§ Law in Context

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Contract, contract, contract

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The aim of this chapter is to look more closely at contracting as a state activity. In light of the pursuit of new forms of governance what better to examine than the functional development of contract in the economic sphere as a way of delivering public services and infrastructures? We have selected two types of regime of great importance in the changing landscape of law and administration. Exhibiting a wide variety of designs, the first one, public franchising, highlights the overlap of contractual with regulatory techniques of governance. As well as contract as a source of administrative rules, there is a significant history

here of deficiencies in, and attempts to improve, the procedure and accountability of agencies. Our second selection, public/private partnerships and 'the private finance initiative' (PPP/PFI), wears a distinct political hue, this being the favoured child of New Labour. There is a pervasive sense of experimentation – sometimes, it must be said, at the expense of the taxpayer – coupled with levels of contractual detail that can appear almost wilfully complex. The question of the extent to which risks in public enterprise can in fact be passed to the private sector is sharply posed.

1. The franchising technique

Franchising as a tool of governance is operative today across a diverse range of activities, from London buses to legal aid, and from cable television to the National Lottery.[1] Harnessing private enterprise in the delivery of services, this fresh lease of life for an old technique epitomises the influence of NPM and the rise in administrative law of contract-type arrangements. The Conservatives' legacy is manifest.

Franchising entails the allocation of exclusive or protected rights to carry on an activity for a certain period of time, typically using the mechanism of an auction to determine entry to the market. The basic premise is that competition *for* the market effectively substitutes for competition *within* it: to enjoy special rights, the private firm first has to engage in competition to secure those rights.[2] Public or governmental franchising may be viewed either as one form of regulation, or as a complement to, even a substitute for, traditional regulatory instruments. As with contracting out, with which it overlaps, the technique is appropriately considered as a *process*, involving both the design and operation of award procedures, and monitoring, negotiation, and sanction under the rubric of franchise management. There is ample scope for agency discretion.

Flexibility of application – the scope for tailoring the technique to different market types and conditions – is a particular virtue. From the Treasury viewpoint, a franchising arrangement may have the considerable benefit of shifting the revenue risk to the service provider. Franchising allows competition for loss-making activities because negative tender prices can take the form of subsidy. The franchise as a source of rules can be used explicitly in defence of 'the public interest' as through specifications for quality. Then again, there is room for explanation in terms of public choice – franchising as the product of rent-seeking behaviour by private-interest groups.

The development has been fuelled by loss of faith in the alternatives.

[1] While such activity is distinguished by its 'public' purpose, commercial franchising provides many instructive parallels. See for a useful overview, J. Adams, J. Hickey and K. Prichard Jones, *Franchising*, 5th edn (Tottel, 2006).

[2] See, generally, R. Blair and F. Lafontaine, *The Economics of Franchising* (Cambridge University Press, 2005).

According to an influential theory of public franchising derived from regulatory economics, the market disciplines unleashed by a properly designed system of allocation undermine the case for traditional modes of regulation: contract terms and conditions constitute the appropriate legal instrument of public control:

> Franchising can be viewed essentially as a mechanism for increasing market contestability. It does so by allowing firms to bid for the rights to supply before they have committed resources to the enterprise, i.e. by reducing the level of sunk costs associated with entry. Of equal importance is the fact that franchising is a mechanism for providing the regulator with information about the competitiveness of potential suppliers. Such information generation is entirely absent under traditional regulation and nationalisation and is a major advantage of the franchising method. Another advantage of franchising over traditional forms of regulation is that it provides a sanction on poor performance, namely the threat of franchise termination, which may in some circumstances be a more credible sanction than the threat of take-over faced by a regulated enterprise. [3]

Franchising as a policy choice fits with the search for 'a third way' in regulation (see p. 241 above). The state retains an element of control, ultimately expressed through the power (not) to renew the franchise; on the other hand, commercial responsiveness and inventiveness can be facilitated in light-touch fashion through respect for managerial freedoms. Of course the benefits of a competition for the market cannot always be realised, as where too few potential franchisees can be found for competitive bidding, where performance cannot easily be benchmarked, or where substitution of poor performers is impractical.[4] In practice, franchising is commonly combined with conventional regulatory tools.

While franchising has the potential to enhance accountability through specification, the issue arises of the legitimacy of franchisor action. The technique likewise highlights the challenge for administrative law presented by government by contract. Reconciling desiderata of VFM and of process-values like fairness, consistency and transparency with precepts traditionally associated with private autonomy, such as commercial confidentiality, is not easy.[5]

(a) Allocation: Fairness

In 'public-interest franchising' the system is geared to selecting the bid which will best serve public-interest goals. Echoing themes in regulatory design (see

[3] S. Domberger, 'Economic regulation through franchise contracts' in Mayer and Thompson (eds.), *Privatization and Regulation: The UK experience* (Clarendon Press, 1986), pp. 275–6.

[4] R. Baldwin and M. Cave, *Franchising as a Tool of Government* (CRI, 1996), p. 49.

[5] But see D. Oliver, 'Common values in public and private law and the public/private divide' [1997] *PL* 467.

Chapter 7), this maximises agency discretion. Subjective judgement is involved in the choice and weighing of different factors; the legislative mandate is less of a guide as dimensions to the 'public interest' multiply. Alternatively, there is 'price-bidding franchising': the highest bid in the auction being successful, or else the bid that accepts to charge service users the lowest price. Combinations of these two basic models abound;[6] given monopoly, it is hard to ignore pricing, while price competition alone creates incentives to reduce quality, etc.

Changing priorities over time are illustrated by the development of franchising in commercial analogue television. Unkindly characterised as 'the apotheosis of the great-and-the-good paternalistic mode of British public administration',[7] the model that originally took root in the 1950s was heavily reliant on 'public interest'. The franchisor, successively the Independent Television Authority and the Independent Broadcasting Authority (IBA), was given virtually untrammelled discretion in the allocation of regional franchises; detailed standards of impartiality, decency, quality, etc. were stipulated in the contracts awarded to the successful bidders.[8] This chief example of public franchising in Britain became increasingly criticised however. Noting 'an atmosphere of prevailing mystery', Lewis stressed the need for rational decision-making and structuring and confining of discretion.[9] With hindsight, the call for American-style procedures (notice and comment, open hearings, reasons) anticipated the debates in administrative law over the Ofdogs (see Chapter 6).

Eventually, commercial pressures coupled with technological advance saw the whole basis of public control challenged. The digital age was dawning. The Broadcasting Act 1990, which provided for both 'Channel 5' and the 'Channel 3' regional franchises, involved a shift in favour of price bidding. Consistent with a policy of deregulation, s. 17 provided that what was now the Independent Television Commission (ITC) 'shall, after considering all the cash bids submitted . . . award the licence to the applicant who submitted the highest bid'. But Parliament would not wear a pure price bidding system.[10] Franchises could be awarded otherwise if it appeared to the Commission that there were 'exceptional circumstances': cases where the quality of the service proposed by the preferred bidder was 'exceptionally high', or where it was 'substantially higher' than that proposed by the highest bidder. Threshold

[6] P. Klemperer, 'What really matters in auction design' (2002) 16 *J. of Economic Perspectives* 169.

[7] M. Elliott, 'Chasing the receding bus: The Broadcasting Act 1980' (1981) 44 *MLR* 683, 692. See further, A. Briggs and J. Spicer, *The Franchise Affair: Creating fortunes and failures in independent television* (Century, 1986).

[8] See Television Act 1954, ss. 3, 6. The discretion of the agency was largely confirmed in the Independent Broadcasting Authority Act 1973, and the Broadcasting Acts 1980 and 1981.

[9] N. Lewis, 'IBA programme contract awards' [1975] *PL* 317.

[10] M. Cave and P. Williamson, 'The reregulation of British broadcasting' in Bishop, Kay and Mayer, *The Regulatory Challenge* (Oxford University Press, 1995).

requirements relating to the sustainability of a service were imposed. Today, of course, the industry is different again. Plagued by diminishing market share, Channel 3 and Channel 5 are but one part of OFCOM's regulatory empire constituted under the Communications Act 2003. In 2004 the surviving companies' analogue licences were duly replaced by digital ones, with the agency setting the financial terms based on its own assessment of what each broadcaster would bid in a competitive tender.[11] Amid the plethora of TV channels domestic and foreign, the original ITA and IBA system appears nothing less than quaint.

Given both a valuable monopoly and a lack of automaticity in the auction process, it would be strange indeed if franchise allocations were not the subject of legal challenge. The courts have again taken a light-touch approach in the commercial context however. Take the allocation of Channel 3 licences under the Broadcasting Act 1990. Suggesting rather more exercise of discretion than Parliament had envisaged, only eight of the sixteen franchises went to the highest bidder, the rest being excluded at the threshold stage.[12] In *TSW Broadcasting Ltd*,[13] one of the unsuccessful companies complained of procedural unfairness, the argument being that staff advice to the Commissioners had presented an unfair and inaccurate assessment of its bid. Appreciative of the need for regulatory flexibility, and positively discouraging of future challenges, the House of Lords proved deferential. In Lord Templeman's words, 'judicial review should not be allowed to run riot. The practice of delving through documents and conversations and extracting a few sentences which enable a skilled advocate to produce doubt and confusion where none exists should not be repeated.' Another round of litigation followed the allocation of the Channel 5 franchise in 1995. In *Virgin Television*,[14] the company argued that the eventual winner, C5B, had unfairly been allowed to increase its shareholders' funding commitment in response to agency inquiries about sustainability at the threshold stage. Rejecting the complaint of no level playing field, the Court of Appeal held that the invitation to tender, while ruling out changes to a cash bid or to programme proposals, did allow the franchisor this measure of dialogue. Fairness should not mean treating the agency like a post box. Predictably, the parallel complaint that Virgin's own disqualification on quality grounds was *Wednesbury* unreasonable also failed:

> *Henry LJ:* Matters of judgment were entrusted to an expert body by Parliament. That body was also made responsible for finding the facts on which such judgment would be based, in circumstances where the level of quality threshold was to be set by the Commission

[11] OFCOM, *Conclusion of the Review of Channel 3 and Channel 5 Financial Terms* (2005).

[12] Cave and Williamson, 'The reregulation of British broadcasting'.

[13] *R v Independent Television Commission, ex p. TSW Broadcasting Ltd* [1996] EMLR 291.

[14] *R v Independent Television Commission, ex p. Virgin Television Ltd* [1996] EMLR 318.

> and no-one else. Of its nature such an exercise is . . . judgmental in character and, therefore, one upon which opinions may readily differ. Especially is this so within this area of decision-making where the exercise is not simply a quantitative exercise . . . but involves a qualitative analysis and judgment . . . It has to follow that a very heavy burden falls on the party seeking to upset a qualitative judgment of the nature described and arrived at by the qualified and experienced body which is the Commission.

First established under the Conservatives, the National Lottery is a classic example of monopoly public franchising. Reflecting different public interests in the regulation of gambling, the agency was given a substantial mix of responsibilities: secure all due propriety, protect the interests of participants, and maximise the amount of money available to good causes.[15] Today a full-blown regulatory commission (the National Lottery Commission (NLC)),[16] it was originally an Ofdog (the Office of the National Lottery (OFLOT)). Following the award in 1994 of the first franchise to Camelot (a powerful consortium of companies), the lottery rapidly became one of the largest in the world in terms of sales, some £5 billion annually.

How then in 1999 would the newly established NLC conduct the second franchise allocation (for 2001–8)? The founding statute typically gave maximum procedural discretion, allowing the agency to decide whether or not to hold a competition. NLC decided to do so, with a view to promoting innovation and achieving the best return for good causes. From this process a serious challenger to the incumbent emerged: 'The People's Lottery', a 'not-for-profit' organisation headed by business celebrity Richard Branson. Having reserved the power so to do in the Invitation to Apply (ITA), the Commission later aborted the process, saying that neither bidder met the necessary criteria. For TPL it was a problem of finance; in Camelot's case the integrity of a key supplier (GTECH) was in issue, although the Commission had previously appeared to accept the company's explanations. With time pressing and on the assumption that Camelot would not meet its concerns, NLC launched a new process of negotiations solely with TPL. The resulting case, *R v National Lottery Commission ex p. Camelot*,[17] stands for greater judicial supervision. Having embarked on a competitive process, NLC now found itself fixed with requirements of fairness accompanying that process, to the extent of a finding (as in recent legitimate-expectation cases – Chapter 5) of abuse of power.

> *Richards J:* I find it remarkable that . . . the Commission chose to allow TPL the opportunity to allay its concerns but to deny a similar opportunity to Camelot. Such a marked lack of even-handedness between the rival bidders calls for the most compelling justification,

[15] National Lottery Act 1993, s. 4; and see D. Miers, 'Regulation and the public interest: Commercial gambling and the National Lottery' (1996) 59 *MLR* 489.

[16] National Lottery Acts 1998 and 2006.

[17] [2001] EMLR 43.

> which I cannot find in the reasons advanced by the Commission . . . Fairness required that each bidder should have the *opportunity* to allay the Commission's concerns . . . The fact that the Commission had been completely silent about its continuing concern contributes to the unfairness of counting Camelot out . . . on the ground that it could not meet that concern within a month . . .
>
> One of the individual strands to Camelot's case is that it had a legitimate expectation of consultation before the Commission reached its decision on the way forward following the termination of the ITA procedure. In my view the conditions for a legitimate expectation . . . were not made out . . . There was no clear and unambiguous representation . . . On the other hand . . . the absence of consultation is an additional factor to be taken into account in assessing the overall position. Where the actual procedure decided on is very unfair to Camelot, as it is, the fact that it was decided on without giving Camelot any opportunity to make representations about it serves to increase the degree of unfairness overall.
>
> The Commission's decision to negotiate exclusively with TPL was, in all the circumstances, so unfair as to amount to an abuse of power . . . The Commission, while intending to be fair, has decided on a procedure that results in conspicuous unfairness to Camelot – such unfairness as to render the decision unlawful. That broad point is perhaps more important than the precise legal analysis . . . The ultimate question is whether something has gone wrong of a nature and degree which requires the intervention of the court. In my judgment it has.

The case ultimately led to a different regulatory outcome: following reconsideration by NLC, Camelot retained the franchise. Procedural lessons have been learned. For award of the current franchise (2009–18), NLC engaged in a lengthy rule-making process replete with consultation.[18] A set of 'hurdles' or required threshold standards, ranging from financial soundness to technology operation, was closely geared to its statutory responsibilities. The agency added a modification phase to the evaluation process, an express opportunity for dialogue aimed at securing the strongest bids possible. Specifically on the basis of greatest forecast returns to good causes, it was then a matter of choosing, and finalising arrangements with, the preferred bidder – in the event, Camelot.

(b) Going on: Franchise management

The prominence afforded the auction should not detract from important issues in the continuing franchise relationship. The legitimacy of sales procedure is undermined if subsequently there is insufficient emphasis on compliance. Take attempts by the franchisee to renegotiate terms. The spectre is raised of opportunistic behaviour and over-bidders aiming to recoup monopoly profits. Why should the state 'insure' against 'the winner's curse'? The issue is

[18] NLC, *A Lottery for the Future* (2005) and *Statement of Main Principles* (2005).

vividly illustrated by a gigantic auction: the sale in 2000 of licences for the next generation of mobile telephones.[19] Some 150 rounds of bidding later, the five licences collectively reached £22.5 billion: roughly 4,000 per cent higher than the minimum or 'reserve' price. Commercial euphoria having evaporated, the Treasury understandably showed little sympathy. These were proceeds on the 1980s privatisation scale.

There must be scope however for adaptation in the light of changed circumstances. Managing the franchise in part means managing the tensions associated with service specification: the need to elaborate and maintain a sufficiently precise description of the successful bidder's obligations, while allowing for flexibility and responsiveness to both public and private demands. This stage of the franchising process further highlights the interface with regulation. Such are the complexities of public services that the franchise, as a source of rules, will be incomplete; the franchisor has a degree of flexibility in the enforcement function. The agency, by monitoring and negotiation, is commonly involved in mandating aspects of the operation – precisely the kind of task familiarly associated with regulatory agencies (see Chapter 7).

The NLC exemplifies this aspect. Its Compliance Directorate is based inside Camelot's headquarters affording quick and easy access to systems and records. Ensuring the security of the operator's IT programme is a chief priority. A Licensing Directorate has the ultimate fire-watching role of vetting individuals and entities to ensure they are 'fit and proper'. It conducts evaluative studies, such as testing new games in light of the Commission's social regulation responsibilities (prevention of underage or excessive play). Flanking elements include approval of codes of practice, for example on advertising, and inspection of retail premises to check provision of information. Building on the financial and technical detail that Camelot must supply under its licence, a Performance Team seeks to mitigate the problem of no direct comparators through various information sources: players' complaints, opinion research, and market data. Legitimacy demands that the franchisor have a series of sanctions: 'the enforcement pyramid'. Breaches of licence are publicised via the Commission's annual reports and website. The 'sticks' include powers to give directions and extract financial penalties.[20] 'Franchising in the shadow of the law', NLC may apply to the High Court for an order requiring Camelot to remedy a licence breach. As well as the threat of non-renewal of franchise, NLC may, *in extremis*, have the licence revoked.[21] This watchdog has chosen to nibble, imposing fines, for example, for reporting and internal control-systems failures.[22]

[19] K. Binmore and P. Klemperer, 'The biggest auction ever: The sale of the British 3G Telecom licenses' 112 *Economic Journal* (2002) 74.

[20] National Lottery Act 1998, s. 2.

[21] National Lottery Act 1993, ss. 9–10.

[22] NLC, *Annual Report 2005–6*, p. 8

The franchisor may however be weakly placed to ensure compliance. Danger of loss of continuity of service can make the threat of 'the big stick' appear hollow. Much turns on substitutability: today in TV the 'blank screens' problem scarcely features; the same could not be said of the National Lottery. Refranchising is another major concern, since the advantages of incumbency are liable to undermine the competition.[23] Notwithstanding the agency's best efforts at a level playing field, is it so surprising to learn that Camelot had only one competitor for the current franchise and won on the basis that it would probably generate higher sales?[24] The further question is raised of the optimum length of the franchise term. While a short term is good for discipline, minimising incumbent advantage and emphasising instead competition and agency leverage, a long franchise minimises transaction costs and is apt to stimulate investment.

The style of franchise management is naturally informed by the general philosophy of the franchise system. In a one-to-one relationship with Camelot, and with a direct interest in its financial viability, NLC is determinedly collaborative. 'We will work with the operator to encourage it to continue to grow sales across every channel to ensure continued growth in returns to good causes.'[25] Showing the space for changed regulatory dynamics, a recent internal review sees 'better regulation' principles being read across. Hampton has cast its spell, prompting NLC to make good a surprising omission: the lack, hitherto, of a formally defined risk-assessment structure.

> Government established the remit of the regulator, who was free to determine the approach to and model of regulation. This needed to reflect the particular circumstances. . . when the National Lottery was launched . . . a newly established operator, inexperienced players and an inexperienced regulator . . . The key to . . . success . . . would be that it inspired confidence among players, and that its reputation would be unquestioned. The regulatory model was therefore designed to reflect the degree of risk that these circumstances posed. It was characterised by a detailed and prescriptive framework which was underpinned by the need for the operator to obtain consent or approval in advance of taking action . . .
>
> The Commission has sought to develop and evolve its approach to regulation by focusing on the objectives and outcomes of its decisions . . . In some commercial areas it has attempted to move away from the detailed control of inputs . . . For example, it has moved away from the licensing of individual games and now grants class licences. These allow the operator to launch certain types of games, within prescribed guidelines, without prior consent from the Commission . . .
>
> The Commission wishes to continue to move towards the regulation of outputs, and away from the detailed regulation of inputs, [adopting] controls which are proportionate

[23] O. Williamson, 'Franchise bidding for natural monopolies: In general and with respect to CATV' (1976) 7 *Bell J. of Economics* 73.
[24] NLC, *Statement of Reasons: Licence to run the National Lottery* (August 2007).
[25] NLC, *Annual Report 2005–6*, p. 8.

> to the outcomes it is seeking. It proposes to begin by identifying areas in which such an approach could be developed with the minimum of risk to the National Lottery and to players . . . It would expect to provide the operator with greater commercial freedom, but would seek to balance this with the application of firmer sanctions for non-compliance.[26]

Enough has been said to highlight the danger of 'franchisor capture'. NLC is notably keen to stress the various forms of oversight of agency activity, beginning with the NAO.[27] As Baldwin and Cave note, 'resort to a competitive allocative process should not be seen as a substitute for accountability and openness concerning the nature of the service to be offered or the steps taken to ensure delivery'.[28]

2. Overground

Britain's railways have in recent times been a chief test bed of the franchising technique. The development epitomises the close connection of contractual and regulatory forms of governance and the fact of mood swings in matters of institutional design and accountability. On show is a succession of elaborate 'contracting regimes' – contract as a major source of rules flanked or supported by individual regulatory mechanisms.[29] The twin themes of juridification and fragmentation in public service provision (see Chapter 2) are powerfully illustrated; there has been much vicissitude.

(a) Context and architecture

Nationalised by the Attlee government in 1948[30] but commonly starved of investment, from the 1960s to the 1990s Britain's railways experienced a slow decline. As a subsidy-ridden, highly unionised, natural monopoly, the industry was not an early candidate for Conservative policies of privatisation. Indeed, the fully integrated network that was British Rail (formerly British Railways) fell victim not to Margaret Thatcher but to John Major, under the Railways Act 1993. In familiar fashion, the White Paper claimed that by re-introducing competition and levering in private investment there would be greater efficiency and innovation, a higher quality of service and better VFM. After an initial boost, the level of subsidy would gradually reduce and ultimately be replaced

[26] NLC, *Review of Approach to Regulation* (2006), pp. 3, 7 –8.
[27] NLC, Memorandum to CC, *The Regulatory State: Ensuring its accountability*, HL 68-III (2003/4).
[28] Baldwin and Cave, *Franchising as a Tool of Government*, p. 283.
[29] M. Considine, 'Contract regimes and reflexive governance: Comparing employment service reforms in the United Kingdom, the Netherlands, New Zealand and Australia' (2000) 78 *Pub. Admin.* 613.
[30] In the then standard fashion of a state-owned corporation: see Transport Act 1947.

by net payments to the Treasury as franchised services turned to profit.[31] This was remarkably sanguine. BR had for some years been making substantial efficiency gains, such that the productivity of its workforce was among the highest of any European railway.[32] The scope for service improvement – or for cutting costs without jeopardising the public interest in both a safe network and a network that comprises an important part of the transport infrastructure – was correspondingly reduced.

Public ownership relies on an internal command structure for co-ordination and organisation; in contrast, in the words of a contemporary, 'the rail network has been privatised by lawyers, and it will be run on a regime dictated by legal documents'. The new service would be governed by 'possibly the most complicated contractual matrix ever drawn up'.[33] Characterised by a high degree of functional separation, both vertical and horizontal, as well as interdependency, rail privatisation thus involved a fundamental restructuring of the industry.[34] It was said that separate ownership of the infrastructure would encourage private-sector involvement in operations and ensure fair treatment between train operators wanting track access.[35]

Under the original scheme, the central player was Railtrack, a publicly listed company that owned and managed most of the operational infrastructure, including the track and signalling equipment. It granted access to passenger-train-operating companies (TOCs), the individual winners of twenty-five regional franchises. Railtrack was responsible for the timetable and the franchisees for running the trains and for day-to-day station operations. Other important players included rolling stock companies (ROSCOs), owners and lessors of trains to the operators; infrastructure service companies (ISCOs), responsible for maintenance; and freight companies. With various support companies and subcontractors, the system was divided into over a hundred separate legal entities.

Flanking the Department, which retained powers of direction and guidance, two new agencies were cast in the Conservative mould of small, personalised units: the Office of the Rail Regulator (ORR) and the Office of Passenger Rail Franchising (OPRAF).[36] As well as licensing the operators, overseeing the general operation of the railways, and enforcing competition law, ORR was tasked with periodic reviews of the level of access charges paid to Railtrack by the train operators.[37] OPRAF was made responsible for the entire franchise

[31] DfT, *New Opportunities for the Railways,* Cm. 2012 (1992) [1] [19–21].

[32] *Ibid.* [3]. See generally, T. Gourvish, *British Rail 1974 to 1997: From integration to privatisation* (Oxford University Press, 2002).

[33] J. Edwards, 'Big ticket' (1996) 6 *Legal Business* 22.

[34] R. Freeman and J. Shaw (eds), *All Change: British Rail privatisation* (Mcgraw-Hill, 2000); also, J. Shaw, *Competition, Regulation and the Privatisation of British Rail* (Ashgate, 2000).

[35] DfT, *New Opportunities for the Railways* [12].

[36] Railways Act 1993, s. 1.

[37] Railways Act 1993, ss. 4, 8: see J. Stittle, 'Regulatory control of the track access charges of Railtrack PLC' (2002) *Public Money and Management* 49.

process: tender, negotiation and award, monitoring and enforcement.[38] Its Franchising Director would commonly be disbursing significant amounts of taxpayers' money to the TOCs in the form of subsidy. Meanwhile, a third set of arrangements covered safety; while the mega HSE provided general supervision, Railtrack – notably wearing two hats – would take the lead role.[39] Could all this possibly add up to the efficient and effective service that the public required?

(b) 'Everything must go'

Expressive of the Conservatives' philosophy, and on the basis of a genuine commercial opportunity ripe for exploitation, the initial approach to rail-passenger franchising was modelled as a series of business disposals for a fixed term (typically seven years). Subject to a 'safety net' – obligations not to let services fall below specified base levels – managerial freedoms would be maximised. Ministers having accepted that most franchises would require some subsidy, the bid requesting least from the public purse was generally to be successful. Using a narrow financial conception of VFM, space on the network would thus be allocated to those showing the greatest appetite for business risk.[40]

Not that this appeared on the face of the statute, the provisions of which were typically skeletal. Take the core concept of a franchise agreement with the franchising director 'under which another party undertakes . . . to provide . . . throughout the franchise term those services for the carriage of passengers by railway to which the agreement relates'. There was broad discretion to determine content, both in relation to major specified items (operator payments/subsidies, 'the fares to be charged for travel') and otherwise ('subject to any [statutory] requirements a franchise agreement may contain any such provisions as the Franchising Director thinks fit').[41] Ministers could again steer through instructions and guidance.[42] Common themes in the 'blue rinsed' approach to state power were forthcoming – a light touch:

> In general the Franchising Director should ensure, within the resources available to him, that the franchise system provides good value for money, encourages competition in the railway industry and protects the interests of passengers . . . He should also leave maximum scope for the initiative of franchisees under franchise agreements imposing requirements no more burdensome than are required in his opinion to achieve his objectives . . . He should act so far as possible to enable franchisees to plan the future of their businesses with a reasonable degree of assurance.[43]

[38] Railways Act 1993, ss. 5, 23–31, 57–8.
[39] S. Hall, *Hidden Dangers: Railway safety in the era of privatisation* (Allan, 1999).
[40] NAO, *The Award of the First Three Passenger Rail Franchises,* HC 701 (1995/6).
[41] Railways Act 1993, ss. 23, 28–9.
[42] Railways Act 1993, s. 5.
[43] OPRAF, *Passenger Rail Industry Overview* (1996), p. 53.

Standard terms in the franchise agreement included incentive payments linked to quality of service; prices, for certain designated classes of ticket; and obligations on the franchisee to participate in inter-operator arrangements. OPRAF, however, was keen to prescribe only the basic parameters:

> It is the Franchising Director's policy that operators should retain a substantial degree of freedom in managing their businesses, protecting the availability, quality and safety standards of rail services. A vital part of the franchising strategy is that operators have opportunities to introduce extra services for which there is public demand. It is also part of the policy that high quality operation is more likely to result if there are fair rewards for the operators.[44]

Procedure was a subject of strong agency discretion. OPRAF was proactive, taking steps to generate competition and, following pre-qualification centred on finance and managerial competence,[45] to advise, clarify and negotiate bids. But there was disdain for process-values in the form of publicly articulated criteria and reasoned decisions.[46] The pre-qualification document was emphatic:

> You are invited to lodge an application to pre-qualify in respect of any one or more of the Passenger Services summarised in . . . this document . . . The Franchising Director will treat as confidential any information so designated by an applicant. [He] reserves the right to refuse pre-qualification and shall not be obliged to give any reason for such refusal . . . If you pre-qualify, you will be asked to sign a confidentiality agreement as a precondition to receiving an [invitation to tender]. The Franchising Director will evaluate tenders in accordance with criteria to be set out in the [Invitation to Tender] and associated information. [He] reserves the right not to accept a tender on the grounds of price or otherwise and without giving any reason for his decision.

A procedure in which not even the invitation to tender was published lacked legitimacy; whither taxpayers' money? Attention is drawn to the speed and scale of rail franchising – the political imperative to complete the task ahead of the 1997 general election. OPRAF's methods were notably rough and ready.

OPRAF did not go unchallenged in the courts. *Save Our Railways*[47] was a major piece of campaigning litigation sponsored by the unions. At issue were the minimum-required service levels in the first seven franchises offered by the Director. With the minister's approval, the agency had set most of these safety nets substantially below existing service levels, reasoning – in determinedly

[44] OPRAF, *Bulletin* (August 1995), p. 1.
[45] Railways Act 1993, s. 26(3).
[46] See OPRAF, *Annual Report 1995–1996*, pp. 8–13.
[47] *R v Director of Passenger Rail Franchising, ex p. Save Our Railways* (1995) Times, 18 December.

economic fashion – that either services would be sustained by demand or unwarranted subsidies for loss-making services avoided. But what, it was asked, of the hierarchy of rules (see Chapter 4)? Laid before Parliament, the relevant instruction stated: 'for the initial letting of franchises, your specification of minimum service levels . . . is to be based on that being provided by BR immediately prior to franchising':

> *Sir Thomas Bingham MR:* 'Based on' is not a term of art, and it is not an exact term. It permits some latitude. It is obvious that every train timetabled by BR need not continue to run. There may be changes, and within limits it is for the Franchising Director to rule on the extent of the changes. His is the primary judgment. But there is a limit to the changes which may be made without ceasing to comply with the instruction . . . The changes must in our view be marginal, not significant or substantial . . . The Franchising Director's approach . . . is an intelligible and no way irrational approach. But it is not in our view an approach which gives effect to the instruction.

The procedural values of lawyers had clashed with the policy judgements of government.[48] The pressure group hoped that specifications would be amended to meet the instructions; the minister, however, preferred 'to clarify' the rules 'to ensure that they reflect beyond doubt the policy that we have always followed'.[49] Save Our Railways won the case but lost the campaign.

In arranging for franchise management, the architects had to confront the weakness of a purely contractual approach (damages 'inefficacious because the principal losses are incurred by consumers, not the franchisor'[50]). Showing the flexibility of statute-based franchising technique, the way round lay in a specially designed public contract grounding additional remedies. A franchise agreement would include such terms as customer compensation, a performance bond and termination for serious default. The Franchising Director was under a duty to act to prevent or rectify any breach of the agreement, if necessary by means of statutory order and financial penalty.[51] OPRAF's own approach to implementation was naturally informed by the general philosophy of the franchise system. Geared to negotiated compliance, not strict enforcement, the preference for a light-touch, even quiescent, role was clearly signalled:[52]

> The Franchising Director intends to develop a constructive and collaborative relationship with each franchise operator. [He] intends to found this relationship on the following general principles:

48 This is reminiscent of *Laker Airways v Department of Trade* [1977] QB 643.
49 HC Deb. vol. 268, col. 1238.
50 A. Ogus, *Regulation: Legal form and economic theory* (Clarendon Press, 1993), p. 332.
51 Railways Act 1993, ss. 57–8.
52 OPRAF, *Passenger Rail Industry Overview* (1996), p. 101.

- to manage the achievement of his objectives, not the activities of the operator;
- to require the operator to provide information only if this is required in relation to one of [his] objectives; and
- to minimise the burden placed on the operator.

(c) A few years later

OPRAF scarcely had time to engage in franchise management before being abolished by the incoming New Labour government. The reform was part of a determinedly 'third way' approach to the railways beyond, in Tony Blair's words, 'the sterile debate between wholesale privatisation and old-style state control'.[53] The Transport Act 2000 established a major new arm's-length agency, the Strategic Rail Authority (SRA). It was meant to cure the hole in the heart of contractual governance on the railways: the lack of industry leadership and thus of a clear, coherent, programme of future development.[54] Far from the contract theorist's ideal of a collaborative and dynamic approach to problem solving premised on mutual interest, ministers were having to respond to the day-to-day realities of 'conflicting priorities and . . . relationships at the front-line [which] have too often been adversarial'.[55] The relational qualities of trust and co-operation, we are reminded, cannot be created by fiat.[56]

But was this papering over cracks in the original construction? Paradoxically, part of the difficulty arose from an increasingly overcrowded network: the industry had now entered on a period of sustained traffic growth.[57] As well as subsuming OPRAF's functions, SRA was tasked, subject to ministerial powers of direction and guidance, with keeping network capacity under review, identifying investment needs, and promoting integration with other modes of transport.[58] Relations with the government rapidly soured; the SRA chairman complained that 'almost every breath we draw has to be cleared by Ministers'.[59] Replicating the sense of a cluttered regulatory space, the new agency was also working alongside ORR, now re-launched as a regulatory commission (the 'Office of Rail Regulation').[60] Soon the wider picture was of a rail industry in crisis. Highlighting poor

[53] Quoted in R. Jupe, 'Public (interest) or private (gain)? The curious case of Network Rail's status' (2007) 34 *JLS* 244, 252.

[54] DETR, *A New Deal for Transport: Better for everyone*, Cm. 3950 (1998); *Transport 2010: The 10 year plan* (July 2000).

[55] *The Future of Rail: White Paper*, Cm. 6233 (2004), p. 16.

[56] A theme elaborated here by T. Prosser, 'The privatisation of British Railways: Regulatory failure or legal failure?' (2004) 57 *CLP* (2004) 213.

[57] Producing over one billion passenger journeys each year: see Transport Committee, *Passenger Rail Franchising: Government response*, HC 265 (2006/7).

[58] Transport Act 2000, ss. 201–22.

[59] Transport, Local Government and the Regions Committee, *Passenger Rail Franchising and the Future of Railway Infrastructure*, HC239 (2001/2) [30].

[60] Railways and Transport Safety Act 2003, ss. 15–16.

maintenance of the track and signalling systems, a series of fatal accidents[61] led to speed restrictions across the network, a period of major disruption. Unable to meet the huge costs of new investment, Railtrack was forced into administration by ministers[62] and subsequently replaced with Network Rail, a 'not-for-dividend' company initially supported through, and made accountable to, the SRA.[63]

Defects in the franchising model became increasingly apparent in this difficult business environment. Indicative of a lack of realism in the original price-bidding system, many TOCs demanded additional subsidy in the face of escalating costs.[64] Absent strong provisions on quality standards, as also a lack of incentive for those TOCs on short-term franchises, service performance and the overall reliability of passenger trains worsened; nor, since the contracts were based on historic levels of performance, was there much scope for regulating for improvement.[65] A major complicating factor was interdependency or the blurring of responsibility. While TOCs routinely blamed track and signalling problems for service deficiencies, the network provider pointed to breakdowns of trains and shortages of drivers. Another element in the huge contractual matrix, and originally designed to encourage efficiency, an internal industry system of compensation provisions was now a vehicle for the circulation of millions of pounds.

The touchstone is agency enforcement, or rather the lack of it. Early efforts exposed the functional limitations of fines: large penalties on monopoly service providers struggling with costs were seen as counter-productive. Subtle techniques of restorative justice – new contractual commitments perhaps in recompense for misdemeanors – did not always fit the message of passenger representations.[66] SRA soon faced the classic problem of the failing franchise. Should public money be poured in, so making a mockery of the original auction process, or should the arrangement be terminated, with possible disruption for the travelling public? Doing both saw the agency castigated by the Treasury Committee:

> In our view, the essence of private sector involvement is that the private sectors pays if it gets its sums wrong. It is outrageous that such astonishingly large sums of taxpayers' money have been used to prop up palpably failing businesses such as £58 million in the case of Connex. While we accept that failures in the initial franchise process may have been

[61] See especially, Lord Cullen, *The Ladbroke Grove Rail Enquiry Report* (2001).

[62] Marked by an unsuccessful tort action by shareholders: *Weir v Transport Secretary* [2005] EWHC 2192 (Ch).

[63] L. Whitehouse, '"Railtrack is dead – long live Network Rail?" Nationalisation under the Third Way' (2003) 30 *JLS* 217

[64] SRA, *Franchising Policy Statement* (2002), pp. 5–6.

[65] R. Gladding, 'Rail regulation in the UK: The role of quality in the passenger rail franchises' (2004) 14 *Utilities Law Rev*. 151.

[66] OPRAF, *News Releases*, 14 March 1997.

> to blame originally, we cannot understand why action was not taken earlier by the SRA. As a result of this failure to monitor Connex properly the SRA bailed out a company using taxpayers' money only to strip it of its franchise a short time later. The SRA's management of this franchise has been woefully poor.[67]

With the first round of franchises drawing to a close, the SRA in 2002 signalled a new form of partnership, with the TOCs focused on delivering reliable performance, meeting passenger needs and containing short- and long-term costs. In a division of labour reminiscent of NSAs (see p. 63 above), agency discretion would thus expand at the expense of managerial autonomy. The talk now was of an expanded role for contract as a source of rules and of a more robust approach premised on a 'smart' regulatory mix of sticks and carrots:

> The SRA is firmly of the view that it should specify service levels and quality standards and the private sector should be charged with delivery. This is the essence of a successful relationship between the public and private sectors . . .
>
> The SRA sees the new Franchise Agreement as a contract with a more precise specification of the franchise proposition in terms of the service to be run, the performance standards to be met, and the rewards for achievement. The agreement will clearly identify the criteria and rewards for a successful franchise. However, it will also effectively penalise poor performance with a set of known financial and other consequences, including the real possibility of terminating an underperforming franchise.[68]

(d) A few years more

The SRA scarcely had time to make a difference before it too was abolished in a development that crystallises concerns about the broad trends of agencification and fragmentation. Reporting in 2004, the Transport Committee drew attention to 'a serious mismatch between the SRA's objectives, powers and responsibilities'.[69] How could the agency be 'strategic' when it had 'no control over the infrastructure which largely determines overall rail performance'? 'Back to government' – ministers duly performed a U-turn:

> When the SRA was conceived and legislation first introduced into Parliament, the scale of the industry's problems was not yet apparent, and a leadership model based on influence and persuasion seemed appropriate. In the light of changing circumstances . . . this has proved not to be the case . . . Without more direct powers the SRA has found itself in an increasingly difficult position. It cannot act as an industry leader, because it is positioned outside the industry in the public sector . . .

[67] Transport Committee, *The Future of the Railway*, HC 145 (2003/4) [122].
[68] SRA, *Franchising Policy Statement*, p. 9.
[69] Transport Committee, *The Future of the Railway*, p. 7.

> It must be for Ministers, accountable to Parliament and the electorate, to set the national strategy for the railways, but in the current industry structure this is not the case. Under the new arrangements, the Government will set the level of public expenditure, and take the strategic decisions on what this should buy.[70]

Flanking developments underwrite the themes of consolidation and rationalisation in a major illustration of re-regulation. ORR is today the sole industry regulator, combining arm's-length calculations of the revenue needed by Network Rail to meet the Government's objectives[71] with additional responsibilities for consumer protection and railway safety. Network Rail is directly responsible for ensuring that the network delivers a reliable service: a government statement of 'reasonable requirements', which ORR is under a duty to enforce, is incorporated in the company's licence.[72] In-house maintenance is the preferred model: less formal contract, more British Rail-type understanding of the infrastructure; and the Department has direct control of the TOCs' franchising process.[73]

The 'new, new' approach to franchise allocation currently on offer emphasises reliability and is noticeably more risk-averse. The Department wants to pre-qualify at the threshold stage:

> those who can be expected to submit attractive, competitive and realistic bids, and who will then be capable of delivering a high-quality service at the price which they have offered. To achieve this, the accreditation questionnaire invites applicants to provide evidence of their competence and experience, which the Department will assess. For assessing the responses the Department uses pre-determined scoring systems, as follows:
>
> - approximately 50-70% of the total score available is awarded for demonstrating a proven track record of service delivery and financial management in relevant areas of activity (which may not necessarily be within the UK) . . .
> - 30-50% of the score is awarded for demonstrating appropriate resources for bidding, the ability to manage mobilisation issues and the quality of outline plans for the development and management of the Franchise . . .
>
> In its scoring, the Department will assess and weight any past failure to deliver on contractual commitments on price and quality in a UK rail franchise, whether it arises from over-optimistic bidding or from poor management.[74]

[70] *The Future of Rail : White paper*, pp. 6, 33; Railways Act 2005; and see P. Leyland, 'Back to government? Re-regulating British Railways' (2005) 12 *Indiana J. of Global Legal Studies* 435.

[71] The High Level Output Specification (HLOS) for the improvements in safety, reliability and capacity that ministers intend to buy is contained in the White Paper, *Delivering a Sustainable Railway*, Cm. 7176 (2007).

[72] *The Future of Rail: White paper*, pp. 45–7.

[73] Allowing for closer alignment with Network Rail's regional structure, the number of franchises is also reduced.

[74] DfT, *Guide to the Railway Franchise Procurement Process* (2008), p.2.

The system is clearly weighted in favour of repeat players, while imposing a discipline of continuous assessment. The obvious danger is failure to realise the benefits of a competition.[75] Again:

> The Department will undertake a risk-assessment of the bidder's delivery plans. This will ask three key questions. What is the risk of failure? Are the potential adverse impacts of failure limited to the financial position of the bidder, or could they impact on the taxpayer and the travelling public? Would the failure be one that would emerge progressively, giving the bidder and the Department time to take corrective action, or could it emerge very abruptly?
>
> In the light of this assessment, the Department will have to exercise its judgement in deciding whether the risks associated with accepting a bid which superficially offers the best proposition on price and reliability are so great that it justifies preferring another bid.[76]

How far we have since travelled from the laissez-faire days of OPRAF! The Department speaks of wielding 'the big stick':

> OPRAF and the SRA have in the past rescued failing franchises, rather than putting in an *operator of last resort* (OOLR) and then re-letting the franchise. The Department will not follow that precedent. Such rescues may have been justified in a relatively immature market where there was only limited experience of commercial passenger-service operation for bidders to draw on, and only limited evidence on which they could base revenue and cost forecasts. Given a more mature market, franchisees must build resilience into both their operational and financial plans to deal with the changes in the economic environment to which a passenger rail operation may be subject. Revenue-risk sharing mechanisms have been built into new franchise contracts, which cushion franchisees against a major downturn in revenue due to circumstances beyond their control (in return for a share for the Department of the potential upside), together with *force majeure* provisions.[77]

There is greater openness. As well as sponsoring lengthy 'stakeholder' consultations on franchise specification,[78] the Department has established a public register of franchise agreements, with information on each operator's contractual commitments. 'Both passengers and taxpayers', it is solemnly declared, 'are entitled to know what has been purchased on their behalf'. Nevertheless, much in this system of contractual governance remains shrouded in mystery:

[75] Especially in view of major concentration of ownership in the sector: Transport Committee, *Passenger Rail Franchising*, HC 1354 (2005/6), pp. 26–7.

[76] DfT, *Guide to the Railway Franchise Procurement Process*, p. 4. See further, NAO, *Letting Rail Franchises 2005-2007*, HC 1047 (2007/8).

[77] *Ibid*., pp. 5–6; and see for practical illustration, the demise of the GNER franchise: DfT press release, 15 December 2006.

[78] If not always to the satisfaction of consumer groups: Transport Committee, *Passenger Rail Franchising*, pp. 12–17.

> The Department also regards commercial confidentiality as essential. It cannot secure the best deal for passengers and taxpayers unless it can operate a commercially confidential procurement procedure. The Department will not, therefore, release any information on unsuccessful bids, because doing so could result in lower VFM in subsequent franchising rounds. Nor will the Department release information which allows a comparison to be made between the winning bid and the second-placed and other bids as this could have market consequences for the winning bidder. Access to bid information is very tightly restricted within the Department. Likewise, the Department insists that bidders do not discuss with anyone the details of their bid or their discussions with the Department.[79]

Nor should it be assumed that 'back to government' means direct ministerial responsibility on the classical Westminster model:

> Ministers do not wish or need to be involved in the procurement commercial decisions, including the pre-qualification of bidders, the award of contracts, or the management and termination of contracts. These will be handled on their behalf by officials. Within the Department a designated committee of senior officials, the Contract Award Committee (CAC), take the decisions on selecting those suppliers who are invited to tender, and subsequently, the winning bid. During this process the names of bidders are anonymised, i.e. the members of the CAC do not know the identities of the bidders whose scores and risk-assessments are presented . . . Contract-signature occurs the day before the award is announced to the financial markets and to Parliament. It is only at the contract signature stage that the identity of the winning bidder is disclosed to Ministers and senior officials.[80]

How convenient!

(e) A new golden age?

A report on franchising from the Transport Committee in 2006 shows MPs far from convinced that government policy was finally on the right track:

> Our inquiry exposed fundamental tensions at the very heart of the Government's model. The Government has embraced the notion that private enterprise is best at delivering high-quality, innovative services such as the passenger railways, and yet it does not trust companies to deliver these services without highly detailed and specific contractual requirements which reduce the scope for innovation . . . It wants risk to be transferred from the public to the private sector, and yet risk cannot be transferred in anything other than name because, as everyone knows, no Government could afford to let the railways go bust. The Government hails the growth in passenger patronage, and yet it does not provide the long-term strategy and investment to increase capacity on the network. It wants coordination and yet continues to operate a system of fragmentation. Finally, the Government wants

[79] DfT, *Guide to the Railway Franchise Procurement Process*, p. 7.
[80] *Ibid*., pp. 6–7.

> the private sector to invest, take risks and innovate, and yet it prioritises price above all of these. There is scant evidence that the current model balances and optimises the benefits from conflicting priorities. It looks more like a muddle that provides little more than a complex, costly and mediocre means of maintaining the status quo.[81]

Not before time the Department was developing a long-term strategy, revealed in the 2007 White Paper *Delivering a Sustainable Railway*. The industry, it was said, had 'turned a corner'.[82] Huge new tranches of public investment in the network were signalled, together with a raft of quality improvements by the TOCs, financed by additional customer revenues. As against managing decline, with which this story of the railway began, ministers now reckoned on a utility that:[83]

- could handle double today's level of freight and passenger traffic
- would be even safer, more reliable and more efficient
- would deliver a substantially reduced carbon footprint
- could cater for a more diverse, affluent and demanding population.

In light of the current economic downturn, this golden age of rail may be some way off!

3. Loads of money: PPP and PFI

A key component of Treasury strategy for the delivery of modern, high-quality public services, and for advancing UK competitiveness, public–private partnerships[84] epitomise the idea of contractual governance. While PPPs cover a broad range of business structures and partnership arrangements,[85] from outsourcing to joint ventures and the sale of equity shares in state-owned business, the principal vehicle is PFI, the Private Finance Initiative. As a way of delivering major capital investment, PFI represents both an alternative to and, since the public sector is not generally the owner and operator of the assets, a transformation beyond the traditional paradigm of government contract. PFI differs from other forms of PPP in that the private contractor not only carries out the project but also arranges finance.

PFI has spawned various sub-species. The common type is 'DBFO', where the private sector designs, builds, finances and operates facilities such that services are 'sold' to the public authority via a unitary charge. Basing the level of payment on the performance of the firm against agreed standards of service or 'output' specifications provides an incentivising element. Then there is

[81] Transport Committee, *Passenger Rail Franchising*, p. 7.

[82] *Delivering a Sustainable Railway*, Cm. 7176 (2007), p. 15.

[83] *Ibid*., p. 7. See also, Transport Committee, *Delivering a Sustainable Railway: A 30-year strategy for the railways?* HC 219 (2007/8).

[84] HM Treasury, *Public Private Partnerships: The government's approach* (2000).

[85] C. Donnelly, *Delegation of Governmental Power to Private Parties: A comparative perspective* (Oxford University Press, 2007).

'DBF', where the public sector does not own the asset, such as a hospital or school, but rather 'rents' it over the term of the contract. Different again, and with old antecedents in toll roads, are financially free-standing projects, where the private-sector supplier recovers costs through direct charges on individual users. Public-sector involvement is limited to assistance with planning, licensing and other enabling procedures. Alternatively, what are often called 'concession contracts' may involve an element of public subsidy; a contribution perhaps to asset development designed to ensure the viability of the project.

New Labour ministers have not been afraid to experiment. An initial policy document in 1997 spoke of new models emerging 'as the Government looks to encourage PPPs, accelerate the flow of good projects and encourage investment'.[86] A major policy review of PFI in 2003 confirmed that ministers would 'investigate potential new areas . . . such as . . . prisons estate, urban regeneration, waste management . . . and social housing'.[87] In another review in 2006 the Government highlighted its commitment 'to developing procurement vehicles . . . through PFI in alternative ways'.[88] A further review in 2008 signposted a chief role for 'innovative procurement approaches . . . in addressing the complex infrastructure investment challenges ahead'.[89] This extends to the so-called 'integrator model', which sees the public body appointing a private partner to manage a PFI process. The general policy has in fact been pursued with an almost religious fervour: to the extent in early 2009 of committing several billion pounds in government loans to shore up PFI projects amid the credit crunch.[90]

(a) Rationale

The standard rationale is VFM; achieved through private-sector innovation and management skills delivering significant performance improvement and efficiency savings.[91] To this end, the Treasury aims to specify the appropriate conditions for PFI (as against a public sector scheme or traditional procurement process):

- there is a major capital investment programme, requiring effective management of risks associated with construction and delivery
- the private sector has the expertise to deliver
- the structure of the service is appropriate, allowing the public sector to define its needs as service outputs that can be adequately contracted for in a way that ensures effective,

[86] HM Treasury, *Partnerships for Prosperity: Private finance initiative* (1997), p. 2.
[87] HM Treasury, *PFI: Meeting the investment challenge* (2003), p. 11.
[88] HM Treasury, *PFI: Strengthening long-term partnerships* (2006), p. 27.
[89] HM Treasury, *Infrastructure Procurement: Delivering long-term value* (2008), p. 11. As for the attraction of foreign capital (via a role for the state in creating markets for private investment), see *ibid.*, Ch. 3
[90] HC Deb. vol. 488, col. 47 WS.
[91] As for the attraction of foreign capital (via a role for the state in creating markets for private investment), see *ibid.*, Ch. 3.

> equitable and accountable delivery of public services in the long term, and where risk allocation between public and private sectors can be clearly made and enforced
> - the nature of the assets and services identified as part of the PFI scheme are capable of being costed on a whole-life, long-term basis
> - the value of the project is sufficiently large to ensure that procurement costs are not disproportionate
> - the technology and other aspects of the sector are stable, and not susceptible to fast-paced change
> - planning horizons are long-term, with assets intended to be used over long periods into the future
> - robust incentives on the private sector to perform can be set up.[92]

PFI and complex IT, for example, is not a clever mix; a bitter experience of burgeoning cost and interminable delay[93] underscores the need of public authorities for more short-term flexibility due to fast changing service requirements. The Treasury considers that for 'small' investment – projects of less than £20 million in capital value – the VFM benefits are unlikely to outweigh the very considerable start-up costs in PFI of bidding and borrowing. The third condition clearly indicates not only the policy sensitivities but also the limitations of contractual technique in front-line service delivery (see Chapter 8).

Appropriate sharing of risk is the key to ensuring that the VFM benefits are realised. Indeed the Treasury speaks of successful PFI arrangements achieving 'an optimal apportionment' of risk between the public and private sectors.[94] The basic contours of the deal are thrown into sharp relief:

> The benefits of PFI flow from ensuring that the many different types of risks inherent in a major investment programme are borne by the party best placed to manage those risks . . . The Government does not seek to transfer risks to the private sector in a PFI project as an end in itself. Where risks are transferred, it is to create the correct disciplines and incentives on the private sector, which then drive value for money through more effective risk management. In general, the Government underwrites the continuity of public services, and the availability of the assets essential to their delivery, but the private sector contractor is responsible for its ability to meet the service requirements it has signed up to. Where it proves unable to do so, there are a number of safeguards in place for the public sector to ensure the smooth delivery of public services, but the contractor is at risk to the full value of the debt and equity in the project. The full value of that debt incurred by the project, and the equity provided by contractors and third parties, is the cap on the risk assumed by the private sector.[95]

Transferred risks will typically include meeting required standards of delivery, cost-overrun risk during construction, timely completion of the facility (no

[92] HM Treasury, *PFI: Strengthening long-term partnerships*, p. 32.
[93] See e.g. PAC, *Department of Health: The national programme for IT in the NHS*, HC 390 (2006/7).
[94] HM Treasury, *Meeting the investment challenge*, p. 35.
[95] HM Treasury, *PFI*: *Strengthening long-term partnerships*, p. 38.

payments until available), latent defects, and industrial action. Certain market risks associated with the scheme may also be included; for example, in some road schemes, those associated with volume and type of traffic. Conversely, as well as general inflation, the Treasury anticipates the retention of risks directly associated with public law values of flexibility and responsiveness. 'Whether the service specified in the contract is required and adequate to meet the public demand and expectations' may admit of no easy assessment; likewise, 'the possibility of a change in public sector requirements in the future' is hardly remote in elongated PFI-type arrangements.[96] Contract technology such as variation machinery designed to mitigate these risks is at a premium.

This is only half the story. With most PFIs, the risks transferred to the private sector will be reallocated, using a central consortium company and subcontracts; highly intricate forms of debt financing and re-financing are commonly involved.[97] From the standpoint of the administrative lawyer there are significant issues here of openness and accountability. The public authority which engaging in PFI does not look to the robustness of the private framework is foolish.

For a Labour Chancellor concerned, on the one hand, to make good years of underinvestment in public-service infrastructure and, on the other hand, to (be seen to) maintain a tough fiscal stance, PFI-type arrangements have also proved highly convenient in terms of government accounting. A form of 'off balance sheet' financing, the capital expenditure or resultant debt may not score as public expenditure. Since today's large-scale investment programme becomes tomorrow's current spending, associated tax increases can be postponed. Meanwhile, other capital projects not suitable for PFI can be prioritised, using the Government's own resources or power of dominium. Like all mortgages this comes at a cost: to be borne by future taxpayers and service users. It should also be recalled that direct government borrowing, backed by tax revenues, and so virtually risk-free, is a cheap way of raising funds. So PFI-type arrangements do not provide public authorities with a cheaper source of finance, but rather with another potential source of funding, generally at a higher capital cost than traditional procurement. No wonder the Treasury has been concerned to stress the VFM benefits derived from risk transfers.

(b) Scale

The figures provide graphic illustration. Following a slow start under the Conservatives, between 1997 and 2007 at least fifty PFI deals have been signed each year. By the end of 2008, the total capital value of PFI contracts was some £66 billion. Estimated to 2031–2, future revenue payments arising under them

[96] *Ibid.*, pp. 39–40.

[97] D. Asenova and M. Beck, 'The UK financial sector and risk management in PFI projects' 23 *Public Money and Management* (2003) 195; and see PAC, *Update on PFI Debt Refinancing and the PFI Equity Market*, HC 158 (2006/7).

Table 9.1 Largest UK PPP/PFI contracts 1987–2006

Project	Government Department	Year Signed	£m*
London Underground	Transport	2002	16,179
Channel Tunnel Rail Link	Transport	1996	4,178
Aldershot Garrison (rebuild)	Defence	2006	1,800
Barts & London NHS (hospital redevelopment)	Health	2006	1,100
National Air Traffic Control	Transport	2001	800
Skynet 5 (satellite communications)	Defence	2003	750
Future C Vehicles (construction/mechanical equipment)	Defence	2005	600
Birmingham NHS (hospital)	Health	2006	560
Colchester Garrison	Defence	2006	539
Highways Agency (integrated digital services)	Transport	2005	490
M6 toll road	Transport	2000	485

*Capital value of signed deals

amounted to £180 billion. Meanwhile, projects valued at £13 billion were in the pipeline. Overall, PFI-type arrangements have accounted for 10–15 per cent of public-sector capital investment in the UK under New Labour.[98] Although other countries, especially in Europe, have been turning to PPP, there is little on the scale of British practice.[99] Some of the projects are gargantuan.

(c) Behind the scenes

The policy implementation demonstrates the great importance of the inherent – discretionary – powers of government.[100] PFI has been pressed forwards using a combination of Treasury 'sticks and carrots', policy guidance and information, and standardised 'contract technology', and through dedicated networks.

Crystallised in the so-called 'Ryrie rules',[101] a cautious attitude to private-finance contracting prevailed in the early years of the Thatcher government.

98 *Public Private Finance Yearbook* (Centaur Media, 2008).

99 See D. McKenzie, *PFI in the UK and PP in Europe* (International Financial Services, 2009).

100 Public procurement being a devolved responsibility, PFI also illustrates how Treasury discretion is today more confined to England. The Welsh Assembly government for example has been noticeably reticent: Welsh Labour/Plaid Cymru, *One Wales* (2007), Ch. 3.

101 See Treasury Committee, *The Private Finance Initiative*, HC 146 (1995/6).

According to this piece of Treasury orthodoxy, investors should not be offered significantly more security than that available on private-sector projects; efficiency gains should be clearly commensurate with the commercial cost of raising risk capital. Such investment should be additional to, and not substitute for, the investment otherwise made through government borrowing to discharge core responsibilities. But as enthusiasm for private-sector involvement took hold, the Ryrie rules were progressively relaxed until by 1993 this classic piece of soft law was officially 'retired'. As new Treasury guidance put it ever so delicately, 'the Government has now made clear that it wants deals, not rules'.[102]

New Labour's step-change involved an immediate revamp of administrative practice and procedure.[103] Much effort went into streamlining; for example, Treasury certification of commercial viability could now be provided ahead of the detailed negotiations at the procurement stage. Internal incentives were developed; PFI investments, the Treasury explained, might now be treated as an addition to departmental budgets rather than being counted against them. To deal with the problem of many local PFI projects not being viable without additional revenue support, machinery for applications by local authorities for 'PFI credits' was elaborated.[104] In what Freedland termed 'the transition from regulatory control to positive-policy-driven regulation',[105] contractual governance thus took on, in paradoxical fashion, a determinedly green light hue.[106]

Techniques of contractual governance themselves generate new administrative structures. A burgeoning support and approvals infrastructure exists for PFI, again orchestrated by the Treasury. The OGC provides general supervision and modelling of VFM. Networking with individual procuring authorities, Private Finance Units are responsible for implementation at departmental level. Testing the deliverability of projects prior to the formal procurement process is the task of an interdepartmental Project Review Group. Reflecting the changed focus as capital assets come on stream, a PFI Operational Taskforce was recently established to tackle key relational issues such as managing variations, 'contractor distress' and refinancing.[107]

PFI is a land fit for advisers and consultants. The Public Private Partnership Programme ('4ps') is a key player. Established in 1996 by the local government associations, the company is self-described as a delivery specialist. As

[102] HM Treasury, *The Private Finance Initiative: Breaking new ground* (1993), p. 7. See also, HM Treasury Private Finance Panel, *Private Opportunity, Public Benefit: Progressing the public finance initiative* (1995).

[103] HM Treasury, *Partnerships for Prosperity*.

[104] DETR, *Local Government and the Private Finance Initiative* (1998).

[105] M. Freedland, 'Public law and private finance: Placing the private finance initiative in a public law frame' [1998] *PL* 288, 302–3.

[106] Not least in the health service, where corporatisation has gone hand in hand with acute local political sensitivity: see NHS Executive, *Public Private Partnerships in the National Health Service: The private finance initiative* (2007).

[107] HM Treasury, *PFI: Strengthening long-term partnerships*, p. 79.

well as training and skills development, it offers hands-on project support to local authorities in priority sectors like school building. Epitomised at central-government level by Partnerships UK, which is itself a PPP, there are strong elements of latter-day corporatism. Described as having 'a unique public-sector mission', PUK brings together senior officials and lieutenants of industry, operating as a PFI developer in partnership with procuring authorities.

The lawyers have contributed standard terms and conditions. Stated aims are to foster a common understanding of the main risks, to engender consistency of approach across a range of similar projects, and to reduce the time and cost of negotiation.[108] But the role of such 'virtual' legal material in underpinning Treasury control and audit should not be underrated. Several hundred pages long, and repeatedly modified, the model form and guidance also demonstrates the great complexity of PFI-type arrangements. Fitting the familiar paradigm of large-scale commercial contracting, there are sheaves of detail on issues such as commencement and duration, service availability and maintenance, delay and dispute resolution. Some much worked-over provisions on management and monitoring of payments, on price variation and early termination, and on final ownership of the capital asset, illustrate the particular concern in PFI with risk sharing.

Take a familiar flashpoint: the question of 'fettering' (see p. 217 above):

> It is important that, in entering into any Contract, a local authority is not fettering itself in the performance of its normal public duties . . . Equally however, the Contractor will want to know that if the Authority expressly agrees to do something in the Contract and fails to do it, then (without seeking to fetter the local authority . . .) the Contractor should enjoy his contractual rights and remedies. . . The obligations of the Authority in any Contract should be limited (normally being confined to payment and perhaps some access and co-operation provisions) and clearly stated in any event. If there is any doubt around the relationship of any of these provisions with any statutory duty, the position should be clarified in the Contract. On any local authority project the Authority should always ensure that it does not undertake any obligations in the Contract which could conflict with its statutory duties and powers . . .[109]

The 'required drafting' on 'authority step-in', where the public body takes over some or all of the contractor's obligations for a period, mimics much in regulation:

> If the Authority reasonably believes that it needs to take action in connection with the Service:
>
> (i) because a serious risk exists to the health or safety of persons or property or to the environment; and/or

[108] HM Treasury, *Standardisation of PFI Contracts*, 4th edn (2007) [1.2.1].
[109] *Ibid.* [1.4.5].

> (ii) to discharge a statutory duty,
> then the Authority shall be entitled to take action . . .
>
> Following service of . . . notice, the Authority shall take such action . . . as it reasonably believes is necessary . . . and the Contractor shall give all reasonable assistance to the Authority . . . Where the Authority steps-in upon Contractor breach, the Authority should continue to pay the Contractor as where there is no breach . . . The Authority should, however, be entitled to set off any costs it incurs.[110]

Taking the example of improvements to social housing, a priority area of PFI activity, Figure 9.1 sketches the many stages in a project process. It highlights the close interplay of central and local government through the machinery of planning and approval of PFI credits. Looking forwards, the Treasury sees the need for public bodies to do more 'front-end' work in PFI, engaging and informing the market and developing 'robust project governance'.[111] 'A sound outline business case', explains 4ps, 'will document a systematic approach to analysing the current service, setting out the evaluation criteria, examining the different project and procurement options, identifying the best value solution, and considering key implementation issues'.[112] Paper must again be piled on paper.

(d) Major concerns: Fine-tuning

That PFI has proved controversial is an understatement. As well as 'disguised form of privatisation',[113] the litany of complaint includes:[114]

- Government becomes overly vulnerable to the vagaries of the market; some PFI contracts produce 'mega-profits' at the taxpayers' expense.
- Many PFI contracts fail to provide 'real' risk transfer from the public to the private sectors; whatever the contract may say, with essential services the public sector remains the guarantor of last resort.
- Limited pool of willing and able PFI contractors undermines competitive discipline.
- Elongated, multifaceted and large-scale PFI arrangements are peculiarly susceptible to contractor failure, a source both of service disruption and further public expense.

[110] *Ibid.* [29.2] [29.4].
[111] Better to achieve compliance with EU requirements: *ibid.* [32.1.2].
[112] 4ps, *A Map of the PFI Process Using Competitive Dialogue* (2006), p. 6. See on competitive dialogue procedure, p. 386 above.
[113] Raising the spectre of 'two-tier' employment terms and conditions; see for the various commitments on workforce protection, HM Treasury, *PFI: Strengthening long-term partnerships*, pp. 36–8.
[114] P. Gosling, *PFI: Against the public interest* (UNISON, 2005); A. Pollock, D. Price and S. Player, *The Private Finance Initiative: A policy built on sand* (UCL, 2005).

Preparation and selection of schemes	Formal PFI procurement process	Post-contract award
Bidding round Investment programme based on PFI credits activated by Department	*Tendering process launched* If project accepted, notice in OJEC (see p. 378 above)	*Manage contract* (perhaps for thirty years) Performance measurement (against output specification) – payment of performance-based unitary charge – potential variation and early termination issues
Expressions of interest Local authorities invited to submit outline proposals	*Pre-qualification and short-listing of bidders*	
Preliminary review Filtering by Department, based on appropriateness and deliverability of individual schemes	*Evaluation, clarification and dialogue on detailed bids*	*Evaluate project*
Outline business case Approved outline proposal worked up with output specification	*Evaluation, clarification and selection of preferred bidder* Fine-tuning, final due diligence etc	
Endorsement and credit approval Reviews by Department and Partnership UK Assessment and determination by Policy Review Group	*Award contract*	

Fig 9.1 Illustrative PFI project process[114]

- Increasingly huge revenue commitments limit the spending options of future administrations.
- There is a lack of transparency: blurred lines of accountability.

This must be put in perspective. Traditional public-procurement process is littered with examples of delay and cost overrun at great expense to the public purse: big projects are big projects. The pathology of PFI – all those headlines when things go wrong – is precisely that. Official research paints a different picture. In a Treasury sample of sixty-one completed projects, 88 per cent came in on time or early, with no cost overruns on construction borne by the public sector.[116] PUK, in a study of the operational phase of 500 projects,

[115] Adapted from DCLG, *Advice for Local Authorities Who Are New to Housing PFI* (2006).
[116] HM Treasury, *PFI: Meeting the investment challenge*, p. 43.

judged overall performance 'at least satisfactory' in 96 per cent; services were provided 'in line with the contract or better' in 89 per cent. With increased standardisation and experience of project management, use of the legal technology had also improved; 83 per cent of contracts were described 'as always or almost always accurately specifying' the services currently required.[117] A full assessment is obviously impossible until current ministers are long gone. But recent imbroglios over cash-flow problems in heavily PFI-engaged hospital trusts[118] are indicative of future wrangles in different economic climes.

The Treasury 'seeks to ensure that PFI is as open and transparent as possible. As well as improving accountability, this approach leads to better management of programmes and projects, and helps the private sector plan its investments in PFI.'[119] Warm words, but the policy development has been tepid. Scrolls of online information about capital values and estimated future payments should not disguise the great respect paid commercial confidence and interests.[120] Only recently has the Treasury insisted that departments publish the original VFM assessments; NHS 'best practice' of publishing executive summaries of projects[121] has been likewise slow to spread.[122]

In this context the contribution of audit technique takes on added value. The NAO has published over sixty reports of investigations into PPP/PFI deals: nearly 1,000 recommendations have resulted from subsequent hearings by the PAC.[123] Demonstrating the flexible fire-watching role, a series of methodological and systemic reviews has covered such topics as comparative assessment of VFM and improvements to tendering process.[124] While basking in the glow of positive findings in many cases, fine-tuning is for the Treasury part of the job. 'The NAO's critical review function has been demonstrably beneficial in highlighting areas of PFI procurement policy that required attention.'[125] An early-warning system based on real evidence of PFI in practice, and ongoing assessment of projects to ensure VFM is maintained during procurement, illustrate this. There is however an underlying tension. VFM is classically viewed as an instrument of regulatory control, not least in the internal processes of government accounting, but it is seen dominating the normative discourse in favour of PFI.[126] The Treasury wears two hats.

Seeing 'a myopic method of modernisation', political scientist Matthew Flinders makes the broader point:

[117] HM Treasury, *PFI: Strengthening long-term partnerships*, p. 45; and see D. Chevin (ed.), *Public Sector Procurement and the Public Interest* (Smith Institute, 2005).
[118] See e.g. Audit Commission, *Learning the Lessons from Financial Failure in the NHS* (2006).
[119] HM Treasury, *PFI: Strengthening long-term partnerships*, p. 24.
[120] As provided for in ss. 41 and 43 of FOIA. See further Ch. 10.
[121] See DoH, *Code of Practice on Openness in the NHS* (2003).
[122] HM Treasury, *Standardisation of PFI Contracts* [26], hammers home the message.
[123] Available with a text search facility on the NAO website.
[124] And see NAO, *A Framework for evaluating the implementation of Private Finance Initiative projects*, 2 vols. (2006).
[125] HM Treasury, *PFI: Meeting the investment challenge*, p. 4.
[126] Freedland, 'Public law and private finance'.

> PPPs represent a Faustian bargain in that forms of PPP may deliver efficiency gains and service improvements in some policy areas but these benefits may involve substantial political and democratic costs. The short term benefits of PPPs may therefore be outweighed by a number of long-term problems . . . regarding increased fragmentation, complexity and opaque accountability channels.[127]

(e) Practical issues

Day-to-day operational experience has revealed a variety of practical problems. A major bugbear is the high cost of developing detailed bids for PFI projects; the tendering period also tends to be long drawn-out.[128] Perhaps then it is not surprising to hear of 'the private sector becoming . . . more selective';[129] weak competitive discipline does not suggest full VFM however. Reshaping the process by doing more 'front-end' work sounds well, but in an often hard-pressed public sector how realistic is this? A City insider draws attention to some basic facts of life:

> The process of risk allocation is, in the standard mantra, about the allocation of risks to those best able to manage and control them. In practice, there are a number of instances of risks being allocated to those least able to resist them. For example, during the competitive tendering and negotiation process bidders may accept risks simply in order to stay in the game, without adequate consideration on either side as to the sustainability of the position; in other situations political commitments and timetables have apparently left procuring authorities with no choice but to assume risks which the private sector could . . . more suitably bear.[130]

The Treasury describes flexibility under PFI contracts in the following terms:

> One of the key benefits of PFI is the requirement for the public sector to define accurately its requirement through an output-based specification and to consider and provide for mechanisms to change its requirements over time. This is a discipline that does not generally exist within conventional procurement . . . Evidence suggests public sector managers appreciate the long-term certainty over maintenance and service provision created by PFI, but want greater flexibility to make minor variations and greater alignment of incentives to agree and complete variations.[131]

Most PFI contracts are changed within a few years of being let. That this commonly involves minor modifications to operational assets highlights

[127] M. Flinders, 'The politics of public-private partnerships' (2005) 7 *Brit. J. of Politics and International Relations* 215–16, 234.

[128] In one study, 2 years average for PFI schools, 3 years for PFI hospitals, and 4 years for other PFI projects: NAO, *Improving the PFI Tendering Process*, HC 149 (2006/7).

[129] *Ibid.*, p. 5.

[130] T. Stone, *PFI : Is there a better way?* (KPMG, 2006), p. 6.

[131] HM Treasury, *PFI: Strengthening long-term partnerships*, p. 6.

the extraordinarily detailed specification in many of these public/private transactions.

Where major increases in capacity are involved, the quest for VFM can be acutely challenging. The NAO warns of 'complex interface issues with the ongoing risks and obligations borne by the incumbent private sector contractor' making competitive tendering less attractive at this stage.[132]

In the Treasury's words, 'relations between the public and private parties to a PFI contract represent a key factor in influencing operational performance'.[133] Emphasis is put on the importance of 'partnership working' (itself a not insignificant administrative cost):

> PFI projects involve long term relationships between authorities and contractors who, at first sight, appear to have inherently different objectives. A successful outcome for both parties can only be achieved if they are prepared to approach projects in a spirit of partnership. This requires an understanding of each other's business and a common vision of how best they can work together . . . A good partnership relationship is one where both sides are open, share information fully and work together to solve problems. It is not easy to secure this form of relationship . . . Authorities must develop a staffing and training plan to ensure that they have staff with the right skills and experience to manage the contract . . . Authorities should regularly re-assess . . . to identify ways in which relationships can be improved.[134]

The Treasury declares that relations at managerial level are generally 'good' and often 'very good'. Notably however, with many more PFI projects in the operational phase, there is growing recognition of the 'balance to be struck between partnering and contract management and enforcement'.[135] While not anticipating much use of the formal process of arbitration made available under the model form, the Treasury has distanced itself from those authorities 'reluctant to levy deductions' for poor performance 'for fear of spoiling the relationship with the private sector'.[136]

The National Physical Laboratory affair, where the company's faulty designs caused massive delays in the construction, sheds light on the problems of enforcement. Rather than act unilaterally, the department eventually agreed a termination, the first one in a major PFI contract to involve serious non-performance. In an age of governance, we learn, it is not only judicial review or tort law which induce official caution:

> The [company's] approach to the project became more adversarial as its problems mounted. The Department strove to avoid compromising its contractual position. It was prepared to

[132] NAO, *Making Changes in Operational PFI contracts*, (HC 205 (2007/8), p. 13.

[133] HM Treasury, *PFI: Strengthening long-term partnerships*, p. 63.

[134] NAO, *Managing the Relationship to Secure a Successful Partnership in PFI Projects*, HC 375 (2001/2), pp. 3, 5.

[135] HM Treasury, *PFI: Strengthening long-term partnerships*, pp. 63, 65–6.

[136] *Ibid.*, p. 65; and see HM Treasury, *Standardisation of PFI Contracts*, Ch. 28.

> accept lower performance requirements providing that the relaxations did not compromise scientific research. Prudently in the circumstances, the Department refrained from requesting changes to the specification, and so avoided obscuring [the company's] design responsibilities. Despite being of the view that some construction phases had been wrongly certified as complete, the Department paid the required unitary charge in full, adhering to legal advice that it was under an obligation to do so . . .
>
> At least three times from 2001 onwards, the Department considered terminating the contract on the basis of default by [the company]. However, each time, the Department was advised that there was a risk that to do so would expose it to a claim for damages. The Department was also concerned that it might not be able to find another contractor to take on the project.[137]

The NAO concluded:

> The Authority should be prepared to set limits on its partnering role when the Contractor's continued poor performance seriously jeopardises the successful delivery of the project, and, where necessary, re-establish any rights that may have been eroded . . . and avoid actions that will inadvertently transfer risk back to the Authority . . . Under normal circumstances, issuing variations in good time is sensible . . . But this project demonstrates that refraining from issuing variations, which would have changed the nature of the works, helped the Department successfully avoid counter claims that it shared responsibility for the poor performance of the new facilities . . .
>
> As part of its risk planning, the Authority should prepare fallbacks/contingency arrangements so that it is not forced to compromise its contractual position in order to maintain services . . . Terminating a contract for reasons of an alleged default by the Contractor is unlikely to be straightforward. Reliance on the threat of termination alone is therefore not an adequate substitute for effective arrangements that confirm, before the contract is signed, that the Contractor can meet its obligations.[138]

4. Underground

Unique in scale and complexity, and mired in political controversy, the PPP arrangements for the London Tube – a £17 billion modernisation programme lasting thirty years – demand special attention. Contract technique has been pushed to extraordinary lengths, both in terms of the allocation of (financial) risk and flexibility for the future (all those 'known and unknown unknowns'). The resulting governance machinery has taken the contemporary juggling of public interest and private autonomy in the contractual sphere to new heights, but has proved inadequate; the arrangements show a substantial accountability deficit. We find the contract theorist's desiderata of trust and planning, and co-operation and mutual interest, tested to destruction.

[137] NAO, *The Termination of the PFI Contract for the National Physical Laboratory*, HC 1044 (2005/6), p. 4.

[138] *Ibid*., pp. 6–7.

(a) Set-up

The earlier model of the Tube[139] under local government control was famously on show in *Bromley* (see p. 103 above). The subsequent abolition by the Conservatives of the Greater London Council saw the establishment of London Underground Ltd ('LUL') as a wholly owned subsidiary of London Regional Transport ('LRT'), a statutory agency firmly under the thumb of central government.[140] There followed years of fluctuating Treasury subsidy, inevitably resulting in disruption to long-term maintenance and renewal programmes, coupled in the 1990s with worst-case examples of conventional procurement (cost overruns on the Central Line upgrade and the Jubilee Line extension project of over 30 per cent). Against this backdrop, and on the basis of a satisfactory train operating performance, the incoming Labour Government opted for a partial privatisation along the lines of the horizontal business structure previously devised for the national railway.[141] While LUL would still be running (and ticketing) the trains, responsibility for maintenance, replacement and upgrade of the network (including the trains) would pass to three private-sector infrastructure companies. These 'Infracos' were to bring in project management expertise and innovation, while being suitably rewarded PFI-style through the infrastructure service charge ('ISC') payable by LUL under their contracts. Greasing the wheels, the Treasury agreed a regime of stable funding, whereby, subject to monitoring and review, the Department would make annual grants to cover the ISC.[142]

The arrangements must be read in the light of New Labour's commitment to restore London-wide local democracy in the form of an Assembly and 'a powerful directly elected Mayor with hands-on responsibility for transport, economic development, strategic planning and the environment'.[143] The legislative framework for the PPP was made part of the subsequent devolution statute, the Greater London Authority Act 1999. Implementation would see LUL become part of Transport for London (TfL), a functional body of the GLA, the primary role of which is to implement the Mayor's transport strategy and to manage transport services across the capital. Whereas Whitehall expected the PPP deals to be done and dusted prior to the Mayor taking office, the process became bogged down in all the technical detail. To ministerial dismay, enter former leader of the GLC Ken Livingstone, implacably opposed to the PPP and elected Mayor of London in 2000.

[139] The system has a long and chequered history. Mostly built by separate, for-profit, companies, the lines were brought under the auspices of a public corporation, the London Passenger Transport Board, in 1933. At nationalisation in 1948 the system was combined with the rest of the nation's railways. Control of the Tube passed to the Greater London Council in 1969.

[140] London Regional Transport Act 1984.

[141] HC Deb. vol. 308, cols. 1539–42 (Deputy Prime Minister John Prescott); and see S. Glaister, 'UK transport policy 1997-2001' (2002) *18 Oxford Rev. of Economic Policy* 154.

[142] NAO, *London Underground: Are the Public Private Partnerships likely to work successfully?* HC 644 (2003/4) and *London Underground PPP: Were they good deals?* HC 645 (2003/4).

[143] *A Mayor and Assembly for London*, Cm. 3897 (1998), Foreword.

So could the PPP be stopped? The attempt was made in the High Court[144] on the basis of the transport strategy listed in the Act as one of the Mayor's responsibilities. Produced in record time, the policy was one of unified management control of the Tube system by TfL 'in order for it to ensure a safe, efficient and reliable system'. Counsel's argument was that LRT and LUL had no power to enter into the proposed arrangements because to do so would place TfL in the 'impossible position' of inheriting the contracts while also being under a statutory duty to facilitate implementation of the Mayoral strategy. Understandably the court was not about to unpick the legislation. Devolution notwithstanding, the 1999 Act had given ministers, through LRT, the last word:

> *Sullivan J:* Presented by Parliament with such a detailed statutory framework, it is simply not open to the Court to draw the implication that Parliament must have intended that a further restriction should be imposed upon the exercise of powers expressly conferred by the 1999 Act. Parliament has said what it wishes LRT to do during the transitional period. It is to facilitate the carrying into effect of PPP agreements whilst at the same time having regard to the Mayor's Transport Strategy. If, having regard to the Strategy, LRT nevertheless concludes that it would be appropriate to enter into the proposed PPP agreements, the 1999 Act enables it to do so . . .
>
> Entering into [these] agreements may be wise, as asserted by the Government, LUL and LRT, or it may be foolish, as claimed by the Mayor and . . . TfL. The electorate will, in due course, have an opportunity to express its views in the ballot box about that issue. That may be small comfort for those who oppose the Government's proposals, but it is as it should be, because judgments about the merits, as opposed to the legality of entering into the proposed PPP agreements, must be made by elected politicians and not by judges.

The roles and relations of the different players at the start of the PPP are illustrated in Fig. 9.2. Ownership of LUL was finally transferred to that reluctant contractual partner, TfL, in 2003. In the meantime, two of the three contracts had been placed with the same consortium, Metronet. With a total equity of £350 million, this featured subsidiaries of leading civil engineering firms such as WS Atkins and Balfour Beatty. Tube Lines, a smaller consortium, bid successfully for the 'JNP Infraco'.

Informed by the burgeoning experience of PFI, the transfer (or otherwise) of risk was much bargained about. So-called political risk featured prominently. To deal with the banks' concerns, especially over the continued disagreement between TfL and the government about the PPPs, lenders of £3.8 billion ('the senior debt') were given 95 per cent protection in the event of termination. Again:

[144] *R (Transport for London) v London Regional Transport* (30 July 2001, unreported). A second judicial review challenge by the Mayor collapsed at the permission stage.

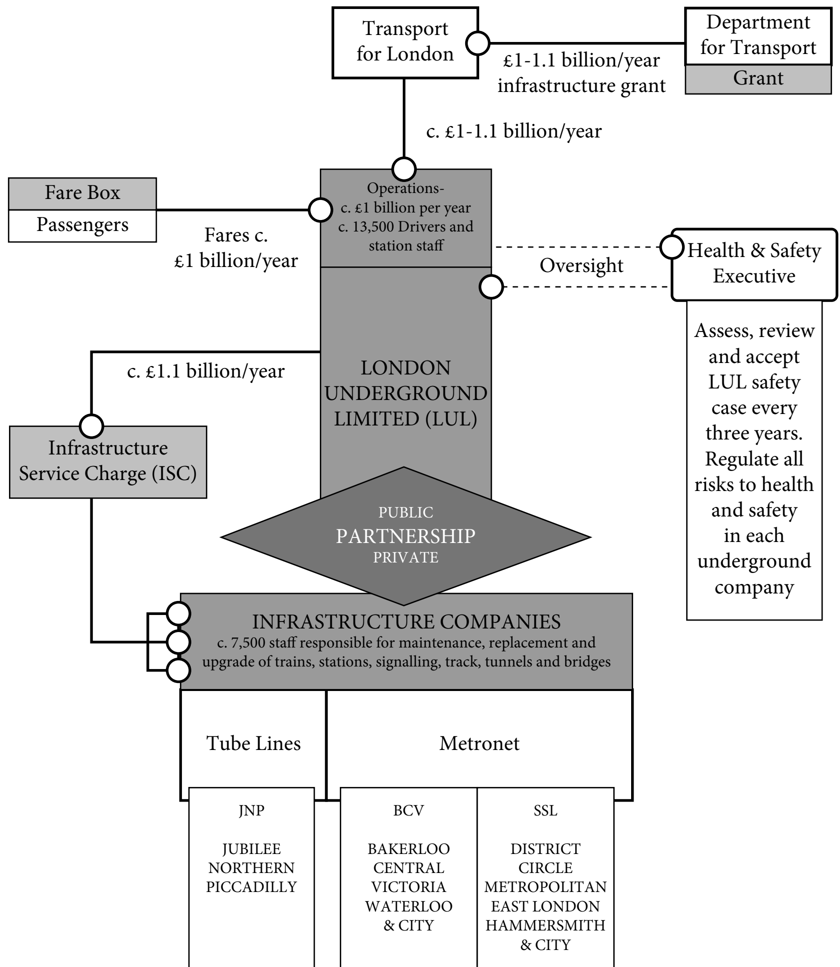

Fig 9.2 Responsibilities and funding flows under the London Tube PPPs[145]

> There are caps, caveats and exclusions to project risks borne by the Infracos. The risk of cost overruns in repairing assets of unknown condition, such as tunnel walls, is excluded because knowledge of their residual life and associated costs is incomplete. In the case of assets whose condition has been fully identified against specific engineering standards, the cost overruns that the Infracos have to bear are capped, so long as the Infracos can demonstrate that they are acting economically and efficiently. In the case of Metronet the limit in each 7½ years period [see below] is £50 million . . . Exclusions to the risks borne by the Infracos include passenger demand, lower income with fewer users and capacity constraints in the face of increased use. These are borne by London Underground.[146]

[145] Source: NAO, *London Underground PPP*. See further European Commission, *London Underground Public Private Partnership* (2002) (decision on compatibility with state aid control).

[146] PAC, *London Underground PPP*, HC446 (2003/4), pp. 3, 11.

The complexity of the legal arrangements is mind-boggling. The original contractual documentation ran to 28,000 pages – over two million words.[147] Determining the precise amounts of money paid to the Infracos on a monthly basis, a chief feature has been the use of hundreds of intricate mathematical formulae to calculate both bonuses and penalties or abatements. Take the following – transparent to whom?

> Service Consistency for a Line Grouping (Y^*) shall be calculated in the relevant Capability Model by the following formula:
>
> Y^* = (vis x wis) + (vmn x wmn) + (vdb x wdb) + (vtm x wtm) + (vcd x wcd) + (vms x wms) + (vfyr x wfyr) + (vfyt x wfyt) + (vfa x wfa) + (vfb x wfb) + (vfta x wfta) + (vftb x wftb).
> *Whereas:*
> wis, wmn, wdb, wtm, wcd, wms, wfyr, wfyt, wfa, wfb, wfta, and wftb are Fixed Parameters defined in the relevant Capability Model Data;
> *and*
> vis, vmn, vdb, vtm, vcd, vms, vfyr, vfyt, vfa, vfb, vfta, & vftb are Infraco Measures set out in the relevant Capability Model Data and the relevant Capability Model where applicable.[148]

The transaction costs of the deals were some £500 million, or 3 per cent of the net present value. With legal fees for advice to LUL amounting to £30 million, City solicitors were big gainers.[149]

And yet, notwithstanding all the detail, the London Tube PPPs are the chief example in UK procurement law and practice of what contract theorists term 'incompleteness by design'.[150] The need for flexibility, or the exercise of discretion on a rolling basis, was a central element of the bargain. While they enabled a vast and intensive programme of work, the agreements very deliberately did not specify the work to be undertaken. Instead, deliverables were set in terms of the service provided to passengers, using three main measures (into which the individual mathematical formulae would feed):[151]

- *availability*: a measure of day-to-day reliability based on whether assets are available for service
- *capability*: a measure of what the assets are capable of delivering in terms of capacity and reduced journey time
- *ambience*: a measure of the quality of the travelling environment.

Fixed prices for the whole thirty years was not thought to represent good VFM: LUL could not confidently predict its service requirements for the distant

[147] See generally C. Wolmar, *Down the Tube: The battle for London's underground* (Aurum Press, 2002).
[148] London Underground PPP Contracts, Sch. 1 [1] to the Performance Measurement Code.
[149] Transport Committee, *The London Underground and the Public-Private Partnership Agreement*, HC 45 (2007/8), p. 15; NAO, *London Underground PPP*, p. 14.
[150] H Collins, *Regulating Contracts* (Oxford University Press, 1999), p. 161.
[151] See Mayor of London, *London Underground and the PPP* (*Annual Report, 2006*), Ch. 3.

future.[152] So, while establishing a long-term relationship between LUL and each Infraco, the agreements provided for LUL to restate its requirements at periodic reviews every seven and a half years and for the ISC to be reset to reflect changes in costs. Provision was also made for 'extraordinary reviews', so allowing charges to be modified within a review period should Infracos experience cost shocks beyond their control.[153]

How then, from a governance perspective, might all this indeterminacy be managed? Given the flammable mix of public and private interests, trusting to a co-operative ethos represented a leap of faith (for investors). An important role in the PPPs for dispute procedures like arbitration familiar from commercial contract might be anticipated. Equally however, being more reactive or 'fire-fighting' in nature, such machinery can only do so much in the crafting of future responsibilities. A special – and specialised – statutory personage was born: 'the Public-Private Partnership Agreement Arbiter'.[154]

(b) Juggling

The statute assigned the Arbiter two main functions: to give directions on matters specified in the PPP agreements, when referred to him by one of the parties; and to give guidance on any matter relating to a PPP agreement, when so requested by either or both of the parties.[155] While armed with information-gathering powers, the Arbiter has had no unilateral power to change provisions in the PPP agreements; a direction made on a disputed matter within his remit might also be set aside by agreement of the parties. In giving directions or guidance, the Arbiter is required to take account of any factors notified by the parties or duly specified in the contract; he must also 'act in the way he considers best calculated to achieve' four different objectives:[156]

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

Duly functioning as a source of administrative rules, the agreements detailed the kinds of financial and technical issues the Arbiter might be asked to

[152] See for analysis by a regulatory economist, S. Glaister, 'The London Underground Arbiter: Effective public utility regulation?' in P. Vass (ed.) *Regulatory Review 2002–03* (CRI, 2003).

[153] *London Underground PPP Contracts*, Sch. 1 [9], Pts 2 and 3.

[154] As constituted under the Greater London Authority Act 1999, ss. 225–7.

[155] Greater London Authority Act 1999, ss. 229–30.

[156] *Ibid*., s. 231.

address. Chief among these is a task naturally touching on many different interests: the determination – via directions – of the key financial terms of the PPP agreements at the periodic (and extraordinary) reviews.[157]

How might all this be conceptualised? As the name suggests, the Arbiter is more than an arbitrator, less than a regulator.[158] On the one hand, ranging beyond the standard institutional limitations of adjudication/arbitration, the Arbiter was clearly conceived as an authoritative and constructive repeat player, so exercising a close and continuing – and on occasion, at the heart of the financial deal, decisive – influence. On the other hand, the remit is restricted (notably excluding enforcement); the role is reactive (in the sense of being party-driven); and the periodic review function is potentially limited (by narrow terms of reference). The Arbiter, in other words, cannot provide the sustained and focused control familiarly associated with a regulatory agency. We shall find him successively main actor and bit-part player in the drama.

Organisationally speaking, the Arbiter is a throwback to the days of small-scale, highly personalised, arm's-length agencies, with notable strengths in law, accountancy and economics.[159] With a view to the legitimacy of agency action in such a contested and technically difficult policy domain, 'better regulation' principles have again been read across:

> The [Arbiter's] aim . . . is to give sound and timely guidance and directions on relevant aspects of the PPP Agreements when . . . requested, and to work constructively with the Parties in support of their key objective of providing . . . a modern and reliable metro service in a safe, efficient and economic manner. We seek to achieve this by:
>
> - working within a clear, transparent and consistent framework
> - giving reasoned guidance and directions which are based on well developed analysis shared with the Parties and procedures which achieve predictability in process and outcome
> - establishing effective dialogue with the PPP Parties and other stakeholders to facilitate timely response to requests for guidance or direction, while maintaining our independence
> - operating to high standards of accountability in all our actions.[160]

At the heart however of this challenging essay in administrative law is a decidedly contestable analytical concept, that of the 'Notional Infraco':

> In the PPP Agreements, adjustments to costs are made by reference to those that would be incurred by a 'Notional Infraco'. [This] is defined as being 'an assumed entity . . . that carries out its activities in an overall efficient and economic manner and in accordance with

157 See on the process, PPP Arbiter, *Procedural Framework for Use in the Giving of Directions and Guidance* (2007) and *Procedural Approach to Periodic Review* (2009).

158 C. Bolt, *Regulating London Underground* (City University, 2003) and *Regulating by Contract and Licence: The relationship between regulatory form and its effectiveness* (CRI, 2007).

159 See PPP Arbiter, *Role, Approach and Procedures* (2003). The first office-holder, economist Christopher Bolt, has combined the job with the chairmanship of ORR.

160 PPP Arbiter, *Draft Directions on Reference from Metronet BCV Ltd*, 16 July 2007, p. 1.

> Good Industry Practice, that has specified characteristics including the same contractual commitments as Infraco and also has Infraco's responsibilities for future performance of the Contract.' Good Industry Practice is in turn defined as meaning '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'.
>
> The guidance from the Parties to the Arbiter expands on these definitions . . . It says that 'what should be expected of an Infraco working to Good Industry Practice [includes]:
>
> - establishing and maintaining whole life asset planning and maintenance regimes;
> - ensuring the right competence is available, including appropriate external advice when needed;
> - 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;
> - recognising the time and resources needed for systems integration and taking appropriate steps to make it possible'
>
> The guidance also emphasises the distinction between good and 'best' practice. It indicates for example that the Arbiter should not base his determination on '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'.[161]

This doppelganger-type reasoning has echoes of the *Wednesbury* test. However, far from a deferential approach, the methodology has seen the Arbiter and his team of experts playing a strong creative role. 'The Agreements recognise that it is impossible to provide a cookbook recipe that will produce *the* right answer if followed properly, not least given that the assessment is dynamic and needs to be relative to changes in the market.'[162]

(c) Implosion

The Infracos made some bold plans:

- three hundred and thirty-six new trains by 2014 and an additional forty-two trains by 2019
- all rolling stock currently more than ten years old replaced by 2019
- all lines to have modern signal and control systems by 2016, providing automatic train operation and automatic train protection
- a total of 80 per cent of the Underground's 400-plus kilometres of track replaced over the life of the contract
- capacity increased within ten years by 22 per cent on the Jubilee line; 14 per cent on the Victoria line; and by 18 per cent on the Northern line, with increases on other lines over the period of the agreements

[161] C. Bolt, *Regulating London Underground*, pp. 15–16.
[162] *Ibid.*, p. 21.

- ten of London's busiest stations modernised or refurbished within ten years
- a programme of modernisation and refurbishment at other stations, including a network of 'step-free' stations, with ongoing refurbishments every seven and a half years
- all infrastructure fully maintained and renewed to achieve a network-wide state of good repair by the end of the third review period.

The service requirements generated a front-loaded expenditure profile, whereby the Infracos would experience negative cash flow in the first period. In PFI-type fashion, this meant the Infracos raising project finance to cover the shortfall, and the public paying more, later. The very long length of the contracts is explained by the need to have sufficient time, not only completely to revamp the network, but also, through fares, etc., to remunerate the private-sector financial input. Conversely, the profile reveals the particular vulnerability of this form of public contracting in the early years.

Performance soon confirmed both the potentials and pitfalls of the PPP arrangements.[163] On the one hand, Tube Lines was commonly delivering plans to time and to budget while generating substantial dividends for its shareholders, much as ministers intended. Attention is drawn to the nature of the consortium's supply chain. Major supply contracts had been awarded by open tender, so engendering a healthy competitive discipline inside the private sector part of the PPP. Metronet, on the other hand, became a byword for inefficiency and service disruption. This was not entirely surprising since the consortium had a tied supply chain, the big subcontracts being parcelled out among the sponsors in cosy corporatist fashion.[164] By early 2007, TfL was estimating delays totalling twenty-seven years in Metronet's station upgrades programme; cost overruns were perhaps as much as £1.2 billion.[165] The Arbiter in a monitoring report remarked on the consortium delivering 'significantly less than was expected in its bid'.[166]

The arrangements created ample space for blame shifting not only between, but also across, the public and private sectors. While conceding deficiencies, it was Metronet management's contention that much of the difficulty arose from additional works required by LUL or changes to standard. 'Events', most obviously the terrorist bombings of the London Tube in July 2005, should not be discounted. Conversely, with Metronet already in receipt of £3 billion in contractual payments, TfL's very public line was not a penny extra. Vindication of Mayor Livingstone's determined struggle against the PPP was the not so subliminal message.

[163] London Assembly Transport Committee, *A Tale of Two Infracos* (2007).

[164] PPP Arbiter, *Annual Metronet Report 2006*, Ch. 3.

[165] TfL, *London Underground and the PPP: The fourth year* (2007). And see *London Underground Ltd v Metronet Rail BCV Ltd and Metronet Rail SSL Ltd* [2008] EWHC 502 (TCC).

[166] PPP Arbiter, *Annual Metronet Report*, p. 8.

By June 2007 Metronet was on its knees. Confronted with weekly cash flow deficits of £10–15m and by forecast losses for the coming year in excess of £1 billion,[167] the banks and the shareholders not unnaturally called time on further credit. Metronet executives were thus driven to seek an 'extraordinary review' of the BCV Infraco agreement, so triggering the independent assessment of efficiency and economy. Such was Metronet's plight that, as part of the reference for a direction increasing the ISC, it requested an interim award of some £550 million. The Arbiter issued his draft interim directions[168] within a matter of weeks. Applying the methodology of the 'Notional Infraco', it was not at all however what Metronet wanted to hear. Efficient costs for the year, assessed at £243 million above the existing baseline, were discounted to £121 million in extra ISC for the company's failure to match good industry practice. Evidently concerned that this might be throwing good money after bad, the Arbiter also provisionally determined no payments for six months, conditions that Metronet executives regularly certify the Infraco as a going concern and funding for any shortfalls, and the appointment of an independent monitoring trustee. A striking example of administrative law powers in an age of public–private partnership, this was nothing less than a death sentence. Enter the Administrators, the product of an immediate High Court application by the Mayor 'in order to maintain the efficient running of the London Tube'.[169] Aiming to transfer each Infraco as a going concern, so fulfilling the statutory purpose of the PPPs,[170] was all very well, but how could this be achieved? With the private sector now proving shy, the Administrators had to deal solely with TfL.[171]

Although the big company shareholders in the consortium had lost their original equity stake of £350 million, they were now not only free of accrued liabilities but also in profit from the valuable subcontracts. Nor did they appear to suffer much reputational damage. As regards the impact on the travelling public, Parliamentary investigation further highlighted the extent of Metronet's service-delivery failure: only 40 per cent of station upgrades and 65 per cent of track renewal completed as scheduled.[172] As for the public purse, ministers were soon paying out an additional £2 billion, mostly by reason of

[167] *Metronet - Statement of Administrators' Proposals*, 27 November 2007.

[168] PPP Arbiter, *Reference from Metronet BCV Ltd: Interim level of ISC pending a direction on ISC at Extraordinary Review: Draft directions* (16 July 2007).

[169] *In the matter of Metronet Rail BCV Ltd and in the matter of Metronet Rail SSL Ltd* (18 July 2007).

[170] *Metronet - Statement of Administrators' Proposals*. For the special provisions on PPP administration orders and transfer, see Greater London Authority Act 1999, ss. 220–4 and Schs. 14–15.

[171] TfL made withdrawing the earlier request for 'extraordinary review' a condition of offer. In *Directions on Form and Structure of Extraordinary Review and Net Adverse Effects: Initial thoughts* (September 2007) the Arbiter had indicated a less unfavourable approach to Metronet.

[172] Transport Committee, *The London Underground and the Public-Private Partnership Agreement*, p. 31.

the 95 per cent guarantee to lenders.[173] In the face of continuing heavy losses, TfL also had to make available some £900 million in emergency-loan funding to the Administrators in order to underpin the works programme. The costs of administration were estimated at a further £600 million. Re-engaged to sort out the legal and financial mess, beneficiaries included City firms that advised on the design of the PPPs.

Metronet's business was later transferred to two TfL nominee companies,[174] to be managed on a stand-alone basis until a long-term structure was agreed with the Treasury. Possible options included bringing the maintenance element of the contracts back into the public sector and letting individual contracts for upgrades and major investment work. Whatever arrangements finally emerged however,[175] the rebuff to Treasury policy on public contracting had been very real. According to the Transport Committee, 'the failure of Metronet fatally damages the Government's assumption that the involvement of the private sector will always result in efficient and innovative approaches to contracts'.[176]

(d) Lessons

Examination of the London Tube PPPs reveals major design faults. Take the tied supply chain (a common feature of PFI-type projects). As the intended beneficiaries, Metronet's shareholders could not be relied upon to address the inefficiencies. Competitive bidding for the Infracos was no substitute for healthy market disciplines through the whole lifecycle of the modernisation programme. Government, in other words, was insufficiently alive to the dangers for the public interest of this blurring of supplier and shareholder functions. There was also insufficient transfer of risk properly to grease the wheels of corporate governance. With few assets of its own, Metronet was little more than a buffer between the consortium and the contractual obligations under the PPP. Rather than be pressured to improve performance, the parent companies could down tools with very limited liability. Likewise, with the risk to lenders being so heavily offset, the financial institutions had less incentive to hold Metronet to account for escalating costs. Meanwhile, the sharp £50 million cap on the cost overruns absorbed by the Metronet Infracos did little to encourage innovation. Looking forward, the Transport Committee emphasises the need for 'detailed assessment . . . of the suitability of the proposed structure of delivery organisations, of bidders' specific expertise and of the strength of

[173] HC Deb. Vol. 471, cols. WS 74–6.

[174] *In the matter of Metronet Rail BCV Ltd and in the matter of Metronet Rail SSL Ltd* (23 May 2008).

[175] In a changed political climate following election of a new Mayor of London (the Conservative, Boris Johnson).

[176] Transport Committee, *The London Underground and the Public-Private Partnership Agreement*, p. 12.

the incentives to efficiency'.[177] So much it may be said for the costly endeavours of the government's City advisers.

Too contractual, insufficiently regulatory, the independent supervisory mechanism has been under-powered. While respect for commercial judgement was an essential ingredient of the relationship, the PPP Arbiter should have been able to self-start the reporting function under the banner of affordability and VFM. In the event, his intervention via the extraordinary review was both resolute and too late. The lack of an early-warning system, whereby the fact of rapidly spiralling costs could have been authoritatively established, was a serious omission. The affair vividly illustrates how public and private discretions alike may otherwise go untracked amid a mass of complex legal documentation. Both sides were all too eager to 'pass the buck'.

The high degree of uncertainty concerning the investment the Infracos had to make should have been a warning. Important transaction costs were bound up in the central design feature of less presentiation, more incompleteness. The sheer scale of the enterprise maximised the scope for disagreement. More and more detailed contractual provision formed part of the problem. The contract theorist might ask, 'trusting and co-operative relationship – what trusting and co-operative relationship?' Imposing the PPP on a powerful and recalcitrant elected authority was itself redolent of failure. Protecting lenders against political risk was one thing, ensuring the parties would constructively address contractual stresses and strains to their mutual benefit quite another. We are reminded of the difficulty of transferring risk in public services and infrastructures. To keep the Tube trains running means the taxpayer is inevitably forced to play the role of safety net. In conclusion, there are important lessons to be learned here about the functional limitations of contractual ordering and the importance of vindicating public law values like transparency and accountability.

[177] *Ibid.*