

Department for Transport

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4 February 2003



- 1 I wrote to Tube Lines Group and its providers of finance on 30 December 2002 setting out the Secretary of State's role in relation to LRT, the Greater London Authority ("GLA") and Transport for London ("TfL") (including any subsidiary of TfL). Annex B to that letter (also attached to this letter and to be read in conjunction with it) sets out the Secretary of State's intentions in relation to the obligations of London Underground Limited (LUL) when setting Transport Grant for the GLA under Section 101 of the GLA Act or, pending transfer of LUL to TfL, when determining grant under the LRT Act.
- 2 Further to that letter and to my letter to Bob Kiley of 4 December 2002 I am writing to set out the Secretary of State's intentions in relation to the funding of LUL, how he would intend to review GLA transport grant in the event of unforeseen circumstances in advance of the next Government spending review and his intended approach at the next and subsequent spending reviews.
- 3 Recognising that the PPP contracts have begun (in the case of Infracos JNP) or will begin (in the case of Infracos BCV and SSL) later than was expected at the time of promulgation of the Funding Statement which forms Annex B to my letter to Tube Lines Group and which was confirmed by the Government's 2002 spending review, the Secretary of State intends to ensure that LUL is no worse off as a result. He therefore intends to allow such underspend as occurs during this financial year, and is needed next, to be carried forward and added to grant for next year to achieve that outcome. He also intends to adjust grant for the following year if, in his view, it is needed for that purpose.
- 4 The Secretary of State also intends, in respect of the years up to 2005-06, to make provision in addition to that contained in Annex B of my 30 December letter in respect of such sums as are incurred by LUL in consequence of its agreement with Canary Wharf Limited (CWL).
- 5 The Secretary of State does not propose any further changes to the levels of grant set out in 02/03 prices in Annex B to my letter of 30 December, those levels reflecting, in his view, what is needed to fund LUL's obligations including provision for management of risks associated with LUL's PPP and other contracts. That letter states that, between

- 6 Government spending reviews, it is his intention that levels of GLA transport grant should be reviewed in the event of major expenditure pressures falling to LUL outside its Business Plan (and therefore unforeseen) and any appropriate adjustments made. The Secretary of State will consider whether such pressures might include sums falling to be paid to CWL in the event of LUL failing to meet the terms of the agreement referred to at paragraph 4 above provided that information on performance of that agreement is provided to him on a regular basis within the framework to be developed under paragraph 7 below.
- 7 The Secretary of State has recognised that it will be desirable for TfL to establish a reserve provision from which to manage LUL's future business risks and has identified (as set out in Annex B to my 30 December letter) certain amounts within GLA transport grant in the years up to 2006/07 to allow TfL to build up such a reserve. Government will expect (under the arrangements set out in paragraph 7 below) to be consulted before any draw down such that it may lead to significant depletion of the reserve. In these circumstances, should major unplanned and unforeseen expenditure pressures fall to LUL such that that reserve is significantly depleted, it is the Secretary of State's intention that levels of grant should be reviewed in light of the desirability of maintaining reserves at the level contained in Annex B to my letter of 30 December and adjustments made such that the reserve can be replenished to an appropriate level. Such review would normally take place at each Government spending review.
- 8 Going forward, it is the Secretary of State's view that Government and TfL should work together to allow better planning and delivery within London Underground and hence to promote better informed decisions in Government spending reviews and in the annual determination of GLA transport grant. To that end, Government will work with TfL to develop a protocol in relation to LUL, covering a Business Plan which both parties believe to be realistic, the provision of management accounts, objectives, performance, areas of co-operation and exchange of information and an approach to project evaluation.
- 7 It is the Secretary of State's intention that GLA transport grant should be reviewed at each Government spending review within the framework of the Funding Statement and that protocol. The Secretary of State has already said that, at those times, account will be taken in particular of changes to LUL's forecast revenues (recognising that the funding provision set out in Annex B to my 30 December letter assumes that LUL fares will rise in line with the Retail Price Index), the expected effect of inflation on London Underground's costs (both infrastructure service charges and the London Underground operating company's own costs) and projected payments under the PPP performance regime. In the context of LUL's own costs, the Secretary of State recognises that account will need to be taken of the costs associated with the management of LUL's PPP and other contracts. In the light of the framework to be developed under paragraph 7 above, the Secretary of State also intends to take into account pressures falling unavoidably to LUL under PFI contracts entered into by LUL or LRT; the need for appropriate provision to rectify any shortfalls as contained in the 2003 valuation of the LRT pension fund and the costs of pension administration; the need for appropriate provision for expenditure on Major Enhancements under the PPP and on LUL Specified Rights under the PPP to the extent in both cases that both parties agree on the need for such investments; and the need for appropriate provision for any payments due under the PPP in respect of working capital.

- 10 When considering the appropriate level of GLA transport grant in relation to the matters covered in this letter, it is the Secretary of State's intention that he would take account of LUL's financial position alone and not that of TfL or any other of its subsidiaries.

Yours sincerely
David Rowlands.

David Rowlands

Attached was the grant letter we received last year



Department for
Transport

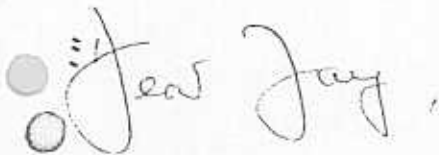
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TRANSFER OF LONDON UNDERGROUND

This letter is to confirm the arrangements for transfer of London Underground ("LUL") to Transport for London.

Ministers have said that they are aware that certain provisions of the GLA Act 1999 may operate in such a way as to restrict the operation of certain other provisions of the PPP Service Contract or the LRT Guarantee in relation to the provision of additional security for the performance of LUL's obligations, or the obligations of its guarantor, which provisions were required by the Providers of Finance in order to proceed to financial close of the PPP transactions. Legislation has been brought forward in the Railways and Transport Safety Bill to amend the GLA Act to address this problem.

The Secretary of State and Transport for London ("TfL") will work, on the basis of the attached letter of undertaking from TfL (draft dated 4 February), to resolve the issues which were the subject of my letter of 30 December (also attached) to Tube Lines' Providers of Finance. The TfL letter of undertaking will seek to address both their concerns and those of Metronet's Providers of Finance with the intention that transfer of London Underground ("LUL") to TfL should take place concurrently with or as soon as possible after completion of the contracts between LUL and Metronet for Infracore BCV and Infracore SSL and in advance of enactment of the relevant provisions of the Railways and Transport Safety Bill, provided the issues are resolved to address the concerns of the Providers of Finance.

The Secretary of State will also work with that same intention with London Regional Transport ("LRT") and LUL to the effect that LRT and LUL will take steps in parallel including, but not limited to, giving appropriate notice sufficient to **trigger the minimum 90 day notice period in relation to the change of control provisions related to PFI contracts entered into by LRT or LUL and with the intention that such notice will be given within 1 business day of the issue of this letter.**

Discussions about early transfer of LUL will also cover the issue of contract management. These will take place with a view to early adoption by LUL of TfL's programme control methodology developed by Parsons Brinkerhoff for the PPP contracts and immediate discussion of that programme control methodology with Tubelines with a view to adoption on transfer. That discussion should take place with TfL's participation, on the basis of the contracts as completed by LUL with Metronet and Tubelines. TfL should also seek to make appropriate appointments to manage those contracts, effective upon transfer. Ministers are also content that there should be early appointment of a TfL nominee as Partnership Director on the Boards of the Infracos as each contract is put in place.

Yours sincerely
David Rowlands

David Rowlands

Tubelines
Metronet

Draft of 4 February 2003

Dear

LONDON UNDERGROUND NETWORK PPP CONTRACT (THE "SERVICE CONTRACT")

In light of agreement having been reached with Government on the provision of a comfort letter to TfL on the future funding for London Underground Limited ("LUL") once it is in TfL's ownership, the Mayor has withdrawn the application which was made on Monday, 27 January 2003 in the CFI and has given an unqualified undertaking to the Secretary of State that he will not pursue any further legal challenge whether in the European or domestic courts or by way of complaint to the European Commission. Accordingly, the Secretary of State and the Mayor have agreed to work together to secure the earliest possible transfer of ownership to TfL.

I am therefore writing to you to set out the following explicit representations and commitments by TfL. These representations and commitments are given explicitly in order to deal with the concerns which have led you to seek changes to section 412(3) and paragraph 2(3) of Schedule 12 to the Greater London Authority Act 1999 (the "GLA Act"). Such primary legislation will add significantly to the time required to enable Transfer of LUL to TfL and both the Secretary of State and the Mayor wish to avoid that. Therefore these explicit representations and commitments are given to obtain your agreement that primary legislation is not required to expedite the timing of transfer of LUL to TfL.

We unreservedly accept that section 412(3) of the GLA Act shall not apply (and we shall not seek to rely on it in any event) so as to avoid the operation of any rights and obligations under the Service Contract (and in particular Paragraph 33.5 of the Service Contract) or the guarantee with LRT (as Guarantor) (which was initialled on 8th May 2002) (the Guarantee).

You are also concerned that TfL might use its powers under Section 165 and paragraph 2(3) of Schedule 12 to the GLA Act to transfer the Guarantee in an attempt to avoid the contractual safeguards LRT negotiated with you. In this regard, TfL unconditionally agrees to be bound by the terms of the Guarantee as if it were executed by us as guarantor in place of LRT provided that TfL shall only be bound by amendments to the Guarantee made with our consent. TfL also hereby represents and warrants that it will not attempt to escape the obligations under the Guarantee through the exercise of its power under section 165, and that if it were to do so in



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(together with any other funders from time to time of
Infraco JNP Limited and Tube Lines (Holdings)
Limited (to the extent of advances on lent to Infraco
JNP Limited), collectively the "Providers of Finance")

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30 DECEMBER 2002

Dear Sirs

London Underground Limited Infraco JNP Public-Private Partnership

The Secretary of State is aware that Tube Lines Group is the nominated preferred bidder for the above PPP and has entered into or is shortly to enter into documentation relating to the same, including acquiring ownership of Infraco JNP Limited (with the exception of one "special share") which will enter into an amended and restated Service Contract with London Underground Limited ("LUL").

The PPP forms an integral part of the Government's long-term plans for transport which were set out in the Department for Transport's (then DETR) document "Transport 2010 – The 10 Year Plan" published on 20 July 2000. Transport for London ("TfL"), a functional body created under the Greater London Authority Act 1999 ("GLA Act"), or a wholly owned subsidiary of TfL, will, after transfer of LUL in accordance with Part XII of the GLA Act, own 100% of the share capital of LUL. TfL will guarantee the obligations of LUL under the Service Contract. Until such transfer of LUL, London Regional Transport ("LRT") will guarantee the obligations of LUL under the Service Contract. Under section 298 of the GLA Act, one of the transitional purposes of LRT is to facilitate the securing and carrying into effect of the PPP.

The Service Contract will contain provisions that seek to protect the Tube Lines Group and its Providers of Finance from adverse consequences arising as a result of a judicial review application or state aid challenge being made in respect of the PPP.

I am writing to confirm the Secretary of State's intentions in relation to transfer of LUL and of LRT's guarantee of LUL's obligations under the Service Contract from LRT to TfL (or any subsidiary of TfL). The Secretary of State cannot and must not fetter his discretion. This letter is therefore not intended to do that and does not create binding obligations.

The Secretary of State notes that officers of TfL have been given authority to institute proceedings challenging the decision of the European Commission in relation to state aid. It is also possible that they may make a further challenge to the PPP by way of judicial review proceedings. The Secretary of State does not consider that the transfer of LUL to TfL, or the transfer of any related obligations of LRT to TfL, could, or should, take place against the background of such threats nor while any such legal proceedings were in progress. As a result the Secretary of State does not propose to make any transfer scheme under section 409 of the Greater London Authority Act 1999 for the transfer of LUL, or its obligations, or any of LRT's obligations, to TfL until such time as all such legal challenges have been finally determined, or in his opinion the time periods for commencing such actions have expired.

The Secretary of State is also aware that sections 165, 412 and Schedule 12 of the GLA Act, may operate in such a way as to restrict the operation of certain provisions of the Service Contract or the LRT Guarantee in relation to the provision of additional security for the performance of LUL's obligations, or the obligations of its guarantor, which provisions are required by the Providers of Finance in order to proceed to financial close of this transaction.

The Secretary of State intends to bring forward legislation to amend the GLA Act ("the relevant legislation") in the current session of Parliament to address this problem so as to permit the operation of such provisions. In the absence of other measures which would address the Providers of Finance's concerns the Secretary of State does not consider that the transfer of LUL to TfL should take place while this uncertainty exists. As a result he has no intention to make any transfer of LUL, or its obligations or any obligations of LRT, under section 409 of the Greater London Authority Act 1999 until the relevant legislation has been enacted, is in force, and any necessary steps have been taken such that the provisions of the Service Contract can be relied upon unless the issues are otherwise resolved to address the Providers of Finance's concerns.

Nor does he propose to make the necessary Order for the dissolution of London Regional Transport until he is satisfied that the scheme transferring LUL and London Regional Transport's guarantee of LUL's obligations to Transport for London has been properly put in place such that the relevant obligations of LRT have been effectively transferred.

Yours faithfully,
David Rowlands

DAVID ROWLANDS

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(together with any other funders from time to time of Infraco
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The PPP forms an integral part of the Government's long-term plans for transport which were set out in the Department for Transport's (then DETR) document "Transport 2010 – The 10 Year Plan" published on 20 July 2000. Transport for London ("TfL"), a functional body created under the Greater London Authority Act 1999 ("GLA Act"), or a wholly owned subsidiary of TfL, will, after transfer of LUL in accordance with Part XII of the GLA Act, own 100% of the share capital of LUL. TfL will guarantee the obligations of LUL under the Service Contract. Until such transfer of LUL London Regional Transport ("LRT") will guarantee the obligations of LUL under the Service Contract.

X
The Secretary of State is aware that financing for Tube Lines Group is in excess of £1800 million comprising senior debt, mezzanine debt and equity, that TfL has been credit rated "AA" by Standard & Poor's and that the Providers of Finance have attached importance to that rating. Standard & Poor's have based their rating analysis on, among other things, discussions with and information provided by TfL.

I am writing to help clarify the Secretary of State's role in relation to LRT, the Greater London Authority ("GLA") and TfL (including any subsidiary of TfL). Annex A to this letter (which is an updated version of the paper LUL sent to you in October 2000) explains this role and some of the statutory obligations of the GLA, TfL and LUL; the financial regime under which the GLA and TfL and its subsidiaries operate; and the powers which are available to the Secretary of State to ensure that the GLA and TfL and its subsidiaries can continue to meet their obligations. However, nothing in this letter or the Annexes is intended as advice or representation; and it must not be relied on as such. You should take your own advice on the matters referred to. The Secretary of State cannot and must not fetter his discretion. This letter and its Annexes are therefore not intended to do that, do not create binding obligations and must not be relied upon as so doing.

In the Secretary of State's opinion:

- he has power under Section 12 of the London Regional Transport Act, 1984 ("the LRT Act"), with the consent of the Treasury, to make grants to London Regional Transport for any purpose and on such terms and conditions as the Secretary of State thinks fit;
- he has power under Section 113 of the GLA Act to issue a credit approval to the Mayor with respect to the credit arrangements and expenditure for capital purposes during each financial year of the GLA and each of the functional bodies; and power under Section 114 to issue additional credit approvals within the financial year;
- he has power under Section 101 of the GLA Act to set transport grant for the GLA;

- he has power under Section 88B of the Local Government Finance Act, 1988, subject to the approval of the House of Commons and the Treasury, to pay special grant to a local authority (which for this purpose includes the GLA) and to specify that the grant shall only be used for specified purposes by TfL. The powers of the GLA and TfL must be exercised to ensure that no subsidiary of TfL does anything which TfL itself is has no power to do.

The Secretary of State further notes:

- the funding statement (the equivalent of the "promissory note" issued to Local Authorities in connection with PFI projects) that will be issued to the GLA and TfL, the text of which is reproduced at Annex B to this letter;
- that the GLA and TfL are subject to the local authority finance regime including the duty of Best Value external audit, the requirements to calculate a budget before a financial year which is used to calculate council tax at a rate which will meet the budget requirement, and the presence of officers with statutory obligations;
- that the Chief Finance Officer of TfL has a statutory obligation to make a written report if for any reason he considers that TfL or any subsidiary of TfL has or is about to enter into commitments which are unlawful or which in a financial year are likely to exceed its available resources;
- that such a commitment could include a situation in which the Mayor, the GLA or TfL or a subsidiary brought about a contract disposition of a PPP contract or termination of one of LUL's PFI contracts, without having the ability to pay the sum due.

The Secretary of State will take into account, amongst other relevant factors, all the obligations of LUL under any PPP contracts (including obligations under the Put Option Agreement or the Stand Still Agreement (being the agreements of those names defined in the documentation referred to in the opening paragraph of this letter in the form as they are entered into or agreed at the date hereof)) in considering and setting transport grant for the GLA under Section 101 of the GLA Act, or in making grants to LRT under Section 12 of the LRT Act.

Further, in the event that LUL was unable to meet its financial obligations under any PPP contracts (including obligations under any put option agreement or stand still agreement) the Secretary of State regards it as untenable that:

- he would not consider whether it was appropriate to make any payment of grant to LRT under Section 12 of the LRT Act;
- he would not consider whether it was appropriate to adjust transport grant for the GLA under Section 101 of the GLA Act or to make payment of a special grant under Section 88B of the Local Government Finance Act 1988;

- he would not take LUL's financial obligations and the financial obligations of any other subsidiary of TFL in respect of sums owed by Infracore to the Providers of Finance into account;
- he would stand by and do nothing in those circumstances.

Moreover, in circumstances where the Novation Price (as defined in Schedule 5.16 to the Service Contract and which could include the Underpinned Amount referred to in Annex B) becomes due from LUL or the LUL Nominee (whether under an agreement in the form of Schedule 5.16 to the Service Contract or equivalent amounts pursuant to any provision of the Service Contract or the Put Option Agreement) and the Secretary of State determines that an amount of grant should be made in respect of meeting that liability, it is the intention of the Secretary of State to seek that payment of such amount be made direct to the lenders' Security Trustee.

*Yours faithfully,
David Rowlands.*

DAVID ROWLANDS

Annex A

TRANSPORT FOR LONDON: FINANCIAL REGIME

Constitutional Arrangements

1. Transport for London (TfL) is one of the functional bodies of the Greater London Authority (GLA). The GLA consists of the Mayor and the elected Assembly. There are four functional bodies reporting into the GLA: TfL, London Development Agency, Metropolitan Police Authority and the London Fire and Emergency Planning Authority. The GLA receives various funding streams for its various activities; for example most of the police funding comes from the Home Office whereas the Transport Grant comes from the Secretary of State for Transport.
2. There are severe constraints on the Mayor's ability to vire money between different parts of the GLA family. Transport Grant is paid for transport purposes as laid down in the GLA Act 1999 and, under section 103 of the Act, the GLA must therefore pass the grant "forthwith" to TfL. The Mayor cannot withhold or divert it elsewhere.
3. Under local government capital finance legislation, TfL is treated as a local authority. The current policy is that central government funding for TfL should take the form of grant. If in future TfL were to be given 'credit approvals' to allow it to finance capital spending by borrowing, it would be subject to the same control mechanisms as apply to local authorities under Part IV of the Local Government and Housing Act 1989, as amended by the GLA Act 1999. TfL could borrow from the same sources as any local authority, including the Public Works Loans Board. The Government is also considering proposals to move to a 'prudential borrowing' regime for local authorities – the Office of the Deputy Prime Minister published draft legislation for consultation in June 2002. This would abolish credit approvals and free local authorities, including TfL, to borrow for capital investment without prior consent, provided they can afford to service the debt.
4. Although the Transport Grant is not hypothecated for particular projects or purposes within the overall heading of transport, the sum is decided after consultation with the Mayor and takes into account continuation of existing services and investment in improvements and new infrastructure. In setting grant annually, the Secretary of State needs to have regard to forecast levels of TfL's income and expenditure, including all their contractual commitments. The Secretary of State's actions in this and all other regards could be subject to a test of "reasonableness" in the Courts if challenged.

Controls

5. DfT like all government departments is accountable to Treasury and Parliament for its expenditure. DfT will therefore monitor the GLA's use of its Transport Grant.
6. TfL and the GLA are subject to the Local Authority finance regime including the duty of **best value**, **external audit**, the "**responsible officer**" (the Chief Finance Officer) function and the **requirements to calculate a budget** before the start of a financial year which is used to calculate council tax at a rate which will meet the budget requirement. In addition to the TfL Finance Officer with statutory duties, there is a statutory **GLA Monitoring Officer** who also oversees the general propriety of the functional bodies' actions.

Duty of Best Value – Local Government Act 1999 ("the 1999 Act"), Part 1

7. The GLA and TfL, as best value authorities, must make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness. The Act imposes duties on best value authorities to produce performance plans, to report against performance indicators (as prescribed by the Secretary of State), and to review the ways in which they carry out their functions. Under section 10 of the 1999 Act, the Secretary of State may direct the Audit Commission, to carry out an examination of the authority's compliance with Part 1 of the 1999 Act.
8. If an authority was found to be failing in its duty of Best Value in any particular function, or as a whole, Section 15 of the Act provides the Secretary of State with a wide range of intervention powers. In extreme cases of failure, this includes a power to exercise a function of the authority himself or through a nominee.

External audit

9. Auditors appointed by the Audit Commission audit the GLA and TfL, and monitor their performance plans under Best Value. The role and powers of auditors are specified in the Audit Commission Act 1998 ("the 1998 Act"), as amended by the Local Government Act 2000.
10. As well as producing a general report at the completion of an audit, the auditor, under section 8 of the 1998 Act, must consider during the course of an audit, whether to make an immediate report on any other matter which he believes should be brought into the public domain in the public interest. Reports must be considered by the authorities within four months.
11. Under section 17 of the 1998 Act, an auditor can apply to the Court for a declaration that an item of account is unlawful. Under section 24, the auditor also has powers under the Act to seek judicial review of any decision or action of the authority which it is reasonable to believe would have an effect on its accounts.

12. Under sections 19A, 19B and 19C of the 1998 Act, if an auditor believes an authority is taking or about to take action which is unlawful, he or she may issue an advisory notice. This requires the authority to reconsider the consequences of their actions and to give the auditor a period of notice of up to 21 days before proceeding.

TfL / GLA Chief Finance Officer function ('responsible officer' function)

13. TfL and the GLA must each appoint an officer with overall responsibility for the financial affairs of that authority. The 'responsible officer' must be a member of one of the recognised professional accountancy organisations, and are covered by the membership requirements and rules of those organisations. (Institute of Chartered Accountants, Chartered Association of Certified Accountants, Chartered Institute of Public Finance and Accountancy, Chartered Institute of Management Accountants, and similar Scottish and Irish bodies.)

14. If the TfL 'responsible officer' knew that the TfL Board or one of its officials:

- has made or is about to make a decision which involves or would involve the authority incurring expenditure which is unlawful;
- has taken or is about to take a course of action which would be unlawful and likely to cause a loss or deficiency, or;
- is about to enter an item of account the entry of which is unlawful;

he/she would be statutorily obliged given his duties under section 114(2) of the Local Government Finance Act 1988, to make a report. He/she must also make a report (under section 114(3)) if it appears that the expenditure to be incurred in the financial year is likely to exceed the resources available to meet that expenditure. This is also the case for the GLA.

15. A report made in respect of the GLA must be sent to the Mayor, Assembly and external auditors and a report made in respect of TfL must be sent to the Mayor, the Chair of the Assembly, external auditors and the TfL Board.
16. The Assembly or TfL as appropriate, would have to meet within 21 days of the report being sent to consider it and decide its actions in consequence of it. In respect of the GLA, the Mayor must also consider the report and must do so within 14 days of the Assembly's meeting. The provisions on openness as set out in Part VA of the Local Government Act 1972 would apply to that meeting. Until the relevant considerations are concluded, the proposed course of action that had led to the report could not lawfully be pursued (if the report was made under subsection (2)) and no new contractual commitments could be entered into once the report was made (if the report was made under subsection (3)).
17. It is possible that any attempt to pursue the original course of action in the time between the issuing of the report and the conclusion of the relevant considerations could be prevented by means of an application for an injunction by an affected party, or the external auditor.

18. If, following any decisions made by TfL or the Mayor, it still appears to the responsible officer that the circumstances described in sections 114(2) and (3) exist, he or she is under a duty to issue a further report. The process could repeat until the responsible officer is content that those circumstances no longer exist.

GLA Monitoring Officer

19. Section 73 of GLA Act requires the GLA to appoint a Monitoring Officer, with duties as specified in S5 of the Local Government and Housing Act 1989. The Monitoring Officer and the Chief Finance Officer cannot be the same person. The GLA Monitoring Officer also has responsibility for making a report in respect of TfL where the Board or employees are exercising functions delegated by the Mayor. If it appears to the Monitoring Officer that the authority or its officers may, by action or omission, be contravening or about to contravene the law the Monitoring Officer must prepare a report. This report must be considered by the Authority within 21 days, during which time the GLA or TfL as appropriate, must ensure that the proposed course of action is not lawfully be pursued.

Budgeting requirements

20. The budgeting requirements for the GLA are specified in sections 85-87 of the GLA Act 1999. The GLA is required to calculate a budget before the start of each financial year, which is used to calculate council tax at a rate which will meet the budget requirement. There is no provision for the GLA to calculate a deficit i.e. to calculate a council tax which will not meet the revenue requirement. The GLA must also calculate an individual budget for each of its functional bodies, including Transport for London. The Assembly has to approve the Mayor's budget in February each year and can amend it in part or in total with a two-thirds majority.

Role of Assembly

21. The Assembly has, inter alia, the role of keeping under review the exercise by the Mayor of his statutory functions and can require him as Chair of Transport for London to attend proceedings and produce documents. The same applies to the staff of TfL and also to any member of a body which has, within the preceding three years had a contractual relationship with, or received a grant from, the authority. Under the Greater London Authority (Protected Information) Order 2000, the Secretary of State has prescribed certain categories of information, or types of documents, that persons giving evidence to the Assembly may refuse to disclose. Those categories include actionable breaches of confidence, information which relates to legal proceedings (other than information requested from TfL by the Mayor for the purpose of discharging his functions), information relating to criminal investigations and police services, information identifying informants and information relating to national security or counter terrorism.

Ethical Framework & Model Code of Conduct – Local Government Act 2000, Pt 3

22. This Act established the new ethical framework for local government, which applies to the GLA including the Mayor and Assembly members (but not to TfL). It introduced a power to prescribe statutory codes of conduct, covering the behaviour of members and officers, and requires each authority to appoint a standards committee. It established the Standards Board to investigate allegations of possible breaches of the members' code of conduct. Sanctions available for those found to have breached the code range from censure to disqualification from office.
23. Local authorities are required to produce their own code of conduct, based on a Model Code prepared by the Secretary of State after consultation. They must produce this code within six months of Model Code being laid before Parliament. The consultation period is now closed, and we expect the Model Code to be made within the next few weeks. It is expected to include provisions which:
- prohibit members from conducting themselves in a way that could be reasonably thought as bringing his office or authority into disrepute;
 - ensure that when reaching decisions, members must have regard to advice of the Chief Finance Officer and the Monitoring Officer, and must give reasons for decisions;
 - require members to report to the Standards Board any conduct by another member which may breach the authority's code.

Special Grants

24. The Secretary of State has power under section 88B of the Local Government Finance Act 1988 to pay a one-off grant, known as a 'special grant', to the GLA. Section 103 of the GLA Act 1999 would require the GLA to pass on a grant received for the purposes of a functional body to that body (e.g. TfL).
25. Subject to the agreement of the Treasury, the Secretary of State prepares a report detailing the amount and purpose of the grant, for approval by a resolution of the House of Commons. Conditions attached to the grant must be specified in the report. For example, a condition might be imposed that the grant be not paid to the GLA until the Secretary of State was satisfied that arrangements were in place for it to be passed to or used for the purposes of London Underground Limited.

December 2002

Annex B**Funding Statement**

The Government is committed to supporting value for money PPP projects and to assisting the development of PPP/PFI in the local authority sector.

In setting Transport Grant for the GLA under Section 101 of the GLA Act, or pending transfer for LT under the LRT Act, the Secretary of State will take into account the obligations of LUL under any PPP, and existing PFI, contracts. In particular, within the total transport grant, the Secretary of State intends separately to identify an element of grant to reflect the obligations of LUL under the PPP contracts. It is his intention to do this throughout the lifetime of the PPP contracts. It is recognised that the average level of Infrastructure Service Charge is projected to rise by some 25% in the Second Review Period compared to the First Review Period, assuming no new obligations are introduced in the Second Review Period.

It is the Secretary of State's intention that this element of grant should be based on the difference between LUL's Net Revenues as defined below (noting that LUL's costs reflect the normal day-to-day operation of the Underground as well as costs associated with the PPP and existing PFI contracts) and Infrastructure Service Charge (ISC) payments.

- **Net Revenues:** The difference between LUL's projected revenues and overall costs of the Operating Company as agreed between DTLR and GLA¹ and reflected in LUL's Business Plan. For these purposes the total operating costs include the exercise of additional obligations on LUL emergency step in, LUL Essential Works and Services, Intermediate Works and other Exceptional Amounts.² In the first period the projected Costs and Revenues are:

Em 02/03 prices	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Traffic and other Revenues	1285	1310	1320	1350	1380	1400	1410	1420
Overall Costs of Operating Company	1175	1185	1155	1070	1040	1100	1120	1100
Net Revenues ²	110	125	165	280	340	300	290	320

¹ Or as proposed by DTLR if they are still to be agreed with GLA when the comfort letter is issued.

² These figures reflect current projections

- ISCs: Underlying ISCs as set out in the Schedules to the contract, or as subsequently determined by the Arbiter following an Extraordinary Review of the ISC, plus base case expected performance payments for all obligations within the PPP transaction documents as at the time of initial signature, excluding amounts to be agreed under Major Enhancement Agreements. Current Government spending plans are based on the expectation that, in the first period, these will be:

£m 02/03 prices	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Infrastructure Service Charges	975	1015	1030	1195	1205	1210	1230	1330

The Secretary of State intends to include within Transport Grant additional provision as necessary to reflect LUL's commitments under the PPP contracts in relation to Infrastructure Company expenditure on Safety Change and Qualifying Change of Law provisions. This will be reimbursed to LUL on an annual basis reflecting actual expenditure that occurred in the previous year. The Secretary of State also intends, as he deems appropriate, to include provision for Major Enhancements as envisaged in the PPP contracts. In the first period these are:

£m 02/03 prices	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Major Enhancements	5	30	65	90	150	140	110	90

The Secretary of State also intends, as he deems appropriate, to include provision for the exercise of LUL specified rights. No such provision is made in the current figures.

Reserve provision

The Secretary of State recognises that it would be desirable for TjL to establish a reserve provision from which to manage LUL's business risks. To enable TjL to build up such a reserve, the secretary of State intends to allow the following amounts within GLA Transport Grant:

£m 02/03 prices	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Reserve provision	60	40	40	20	10	0	0	0

This allows LUL to build accumulative reserve provision as follows:

£m 02/03 prices	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Accumulative provision	60	100	140	160	170	170	170	170

On the basis of the above, the Secretary of State intends to allocate the following levels of GLA Transport Grant (excluding the expenditure on Safety Change and Qualifying Change of Law provisions) in the first period:

£m 02/03 prices	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Transport Grant provision	930	960	970	1025	1025	1050	1050	1100

The Secretary of State will expect LUL to abide by the PPP contracts and their terms and will also expect TjL to abide by the terms of its guarantee.

The financial outlay represented by future Transport Grant will be identified within the Government's current spending plans and DTLR's 10 year Transport Plan.

It is the Secretary of State's intention that Transport Grant should be reviewed at each Government spending review. Account will be taken in particular of changes to London Underground's forecast revenues, the expected effect of inflation on London Underground's costs (both Infrastructure Service Charges and the London Underground operating company's own costs) and projected payments under the PPP performance regime.

Between Government spending reviews, it is the Secretary of State's intention that levels of transport grant should be reviewed in the event of:

- Major expenditure pressures falling to LUL under the PPP contracts outside its Business Plan (e.g. catastrophic asset failure, or any other substantial changes to the ISC or liabilities arising under the PPP contracts);
- LUL or the LUL Nominee becoming liable to pay the Novation Price (as defined in Schedule 5.16 to the Service Contract and which could include the Underpinned Amount) in any situation of contract disposition or pursuant to the put option agreement between LUL and the Lenders