CG NB

PRIME MINISTER

GLC CHALLENGE TO DIRECTION UNDER SECTION 49 OF LONDON REGIONAL TRANSPORT ACT

As you will know from my correspondence with Peter Rees in December, we face a potentially awkward situation following the GLC's legal challenge of a direction made last June under s49 of the London Regional Transport Act. The direction required the GLC to pay continuing subsidy to LRT for the rest of this financial year. The case was heard in the High Court last month.

The purpose of this minute is simply to warn you and Cabinet colleagues that judgement on the case is expected on Friday, 11 January. It is quite possible that judgement will go against the Government. Possible consequences of this, and ways of dealing with them were set out in the paper attached to my letter to Peter Rees of 7 December.

If the case does go against us I intend immediately to seek leave to appeal. This will avoid the need for an early public statement. Meanwhile I shall be urgently studying the implications of the judgement and will consult you and other members of E(A) as soon as possible on the action I propose.

I am sending copies of this minute to Cabinet colleagues, to Michael Havers and Patrick Mayhew, and to Sir Robert Armstrong.

NR

NICHOLAS RIDLEY

9 January 1985

TRANSPORT: London Regional Transport: Nov 83.

10 JAN 1985

DEPARTMENT OF TRANSPORT

PRIVATE SECRETARIES' OFFICE

Private Secretaries

Mr Ridley's minute to the Prime Minister dated 9/1/85 & headed 'GLC Challenge to Direction Under S. 49 of London Regional Transport Act' referred to our correspondence with Peter Rees in December.

A copy of that letter and attachments is below for your information.

PSO - DTp
14/1/85

AT
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& says original minute has gone to PM.

(3)

SECRETARY OF STATE FOR TRANSPORT

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

The Rt Hon Peter Rees QC MP
Chief Secretary to the Treasury
HM Treasury
Parliament Street
LONDON SW1P 3AG

7th December 1984

Mr Yaggs

cc PS/Mrs Chalker
PS/Mr Lazarus
Mr Holmes
Mr Palmer
Mr Goldman
Mr Bellis
Mr Gale
Mr Moulton
Mr Smethurst
Mr Ramsay
Mr Hewett
Mr Wadsworth
PSS/File

Dear Chief Secretary

LRT: GLC CHALLENGE AND RATEPAYER LEVY

As promised in my letter of 4 December I attach papers on these subjects for discussion on Monday.

I believe that we must continue to fight the case, but also prepare contingent legislation.

I also believe that there is no alternative to going forward with the ratepayer levy on the basis set out in the second paper, ie an Exchequer contribution of £111m out of the total grant of £323m, ie a ratepayer contribution of 65.6%.

We shall need to think about the financial consequences of losing part of the GLC's payments to LRT. I have already asked Dr Bright about the possibility of LRT absorbing the £10.2m loss of grant within their existing EFL for 1985-86. That will not be easy. As you know, the EFL itself represents a very substantial reduction in LRT's call on public funds compared with this year. Even allowing for the 9% fares increase in January which has now been announced. LRT will have to make rapid progress in reducing costs, with the attendant risks of industrial disruption. Nevertheless I believe Dr Bright will be able to absorb the £10.2m over the next 12 months or so, provided things do not go wrong on other fronts. In the circumstances I think it right to ask him to do so.

Larger sums are of course now at risk. As well as the risk in relation to the s49 challenge there is a real threat of industrial disruption. The more we press LRT to bring forward cost savings, the greater this risk becomes. I believe that the £323m EFL, effectively abated by the £10.2m conceded to the GLC, is as much as Dr Bright can reasonably undertake to deliver. The January fares increase has been announced and I shall shortly have to announce the levy for 1985-86. Timing considerations effectively rule out any alteration of the levy at a later stage. As I see it therefore we face very severe constraints in adapting to any future deterioration in LRT's financial position and I cannot rule out the possibility of having to ask you to agree to a call on the contingency reserve.

I am copying this letter to Patrick Jenkin, John Biffen, Patrick Mayhew, and to Sir Robert Armstrong.

yours sincerely

[signature]

pp NICHOLAS RIDLEY

(approved by the Secretary of State and signed in his absence)

CONFIDENTIAL

LONDON REGIONAL TRANSPORT (LRT):

IMPLICATIONS OF GLC CHALLENGE TO SECTION 49 DIRECTION

1. This paper discusses the legal and financial issues arising from a GLC challenge to a direction under s49 of the LRT Act 1984 requiring them to continue to finance LRT for the rest of 1984-85.

Background

2. When the Government took control of LRT from the GLC on 29 June, because this was in the middle of a financial year, s49 of the LRT Act empowered the Secretary of State to issue a direction to the GLC requiring them to pay to LRT a sum not exceeding:

a. their planned revenue support (£190m), plus

b. £170m (representing the capital budget), less

c. the amount paid to LRT between the beginning of the financial year and 29 June.

The s49 direction was made on 29 June for £281.3m (190 + 170 - 78.7 already paid). Because of the need to take over as soon as possible after Royal Assent (26 June) and to maintain LRT's cash flow, the direction was made on 29 June without formal consultation with the GLC.

3. The GLC have challenged the direction on a number of grounds, of which the strongest was a disagreement about the amount already paid. LT told us that £10.2m paid in April was grant outstanding from 1983-84 and we did not credit the GLC with this. However, it turned out that the GLC had been careful to label the money as 1984-85 grant. We were advised that we would stand no chance of upholding the direction unless we conceded the point and asked the Courts to sever the direction to that

extent. Our defence is now proceeding accordingly. The £10.2m of 1983-84 grant remains unpaid and we are advised that because of the drafting of the Transport Act 1983, the money is not a legally recoverable debt. LRT have reluctantly agreed to accept the implied cut in their income and have adjusted their plans to suit.

4. The other grounds of challenge by the GLC also carry substantial financial risks:

a. LRT are currently forecasting a substantial cash surplus (after grant) of over £30m because of the fares increase, higher demand, and cost savings. GLC claim they should not be asked to fund this surplus - which has already been assumed in setting LRT's 1985-86 EFL;

b. LRT's capital expenditure in 1984-85 counts as the GLC's for control purposes. The pro rata cut imposed on the GLC Money Bill proposals reduced LRT's prescribed expenditure by £12.9m. The GLC claim their cash payments to LRT should be reduced by a similar amount;

c. the GLC insisted on LT leasing new buses as a way of circumventing the ceiling on their prescribed expenditure. The direction included £20.8m to set up a leasing reserve to fund this. The GLC claim this goes beyond the purpose of s49.

<u>Timing</u>

5. The Court hearing of the judicial review of the s49 direction is now in progress. GLC Counsel is taking the case slowly and it is unlikely that the hearing will be concluded before 14 December. We expect a reserved judgement in mid-January although Counsel has been instructed to urge for a speedy decision.

6. If we win, the GLC can be expected to appeal. The GLC will have four weeks to do so. If they gave notice immediately, it is just possible that a final decision in our favour could be reached before the end of the financial year. But there are serious risks:

i. the case might not be concluded before the end of the financial year; if we then lost there would be no power to make a new direction under s49;

ii. if we had judgement against us on appeal before the end of the financial year, the GLC might still contrive to mount a further challenge against any new direction.

If we lose at first instance, a new direction would have to be made following consultation with the GLC. Even so there would be a risk of further challenge.

Options

7. There are three possible options at this stage:

i. submit now and make a new direction;

ii. negotiate with the GLC;

iii. wait for judgement.

Option 1: Submit Now

8. Under this option, we would withdraw from the present action against us. The court would then uphold the GLC case and quash the present direction. We would then have to make a new direction without the benefit of any guidance from the Court on the GLC's various grounds of complaint. So we would not have a

safe basis for making a new direction: the GLC challenge was based on a number of factors, and even if we consulted them before making a new direction, it is unlikely that we could satisfy all their demands. If we submitted to judgement now, the GLC would have three months in which to seek a judicial review of any fresh direction, in which case, the hearing would not be until after the end of the financial year, with the consequences set out in option 3 a. below.

9. The financial consequences of submitting now are, at the very least:

i. we should have to forgo the surplus LRT are building up this year, on a cash basis this is likely to exceed £30m, but their accounts on an accruals basis are likely to show a considerably smaller surplus;

ii. we should have to accept that the £12.9m cut in the GLC Money Bill provision for LRT meant a similar reduction in the cash we could require the GLC to pay. This could only be avoided if we could indicate to the GLC that the Treasury would be willing to allow them to draw on "Part IV" provision (ie effectively anticipate some of next year's provision);

iii. we would have to forgo the leasing reserve of £20.8m. This would mean LRT facing unfunded additional leasing costs of £2m pa for 15 years starting in 1985-86.

10. These losses would deprive LRT of up to £50m in 1985/86. At the same time, the GLC would receive a windfall of about the same order. (The failure to secure a leasing reserve should not increase the GLC's windfall, as they claim not to have rated for it).

11. Submitting to judgement now would attract a great deal of publicity. The s49 direction was one of the first of many provisions for Ministerial discretion under abolition-related legislation. Its overthrow will be hailed as a major victory by the Government's opponents. And the PAC may well criticise the Accounting Officer for conceding such an increase in public expenditure and for accepting without a fight the GLC's litigation costs, when Counsel's current view is that there is an arguable case.

Option 2: Negotiate

12. A variant on submitting to judgement now would be to offer to negotiate with the GLC. This could be done at any time up to the delivery of judgement, but would be most easily achieved by Counsel sounding out his opposite number while the case is still running. The concessions which might be offered in negotiation are:

i. give up the leasing reserve: this would not directly affect public expenditure, but would leave LRT to meet £2m a year leasing charges out of revenue;

ii. offer the GLC an increase of £12.9m in their capital expenditure under Part IV of the Money Act: this would enable them to fund LRT's full capital budget this year without making offsetting reductions in their expenditure on other services. To that extent it would increase local authority overspending this year.

13. A deal on this basis would still allow a cash surplus to be carried forward to 1985-86 and so enable LRT to live within their existing EFL.

The main disadvantages are:

i. the GLC would see this as a weakening in our position;

ii. they would have little incentive to reach agreement (they appear to be relying on getting at least £47m from this case); and

iii. even if an approach was made by Counsel on a confidential basis, it would have to be reported to GLC elected members and would probably leak.

<u>Option 3: Wait for Judgement</u>

14. The possibilities are:

a. <u>If we lose</u>, we expect guidance from the Court on what could be safely included in any new s49 direction. It is unlikely that the judgement will go against us on all the potential grounds of challenge, and so the total cost to public expenditure should be less than conceding everything now. But there would still be a risk that the GLC would seek to challenge any further direction.

b. <u>If we win</u>, the GLC will almost certainly appeal. The timetable would then be as set out in paragraph 6 above. If we win on appeal, all well and good. If not, the GLC could sue LRT for all the money so far paid under s49 (up to £271m) and would be able to spend that in 1985-86. Conversely, LRT would be that much short, and so the total public expenditure effect will be up to £542m.

Legislation

15. The over-riding need is to ensure that LRT has sufficient funds for the remainder of this financial year and, if possible, to retain the surplus carried forward to 1985-86 assumed in its EFL. To be sure of achieving this we will need to have legislation ready on a contingent basis.

16. There are two options:

   i. extend the direction making powers under s49 to allow new directions to be made in 1985-86;

   ii. name a specific sum, up to the full £281.3m in the original direction before conceding the £10.2m.

17. Neither of these options is necessarily retrospective. The first simply extends the existing power to allow a valid direction to be made in circumstances which were not envisaged when the Act was passed. The advantage of this course is that it should be relatively uncontentious. The disadvantages are that it could allow litigation to drag on and would mean accepting the loss of whatever sums were held to be inadmissible on the basis of the existing powers at the conclusion of proceedings.

18. Option 2 would be framed to require the GLC to pay the specific sum less any monies paid under a valid direction under s49. If the existing direction were quashed after the end of the financial year, no monies would have been paid under a valid direction and the whole of the sum specified would fall due. If on the other hand any direction made under s49 were upheld in whole or in part, any monies payable under it would be deducted from the specified sum. In this way retrospection would be avoided and the court proceedings would not be interfered with. But it would be much more controversial since it would deprive the GLC of any benefit they might derive from litigation.

Conclusions

19. i. there would be every disadvantage in submitting to judgement now;

ii. we should proceed with the case;

iii. drafting of contingency legislation on the basis of either option i. or ii. above should be set in hand.

LRT: RATEPAYERS' LEVY

Background

1. Under section 13 of the LRT Act the Secretary of State is empowered to make a levy on ratepayers in London of up to two-thirds of the grants he makes to LRT; the balance of the funding is to come from the Exchequer. The proportion of the grant to be recovered in this way is to be set out in an annual Order, subject to affirmative resolution.

2. LRT have been set an External Finance Limit for 1985-86 of £323m, all of which is to be met by grant. The maximum amount available from the Exchequer is £111m, made up as follows:

£101m transfer from AEG;

£ 6m specific addition for Docklands Light Railway;

£ 3m 50% grant for experimental tube trains;

£ 1m 50% grant on LT research programme.

On this basis the ratepayer contribution would be £212m (65.6%).

2. The alternative would be to take the full 2/3 from the ratepayer, giving a ratepayer/Exchequer split of £215m/£108m. This option has the merit of simplicity, but it is necessary to show that the Secretary of State has exercised his discretion reasonably. This would be easier if it did not appear that he had simply chosen the maximum allowed by the Act.

3. Further, subject to the outcome of the GLC challenge, LRT expect to make a substantial surplus this year, to be carried forward into 1985-86. The GLC point out that this is money raised from ratepayers and that they should therefore get full

credit for it if there is any carry-over into 1985-86. Providing the maximum available Exchequer contribution means that the ratepayer contribution has, by definition, been kept to the minimum.

Legal Advice

4. The Law Officers advise that either option could be legally defended with a reasonable chance of success, but that the Exchequer contribution of £111m would be marginally safer in that it reduces the chance of a successful challenge based on the failure to give the ratepayer credit for any surplus, and that it also avoids the charge that the Secretary of State has failed to exercise his discretion by simply selecting the maximum contribution permitted in the Act.

Relationship with s49 Challenge

5. In the absence of a s49 challenge, the choice would be a straight one between the 1/3 : 2/3 option and the 65.6% option. But it is necessary to consider whether the levy order provides an opportunity for recouping some of the grant lost to the GLC in the event of our losing the s49 case.

6. The principal issue is one of timing. Should Ministers bring forward a levy order now, on present assumptions about financing for 1985-86 or should they await the outcome of the s49 case? The overriding constraint is that we must have an order approved by Parliament in time to send the levy demand to rating authorities in mid-February (statutorily this could be left until early March, but that risks strong criticism from the rating authorities and the likelihood of their non-co-operation in collecting the levy). Aiming for mid-February means a debate at the latest in early February. Before that, the order needs to be approved by SCSI, and it is essential to allow two weeks for this in case the Committee has points to raise. Assuming that the

debate could be arranged in the week immediately after SCSI approval, the <u>latest</u> time for laying the Order is 15 January.

7. But it is most unlikely that we shall have a judgement in the s49 case before 12 January and that hardly gives us time to consider the judgement's implications, let alone consult the GLC, as we would have to do, on any new s49 direction.

8. There is really no alternative, therefore, to laying the order before Christmas, on the basis of present financing assumptions. If the order is then at variance with the effect of the outcome of the case (ie LRT lose money as a result of the judgement), it will then be for consideration how to recoup the situation in 1985-86.

<u>Conclusions</u>

9. (a) the levy should be on the basis of an Exchequer contribution of £111m and an EFL of £323m;

(b) the levy order should be laid before Christmas;

(c) the order should not anticipate the outcome of the s49 case;

(d) if the s49 case goes against the Government, further consideration will have to be given to the methods of bridging the resulting loss.

TRANSPORT:

London Regional Transport:

Nov 1983.