being the simple average value of the most recently quoted views of London Business School and Barclays Capital expressed to one decimal place) and the premium on the Review Date;
- (d) any change in the appropriate risk free rate (that is, a change in the gross yield to redemption on UK Government gilt edged stock of a maturity matching the remaining period of the contract, between the yield as at the Transfer Date (which is agreed to be 4.491 per cent. when expressed to three decimal places) and the yield on the Review Date); and
- (e) any material difference in the proportions of debt and equity components of Eligible Finance as compared to existing finance.

Provided that the Equity Rate of Return for equity and Shareholder Subordinated Debt referred to in paragraph (a) of the definition of Equity Rate of Return shall, when expressed to one decimal place, be 18.2% per cent. (the **Nominal Figure**) and that rate of return and any other Equity Rate of Return directed by the Statutory Arbitrator pursuant to this paragraph shall in respect of the corresponding equity and Shareholder Subordinated Debt all be rates of return incorporated into this Agreement for the purposes of Section 231(4) of the GLA Act, provided that for the purposes of calculating component **E** of the Estimated Fair Value of the Contract, the Equity Rate of Return shall, when expressed to one decimal place, be 15.4% per cent. (the **Real Figure**) as that figure may be adjusted in order to reflect any adjustment to the Nominal Figure pursuant to this Schedule 1.9.

Prior Net Adverse Effect

1.7 This paragraph refers to:

- (a) whether Infraco incurred Net Adverse Effects during the last Review Period in excess of the Materiality Threshold which have not been compensated pursuant to an Extraordinary Review; and
- (b) where the Statutory Arbiter has directed in terms of sub-paragraph (a) above, the amount and timing of any adjustments to the level of ISC or other payments to be made to compensate Infraco in respect of that excess.

Interim ISC

1.8 This paragraph refers to an interim level of ISC that would be sufficient to enable a Notional Infraco to perform its existing obligations:

- (a) in relation to a Periodic Review, pending the Restated Terms taking effect pursuant to paragraph 5.5 below where this has not occurred prior to the Review Date; and
- (b) in relation to an Extraordinary Review, pending any direction pursuant to paragraph 1.9(b) below.

Extraordinary Review

1.9 This paragraph refers to:

- (aa) any contention by Infraco, once a year but not more frequently, as to the level of Eligible Costs and/or Eligible ISC that it has incurred during the Review Period and any reasonable request for ancillary directions to enable factual findings relevant to any such direction to be final, so as to avoid reconsideration if later directions are sought about Net Adverse Effects. The parties agree that any contention pursuant to this sub-paragraph (aa) is to be treated as in connection with an actual or potential Extraordinary Review;
- (a) any contention by Infraco that it has incurred or will incur Net Adverse Effects during the Review Period in excess of the Materiality Threshold;
- (b) where the Statutory Arbiter has directed in terms of sub paragraph (a) above (or, in relation to sub paragraph (i) below only, where any Extraordinary Review is instigated by LUL pursuant to paragraph 16 below or clause 40.3(d) of the Contract), the amount and timing of any adjustments to the level of ISC sufficient for a Notional Infraco:
 - (i) properly to perform its contractual obligations during the remainder of the current Review Period; and
 - (ii) to avoid the need for Infraco to finance any Net Adverse Effect during the then current Review Period as a whole that is in excess of the Materiality Threshold;
- (c) [not used]

- (d) [not used]
- (e) any contention by Infraco as to restrictions on the scope of contract changes that LUL may propose so as to limit these:
 - (i) (in relation to an Extraordinary Review instigated by LUL pursuant to paragraph 16 below) to ones designed to address shortfalls in contract performance that LUL has experienced and to enable LUL to finance any costs of those changes; or
 - (ii) (in relation to an Extraordinary Review instigated by LUL pursuant to clause 40.3(d) (*LUL Breaches*) of the Contract) to ones designed to remedy the impossibility referred to in that clause; or
 - (iii) (in relation to an Extraordinary Review instigated by Infraco) to ones designed to address affordability considerations raised by the need for LUL to finance Net Adverse Effects in excess of the Materiality Threshold;
- (f) any contention by LUL, where it has served a Warning Notice in relation to circumstances primarily attributable to matters that are the subject of an earlier notice by Infraco pursuant to paragraph 14 (*Extraordinary Review*), that it is unlikely that any direction pursuant to sub paragraph (c) above will materially further increase the resources available to Infraco to respond to the Warning Notice over and above those already made available pursuant to paragraph 1.8(b); and
- (g) any ancillary direction as to the form and content of the next Periodic Review that may be necessary or desirable to prevent inappropriate double counting of items in both Reviews which by their nature should be taken into account in one review only.

Exercise of Special Share Rights

1.10 This paragraph refers to:

- (a) any contention by Infraco that an exercise of the Special Share Rights by giving consent to a specific action for which the Special Shareholders' consent is required would enable Infraco to pay to its shareholders amounts that are lawfully distributable by it while also leaving it, after the distribution had been made, with adequate resources available to perform properly its activities under the Contract and that consent shall therefore be given;
- (b) any resolutions of Infraco to make such changes (if any) to the terms of the Special Share Rights as may be reasonably necessary to give effect to any direction pursuant to paragraph (a) above; and
- (c) any resolutions of Infraco to make such changes (if any) to the terms of the Special Share Rights as may be reasonably necessary to give effect to

distributions that may be made to Base Equity or Eligible Equity subscribed in a subsequent Review Period.

(d) for the purpose of this Contract:

Special Share Rights means, save as provided below, the right of the Special Shareholder, pursuant to the Articles of Association of Infraco, to require that its consent be obtained prior to Infraco releasing any uncalled equity commitments or undrawn Shareholder Subordinated Debt commitments or making any distribution of equity or any payment or repayment in respect of Shareholder Subordinated Debt:

(a) in any particular year during the period of four (4) years immediately following the Transfer Date, which, if released, distributed, paid or repaid during that year would, when aggregated with:

- (i) all other such acts during that year;
- (ii) all such acts during that year of any Finance Obligor;
- (iii) all payments, loans, contractual arrangements or transfers of assets or rights made by Infraco to any Sponsor, whether directly or indirectly, during that year to the extent (in each case) it was put in place after the Transfer Date and was neither in the ordinary course of business nor on reasonable commercial terms; and
- (iv) receipt of any other benefit by any Sponsor, whether directly or indirectly, from Infraco during that year which is not received in the ordinary course of business and not on reasonable commercial terms,

exceed the agreed maximum aggregate amount to be distributed to equity providers or to be paid or repaid to providers of Shareholder Subordinated Debt for that year as set out in the Articles of Association of the Infraco; or

(b) during a particular Review Period, which, if released, distributed, paid or repaid during that Review Period would, when aggregated with:

- (i) all other such acts during that Review Period;
- (ii) all such acts during that Review Period of any Finance Obligor;
- (iii) all payments, loans, contractual arrangements or transfers of assets or rights made by Infraco to any Sponsor, whether directly or indirectly, during that Review Period to the extent (in each case) it was put in place after the Transfer Date and was

neither in the ordinary course of business nor on reasonable commercial terms; and

- (iv) receipt of any other benefit by any Sponsor, whether directly or indirectly, from Infraco during that Review Period which is not received in the ordinary course of business and not on reasonable commercial terms,

exceed the agreed maximum aggregate amount to be distributed to equity providers or to be paid or repaid to providers of Shareholder Subordinated Debt for that Review Period, as set out in the Articles of Association of Infraco, by a sum greater than £17,500,000 being the amount which is equal to ten per cent (10%) of the aggregate of the fully paid up or unconditionally committed share capital of Infraco and the advanced or unconditionally committed Shareholder Subordinated Debt as at the Transfer Date to be adjusted to take account of any Base Equity or Eligible Equity,

PROVIDED THAT to the extent Infraco has received equity contributions or Shareholder Subordinated Debt or commitments in respect of the same in excess of £175,000,000, the consent of the Special Shareholder shall not be required for Infraco to release any such commitment or to make any distribution, payment or repayment up to the amount of such additional equity or Shareholder Subordinated Debt.

(PARAGRAPH 1.11 - AS INSERTED BY THE SUPPLEMENTAL AGREEMENT TO THE SERVICE CONTRACT)

Extraordinary Mandatory Sale

1.11 This paragraph refers to any contention by Infraco that any reasonable Intercreditor Agent (as defined in the Common Terms Agreement) would have concluded that:

- (a) a successful legal challenge or appeal by the European Commission, or before a European Court, in which it is alleged that a provision of such Transaction Document, the Put Option Agreement, the Stand Still Agreement, the Share Purchase Agreement, the Supplemental Share Purchase Agreement and/or the CTRL Works Agreement amounts to state aid within the meaning of Article 87.1 of the EC Treaty; or
- (b) a successful petition or application to a competent court of any judicial review proceedings challenging the validity of the any aspect of the Project, the Transaction Documents, the Put Option Agreement, the Stand Still Agreement, the Share Purchase Agreement, the Supplemental Share Purchase Agreement and/or the CTRL Works Agreement,

had, or will have, an EMS Material Adverse Effect (as defined in the Common Terms Agreement).

Part 2: Periodic Reviews

2. *LUL's periodic review notice*

Timing and content

2.1 LUL shall serve Infraco with notice in writing at least eighteen months before a Review Date setting out:

- (a) the Restated Terms including the profile for payments of the ISC to be taken into account pursuant to paragraph 7.4; and
- (b) its Affordability Constraints.

Limitations

2.2 The Restated Terms shall:

- (a) be within the scope of the Key Objectives and the General Purposes;
- (b) not include changes to any of the General Purposes, any of clauses 1 (*Key Objectives*), 3 (*Contract Period*), 4.2 (*Infrastructure Services*), 16.1, 16.5 and 16.7 (*Co-operation*), 16.8 (LUL Breach of Safety Case) 18.5-18.10 (*Disputed Amounts*) 18.17 (*Interest on Late Payment*) 18.18 (*Payment Deductions*) 21 (*Indexation*), 23.1 and 23.9 (Step-in), 24.12 and 24.13 (*Consequential Loss*), 27 and Schedule 1.9 (*Review*), 32 (*Change of Infraco control*), 33 (*Change of LUL control*) 35.6-7 (*Environmental Risks*), 37.8-9 (*IPR Licences*), 40 (*Default*), 41 (*Contract Disposition*), 42.3 (*Payment on Expiry*), 44.3 (*Compensation*), 46 (*Corrupt Gifts and Fraud*), 49 (*Dispute Resolution*), 50 (*Claims*), 52 (*Acceptance of Network Conditions and Terms*), 53 (*Tax*), 54 (*Survival*), 57 (*Assignment*), 62 (*Entire Agreement*) 67 (*Governing Law and Jurisdiction*), paragraph 1.2 of Schedule 5.9 (*Key System Assets*), Schedule 5.16 (*Contract Disposition Agreement*) of the Contract and any other provisions of the Transaction Documents (including terms defined in the Master Definitions Agreement) the effect of which would be to cause a material change to the commercial arrangements established by the clauses referred to above;
- (c) be technically achievable;
- (d) where they stipulate fixed times for performance of any new or varied obligations, do so by reference to the effective date for the Restated Terms and not by reference to fixed calendar dates;
- (e) not contain any Major Enhancements other than Station Control Room Projects and/or Additional Staff Accommodation the capital cost of which would either on its own exceed Fifty Million Pounds (£50,000,000) or which would in aggregate with other such projects proposed in the Restated Terms exceed Two Hundred Million Pounds (£200,000,000) in the following Review

Period provided that this shall not prohibit LUL from proposing that such projects be carried out pursuant to the Major Enhancement Agreement; and

- (f) in stipulating any payment profile for the ISC with effect from the Review Date, have due regard to doing so in a way that would enable Infraco to maintain its cover ratios.

Failure to serve and consequences

2.3 In the event that LUL does not serve any such notice, Infraco shall put LUL on notice, in writing referring to this paragraph and addressed to LUL's Chief Executive, of that fact and if LUL has not served its notice within ten (10) Business Days thereafter LUL shall be deemed to have served a notice to the effect that the then subsisting contractual terms shall be the Restated Terms in respect of that Review Date.

3. *Infraco response*

Timing and subject

3.1 Following the serving of a notice pursuant to paragraph 2.1 or the deemed serving of a notice pursuant to paragraph 2.3 above, Infraco shall serve a written notice on LUL at least twelve months before the Review Date, setting out:

- (a) whether it contends that a Notional Infraco would be incapable of financing performance of the Restated Terms on any basis;
- (b) whether it disputes that the Restated Terms, or any of them, comply with paragraph 2.2 and, if it does, in what specific respects and what changes are required in order to produce compliance;
- (c) whether it contends that a Notional Infraco would require Base Finance;
- (d) whether it contends that new or varied obligations in the Restated Terms:-
 - (i) involve an increase in risk for Infraco that is material in the manner referred to in paragraph 1.3 above; and/or
 - (ii) are such that a Notional Infraco would require Eligible Debt and/or Eligible Equity for performance of the Restated Terms and, if so, in what amounts; and
- (e) the level of ISC it proposes for efficient and economic performance in accordance with Good Industry Practice of the Restated Terms from the Review Date, disregarding the need to comply with any that it states do not comply with paragraph 2.2.

Failure to serve and consequences

3.2 If Infraco does not serve any notice pursuant to paragraph 3.1 above, LUL shall put Infraco on notice, in writing referring to this paragraph and addressed to Infraco's Chief Executive, of that fact and if Infraco has not served its notice within ten (10) Business Days thereafter Infraco shall be deemed to have served a notice to the effect that it accepts that the Restated Terms comply with paragraph 2.2 in all respects and that it proposes that the level of ISC shall continue in accordance with the existing terms of the Contract.

4. *Disputed LUL notice*

4.1 If Infraco contends pursuant to paragraph 3.1(a) that a Notional Infraco would be incapable of financing on any basis the continued and future performance of the Restated Terms, either party may refer that matter to the Statutory Arbiter for his direction. In the event that the Statutory Arbiter directs that the contention is correct LUL shall within such further period as the Statutory Arbiter may direct provide further Restated Terms which do not include the terms directed to have had the effect that the contention is correct and paragraphs 2.2, 2.3 and 3 shall apply subject to any agreement between the parties, or in default of agreement to any directions made by the Statutory Arbiter, with regard to the time at which the steps referred to in such paragraphs shall be taken.

4.2 If Infraco disputes that LUL's notice pursuant to paragraph 2.1 above or pursuant to exercise by LUL of an LUL Option complies with paragraph 2.2 then:

- (a) the dispute shall be resolved in accordance with the Dispute Resolution Agreement and may not be referred for resolution to the Statutory Arbiter, save in relation to any dispute as to whether LUL has had due regard in the manner required pursuant to paragraph 2.2(f) above, which may only be referred to the Statutory Arbiter for a direction either that:
 - (i) LUL has had due regard in the manner required pursuant to paragraph 2.2(f), in which case the stipulated payment profile is to stand; or
 - (ii) that LUL has not had due regard in the manner required pursuant to paragraph 2.2(f) and that LUL shall reconsider and restate the Restated Terms in a manner that does have due regard as required pursuant to paragraph 2.2(f) and paragraphs 2.2, 2.3 and 3 shall apply subject to any agreement between the parties, or in default of agreement to any directions made by the Statutory Arbiter, with regard to the time at which the steps referred to in such paragraphs shall be taken; and
- (b) LUL may elect to proceed with any reference to the Statutory Arbiter with the Restated Terms modified so as to exclude the terms in dispute and/or so as to substitute others for them and may also, when the dispute is agreed or finally determined, introduce into the Review Process the disputed terms (if agreed or upheld) and/or compliant substitutes for any of them (and the Review Process shall not be regarded as complete until the dispute is finally determined and LUL has had a reasonable opportunity to do so).

5. *Discussions and effectiveness of restated terms*

5.1 The parties agree to discuss their respective notices with one another in good faith with the objective of agreeing the level of ISC for the Restated Terms.

5.2 If either party believes that these discussions are not progressing with suitable priority and the other party does not address this satisfactorily in response to a written request to do so, then the first party may invoke dispute resolution, as a means of securing due priority, in accordance with clause 5.3 below.

5.3 A party, by giving notice in writing to the other party, may refer its own contention as to the operating and capital costs of a Notional Infraco after the Review Date (as referred to in paragraph 7.2(a/b) and (b) below) for consideration under the Dispute Resolution Agreement, on the basis that it is to be considered directly by the Senior Representatives and may be referred to (but not beyond) the Adjudicator.

5.4 Any decision of an Adjudicator, in respect of the matters referred to in paragraph 5.3, is not to be dispositive but it, together with any statement of reasons given in accordance with clause 4.8 of the Dispute Resolution Agreement, shall be provided to the Statutory Arbiter along with any relevant information provided to the Adjudicator and/or a transcript of proceedings before him.

5.5 The Restated Terms shall have effect between the parties on the latest of:-

- (a) the Review Date;
- (b) at the start of the first Payment Period in respect of which the level of ISC as agreed between the parties or directed by the Statutory Arbiter is payable; and
- (c) on procurement of the Required Finance by Infraco in circumstances where the parties agree or the Statutory Arbiter directs that: -
 - (i) Base Finance or Eligible Finance is required; or
 - (ii) there has been a material change in risk within the terms of paragraph 1.3 and any of the existing Funders require to be refinanced.

5.6 The Contract shall (apart from any direction about interim ISC pursuant to paragraph 1.8 above) continue in accordance with its existing terms until then.

6. *Guidance to the Statutory Arbiter*

General

6.1 This paragraph 6 and Annex 2 to this Schedule 1.9 sets out guidance that LUL and Infraco jointly give to the Statutory Arbiter pursuant to section 231(6) of the GLA Act. The guidance set out in this paragraph 6 and in Annex 2 has equal status.

Transparency

6.2 LUL and Infraco attach great weight to the Statutory Arbiter following open and transparent procedures in determining what directions to give on any matters that are referred to him in connection with a Periodic Review (including pursuant to paragraph 1.1A) or in connection with an actual or potential Extraordinary Review and, in particular, to:

- (a) both parties being notified of any matters referred to him and of the general process that he intends to adopt in dealing with them;
- (b) LUL, Infraco and their respective stakeholders (including, in the case of LUL, its holding company, Transport for London, the Mayor and any Minister and in the case of Infraco, direct and indirect providers of equity and debt finance) being invited to submit representations to the Statutory Arbiter on these matters and having access to the representations submitted by others;
- (c) the Statutory Arbiter taking expert advice on matters where he would be better informed by expert opinion and making available to the parties and their stakeholders the terms of reference of the advisors and an informative summary of their advice;
- (d) the Statutory Arbiter providing the parties and their stakeholders with provisional conclusions on matters referred to him, with summaries of the arguments made to him in relation to those matters and the reasons in support of the conclusions provisionally reached;
- (e) LUL, Infraco and their stakeholders being invited to submit representations to the Statutory Arbiter on the provisional conclusions and having access to the representations submitted by others; and
- (f) the issue of final conclusions taking into account the representations received.

Credit rating

6.3 LUL and Infraco attach great weight to the Statutory Arbiter having regard to the desirability, from the point of view of maintaining Infraco's ability to finance contract performance by borrowings in the debt finance market, of Infraco having a credit rating at the end of a Periodic Review not less than the lower of its credit rating at the Transfer Date, and its credit rating immediately before the Review Process, it being acknowledged that:

- (a) the quality and/or quantity of information available to the Statutory Arbiter may be greater than that available to the rating agencies and that the Statutory Arbiter is to be able, in accordance with his statutory duties and any other guidance provided to him, to draw whatever conclusions are supported by information available to him and relevant to his functions; and

- (b) the parties intend that the credit rating of Infraco ought not to be adversely affected solely because of new or varied obligations to be assumed by it at a Periodic Review or solely because of the level of the ISC set by the Statutory Arbiter in respect of the efficient and economic costs of performing the Infraco Obligations after the Review Date.

Market advice

6.4 The parties:

- (a) agree to procure joint advice to the Statutory Arbiter from a financial adviser of international repute in relation to the markets available to Infraco to finance efficient and economic performance in accordance with Good Industry Practice of the Restated Terms from a Review Date (based on preparation and circulation of an appropriate information memorandum to interested parties and the indicative commitments they are willing to offer in response) and the terms of offers of finance that Infraco may reasonably expect to be able to obtain in those markets; and
- (b) attach great weight to the Statutory Arbiter having due regard to such advice.

Joint guidance

6.5 The parties may by joint notice in writing given pursuant to this paragraph 6.5 provide to the Statutory Arbiter further guidance on any matter relating to the exercise of his functions on which the parties hold a common view. 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.

Form of reference

6.6 The parties may, by agreement referring to this paragraph 6.6 but not otherwise, express the terms of any matter that is referred to the Statutory Arbiter so as to advise him that they do not request or require him to consider any aspect of the matter being referred on which they state they have reached agreement.

7. *Cashflows*

Relevant cashflows

7.1 The cashflows referred to in this paragraph 7 are the negative cashflows referred to in paragraph 7.2 and the positive cashflows referred to in paragraph 7.3, in each case from the Review Date for the remainder of the Contract Period and disregarding:

- (a) negative cashflows in respect of matters to the extent covered by insurance and positive cashflows to the extent of insurance receipts; and
- (b) negative cashflows associated with matters to the extent of any ability of Infraco to recover under any provision in the Transaction Documents and Share Purchase Agreement and the positive cashflows to the extent of those recoveries.

Negative cashflows

7.2 The negative cashflows are:

- (a) the Fixed Amounts and the timing of their payment as set out in Annex 3 of this Schedule 1.9 (*Fixed Amounts*) as the same may have been adjusted pursuant to paragraphs 3 and 4 of the introduction to such Annex but with any amendments thereto as directed pursuant to paragraph 1.5 (aa) above, save that the Fixed Amounts referred to in this paragraph (a) shall not include the Fixed Amounts set out in table 1.1 (Fixed Rate Bonds), 1.2 (Index Linked Bonds), 1.3 (Bank Debt) and 1.4 (EIB) of Annex 3 of this Schedule 1.9 which shall be dealt with in accordance with paragraph 7.6.
- (a/b) the operating and capital costs of a Notional Infraco in performing its activities after the first Review Date in respect of assets classified as Grey Assets on the Transfer Date;
- (b) the other operating and capital costs of a Notional Infraco of performing its activities after the Review Date:
 - (i) including commitment and arrangement fees and premia (in respect of financial guarantee policies) in respect of any liquidity and standby facilities (including, but not limited to, any facility in relation to Reimbursable Law and Safety Change Costs) and in respect of the amounts of finance referred to in sub paragraphs (c) and (d) below;
 - (ii) excluding both VAT or Taxation on, or calculated by reference to, income, profits or gains, subject to sub-paragraph (iii);
 - (iii) including such Taxation as arises as a direct result of a Qualifying Change of Law that is a Discriminatory Change of Tax Law; and
 - (iv) where the parties agree or the Statutory Arbiter directs pursuant to paragraph 1.3 that there has been an increase in risk as described in paragraph 1.3(b)(i) or that Eligible Finance is required, also including costs and fees associated with any termination or prepayment of existing finance arrangements in addition to the costs and fees associated with putting new finance arrangements in place save to the extent that such amounts may be taken into account in calculating the Refinancing Benefits from any refinancing to which such costs and fees relate.

- (c) the amounts to be paid to achieve the Equity Rate of Return as at the Review Date for any Base Equity, and/or Eligible Equity;
- (d) the amounts required to pay interest (including net hedging cashflow) on and repay the principal amount of any Base Debt and/or Eligible Debt;
- (e) the amounts and/or timings of any payments concerning specific activities on which the parties have notified pursuant to paragraph 6.6 their agreement to the Statutory Arbitrator (which amounts, timings and activities are then to be disregarded for purposes of sub-paragraphs (a) to (d) above); and
- (f) Net Adverse Effects incurred during the last Review Period in excess of the Materiality Threshold that have not been compensated previously pursuant to an Extraordinary Review.

Positive cashflows

7.3 The positive cashflows are:

- (a) the amounts of any Base Finance and/or Eligible Finance;
- (b) any amount which is deemed to have arisen at the Review Date pursuant to paragraph 1.5(aa);
- (c) the amount of any payment which LUL has stated pursuant to paragraph 2.2 it wishes to make upon expiry of the Contract;
- (d) the amount of any increases to be made to the ISC in relation to the Delivery into Service of the Specified Line Upgrades that are not yet Delivered into Service and having a Latest Implementation Date following the Review Date;
- (e) the amounts and/or timings of any receipts concerning specific activities on which the parties have notified pursuant to paragraph 6.6 their agreement to the Statutory Arbitrator (which amounts, timings and activities are then to be disregarded for purposes of sub paragraphs (a) to (d) above); and
- (f) the effect of indexation pursuant to Schedule 4.2 (*Indexation*).

Profile of periodic payments

7.4 The payment obligation to be assumed by LUL such that the negative cashflows (as directed pursuant to paragraph 1.5(a)) are funded by the positive cashflows (as directed pursuant to paragraph 1.5(a)) without the need to draw on other finance is one that requires a payment from LUL to Infracore in each Payment Period from the Review Date or, if later, from the date upon which the Restated Terms take effect pursuant to paragraph 5.5, up to the Expiry Date that is in accordance with the profile for payments that LUL has stated pursuant to paragraphs 2.2 and 4.2 save in respect of any variations in payment attributable to any of the factors referred to in paragraph 7.5.

7.5 The factors referred to in this paragraph are increases in payment attributable to:

- (a) the amount of any increases to be made to the ISC in relation to the Delivery into Service of the Specified Line Upgrades that are not yet Delivered into Service and having a Latest Implementation Date following the Review Date;
- (b) the amount of any payment which LUL has stated pursuant to paragraph 2.1(a) it wishes to make upon expiry of the Contract; and
- (c) indexation in accordance with Schedule 4.2 (*Indexation*).

Fixed Amounts in respect of Existing Debt

7.6 In relation to the Fixed Amounts of Annex 3 of this Schedule 1.9 (*Fixed Amounts*) excluded from the negative cashflows identified in paragraph 7.2(a):

- (a) the Fixed Amounts in respect of the bank debt and fixed rate bonds contained in Tables 1.1 (Fixed Rate Bonds), 1.3 (Bank Debt) and 1.4 (EIB) of Annex 3 of this Schedule 1.9 are nominal amounts and do not form part of the Underlying ISC but rather, are added to the Underlying ISC in respect of each Payment Period (without applying indexation) in order to form, together with the amount referred to in (b) below, the Baseline ISC;
- (b) the Fixed Amounts in respect of the index linked bonds contained in Table 1.2 (Index Linked Bond) are real figures as at February 2002 and do not form part of the Underlying ISC but rather, are added to the Underlying ISC in respect of each Payment Period (such sums having been indexed as at the last day of such Payment Period in accordance with Schedule 4.2) in order to form, together with the amount referred to in (a) above, the Baseline ISC.

8. *Financing Programme*

8.1 Following agreement or direction as to the ISC in respect of the remainder of the Contract Period the parties shall agree or obtain direction as to the financing programme (and its joint conduct) by which Infraco is to seek to procure the Required Finance prior to the Last Financing Date, on the basis subject as provided in paragraph 8.7 below, that all Existing Debt is to be refinanced at the Review Date and on the basis, subject as provided in paragraph 8.7 below, that the Existing Debt is not to be refinanced, in each case in accordance with the statement in the information memorandum referred to in sub-paragraph 8.4(e) below.

8.2 The financing programme and the process by which it is to be implemented shall be whatever the parties agree or the Statutory Arbiter directs is best calculated to result in Infraco receiving the most economically advantageous offers for the provision of the Required Finance as may be available to it in the market.

8.3 The financing programme is to make provision for the following where the parties agree or Statutory Arbiter directs that Eligible Equity is required:

- (a) Infraco may elect not to procure subscribers for Eligible Equity by notice to LUL within thirty (30) days of the parties agreeing or the Statutory Arbiter directing as to the amount of Eligible Equity and the Equity Rate of Return for the Eligible Equity;
- (b) LUL may, within thirty (30) days thereafter, exercise its rights set out in paragraph 10 below, in which case the provisions of that paragraph shall apply in place of the provisions of sub-paragraph (d) below;
- (c) alternatively, LUL may, subject to a direction of the Statutory Arbiter pursuant to paragraph 1.3A(a) above permitting it to do so, itself elect to subscribe or procure subscribers for such equity on the terms set out in Annex 4. LUL's election is to be made by notice to Infraco within thirty (30) days after service of Infraco's notice pursuant to sub-paragraph (a) and any election made is to be on terms that it is subject to LUL later electing to exercise the LUL Options pursuant to paragraph 10 in preference to completing the Eligible Equity subscription; or
- (d) subject to paragraph (b) above, where neither party is willing to commit to the subscription of the Eligible Equity and Infraco is not otherwise able to procure the Required Finance prior to the Last Financing Date then a Mandatory Sale shall be instigated pursuant to paragraph 11.1(a) below.

8.4 The financing programme shall, at the request of either party, make provision for the issue of an information memorandum ("Information Memorandum") and its circulation to parties interested in providing finance to Infraco to raise the Required Finance. The Information Memorandum shall require interested parties to put forward proposals within a reasonable period of time based upon initial approval of senior management. The Information Memorandum shall contain such information as it is reasonable for the parties to provide and for the recipients to receive in order for Infraco to solicit the most economically advantageous offers of finance as may be available, including:

- (a) the statement of the Statutory Arbiter provided for in paragraph 1.5(c) as to whether during the Review Period expiring on the Review Date:
 - (i) Infraco has performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice; or
 - (ii) Infraco has not performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice;
- (b) a report from the Statutory Arbiter on Infraco's performance as a whole during the Review Period in relation to such statement and setting out the basis therefor;
- (c) a statement by Infraco as to whether it believes it can perform the Restated Terms after the Review Date on the basis of the ISC in respect of the remainder of the Contract Period and the Required Finance;

- (d) a report from Infraco supporting such statement and setting out the basis therefor; and/or
- (e) an invitation that proposals be submitted by prospective funders for providing the Required Finance both on the basis that all Existing Debt is to be refinanced at the Review Date and on the basis, subject as provided in paragraph 8.7 below, that the Existing Debt is not to be refinanced, with equal prominence given to each approach and, in relation to the second approach, a statement of the conditions set out in the existing Funding Agreements which are to be satisfied following procurement of the Required Finance, including conditions to any of the Required Finance ranking *pari passu* with and sharing accordingly in security available to the existing Funders.

8.5 The financing programme shall make provision for, and the parties agree to procure, within thirty (30) days (the *Advice Date*) of the issue of the Information Memorandum, joint advice from the financial adviser of international repute retained pursuant to paragraph 6.4 above, as to whether he is highly confident that Infraco has the financing ability, based on the ISC to be assumed by LUL pursuant to paragraph 7.4 above and any election pursuant to paragraph 8 by LUL or Infraco to procure any Eligible Equity, to procure the Required Finance prior to the Last Financing Date;

8.6 The financing programme shall make provision for LUL to, and the parties agree that LUL may, where the financial adviser has not advised that he is highly confident in the terms of paragraph 8.5 above prior to the Advice Date, exercise any of the LUL Options pursuant to paragraph 10 below.

8.7 Where the Statutory Arbiter has made a direction pursuant to paragraph 1.3(b) above that Eligible Finance is required and/or there has been an increase in risk which is material in the manner referred to in paragraph 1.3 above and any of the existing Funders are entitled pursuant to any of the existing Funding Agreements to require (and do so require) Infraco to repay its existing indebtedness to them then Infraco shall seek to procure the Required Finance on the basis that it is to refinance the Existing Debt in respect of which the existing Funders have given notice that they require to be refinanced.

9. *Market Adjustment*

9.1 Where the statement from the Statutory Arbiter provided for in paragraph 1.5(c) is that Infraco has performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice during the Review Period ending on the Review Date, and the Statutory Arbiter has directed pursuant to paragraph 1.3 that Base Finance or Eligible Finance is required or that there has been an increase in risk which is material in the manner referred to in paragraph 1.3, then if:

- (a) Infraco is not able to procure the Required Finance prior to the Last Financing Date, a Special Mandatory Sale shall be instigated pursuant to clause 41 (*Mandatory Sale*) of the Contract and on the terms set out in paragraph 11.1(a) below;

- (b) Infraco is able to procure the Required Finance prior to the Last Financing Date, the amount allowed by the Statutory Arbiter pursuant to paragraph 7 in respect of the cost of any Base Finance and/or Eligible Finance differs from the actual cost to Infraco of borrowing that amount of money on the terms of the most economically advantageous offer received pursuant to paragraph 8 above and for which credit committee approval has been obtained, then the ISC to be paid by LUL from the Review Date pursuant to paragraph 7.4 above shall be adjusted by such amount as the parties agree or the Statutory Arbiter directs is required to eliminate that difference,

Provided that to the extent that any adjustment of the ISC has the result that Infraco is not able to obtain the Required Finance such adjustment shall not be made.

9.2 The provisions of paragraphs 9.3, 9.4 and 9.5 below apply only where: -

- (a) the statement from the Statutory Arbiter provided for in paragraph 1.5(c) is that Infraco has not performed its activities in an overall efficient and economic manner and in accordance with Good Industry Practice during the Review Period ending on the Review Date; and
- (b) The Statutory Arbiter has directed that Base Finance is required and/or that new or varied obligations contained in the Restated Terms or the Affordability Constraints:
 - (i) involve an increase in risk for Infraco that is material in the manner referred to in paragraph 1.3; and/or
 - (ii) are such that a Notional Infraco would require Eligible Finance for performance of the Restated Terms from the Review Date.

9.3 Where this paragraph applies and Infraco is not able to procure the Required Finance prior to the Last Financing Date, a Special Mandatory Sale shall be instigated pursuant to clause 41 (*Mandatory Sale*) of the Contract and:-

- (a) on the terms set out in paragraph 11.1(a) below where any of the factors referred to in sub paragraph (c) below are present;
- (b) on the terms set out in paragraph 11.1(b) below where Base Finance is required and each of the factors referred to in sub paragraph (c) below is absent;
- (c) the factors referred to here are any direction from the Statutory Arbiter:
 - (i) after agreement or direction pursuant to paragraph 8.1 above as the financing programme, that a Notional Infraco with the ISC agreed or directed pursuant to paragraph 1.5 would be incapable of procuring the Required Finance for any reason (including concerning the credit rating of Transport for London);

- (ii) that new or varied obligations contained in the Restated Terms or Affordability Constraints:-
 - (x) involve an increase in risk for Infraco that is material in the manner referred to in paragraph 1.3; and/or
 - (y) are such that a Notional Infraco would require Eligible Finance for performance of the Restated Terms from the Review Date.

9.4 Where this paragraph applies and Infraco is able to procure the Required Finance prior to the Last Financing Date, but the amount agreed or directed by the Statutory Arbiter pursuant to paragraph 7 in respect of the cost of any Base Finance and/or Eligible Finance is:

- (a) less than the actual cost to Infraco of borrowing that amount of money on the terms of the most economically advantageous offer received pursuant to paragraph 8 above and for which credit committee approval has been obtained, then Infraco may within thirty (30) days of the Last Financing Date ask the Statutory Arbiter to reconsider his earlier direction and either confirm or amend its terms (and so the amount of the ISC to be paid by LUL from the Review Date) as appropriate in the circumstances;
- (b) is greater than the actual cost to Infraco of borrowing that amount of money on the terms of the most economically advantageous offer received pursuant to paragraph 8 above and for which credit committee approval has been obtained, then the ISC to be paid by LUL from the Review Date pursuant to paragraph 7.4 above shall be reduced by such amount as the parties agree or the Statutory Arbiter directs is required to eliminate the excess in the amount allowed by the Statutory Arbiter pursuant to paragraph 7,

Provided that to the extent that any adjustment of the ISC has the result that Infraco is not able to obtain the Required Finance such adjustment shall not be made.

9.5 Where this paragraph applies and Infraco does not wish to proceed with the Contract on the basis of the ISC as directed pursuant to paragraph 7.4 (or as subsequently confirmed and/or amended pursuant to paragraph 9.4 above), it may within thirty (30) days of notification of such direction give notice to LUL of that fact citing this paragraph 9.5 whereupon either:

- (a) LUL shall elect within 30 days of receipt of Infraco's election to exercise any of the LUL Options pursuant to paragraph 10 below; or
- (b) if no such election by LUL is made then a Special Mandatory Sale shall be instigated pursuant to clause 41 (*Mandatory Sale*) of the Contract and on the terms set out in paragraph 11.1(b) below.

9.6 LUL may also exercise any of the LUL Options:

- (a) at any time after the Statutory Arbiter gives a direction as referred to in paragraph 1.4 (b) or (c) above;
- (b) at any time after the Advice Date if the financial adviser is not able to repeat any “highly confident” opinion that he has given pursuant to paragraph 8.5 reasonably promptly after being asked to do so and by reference to the facts then subsisting.

10. *LUL Options*

10.1 LUL may pursuant to paragraphs 8 and 9 prior to the End Date elect to exercise any one or more of the LUL Options by service of a notice in the form required in paragraph 2.2 in a manner that is specified in the notice with a view to: -

- (a) addressing any direction of the Statutory Arbiter’s as to financing impossibility pursuant to paragraph 1.4 above; or
- (b) removing any material increase in risk which the Statutory Arbiter has directed results from the Restated Terms pursuant to paragraph 3.1; and/or
- (c) removing or reducing the need for Infraco to procure further Eligible Equity and/or Base Equity; and/or
- (d) removing or reducing the need for Infraco to procure Eligible Debt and/or Base Debt; and/or
- (e) enabling LUL to facilitate Infraco’s financing programme by an increase to the ISC in combination with the attachment of an economic return to the Special Share.

10.2 The *LUL Options* are any one or more of the following:

- (a) any change to the Restated Terms permitted in accordance with paragraph 2.2; and/or
- (b) any change to the Affordability Constraints; and/or
- (c) [not used];
- (d) any subscription of Base Equity and/or Eligible Equity to Infraco on the terms set out in Annex 4, subject to a direction of the Statutory Arbiter pursuant to paragraph 1.3A(a) above permitting it to do so; and/or
- (e) the attachment of an economic return to the Special Share, subject to a direction of the Statutory Arbiter pursuant to paragraph 1.3B above permitting it to do so.

10.3 The parties shall proceed following the service of a notice in relation to the LUL Options pursuant to paragraph 10.1 above in whatever manner they may agree or the Statutory Arbiter may direct pursuant to paragraph 1.2 above.

11. *Mandatory sale*

11.1A Where the Statutory Arbiter has issued a direction in terms of paragraph 1.4 that remains current at the Last Financing Date and Infraco has been unable to procure the Required Finance then a Mandatory Sale shall be instigated pursuant to clause 41 (*Mandatory Sale*) of the Contract and paragraph 11.1(a) shall apply thereto.

11.1 Where a Mandatory Sale is to be instigated pursuant to:-

(a) paragraph 8.3(d), 9.1, 9.3(a) or 11.1A above then *Special Mandatory Sale Amount* means the sum (without double counting) of, calculated as at the Contract Disposal Calculation Date:

- (i) the amount of the Approved Debt;
- (ii) [Not Used]
- (iii) one of the following amounts, as applicable, which shall not be subject to indexation in accordance with Schedule 4.2 (*Indexation*) of the Contract:
 - (A) where a Mandatory Sale occurs as a consequence of the first Periodic Review, £303.88 million;
 - (B) where a Mandatory Sale occurs as a consequence of the second Periodic Review, £366.85 million;
 - (C) where a Mandatory Sale occurs as a consequence of the third Periodic Review, £435.06 million;

provided that to the extent that additional Eligible Equity and/or Base Equity is subscribed the figures in sub-paragraphs (B) and/or (C) will be adjusted to include an additional payment which when added to the expected cashflows to additional equity gives the appropriate blended nominal equity and shareholder loan return over the period invested. Such amount shall be recalculated on each subsequent Periodic Review and shall not be subject to indexation.

- (iv) any Sellback Costs;
- (v) any Reimbursable Law & Safety Change Costs;
- (vi) any Termination Costs;
- (vii) to the extent not included in (iv) or (v), any Exceptional Amounts, or amounts payable in accordance with Schedule 5.7 (*Non-ISC Invoices*) to the PPP Contracts, either previously agreed with LUL as being due to be paid prior to the Contract Disposal Calculation Date or payable to the Infraco under the terms of the Transaction Documents or the Share

Purchase Agreement in respect of costs of the Infraco which have not been paid at the Contract Disposal Calculation Date; and

(viii) any Administration Costs,

provided that, if such amount is less than the Approved Debt (as at the Contract Disposal Calculation Date), then the Special Mandatory Sale Amount for the purposes of this clause 11.1(a) shall be the Approved Debt (as at the Contract Disposal Calculation Date).

(b) paragraph 9.3(b) or 9.5(b) above then *Special Mandatory Sale Amount* means the sum (without double counting) of:

(i) the amount of the Approved Debt as at the Contract Disposal Calculation Date less the amount of One Year's Margin;

(ii) [Not Used]

(iii) the higher of:

(A) (x) where a Mandatory Sale occurs as a consequence of the first Periodic Review, £90 million, such amounts not to be subject to Indexation in accordance with Schedule 4.2 (*Indexation*) of the Contract;

(y) where a Mandatory Sale occurs as a consequence of the second or third Periodic Review, nil;

plus: (aa) any Sellback Costs;

(bb) any Reimbursable Law and Safety Charge Costs;

(cc) to the extent not included in (aa) or (bb), any Exceptional Amounts, or amounts payable in accordance with Schedule 5.7 (*Non-ISC Invoices*) to the PPP Contracts, either previously agreed with LUL as being due to be paid prior to the Contract Disposal Calculation Date or payable to the Infraco under the terms of the Transaction Documents or the Share Sale and Purchase Agreement in respect of costs of the Infraco which have not been paid at the Contract Disposal Calculation Date; and

(dd) any Administration Costs,

less: any Rectification Costs,

in each case as at the Contract Disposal Calculation Date, and

(B) zero.

provided that to the extent that Eligible Equity and/or Base Equity is subscribed the figure in sub-paragraph (A) will be adjusted to include an additional payment which when added to the expected cashflows to additional equity would result in the additional equity providers substantially recovering their original investment.

One Year's Margin means the value of the weighted average margin payable by any Finance Obligor to the Funders under the Funding Agreements in respect of the twelve (12) month period ending on the Contract Disposal Calculation Date, calculated as the aggregate of:

- (1) the aggregate of (**F** x **M**) for every bank facility falling within the definition of Approved Debt; plus
- (2) the aggregate of (**B** x **DM**) for every series of Bonds (as defined in the Funding Agreements) falling within the definition of Approved Debt:

Where:

- F** is the amount of principal outstanding, as at the Contract Disposal Calculation Date, under a bank facility of Approved Debt;
- M** is the weighted average margin (weighted by time) applicable to that bank facility in respect of the twelve (12) month period ending on the Contract Disposal Calculation Date;
- B** is the amount of principal outstanding, as at the Contract Disposal Calculation Date, in relation to a series of Bonds (as defined in the Funding Arrangements) falling within the definition of Approved Debt; and
- DM** in relation to the fixed rate bond shall be deemed to be 48 basis points and in relation to the index linked bond shall be deemed to be 55 basis points.

11.2 A Mandatory Sale for a Special Mandatory Sale Amount may not be implemented pursuant to paragraph 8 or 9 above prior to the End Date unless LUL elects to do so in preference to exercising any one or more of the LUL Options.

11.3 The circumstances referred to in paragraph 11.1 are the only circumstances in which a Mandatory Sale for a Special Mandatory Sale Amount may be instigated.

[Paragraphs 12 and 13 are not used]

Part 3 : Extraordinary Review

Infraco's notice

14. If Infraco reasonably considers that Net Adverse Effects arising in a Review Period have exceeded or will exceed the Materiality Threshold it may by notice to LUL pursuant to this paragraph instigate an Extraordinary Review in relation to which the scope of any Restated Terms that LUL may propose is to be restricted to ones designed to address affordability considerations raised by the need for LUL to fund Net Adverse Effects in excess of the Materiality Threshold.
15. **[Not used]**

LUL's notice

16. If:
 - (a) LUL suffers a substantial shortfall in the performance of the Services which Infraco is required to perform under the Contract having regard (where applicable) to Benchmarks in relation to Service Performance and to the Asset Management Strategy in relation to Asset Management Services and which it is unable to cause Infraco to remedy, LUL may by notice to Infraco pursuant to this paragraph instigate an Extraordinary Review the scope of which shall be restricted to the proposal of Restated Terms designed to address shortfalls in performance under the Contract that LUL has experienced and so as to enable LUL to finance any costs of those changes;
 - (b) a Law Change occurs which renders it impossible for Infraco to perform a material part of its obligations under the Transaction Documents, LUL may by notice to Infraco pursuant to clause 40.3(d) (*LUL Breach*) of the Contract instigate an Extraordinary Review the scope of which shall be restricted to the proposal of Restated Terms designed to remedy such impossibility and so as to enable LUL to finance any costs of those changes.

Effect of notice

17. If notice is served under paragraph 14 or paragraph 16 above, the parties shall meet with a view to agreeing the form and conduct of the Extraordinary Review within ten (10) Business Days thereafter. In the absence of agreement, either party may refer the matter to the Statutory Arbiter for him to give a direction pursuant to paragraph 1.2 above on the basis that the provisions relating to a Periodic Review shall apply to the Extraordinary Review mutatis mutandis.

Part 4: Other Matters

18. The parties agree that for the purposes of paragraph 6.6 there are a range of approaches to procurement available to a Notional Infraco, and that Infraco's approach at the Transfer Date, as described in paragraphs (a) and (b) below, is (as at that date) one that is efficient and economic and a Notional Infraco could follow (without prejudice to any consideration of whether Infraco has implemented this approach in an efficient and economic manner and to the standards of a Notional Infraco). Infraco's approach at the Transfer Date is:

- (a) to have in place long-term supply contracts for the supply of new trains and signalling, the maintenance upgrading and renewals of civil assets, track renewal and the maintenance, refurbishment and modernisation of stations on a pre-agreed pricing basis as deemed appropriate by Infraco based on the nature of the work being undertaken, (and thereby transferring or sharing the risk that the costs incurred in respect of those activities may differ from the costs anticipated by the parties at the Transfer Date or at a subsequent Review Date); and
- (b) to perform most operating and maintenance activities through its own work force (and thereby accepting the risk that the costs incurred in respect of those activities may differ from the costs anticipated by the parties at the Transfer Date or at a subsequent Review Date).

The parties also agree for the purposes of paragraph 6.6 there are a range of approaches to financing available to a Notional Infraco, and the Infraco's approach at the Transfer Date, as described in paragraphs (a), (b) and (c) below, is (as at that date) one that is efficient and economic and a Notional Infraco could follow (without prejudice to any consideration of whether Infraco has implemented this approach in an efficient and economic manner and to the standards of a Notional Infraco). Infraco's approach at the Transfer Date is:

- (a) to have in place finance with a final maturity of around 27 years for the Infraco's financing requirements for the period up to the first Review Date only (other than in relation to Safety Change Costs and Law Change Costs), including a liquidity facility and funded reserves representing around 15% of that finance;
- (b) to use for that finance a mixture of fixed-rate and index-linked bond financing (each guaranteed by monoline insurers), floating-rate commercial bank finance and floating-rate EIB finance, together with interest rate hedging of the same maturity for around 75% of the floating-rate portion of the finance and contracts for the investment of bond proceeds;
- (c) to have in place a standby facility with a final maturity of around 8 years for the Infraco's financing requirements in relation to Safety Change Costs and Law Change Costs for the period up to the first Review Date only.

19. The parties agree that for the purposes of paragraph 6.6 where Infraco has procured a contract through competitive tendering in accordance with paragraph 1A of Schedule 5.4 (*Sub-contracts*) of the PPP Contract, the Statutory Arbiter should presume that any such contract was entered into in an efficient and economic manner and in accordance with Good Industry Practice and that the pricing and terms of that contract were a fair reflection of the market for such a contract at the date when the contract was entered into. However, where there is any reason to doubt that such pricing and/or terms were such a fair reflection (including but not limited to any instance where the contracting party is or was an Affiliate of Infraco and when the contract was put out to tender such contracting party was the only bidder) and that this might be to the disadvantage of Infraco or successors in title to Infraco, the Statutory Arbiter may take into account any other evidence he reasonably considers relevant in assessing whether the pricing and/or terms of the contract were a fair reflection of the market for such a contract.

20. The parties agree for the purposes of paragraph 6.6 in considering any matters referred to him, the Statutory Arbiter is to have regard to the following:

- (a) having evaluated the commercial and financial proposals put forward by or on behalf of Metronet as part of the bidding process pursuant to which Infraco was sold to Metronet Rail SSL Holdings Limited (including the procurement arrangements referred to in paragraph 18 above) LUL considered that:
 - (i) they were founded on a sound understanding of how Metronet proposed Infraco would deliver the Infraco Obligations under the Service Contract;
 - (ii) Metronet's bid for Infraco as part of the bidding process pursuant to which Infraco was sold to Metronet Rail SSL Holdings Limited offered the most economically advantageous terms;
 - (iii) the sub-contracting and funding arrangements proposed by Metronet to be adopted and/or entered into by Infraco on or around the Transfer Date were an acceptable position from which to start performance of the Infraco Obligations.
- (b) the Statutory Arbiter may not conclude that any contractual commitments arising out of and consistent with such sub-contracting and funding arrangements are inconsistent with Infraco performing its obligations in an overall economic and efficient manner and in accordance with Good Industry Practice unless (subject to sub paragraph (c) below):
 - (i) Infraco has not performed the Infraco Obligations in accordance with their terms where such a failure to perform is inconsistent with the expected performance of a Notional Infraco; or
 - (ii) Infraco is seeking an increase in the Baseline ISC payable by LUL in the context of a Periodic Review or an Extraordinary Review;

and such contractual commitments are relevant to the failure to perform or to the increase in Baseline ISC being sought.

- (c) in considering Infraco's contractual commitments in the circumstances of sub paragraph (b) the Statutory Arbiter may conclude that such contractual commitments are inconsistent with Infraco performing its obligations in an overall economic and efficient manner and in accordance with Good Industry Practice only if the relevant contractual commitment at the time it was entered in to was not appropriate having regard to:
- (i) market practice for a contract of that nature on arm's-length terms (taking into account the overall commercial terms of the relevant contractual commitment) and
 - (ii) the Infraco Obligations and
 - (iii) the circumstances and information known to or reasonably foreseeable by Metronet at that time (and not the circumstances and information known at the time of the Statutory Arbiter's consideration).

ANNEX 1

Definitions

1.1 In this Schedule 1.9, the following expressions shall have the following meanings:

Existing Debt means any financial obligations outstanding or owing from time to time under the Funding Agreements other than financial obligations outstanding or owed in respect of Shareholder Subordinated Debt.

Materiality Threshold means in each Review Period £50 million;

1.2 Words and expressions used in this Schedule 1.9 shall, to the extent applicable and unless defined herein or the context otherwise requires, have the meaning assigned to them in Schedule 2 of the MDA.

ANNEX 2

Guidance to the Statutory Arbiter

Factors to which the Statutory Arbiter must have regard in giving any direction under section 229(3) of the GLA.

Date: _____

GUIDANCE FROM PARTIES TO A PPP AGREEMENT

1. Introduction

1.1 This guidance and paragraph 6 (*Guidance to the Statutory Arbiter*) of Schedule 1.9 (*The Statutory Arbiter and Reviews*) of the PPP agreement is issued to the Statutory Arbiter pursuant to Schedule 1.9 (*The Statutory Arbiter and Reviews*) of the PPP agreement between London Underground Limited (*LUL*) and Infraco SSL (*Infraco*) (collectively, the *Parties*) dated ____ (the *PPP Contract*). The guidance constitutes factors notified to Statutory Arbiter by the Parties, acting jointly, for the purpose of Section 231(6) of the Greater London Authority Act 1999 (the *GLA Act*). It covers matters relating to the exercise of the Statutory Arbiter's functions on which the Parties hold a common view.

1.2 This guidance dated [•] relates to the discharge by the Statutory Arbiter of the functions conferred or imposed on him by or under the GLA Act in connection with any reference to him for directions and/or guidance pursuant to Schedule 1.9 of the PPP Contract.

1.3 The Parties have agreed that the guidance on this matter may not be changed or rescinded except by consent of both Parties.

2. Objective

The Parties agree that their objective in issuing this guidance to the Statutory Arbiter is to provide a clear statement of the approach that the Parties agree should be taken on certain issues, so that the Statutory Arbiter can take account of the Parties' agreement on these issues.

3. Process

LUL and Infraco attach great weight to the Statutory Arbiter following open and transparent procedures in determining what directions to give on any matters that are referred to him in connection with a Periodic or Extraordinary Review and, in particular, to:

- (a) both parties being notified of any matters referred to him and of the general process that he intends to adopt in dealing with them;

- (b) LUL, Infraco and their respective stakeholders (including, in the case of LUL, its holding company, Transport for London, the Mayor and any Minister and in the case of Infraco providers of equity and debt finance) being invited to submit representations to the Statutory Arbiter on these matters and having access to the representations submitted by others;
- (c) the Statutory Arbiter taking expert advice on matters where he would be better informed by expert opinion and making available to the parties and their stakeholders the terms of reference of the advisors and an informative summary of their advice;
- (d) the Statutory Arbiter providing the parties and their stakeholders with provisional conclusions on matters referred to him, with summaries of the arguments made to him in relation to those matters and the reasons in support of the conclusions provisionally reached;
- (e) LUL, Infraco and their stakeholders being invited to submit representations to the Statutory Arbiter on the provisional conclusions and having access to the representations submitted by others; and
- (f) the issue of final conclusions taking into account the representations received.

4. Credit rating

LUL and Infraco attach great weight to the Statutory Arbiter having regard to the desirability, from the point of view of maintaining Infraco's ability to finance contract performance by borrowings in the debt finance market, of Infraco having a credit rating at the end of a Periodic Review not less than the lower of its credit rating at the Transfer Date, and its credit rating immediately before the Review Process, it being acknowledged that:

- (a) the quality and/or quantity of information available to the Statutory Arbiter may be greater than that available to the rating agencies and that the Statutory Arbiter is to be able, in accordance with his statutory duties and any other guidance provided to him, to draw whatever conclusions are supported by information available to him and relevant to his functions; and
- (b) the parties intend that the credit rating of Infraco ought not to be adversely affected solely because of new obligations to be assumed by it at a Periodic Review or solely because of the level of the ISC set by the Statutory Arbiter in respect of the efficient and economic costs of performing the Infraco Obligations after the Review Date.

5. Market advice

The parties:

- (a) agree to procure joint advice to the Statutory Arbiter from a financial adviser of international repute in relation to the markets available to Infraco to finance

efficient and economic performance in accordance with Good Industry Practice of the Restated Terms from a Review Date (based on preparation and circulation of an appropriate Information Memorandum to interested parties and the indicative commitments they are willing to offer in response and the terms of offers of finance that Infraco may reasonably expect to be able to obtain in those markets; and

- (b) attach great weight to the Statutory Arbiter having due regard to such advice.

6. Notional Infraco; efficiency and economy; Good Industry Practice

6.1 Paragraph 1 (*Statutory Arbiters' Jurisdiction*), Schedule 1.9 (*The Statutory Arbiter and Reviews*) of the PPP Contract describes the basis on which references to the Statutory Arbiter for directions and/or guidance may be made. A copy of Schedule 1.9 (*The Statutory Arbiter and Reviews*) of the PPP Contract is attached.

6.2 Many of the matters on which the Statutory Arbiter may be asked to give directions and/or guidance relate to the level of Underlying ISC that LUL is to pay to Infraco from the next Review Date and to the components from which this amount is constructed.

6.3 For these purposes the Statutory Arbiter is referred to a Notional Infraco. A Notional Infraco is defined by the PPP Contract as an assumed entity that has taken over Infraco's responsibilities at the Transfer Date, that carries out its activities in an overall efficient and economic manner and in accordance with Good Industry Practice, that has the characteristics set out below and also has Infraco's responsibilities for future performance of the Contract. The characteristics are that the assumed entity:

- (a) by the time of any Periodic Review, has performed the activities that an efficient and economic Infraco would have performed in prior Review Periods so as to be reasonably certain of its ability to perform obligations that are due for performance in that and subsequent Review Periods;
- (b) in the next Review Period, will perform the obligations that are due for performance in that Review Period and the activities that an efficient and economic Infraco would perform in that Review Period so as to be reasonably certain of its ability to perform obligations that are due for performance in a subsequent Review Period;
- (c) has the same contractual commitments to third parties as Infraco actually has to the extent that these relate to:
 - (i) performance of the matters referred to in paragraph (b) above; or
 - (ii) performance of obligations that LUL modifies or discontinues through the Restated Terms,

and, in either case, such contractual commitments are consistent with Infraco performing its obligations in an overall efficient and economic manner and in accordance with Good Industry Practice;

- (d) has the same funding arrangements as Infraco actually has, to the extent that these are consistent with Infraco performing its obligations in an overall efficient and economic manner and in accordance with Good Industry Practice, and where further finance is required for the future performance of its obligations and activities (other than to meet Net Adverse Effects in excess of the Materiality Threshold), will procure finance in an efficient and economic manner both as to the proportions to be contributed by equity and debt and to the cost of the debt assuming the equity to be remunerated at the Equity Rate of Return; and
- (e) assesses operating and capital costs as it would when entering into a contract after a competitive tendering process in respect of the relevant activities and having regard to:
 - (x) the risks associated with individual activities (including the risk of cost overruns and ISC Adjustments);
 - (y) the risk that it may have to undertake activities which it has not expected to have to carry out; and
 - (z) the probability that in the management of a portfolio of activities, the actual cost of some individual activities will exceed the costs allowed, and the actual costs of other individual activities will be less than the costs allowed;

6.4 The Parties' guidance to the Statutory Arbiter is that, in considering the costs that would be incurred and the debt and equity required by Notional Infraco, he should proceed on the basis that such an Infraco would follow Good Industry Practice, which is defined in the Master Definitions Agreement as:

“in respect of any aspect of the Services and subject always to its statutory safety obligations, whilst always ensuring that risks are reduced to a level which is as low as is reasonably practicable the exercise of the degree of skill, diligence, prudence and foresight and practice which could reasonably and ordinarily be expected from a skilled and experienced person engaged in:

- (a) carrying out the same type of responsibilities of Infraco under the PPP Contract with respect to such aspect of the Services; or
- (b) carrying out responsibilities, whether individually or as a package of responsibilities, which could reasonably be regarded as being comparable to the responsibilities of Infraco under the PPP Contract with respect to such aspect of the Services,

in each case, performing its obligations under the same, reasonably comparable or similar circumstances and utilising all the information available at the relevant time”.

6.5 The Parties’ guidance to the Statutory Arbiter is that what should be expected of an Infraco working to Good Industry Practice is:

- (a) establishing and maintaining whole life asset planning and maintenance regimes;
- (b) considering the issues relevant to each stage in any project and putting in place a strategy to deal with them;
- (c) ensuring the right competence is available, including appropriate external advice when needed;
- (d) planning for operational, contractual and financial contingencies;
- (e) recognising that systems and assets must be useable in practice and taking appropriate steps to ensure this, looking at comparable industries where relevant and taking account of practical constraints;
- (f) recognising the time and resources needed for systems integration and taking appropriate steps to make it possible;
- (g) understanding the degraded operation of complex systems so as to ensure controlled degradation;
- (h) planning, and monitoring projects effectively, and monitoring and taking account of critical constraints;
- (i) designing to take account of buildability and operational constraints; and
- (j) effective change management.

6.6 The Parties’ guidance to the Statutory Arbiter is that where Infraco has procured a contract through competitive tendering in accordance with paragraph 1A of Schedule 5.4 (*Sub-contracts*) of the PPP Contract, the Statutory Arbiter should presume that the pricing and terms of that contract were a fair reflection of the market for such a contract at the date when that contract was entered into (although this shall not constitute a presumption that the procurement strategy of Infraco under which such contract was entered into was efficient and economic). However, where there is any reason to doubt that the pricing and/or terms were such a fair reflection and that this might be to the disadvantage of Infraco or its “successors”, the Statutory Arbiter may take into account any other evidence he reasonably considers relevant in assessing whether the pricing and/or terms of the contract were a fair reflection of the market for such a contract.

6.7 The Parties’ guidance to the Statutory Arbiter is that, subject to paragraph 6.8 the Statutory Arbiter should have regard, in particular, to the following factors in

estimating the level of costs that would be incurred and the amount of debt and equity that would be required by a Notional Infraco:

- (a) the costs actually incurred by all Infracos who are party to PPP Contracts with LUL in the period prior to the Review, to the extent that these are incurred with efficiency and economy and in accordance with Good Industry Practice;
- (b) efficiency savings that can reasonably be expected based on the experiences of other Infracos and other participants in markets relevant to the Infraco's activities;
- (c) reasonable expectations about trends of these costs taking account of likely trends in input costs to the Infracos;
- (d) trends in costs that have been exhibited in similar industries in the past;
- (e) cost implications of changes in LUL's performance and/or contractual requirements including appropriate provision for contingencies in the manner referred to in paragraph 6.8;
- (f) reasonable standards of financial prudence having been demonstrated by Infraco;
- (g) the proportion of debt and equity in the Infraco's financing plan at the Transfer Date; and
- (h) the proportion of debt and equity which could be expected in any future funding for an efficient and economic Infraco which had properly performed its contractual obligations up to the date of the Review following Good Industry Practice.

6.8 The Parties' guidance to the Statutory Arbiter is that it is particularly important that he should determine Infrastructure Services Charges based on his estimate of what the most likely level of operating and capital costs would be in future periods for a Notional Infraco on the basis that such best estimate shall be the aggregate of all the amounts as would be agreed to by a Notional Infraco in a competitive tender in respect of the relevant activities having regard to:

- (a) the risks associated with individual activities (including the risk of cost overruns and revenue abatements);
- (b) the risk that a Notional Infraco may have to undertake activities which it has not expected to have to carry out; and
- (c) the probability that in the management of a portfolio of activities, the actual cost of some individual activities will exceed the costs allowed, and the actual costs of other individual activities will be less than the costs allowed.

He should not base his determination on:

- (x) expected levels of efficiency for future periods which would represent a target that is unlikely to be achieved by such an Infraco; and

- (y) an assumption that all the Infracos could reasonably be expected to achieve the financial performance previously demonstrated by the best Infraco, unless there is a clear reason for this assumption.

The Statutory Arbiter should base his decision by reference to Good Industry Practice notwithstanding that he may consider that an Infraco could in future outperform the level of costs which would be agreed to by a Notional Infraco in a competitive tender in respect of the relevant activities in the manner described above.

6.9 The Parties' guidance to Statutory Arbiter is that in determining the Infrastructure Service Charge the Statutory Arbiter should also have regard to and take account of the following factors:

- (a) to give great weight to the importance of concluding his review and issuing his directions by the Review Date or of making interim adjustment to the level of Infrastructure Service Charge where there is overall benefit in extending his review beyond the Review Date;
- (b) in considering whether the actions of an Infraco are efficient and economic, (i) the implications of the contractual structure and performance and payment regime under which the Infraco operates; (ii) the fact that following Good Industry Practice may still allow for different methods of procurement; and (iii) the specific nature of Infraco's asset base, should be considered;
- (c) that the Infracos may have continuing commitments in connection with supply contracts and/or collective labour agreements and (in relation to the impact of the new finance on the cost of finance already in place, and in relation to the new fixed amounts to be allowed in respect of Base Finance and Eligible Finance respectively) funding documents at the Review Date to meet the continuing requirements of the PPP Contract and these commitments are less good value for money than terms available in relevant supply market at the time of the Review. In these circumstances, it would be appropriate to consider:
 - (i) whether those supply contracts and/or collective labour agreements and/or funding documents and the constraints on Infracos that they imply, were nevertheless consistent with Infraco performing its obligations in an overall efficient and economic manner and in accordance with Good Industry Practice rather than considering them in isolation; and/or
 - (ii) whether, taking due account of all consequences (including any Refinancing Benefit which accrues to LUL) which may arise as a consequence of any termination (or in the case of funding documents, prepayment), the Infraco could now effect overall efficiency and economy gains by terminating the existing commitment in accordance with its terms or by agreement, bearing any termination costs and recommitting on current market terms;

- (d) that an Infraco may have continuing contractual commitments entered into to meet obligations which LUL modifies or discontinues from the Review Date, where regard should be had to whether the commitments would have been assumed by an efficient and economic Infraco at the point of entering into such contractual commitment and the cancellation expenditure which an efficient and economic Infraco would now incur in terminating the commitment;
- (e) in relation to amounts to be allowed pursuant to paragraphs 7.2(c) and (d) of Schedule 1.9 of the PPP Contract and in respect of finance costs and fees and like matters associated with finance which are considered to be part of operating and capital costs pursuant to paragraph 7.2(b) of Schedule 1.9, that:
 - (i) the terms of reference to the Statutory Arbiter require him to allow the costs of finance as stipulated in or pursuant to annex 3 to Schedule 1.9 without regard to whether these represent efficient and economic costs;
 - (ii) where Base Finance or Eligible Finance is required, it is relevant to consider whether this can be obtained with greater efficiency and economy or this can only be obtained at all, by refinancing existing facilities and in such circumstances to take into account the costs and fees associated with termination or prepayment of existing finance arrangements in addition to the costs and fees associated with putting new finance arrangements in place; and
 - (iii) for purposes of paragraph (ii) above, it is relevant to have regard to the considerations referred to in paragraph (c) above and also to (x) existing terms and types of financing it has utilised prior to the Review, to the extent that these are on an efficient and economic basis, which includes the recognition of the possible requirement of the Infracos to raise additional finance; (y) the terms on which efficient and economic finance is available to a Notional Infraco in the market at the time; and (z) reasonable standards of financial prudence in light of the obligations of the PPP Contract at the time;
- (f) to the extent that raising incremental finance impacts on the cost of existing finance, the cost allowed as referred to in paragraph (e) in respect of the incremental finance that would be incurred by a Notional Infraco should take include the costs created for the original finance by any conditions in the original financing; and
- (g) representations by and evidence from the Parties as to the availability, levels and terms of financing that would then be available to a Notional Infraco.

7. Refinancing Benefits

7.1 Schedule 1.9 of the PPP Contract makes provision for the benefit of a proportion of specified Refinancing Benefits that Infraco may obtain to accrue to LUL through a reduction in the level of Underlying ISC that would otherwise be provided for at a Periodic Review. The Schedule also provides for the Statutory Arbiter to

disregard any Refinancing Benefit that he considers to have been attributable to a refinancing in distress circumstances.

7.2 The Parties wish to guide the Statutory Arbiter that in assessing Refinancing Benefits there is not intended to be any sharing of any benefits that are attributable to:

- (a) Infraco's prior operational (rather than financial) efficiency gains; and
- (b) tax efficiencies within Infraco (rather than a reduction in financing costs) which ought to accrue wholly to Infraco consistently with Infraco's general assumption of tax risk under this Agreement,

and the Parties therefore wish to guide the Statutory Arbiter as to the need to make a judgment where Infraco's actual aggregate amount of debt borrowed and equity contributed after the refinancing falls short of the amount of debt projected to have been borrowed and equity projected to have been contributed as of the date of the refinancing, determined by reference to Fixed Amounts in Annex 3 (*Fixed Amounts*) of Schedule 1.9 of the PPP Contract, the shortfall should be shared to the extent that the Statutory Arbiter considers that it has not been achieved by efficiency gains attributable to (a) or (b) above.

7.3 The parties also wish to guide the Statutory Arbiter that Refinancing Benefits should not be shared to the extent they accrues from a refinancing that is solely attributable to tax efficiencies within Infraco (rather than a reduction in financing costs) which the Statutory Arbiter considers ought to accrue wholly to Infraco consistently with Infraco's general assumption of tax risk under the Contract.

8. Net Adverse Effect

8.1 Schedule 1.9 of the PPP Contract contains a number of provisions that are designed to protect Infraco altogether from Net Adverse Effect within a Review Period that are in excess of the Materiality Threshold.

8.2 When assessing whether Infraco has incurred Net Adverse Effects it is necessary to start by ascertaining the lower of: -

- (a) the aggregate costs that Infraco actually incurred in performing the Infraco Obligations during a Review Period; or
- (b) the aggregate costs that Infraco would have incurred in performing the Infraco Obligations during a Review Period in an overall efficient and economic manner and in accordance with Good Industry Practice with regard to the extent applicable to the characteristics of a Notional Infraco.

In considering the aggregate costs that Infraco would have incurred in performing the Infraco Obligations during a Review Period in an overall efficient and economic manner as referred to in sub-paragraph (b), the parties wish the Statutory Arbiter to have regard to:

- (x) Infraco's costs, budgets and programmes of activities proposed as part of the original bidding process; and
- (y) the possibility that some of the costs Infraco actually incurred (including but not limited to costs incurred under subcontracts) may be less than those that would have been incurred by performance in an efficient and economic manner as referred to in sub-paragraph (b) (and the parties wish any such difference to be ignored for purposes of determining costs pursuant to paragraph (b) above) as well as having regard to the possibility that some of the costs that Infraco actually incurred (including but not limited to costs incurred under subcontracts) are more than those that would have been incurred by performance in an efficient and economic manner as referred to in sub-paragraph (b) (and the parties wish any such difference to also be ignored for purposes of determining costs pursuant to paragraph (b) above).

8.3 For these purposes, the parties also wish the Statutory Arbiter to allow the efficient and economic costs that Infraco incurs after the Transfer Date:-

- (a) arising out of the pre-Transfer Date working practices that may or may not have been efficient and economic; or
- (b) from settling undischarged pre-Transfer Date liabilities not reimbursable under the Share Purchase Agreement that may or may not be efficiently and economically incurred.

8A. Lease Financing

The parties' guidance to the Statutory Arbiter in relation to the financing of the procurement of certain assets (such as rolling stock) which may be procured by Infraco in order to fulfil the Infraco Obligations is that it is likely that an efficient and economic means of financing such procurement may be to use an operating or finance lease with a duration which is linked to the likely economic life of the assets. As the economic life of such assets is likely to exceed the remaining duration of the Contract Period, it is recognised that it is unlikely to be possible to proceed on the basis of such a lease unless LUL agrees to enter into arrangements with the proposed lessors, including with regard to LUL's acceptance of appropriate liability under the lease after the end of the Contract Period. The parties recognise that LUL may not wish to undertake such a liability, or it may not agree terms in respect of such liability, so that the Infraco may need to arrange different means of finance. In particular such finance is likely to have to be repaid on or before the end of the Contract Period. The parties' guidance to the Statutory Arbiter is that if it is necessary for the Infraco to proceed as described in the last two sentences, then that course of action is one which a Notional Infraco could follow.

9. Partnership

The Parties' guidance to the Statutory Arbiter is that in determining the level of Infrastructure Service Charges the Statutory Arbiter should be mindful of the fact that, in the context of their respective rights and obligations under the PPP Contract, the

Parties intend to work in a spirit of partnership, which London Underground described in its Invitation to Tender as follows:

“We are committed to providing the best possible Underground service to the travelling public by:

- working together to improve customer service
- creating an environment based on mutual respect, trust and fairness that promotes open and honest communication at all levels
- solving problems together
- recognising and rewarding those who contribute to the success of the partnership
- working together to achieve our objectives”

As the parties intend to work together in partnership, in accepting evidence from either party as to the likely level of future costs, the Statutory Arbiter should have regard to the extent that such information has been shared with the other party on a timely and open basis.

Yours faithfully

LONDON UNDERGROUND LIMITED

INFRACO