



Metronet, Tube Lines and the London Underground PPP

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1. Summary

- 1.1 This article explains the decision of the Office for National Statistics (ONS) to reclassify both Tube Lines and Metronet from the private sector to the public sector for the purposes of the National Accounts and Public Sector Finances. The article also explains the classifications concerning the London Underground PPP.
- 1.2 The reclassification as public non-financial corporations takes effect from the dates in 2002 and 2003 when Tube Lines and Metronet signed their respective contracts to manage and improve the London Underground infrastructure. In a recent review ONS established that London Underground Limited – part of the public sector - has a Special Share in both companies. The Special Share gives its holder powers with respect to both infrastructure companies' financial policies which, combined with other factors such as the infrastructure companies being restricted to work only on the London Underground PPP contracts, are important when assessing classification of the companies. For National Accounts purposes these factors are judged sufficient to classify the companies as part of the public sector.
- 1.3 Prior to the announcement of this decision both infrastructure companies had been classified as private non-financial corporations for National Accounts purposes.
- 1.4 The reclassification will have an impact on the Public Sector Finances and on the National Accounts estimates. The precise impact has not been quantified, but will include bringing debt associated with London Underground's refurbishment programme into Public Sector Net Debt earlier than previously.
- 1.5 The decision is independent of, and unaffected by, Metronet's administration order.

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3. The context of National Accounts classification decisions

- 3.1 The National Accounts provide a framework for describing what is happening in national economies. All institutional units operating within an economy are classified to an institutional sector and all transactions between the sectors of the economy are also categorised as part of the National Accounts framework. Work on classification of sectors and transactions is a key input in the production of National Accounts.
- 3.2 This is particularly relevant in the area of public expenditure, revenues, borrowing and debt. This applies both domestically, and within the European Union. For example, in the European Union statistics based on the *European System of Accounts 1995* (ESA95) are used in:
- the *Maastricht Treaty* measures, particularly of government debt and deficit, where they determine the convergence criteria for monetary union for non-members, and performance against the *Stability and Growth Pact* for eurozone members; and
 - the measurement of Gross National Income, one of the main determinants of member states' contributions to the European Union's budget.
- 3.3 It is a legal requirement for European Union countries to compile specified statistical returns on the basis of ESA95. The United Kingdom National Accounts are produced by the Office for National Statistics (ONS) on this basis. Further guidance is contained in Eurostat's *Manual on Government Deficit and Debt*.
- 3.4 In the United Kingdom, the Government has also decided to base its fiscal policy framework on the National Accounts. Fiscal policy objectives are in terms of statistics based on National Accounts aggregates. This means that key public sector targets such as the public sector current budget (for the "golden rule") and the public sector net debt to Gross Domestic Product ratio (for the "sustainable investment rule") are dependent on National Accounts definitions and classifications.
- 3.5 As a result classification decisions for National Accounts purposes are taken by ONS. The National Accounts Classification Committee (NACC) is the committee of expert staff within ONS that has responsibility for interpreting the international statistical guidance. The classification process is being included within a revised National Statistics Protocol on Statistical Integration and Classification¹. The process followed in this case is consistent with the draft version of the Protocol.

¹ http://www.statistics.gov.uk/about/consultations/integration_classification.asp

4. Background to the London Underground PPP and associated entities

4.1 The London Underground

- 4.1.1 London's underground rail system, also known as the Tube, was the first in the world. The first underground line was opened by Metropolitan Railway in 1863, running from Paddington to Farringdon Street. By the early twentieth century there were six private sector operators running different underground lines, a situation that caused inconvenience to passengers. A period of consolidation followed whereby the lines came under the ownership of an organisation known colloquially as the Combine.
- 4.1.2 In 1933 the London Passenger Transport Board (LPTB) was established, as a public corporation, to bring London's road and underground transport under one authority. The Combine was merged into the LPTB. This board ran until 1948, when it was absorbed into the British Transport Commission. In 1963 the British Transport Commission was recreated as five separate corporations, including the London Transport Board.
- 4.1.3 The London Transport Board was reconstituted as the London Transport Executive in 1970. This change represented the first time that the public corporation owning the London Underground was controlled by the local government sub-sector (in this case the Greater London Council) rather than by central government.
- 4.1.4 Responsibility for public transport was removed from the Greater London Council in 1984, prior to the council's abolition in 1986. The London Transport Executive was replaced by London Regional Transport (LRT) in 1984. LRT, a public corporation, reported directly to the Secretary of State for Transport – part of central government. In 1985 London Underground Limited was established as a wholly-owned subsidiary of LRT.
- 4.1.5 In 2000 the Greater London Authority was created as a new local government² entity for Greater London. Its transport body, Transport for London, is also classified as local government. Responsibility for London Underground Limited passed to Transport for London on 15 July 2003, following conclusion of the Public Private Partnership (PPP) agreements.
- 4.1.6 The activities of London Underground, have continuously been classified in the public corporation sub-sector from 1933 to date, either directly or via the entities responsible for it.

² The National Accounts recognise a tier of government, known as state government, which exists between central government and local government. There is a case for classifying both the Greater London Authority and Transport for London as state government rather than local government. The National Accounts currently only show two sub-sectors of general government (central and local), but will be updated to show all four (the additional ones being state government and social security funds) following a modernisation programme known as National Accounts reengineering.

4.2 The London Underground PPP

4.2.1 In February 2002 it was announced that the maintenance and renewal of London Underground's infrastructure would be undertaken through three Public Private Partnerships.

4.2.2 In May 2002 the Department for Transport, Local Government and the Regions set out its reasoning:

“London Underground has for too long suffered from unstable and inadequate investment. If the plans go ahead, they will deliver the stable funding the Tube needs.”

London Underground has managed two roles. It runs a key public service and has at the same time to carry out maintenance and renewal of a significant piece of infrastructure.

Under the plans, three private sector companies will undertake the maintenance and renewal of the infrastructure. They will carry out their work mainly during the night, when train services do not run. The private sector can bring new disciplines, skills, expertise and innovation, driven by a focus on customer requirements. The modernisation plans harness these skills for the benefit of the transport operator, leaving London Underground free to concentrate on delivering services to passengers.

The long-term nature of the plans delivers benefits over and above piecemeal improvement on an individual project basis:

- *The infrastructure companies, through 30-year contracts, have a longterm interest in the work they do – they have to live with the results and have every incentive to get it right from day one. They cannot make mistakes and walk away, leaving others to pick up the pieces.*
- *The companies are responsible for managing delivery across the complete range of infrastructure assets: trains, track, signalling, communications, stations, tunnels and structures. This system integration means that all elements will be designed and maintained to work with each other. Compatibility will be the basis of design and maintenance work.*

London Underground will set the strategic priorities for investment and monitor the performance of its private sector contractors who build and maintain the infrastructure. If the private sector does not do the work properly or puts safety at risk, London Underground can step in and do the work itself at the private sector's expense.”

4.2.3 Responsibility for stations, train operations, signalling and safety remained in the public sector, being run by London Underground Limited, a new operating company set up for the purpose. It also had responsibility for determining service patterns and setting fares.

4.2.4 The PPP was designed so that the private sector provided the finance necessary. To recover this investment and ensure proper long-term management of the assets, 30 year contracts were signed. Each was sub-divided into four 7½ year segments.

Responsibility for stations, train operations, signalling and safety remained with the public sector, through London Underground Limited.

- 4.2.5 Three infrastructure companies (referred to as ‘infracos’) were created to manage and refurbish the trains, stations, track and signal infrastructure. They were called Infraco BCV, Infraco JNP and Infraco SSL (Sub-Surface Ltd). The table below shows the lines covered by each infraco. Initially the infracos were part of London Underground Limited and hence the public corporation sector.

<i>Infraco</i>	Lines
<i>Infraco BCV</i>	Bakerloo, Central, Victoria, Waterloo & City.
<i>Infraco JNP</i>	Jubilee, Northern, Piccadilly.
<i>Infraco SSL</i>	Circle, District, East London, Hammersmith & City, Metropolitan.

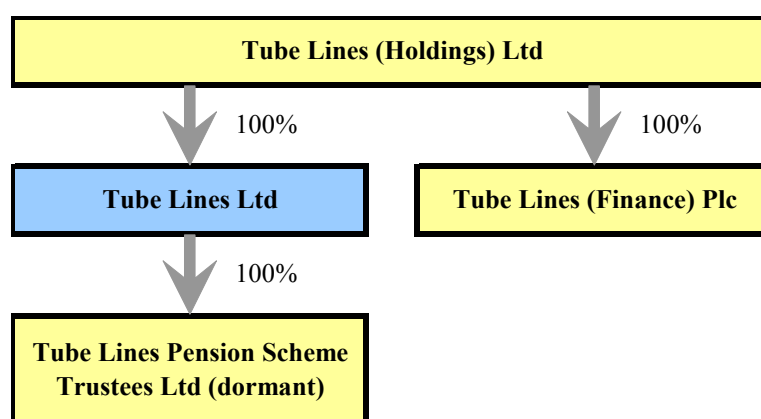
- 4.2.6 From September 1999 the new arrangements were shadow run, similar to the situation with British Rail prior to its privatisation. The PPP contracts started from 1 April 2000, although the 30 year term previously mentioned started from later dates when the infracos were taken over.
- 4.2.7 On 8 May 2002 an announcement was made that the PPP would go ahead.
- 4.2.8 On 31 December 2002 Tube Lines took over Infraco JNP. On 4 April 2003 Metronet took over the other two infracos.
- 4.2.9 The PPP contracts gave Tube Lines and Metronet legal ownership of the London Underground infrastructure during the term of the contract. However, for the purposes of the National Accounts, London Underground Limited is judged to retain economic ownership of these assets, so they continue to be recorded as public sector assets in the National Accounts and Public Sector Finances. This is recognised through a type of recording known as “on-balance sheet” or “finance leasing” in the National Accounts. This is explained in section 7.
- 4.2.10 The shareholders of each of Tube Lines and Metronet put forward a proportion of the private finance necessary through their ‘equity stake’. The companies were to raise the remainder through bank loans or the bond markets, referred to as third-party debt. Transport for London guarantees 95 per cent of the third-party debt.

4.3 Tube Lines

- 4.3.1 The Tube Lines consortium was created to bid for work as a partner in the London Underground PPP. It was originally owned by three companies, all classified as private sector.
- 4.3.2 The share capital was divided equally between Jarvis JNP Limited (part of Jarvis), JNP Ventures Limited (an indirect wholly owned subsidiary of Amey UK Plc) and UIC Transport Limited (an indirect wholly owned subsidiary of Bechtel Enterprises Holdings Inc., USA).

- 4.3.3 In 2003 Grupo Ferrovial SA of Spain acquired Amey. In 2004 Jarvis sold its shareholding to Amey. Hence Grupo Ferrovial SA is now the ultimate owner of two-thirds of the share capital, with Bechtel owning the other third.
- 4.3.4 Tube Lines Group took over Infraco JNP on 31 December 2002.
- 4.3.5 The company structure shows a holding company, a main subsidiary and a financing subsidiary. For the National Accounts the financing subsidiary is not considered a separate institutional unit, instead the group is regarded as a single economic entity, referred to in this article as “Tube Lines”. So, although the powers in London Underground Limited’s Special Share are focused on the Tube Lines Ltd subsidiary, the economic reality is judged to be that the powers affect the “Tube Lines” single entity.
- 4.3.6 Diagram A shows the company structure of Tube Lines. The company shown in blue, Tube Lines Ltd, is the one that London Underground Limited holds its Special Share in.

Diagram A



4.4 Metronet

- 4.4.1 The Metronet consortium was created to bid for work as a partner in the London Underground PPP. The consortium was owned by five companies, all classified as private sector and having equal shareholdings. The five companies are now ultimately owned by W. S. Atkins plc, Balfour Beatty plc, Bombardier Inc. of Canada³, Electricité de France S.A.⁴ and Kemble Water Ltd plc⁵.
- 4.4.2 Metronet took over Infraco BCV and Infraco SSL on 4 April 2003.
- 4.4.3 The company structure consists of separate holding companies for each infrastructure company. They follow the same structure as Tube Lines, with a main subsidiary and a

³ In 2001 Bombardier Inc acquired ADtranz, the original shareholder.

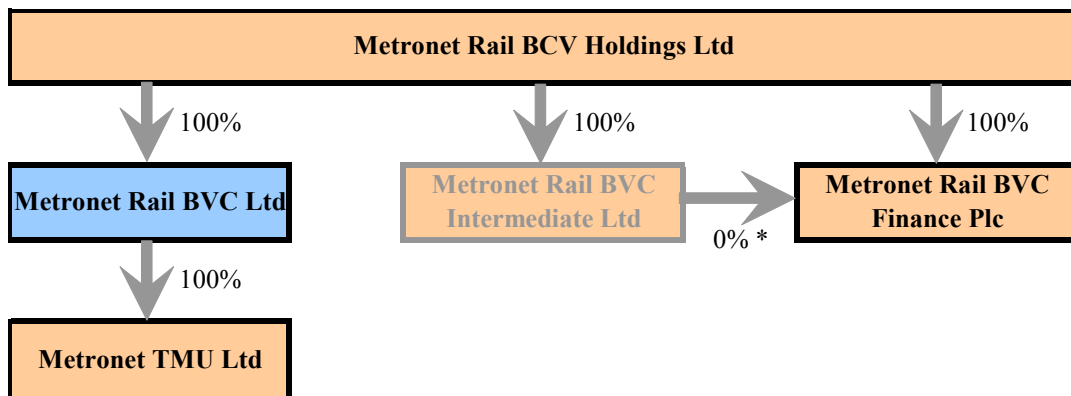
⁴ In 2002 Electricité de France acquired Seeboard, the original shareholder.

⁵ In 2000 RWE AG acquired Thames Water plc, the original shareholder. RWE Thames Water plc was sold to Kemble Water Limited in 2006.

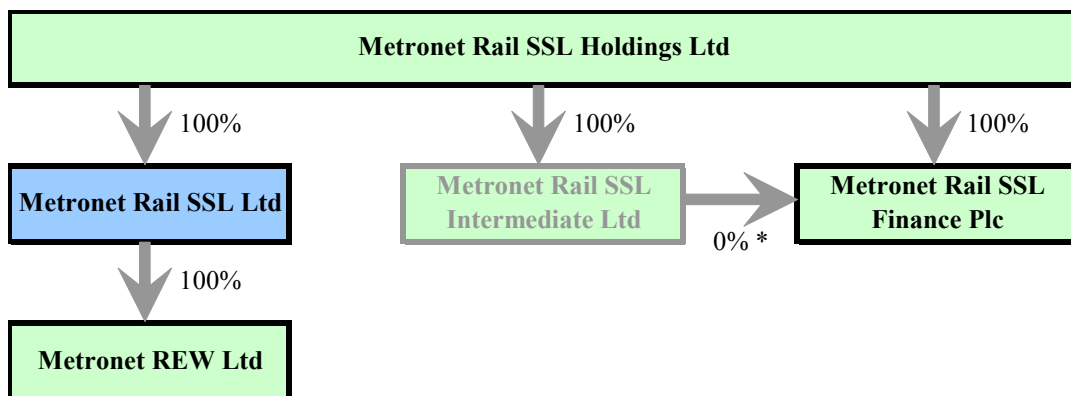
financing subsidiary. The ‘intermediate’ subsidiaries are non-trading and each holds one share in the financing subsidiary. Similar to the description above for Tube Lines, for National Accounts we consider the economic reality that there is one economic entity for each of the Metronet groupings. The combination of these two entities is collectively referred to in this article as “Metronet”.

4.4.4 Diagram B shows the company structure of Metronet. The companies shown in blue, Metronet Rail BVC Ltd and Metronet Rail SSL Ltd, are the ones that London Underground Limited holds Special Shares in.

Diagram B



* Metronet Rail BVC Intermediate Ltd holds 1 ordinary share (0.002%) in Metronet Rail BVC Finance Plc.



* Metronet Rail SSL Intermediate Ltd holds 1 ordinary share (0.002%) in Metronet Rail SSL Finance Plc.

4.4.5 On 18 July 2007 Metronet was placed into a special form of administration following a court order. At the time of publication of this article it continues to operate from administration.

4.5 The PPP Arbiter

- 4.5.1 The role of the PPP Arbiter was established by the *Greater London Authority Act 1999*. The first Arbiter was appointed by the Secretary of State for Transport for a four year term from 31 December 2002, the date of commencement of the Tube Lines contract. This term was subsequently extended for a further four years until December 2010.
- 4.5.2 If a dispute arises between London Underground Limited and an infraco regarding payments, or in relation to economy and efficiency, the function of the PPP Arbiter is to resolve the issue independently, swiftly and with certainty.
- 4.5.3 For National Accounts purposes the PPP Arbiter is classified to the local government sub-sector. This is because, although the Arbiter is appointed by a representative of central government - the Secretary of State for Transport - the Arbiter's remit is defined by the *Greater London Authority Act* and hence the jurisdiction only extends over a local geographical area.

5. The classification process

- 5.1 The National Accounts Classification Committee's approach to classification cases involving the public sector is to first consider whether government, or any other part of the public sector, can exercise control or influence over an entity's directors through the appointment process.
- 5.2 In addition to securing control through power of appointment, ESA95 also recognises that control over a corporation can result from legislation, decree or regulation. The classification committee examine the situation to see whether there are any special factors that enable any part of the public sector to determine general corporate policy, either individually or collectively. In addition to this, the classification committee recognise that government, or other sectors, may also be able to exercise control over a unit through contractual arrangements.
- 5.3 The classification committee judge cases according to case law and considers any powers present against a list of control indicators. Section 6 below examines the various public sector powers over Metronet and Tube Lines and the classification committee's views on them.

6. National Accounts Sector Classification of Tube Lines and Metronet

6.1 Introduction

- 6.1.1 UK National Accounts classification decisions are consistent with the principles of the international statistical manuals: ESA95, its worldwide equivalent the *System of National Accounts 1993* (SNA93), and supporting manuals and case law.
- 6.1.2 The National Accounts are a comprehensive, integrated and consistent set of macroeconomic accounts that describe a national economy. In particular, a set of National Accounts "shows the economic behaviour of the economy's participants, their interrelationships and the results of their economic behaviour". They need to be based on a set of internationally agreed concepts, accounting rules, classifications and definitions, both for the production of time series that show how an economy is changing and for international comparability. The international standards, SNA93 and ESA95, have evolved through time to facilitate analysis of decision making and form an important input into economic decision making. For example, both fiscal and monetary policies are increasingly based on National Accounts statistics.
- 6.1.3 To describe adequately the behaviour of the participants in the economy it is necessary to classify the participants into sectors, and subsequently sub-sectors, based on the similarities in their economic behaviour. This sectorisation involves, amongst other criteria, distinguishing whether units are public or private sector and whether they operate as market or non-market producers.
- 6.1.4 Chapter two of ESA95 defines the institutional sectors in the National Accounts system and clarifies the difference between the public and private sectors. It concentrates on the concept of control rather than ownership. This leads to the situation where some private sector owned corporations, such as British Energy and London & Continental Railways, are classified as public corporations because they are judged as being subject to public sector controls.
- 6.1.5 Paragraph 2.28 of ESA95, which defines public non-financial corporations, states:

The sub-sector public non-financial corporations consists of all non-financial corporations and quasi-corporations that are subject to control (see paragraph 2.26) by government units.

- 6.1.6 The key paragraph in ESA95 for determining control is 2.26. It is reproduced below:

Control over a corporation is defined as the ability to determine general corporate policy by choosing appropriate directors, if necessary.

A single institutional unit (another corporation, a household or a government unit) secures control over a corporation by owning more than half the voting shares or otherwise controlling more than half the shareholders' voting power. In addition, government secures control over a corporation as a result of special legislation decree or regulation which empowers the government to determine corporate policy or to appoint the directors.

6.1.7 It should be noted that it is the power to control rather than the actual exercise of that power that matters for National Accounts classification purposes.

6.2 The Tube Lines and Metronet classification case

6.2.1 The Metronet and Tube Lines cases were reviewed by ONS following work to improve the measurement of finance leases in the National Accounts and Public Sector Finances⁶. During this work ONS discovered the existence of London Underground Limited's Special Shares.

6.2.2 Although the Special Shareholder has the right to nominate one executive director in both Metronet and Tube Lines, this minority appointment does not give the public sector control through the appointment of directors.

6.2.3 The case required examination of the public sector's relationship with both Tube Lines and Metronet through the companies' Articles of Association; provisions of the Special Shares held by London Underground Limited; and the PPP contracts with London Underground Limited. Following examination of these documents the public sector has been judged to have the ability to determine general corporate policy. The relevant control indicators examined in this case are:

- i. Distribution policy;
- ii. Restrictions on economic activity;
- iii. Restrictions on disposal of assets; and
- iv. Financial policy.

6.3 Distribution policy

6.3.1 The companies' Articles of Association detail the provisions of the Special Share. These provisions are summarised below:

- i the Special Share may only be issued to, held by and transferred to a public sector entity or representative;
- ii during the term of the contract, unless otherwise directed by the PPP Arbiter the Special Shareholder must give consent for any distributions⁸ by the company to equity providers or providers of Shareholder Subordinated Debt. For Tube Lines, the consent is required for amounts over a varying but specified maximum amount. For Metronet, the consent was required for any

⁶ Including finance lease liabilities in public sector net debt: PFI and other by Adrian Chesson and Fenella Maitland-Smith (*Economic Trends* 636 November 2006)

⁸ Distributions refer to: dividends, capitalisation, reduction of capital or otherwise or any crediting or releasing of any undrawn Shareholder Subordinated Debt commitments or of any unpaid sums in respect of any shares or making any payment or repayment in respect of Shareholder Subordinated Debt.

distributions within the first four years of the contract and thereafter for distributions over a varying but specified maximum amount;

iii the Special Shareholder must consent to any change to the Articles of Association which refer to the provisions relating to the Special Share.

6.3.2 Thus London Underground Limited has powers to restrict the dividend policy of Tube Lines and Metronet, through the requirement for its consent for distributions above specified amounts.

6.4 Restrictions on economic activity

6.4.1 In addition to the rights of the Special Shareholder, the infrastructure companies' PPP contracts with London Underground Limited restrict them from involvement in any economic activity outside the terms of the contracts and their ancillary agreements.

6.5 Restrictions on disposal of assets

6.5.1 The infracos are restricted in their ability to dispose of assets and cannot dispose of 'Primary Assets', which include trains, signals and track, without the consent of London Underground Limited. London Underground Limited also has the ability to designate other assets as 'Primary Assets' at any time by giving notice and providing reasons for the designation.

6.5.2 In relation to their undertakings within the PPP contracts, the infracos are required to remain wholly-owned subsidiaries of their holding companies. Indeed, during the first few years of the contract term the original sponsors were required to maintain a minimum holding. And, in the event that one of the original sponsors were to dispose of their holding during the first review period (e.g. the first 7½ year segment of the contract), London Underground Limited would be entitled to up to 50 per cent of the net gain on any disposal.

6.6 Financial Policy

6.6.1 The infracos are also required to obtain London Underground Limited consent before they, or their subsidiary companies make any loans, grant any credit or give any guarantees which, in aggregate, exceed £5 million at any time⁹. Similarly there were controls around any refinancing within the first 11 months after the infracos were taken over. Such refinancing required London Underground Limited's consent and was required to be in accordance with detail specified in the contract.

⁹ With the exception of season ticket loans for staff.

6.7 Other powers

- 6.7.1 In the event that an infraco breaches its contractual obligations London Underground Limited has several options. One of these is a ‘Corrective Action Notice’. If the infraco fails to comply with this London Underground Limited can step in to remedy the problem, or instruct a third party to do so.
- 6.7.2 If there is an urgent need, for reasons of health, safety or security, London Underground Limited may issue an ‘Emergency Step-In Notice’. This step-in can only be used to remedy matters and London Underground Limited must step-out as soon as possible.
- 6.7.3 In certain specified circumstances, attributed to either non-remedy of a contractual breach or a ‘Standstill Agreement’¹⁰, London Underground Limited may issue a ‘Mandatory Sale Notice’ to sell the PPP contract and the infraco.

6.8 ONS judgement on control

- 6.8.1 None of the rights of the public sector have been judged, individually, to provide the public sector with effective control of either Metronet’s or Tube Lines general corporate policy. However, taken in combination, they are judged sufficiently strong to classify the companies as being in the public sector.
- 6.8.2 Previously ONS was unaware of the extent of London Underground Limited’s powers, which have been in place since the contracts were signed. Although London Underground Limited does not own Tube Lines or Metronet, London Underground Limited’s powers have been judged sufficient to give control of the general corporate policies of Tube Lines and Metronet in the context of National Accounts. It should also be noted that control of general corporate policy is different from control over day to day operations.

6.9 Sector classification

- 6.9.1 ESA95 divides entities operating in the economy into market and non-market entities. Examples of non-market entities include government units which generally do not sell their output at economically significant prices. The ESA95 market test has been carried out on Tube Lines and Metronet, determining both as market. Hence they are classified as public non-financial corporations. This classification dates from the time they became economically active.
- 6.9.2 Prior to the publication of this decision, Metronet and Tube Lines were classified as private non-financial corporations. Thus this latest classification decision is effectively a reclassification of the companies from the time they took over the infracos.

¹⁰ This gives London Underground Limited the ability, for a limited period, to prevent lenders making an infraco insolvent following a default under lending arrangements.

However, it should be noted that the infracos were initially set up in 1999 as subsidiaries of London Underground Limited and therefore, from 1999 until the infracos were taken over their activities were classified within the public non-financial corporations sub-sector. The classification in that era remains unchanged and, as a result of the reclassification from the time of the take over, they are now continuously classified as public corporations from their initial inception.

7. The recording of finance leases in the National Accounts and Public Sector Finances

- 7.1 Assets can be leased by one party (the lessee) from another (the lessor). In the National Accounts two types of lease are distinguished: finance leases and operating leases. The National Accounts system works on the concept of “economic ownership” rather than legal ownership. Economic ownership is determined by judgments on the party that bears the risks and rewards. A finance lease is defined as a lease which transfers substantially all the risks and rewards of ownership of an asset to the lessee. All other leases are operating leases.
- 7.2 Accounting for leased assets, and their impact on measures of indebtedness, is a complex area. Where the lessee is judged as taking economic ownership of an asset that it leases from the legal owner – that is, when it assumes the risks of ownership, such as the obligation to make repairs – it is said to have entered into a finance lease.
- 7.3 The concepts of finance and operating leases are covered in UK commercial accounting practice and National Accounts. Their approach is similar. As a precursor to applying the treatment of finance leases in the National Accounts, a judgement is needed about which party bears the risks and rewards of the capital asset, and is thus the economic owner.
- 7.4 The recording of asset leasing is particularly relevant for Private Finance Initiative (PFI) and Public Private Partnership deals. In the situation where a public sector entity is a lessee and is judged the economic owner of the asset, then in such “on balance sheet” deals the value of both the asset itself and a finance lease liability will appear on the balance sheet of the public sector entity’s annual accounts.
- 7.5 In such cases the finance lease liability usually only starts when the assets become operational. This is because during the construction phase of the deal the economic owner is usually considered to be the party doing the construction, as the risks rest with them at that stage. When the lessee accepts that the asset has been constructed to a satisfactory standard and is ready for operation, the public sector entity will become committed to make payments. The economic reality is that the lease is entered into at this stage. The change in the arrangements requires the economic ownership to be reassessed.
- 7.6 During the construction phase the construction work will typically be recorded in UK National Accounts as work-in-progress by the lessor.

- 7.7 For on-balance sheet deals, when the asset, or a completed part of it, is re-assessed as having changed economic ownership, then the following transactions are recorded in National Accounts. The capital expenditure for economically “acquiring” the completed asset (or part of it depending on the contractual agreements) is recorded in the sector of the lessee, with an offsetting disposal by the lessor, and this expenditure is matched by the creation of a financial liability for the lessee – the finance lease liability. In the sector of the lessor the disposal is matched by the creation of a financial asset, the finance lease asset.
- 7.8 An alternative way of conceptualising this is as the equivalent of the legal owner (the lessor) making a loan to the new economic owner (the lessee) who uses the proceeds in order to buy the asset from the lessor.
- 7.9 Under PFI type deals, once the construction phase has been concluded there is usually an operational phase that involves a lengthy period of contractual payments from the lessee to the lessor.
- 7.10 The payments the lessee makes to the lessor, who remains the legal owner of the asset during the operational phase, can be divided into three main components¹²:
- i. a service charge usually associated with maintenance;
 - ii. part repayment of the finance lease debt; and
 - iii. payments of interest on that debt.
- The finance lease repayments reduce the level of the outstanding finance lease liability.
- 7.11 The finance lease liabilities between public sector lessees and private sector lessors are included in public sector net debt. The “debt” associated with future service payments is not included, as these future payments are contingent on the service being satisfactorily delivered. Contingent liabilities are not included in National Accounts, since National Accounts reflects transactions occurring in an economy, at the time that they happen or accrue, and the assets and liabilities that arise from these transactions.
- 7.12 The treatment of “off balance sheet” deals, when the economic ownership of the asset is judged to remain with the lessor, is different. Here the payments from the public sector lessee are recorded as rentals for using the asset plus service payments where appropriate.
- 7.13 The London Underground PPP has been judged by London Underground’s accountants as being “on balance sheet”. The treatment as a finance lease in UK National Accounts is consistent with this judgement. However, Metronet’s accountants have also judged their PPP assets as on-balance sheet in their accounts. This identical approach may be an acceptable view under Generally Accepted Accounting Practice, which is designed to show shareholders the financial health of the entity being accounted for, but is unacceptable for National Accounts because it would lead to “double counting” the assets. In National Accounts each and every asset can be recognised once only – there are not two London Undergrounds in the economy. Similarly every financial asset recorded has only one corresponding

¹² There may also be additional components, which have not been covered here in the interests of simplicity.

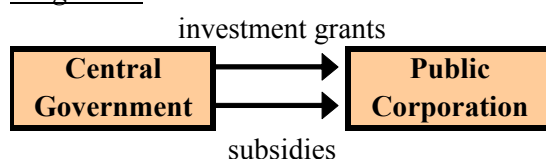
financial liability. Tube Lines accountants have judged their London Underground infrastructure asset as off balance sheet, and are thereby, from a National Accounts perspective, consistent with London Underground Limited's on balance sheet recording.

- 7.14 However, having described the situation for a typical on-balance sheet finance lease deal, the London Underground PPP is atypical. Most PFI deals include the construction of new assets; with London Underground the asset already exists and is being refurbished and maintained. When each piece of capital investment work is completed it is recorded as public corporation capital expenditure with an associated finance lease transaction recorded.
- 7.15 In National Accounts transactions between entities that are part of the same sector are consolidated out, so that a picture of economic transactions between the different sectors of the economy emerges. Now that London Underground Limited and the infracos are part of the same sector, any transactions between them, including the finance lease asset and liability, are consolidated out.

8. The classification of grants to London Underground

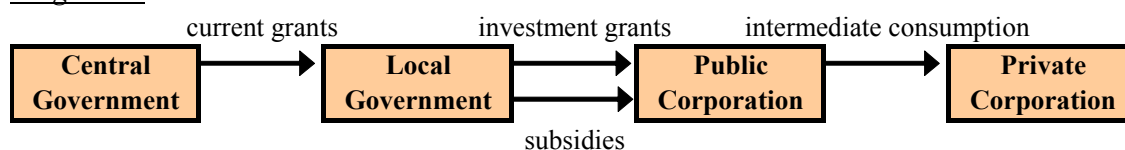
- 8.1 Traditionally some London Underground capital investment and running costs have been financed by central government.
- 8.2 Prior to responsibility for London Underground Limited passing to Transport for London in 2003 the grants were recorded as shown in diagram C. The part of the grant used for capital investment is recorded as an investment grant in the National Accounts (transaction category D.92) and the part covering some of the running costs is recorded as a subsidy (transaction category D.31).

Diagram C



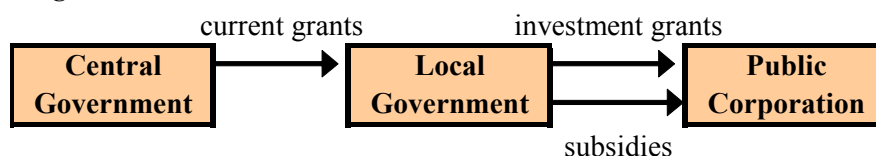
- 8.3 After London Underground Limited passed to Transport for London in 2003 the grants passed through more organisations and were recorded as shown in diagram D. The transaction from central government to local government is classified as current grants within general government (transaction category D.73). The investment grants and subsidies flow from Transport for London.

Diagram D



- 8.4 The reclassification of Tube Lines and Metronet simplifies this diagram, as flows between London Underground Limited and the infracos are consolidated out since they are both in the public corporations sub-sector. The simplified structure is shown in diagram E.

Diagram E



9. Impact on the Public Sector Finances

- 9.1 The Public Sector Finances record transactions as they relate to the general government and public corporations sectors of the economy.
- 9.2 The inclusion of Metronet and Tube Lines in the public sector leads to changes to the key public sector finance statistics: public sector current budget (the “Golden Rule” measure), public sector net borrowing, and public sector net debt (the “Sustainable Investment Rule” measure).
- 9.3 Metronet and Tube Lines profits, interest payables and receivables, dividend and tax payments will all impact on public sector current budget and public sector net borrowing. The amounts had not been quantified when this article was finalised but a preliminary analysis showed that the cumulative revision over the Treasury-defined economic cycle will be relatively small.
- 9.4 The larger impact will be on public sector net debt. The borrowing of Tube Lines and Metronet will now be included, net of any liquid assets. At end-March 2006 the borrowing was £2.4bn and holdings of liquid assets were £0.7bn. Offsetting this, the London Underground Limited finance lease liability (£1.4bn at end-March 2006) is now a balance sheet position between two public corporations and hence it is consolidated out of the accounts. Consequently Public Sector Net Debt should rise by about £0.3bn at end March 2006 as a result of the reclassification. As this is less than 0.1 per cent of Gross Domestic Product, the Public Sector Net Debt ratio will rise by at most 0.1 as a result of this reclassification.
- 9.5 The effect of the reclassification on public sector net debt can be described simply as the substitution of London Underground Limited’s debts to pay off the capital investment work with the debt associated with raising the finance to fund the work. This brings the debt into Public Sector Net Debt at an earlier stage and at higher amounts.
- 9.6 As described in paragraph 4.2.10, 95 per cent of Tube Lines and Metronet’s third party debt is guaranteed by Transport for London. The existence of such guarantees has no impact on the sector classification of an entity, since a guarantee does not by itself bring control. In the United Kingdom National Accounts, we impute a subsidy

from general government to the guaranteed entity to reflect the economic effect of the guarantee, which is that the entity can borrow more cheaply.

- 9.7 In the event of a guarantee being called, a transaction is recorded with general government assuming the debt from the entity.
- 9.8 ONS will make the reclassification in the September publication of the *Public Sector Finances First Release*. At this stage however, the precise information will not be available and estimates will be used.

10. Impact of the classification decision on published National Accounts estimates

- 10.1 The reclassification moves transactions from one sector to another, so will not alter any whole-economy aggregates such as Gross Domestic Product or Gross National Income. It will have a minor effect on the net lending of Private Non-financial Corporations. The reclassification will take place in National Accounts at the earliest possible opportunity in line with the revisions policy for the National Accounts.

11. Further information

- 11.1 This classification decision is consistent with international statistical guidelines on National Accounts. Further information on ONS classifications and the NACC can be found on the National Statistics website using the following link <http://www.statistics.gov.uk/nacc>. If you have any questions on statistical classification, please contact psa@ons.gov.uk.

12. Abbreviations used in this article

AG	Aktiengesellschaft
BCV	Bakerloo Central Victoria
bn	billion (1,000 million)
ESA95	European System of Accounts 1995
GNI	Gross National Income
Inc.	Incorporated
Infraco	Infrastructure Company
JNP	Jubilee Northern Piccadilly
LPTB	London Passenger Transport Board
LRT	London Regional Transport
NACC	National Accounts Classification Committee
ONS	Office for National Statistics
PFI	Private Finance Initiative
Plc	Public limited company
PPP	Public Private Partnership
RWE	Rheinisch-Westfälisches Elektrizitätswerk
S.A.	Société Anonyme
SA	Sociedad Anónima
SNA93	System of National Accounts 1993
SSL	Sub-surface lines
UIC	United International Carriers
UK	United Kingdom
USA	United States of America