



THE TREASURY SOLICITOR

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Please quote:

L90/6162/CJR/L8

Your reference:

Date:

1st May 1996

Dear Mr Singh

ALEXANDRA PARK AND PALACE

I am now in a position to give a detailed response to your letter of 19th February, which has been considered by the Attorney General with the advice of leading counsel.

Before turning to the issue of debt liability, I must mention two important preliminary points:

1. Mr Pascho did not say on 16th February 1995 (as you suggest in your letter) that the settlement of the debt liability could relatively easily be agreed. What he did say was that there was unlikely to be much dispute about the previous year's deficit (i.e. 1993-4), where the Council's budget had been shown in advance to the Charity Commission and the result for the year had been close to the budget.
2. Mr Pascho also said at the same meeting that if the Council wished to propose a settlement of the debt liability, they should let him have a suggested figure as soon as possible. It is a pity that this was not done, since it would have saved time if your present proposals had been put forward earlier.

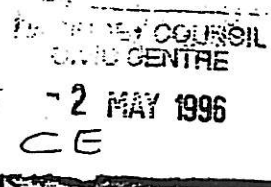
The revenue deficit

Your suggestion that the charity should bear the whole of the operating deficit is not acceptable. To explain why, I will break the deficit down into different chronological periods.

1. Period up to 31st March 1987

Touche Ross's report shows £5.1 million of "operating deficit"

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(b)

accruing up to 31st March 1987. However the Council did not provide any funding for the charity during this period. All development expenditure and running costs were paid out of the GLC's dowry of £8.5 million, the insurance money received after the fire, and the investment income from these two sums. The Council only started making payments from their own money when these other sources ran out, and it is only after that date that any question of reimbursement by the charity arises.

Once the Council started to make payments in 1987/8, one has to identify what they were paying for. The answer can only be the revenue and capital expenditure incurred from that date onwards. To suggest that they were somehow paying for a notional pre-existing deficit bears no relation to reality. All those previous running costs had already been paid for in earlier years. That is clear from the accounts for the relevant years, and it is what one would expect to have happened. The Council knew at the outset that the total funds available (including the insurance proceeds and the dowry) would have to pay for any running costs during the period of development. Thus, for example:

- (1) a report to the Alexandra Palace and Park Committee in November 1981 showed how the dowry would be used to pay (among other things) the running expenses of the Park during the period of development at a rate of £400,000 p.a. for four years; and
- (2) paragraph 7.1.5 of the Inspector's Report (following the planning inquiry) said that £3 million should be set aside from the total sums available to allow for possible revenue shortfall during the "build up" period.

No claim for the alleged revenue deficit in the period to 31st March 1987 can therefore be accepted.

2. Year ended 31st March 1988

The revenue deficit claimed for this year (according to the schedule attached to Mr Pirrie's letter of 23rd November 1995) is about £1.5 million. This was the year in which the charity's funds ran out and it became dependent on the Council for further funding. According to its accounts, the charity had a surplus of £13.57 million at the beginning of the year and received investment income during the year of £1.46 million. At the end of the year it had a total deficit of £3.1 million.

There is no reason why the whole operating deficit of £1.5 million in that year should be treated as having been funded by the Council, rather than the bulk of it coming from the charity's own money. In the absence of further evidence, it would be reasonable to treat no more than one sixth of the operating deficit as having been funded by the Council; ie

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about £250,000. That reflects the proportion which the Council's total funding for this year bore to the charity's own resources. As to whether the Council have yet shown that this operating expenditure was properly incurred, the position is similar to 1988/9 and 1989/90, which I deal with next.

3. 1988/9 and 1989/90

The revenue deficit claimed for these two years totals £827,000. This was a period while the development was still being completed and before either the Charity Commission or the Attorney General had become involved. It is impossible to treat the revenue deficit in this period in isolation from the capital overspend. The development was taking much longer to complete and was costing far more than expected. One cannot tell whether there would still have been any revenue deficit to be funded by the Council if the development had been carried out properly. This difficulty in trying to treat the revenue and capital deficits in isolation during the period of development was referred to in Mr Pascho's letter of 8th July 1993.

The Council have therefore not yet made out a sufficient case for reimbursement of revenue expenditure in these years. They will need to be considered in conjunction with the capital claim.

4. 1990/1

The analysis sent on 23rd November 1995 shows an operating deficit of £44,000 in 1990/1. However, we are concerned only with the extent to which the Council have spent money and provided funds on the charity's behalf. To calculate that amount, one needs to make adjustments to reflect changes in working capital balances, as Touche Ross did in Appendix 9 to their Report. Those adjusted figures were then used by Touche Ross to calculate the amount of interest payable, and I believe that the Council's calculations of interest in other years have also used similarly adjusted figures.

In 1990/1 these adjustments change the deficit of £44,000 into a surplus of £39,000, so no question of reimbursing the Council arises.

5. 1991/2 - 1994/5

It is accepted that the Council are entitled to an indemnity in respect of the revenue deficit in these four years. The figures in the November letter will need to be adjusted to reflect changes in working capital balances, as explained above, although the resulting total is unlikely to differ very greatly from the total of £4.7 million in the November letter.

I suggest that you should provide adjusted figures as soon as possible, with sufficient explanation to enable us to understand the adjustments. I would expect that the figures can then be quickly agreed. Could you please also confirm that the 1995 accounts have now been audited. If they have not, any final agreement for that year will have to await the result of the audit.

Interest

It is accepted that the Council are entitled to recover the actual borrowing costs of expenditure properly incurred on the charity's behalf. However the method adopted by Touche Ross for apportioning interest between capital and operating costs is not acceptable, and Mr Pirrie agreed at our meeting on 14th February 1996 that it was difficult to defend. The interest should be calculated on the average amount of the accrued revenue deficit in each year.

The rate of interest can be taken (as it was by Touche Ross) as the average of the Council pool rate in the year. I suggest that you should submit a computation of interest to date on the revenue deficits for the four years 1991/2 - 1994/5. Would you please also provide evidence to confirm the interest rate taken for each year; for example a certificate or letter from the auditor. I would again expect that these figures can be quickly agreed.

Capital deficit

Your suggestion that the charity should bear half of the capital deficit is quite unacceptable. As you know, the Attorney General's position is that the sheer size of the overspend, coupled with the severe criticisms in the PMI Report, create a strong prima facie case that the expenditure was not reasonably and properly incurred. The Council have so far done nothing to dispel that inference. You say in your letter of 19th February that "a great deal of supporting evidence was provided to the Department of the Environment before the Ministerial Meeting". I asked you on 29th February to send me copies of this material, but nothing has so far been supplied. If the material includes any additional evidence which you would like us to consider, please let me have it as soon as possible.

On page 5 of your letter, you set out eleven numbered points, which I shall take in turn:

1. It is irrelevant that the PMI Report did not reveal any misappropriation. The question is not whether the expenditure was dishonest, but whether it was reasonably and properly incurred.
2. It may be true that the nature of the building and the

project were such that it was difficult to predict in advance the total costs to be incurred. But that merely emphasises the riskiness of the entire venture. The Council's financial projections were subject to fierce criticism by objectors at the planning inquiry in 1982; see for example paragraphs 7.2.4-6 of the Inspector's Report. Although the Inspector did not make any findings about the financial issues because he decided that was unnecessary to his planning decision, he did conclude (in paragraph 17.49) that the objectors' analysis had posed a number of interesting questions and raised doubts about financial viability of the project.

- 3 & 4. Your suggestion that the design team had the necessary experience is explicitly contradicted by the PMI Report. They said (in section 3.2), "a project of this nature and complexity required a high degree of professional expertise...In our opinion, apart from Dr Smith the APDT did not include the expertise required for this type of project and should not have been undertaken "in house"".

You also refer to the team's previous experience on the Wood Green Shopping City project. However, I note that one of the points raised by the objectors in 1981/2 was that Wood Green was not an encouraging precedent. Costs were said to have been much higher than predicted and rental income much lower, while other expected benefits for the local community (such as a traffic-free high road, a rail link and sports facilities) never materialised at all.

5. Delays in construction work may indeed have led to increased costs. This again emphasises the risk involved in proceeding with a scheme where the financial margins were very tight from the outset and where (according to section 9 of the PMI Report) even by April 1984 the designs were "only in outline form and lacking in any substance or detail".
6. The same answer applies to your argument about the difficulty of stopping the work part of the way through. It is difficult to stop any building project mid-stream. That is why such projects have to be very carefully appraised and costed before they are undertaken at all. Where the property belongs to trustees, that is even more vital.
7. The forecasts of revenue allowed only a small margin, and they too had been criticised by objectors from the outset as being over-optimistic. The Inspector accepted (at paragraph 16.104) that a 10% increase in costs coupled with a 10% fall in revenue would lead to the Palace and Park running at an overall loss.

8. The recession probably did affect the exhibition industry and contribute to the large operating losses in the past few years. The Council is entitled to claim an indemnity for revenue expenditure in that period, as explained above. But this did not affect the capital overspend.
9. If, as you say, the Council embarked on the development without having had sufficient opportunity to understand the complexity of running the Palace and Park, that again only emphasises the risk which they were taking.
10. The interim measures taken before the main building project were plainly not able to generate a surplus. But they should at least have emphasised the need for extreme care in projecting future costs. Paragraph 2.4.8 of the Inspector's Report describes how the temporary structure known as "the Bubble" had overrun its costs estimate by at least 50%.
11. Your point about the last four financial years goes only to the revenue deficit, which I have already dealt with.

Resolution of the disputed liability

On paper, the amount of deficit still in dispute remains enormous. But you recognised at our meeting on 14th February 1996 that a part of the deficit would have to be written off by the Council in any event, even if (as you contend) the charity is theoretically liable to bear it. Indeed that has been recognised by the Council for some time. A briefing note to the majority group on 25th March 1993 said that the charity was "very unlikely to reach a position where it can repay any of the [capital deficit]".

Before the charity can be in a position to make any reimbursement, it must of course be sure that its future running costs are fully and securely provided for, either by future rental income from a developer who takes a lease of the Palace or by setting aside an appropriate part of any lease premium or by a combination of the two. When that has been done, the charity will need to provide for (a) reimbursement of the revenue deficit for the four years from 1991/2 together with interest, (b) any continuing revenue deficit and interest which the Council can show that they have funded reasonably and properly in 1995/6, and (c) any further revenue deficits which may continue until payments are received from a developer. Any additional liability of the charity for the past deficit will only be a live issue to the extent that a surplus may be expected after those payments and provisions.

You suggest in your letter (as Option C) that you might then be able to carry out further analysis in-house, including "looking at discrete areas of capital expenditure which could

easily and speedily be agreed". We will certainly consider any suggestions which you may have for identifying such discrete areas and deal with them as quickly as possible.

We would sound only one note of caution. Our concerns about the capital expenditure go to the very root of the development project which was undertaken. They include whether the project was appropriate for the charity at all, having regard to its risks and uncertainties; whether the original building contract was appropriate; and whether it was appropriate to use an in-house team. Unless the Council are able to go some way towards satisfying the Attorney General on these fundamental issues, it may be hard to identify particular areas of capital overspend which can be shown to have been reasonably incurred. If it does become necessary to resolve these fundamental issues, I do not suggest that the Council should embark at once on a forensic accounting exercise. The best starting-point would be for the Council to produce one or more papers, explaining in some detail their case on those issues, and producing the relevant contemporary documents. This is likely to provide the quickest and most effective start either to reaching agreement or to identifying points which will have to be investigated further.

Decisions in relation to the proposed development

On 30th October 1995 a joint meeting of the Alexandra Palace and Park Board and the Policy Committee of the Council agreed that you, as Chief Executive, should "engage the necessary resources to complete the project" (i.e. the proposed new development) and that details should be approved by a members' steering committee. The effect of this resolution seems to have been to deprive the Board of most of its decision-making functions for any new development.

This is contrary to advice which Mr Elias QC gave the Council in November 1990. He said that in circumstances where there was a potential conflict of interest between the Council and the charity, all decisions for the charity should be taken by the Board and all decisions of the Council qua Council should be taken by a separate committee. Could you please explain why that advice has apparently been departed from and what steps are now being taken to ensure that the Board will be able to consider the proposals fully and with a single-minded view to the interests of the charity. Could you please also let me have the minutes of all meetings of the Board since last September, let me know when the Board will be considering the short-listed alternative proposals, and what further meetings of the Board are now planned.

Mr Elias also advised that where there was a potential conflict of interest it was essential that separate advice was given to each interest. It seems surprising that the Board have apparently not yet sought advice on the proposed development, and I understand that they decided on 26th March

to put their legal work out to tender. Could you please tell me whether new solicitors have yet been appointed, and confirm that the new solicitors (whether Malkins or another firm) will be instructed at once to advise the Board on the present development proposals.

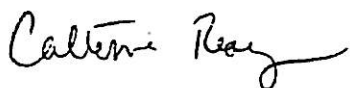
It is also vital that the Advisory Committee have a proper opportunity to fulfil their statutory functions under the 1985 Act. Their role (set out in paragraph 19 of Schedule 1) is to consider and advise the trustees on various matters, which specifically include general policy relating to activities permitted in the Park and Palace and any proposals requiring planning permission. I am concerned that a meeting of the Committee on 17th January 1996 was inquorate because insufficient councillor members attended. Will you please supply copies of minutes of any meetings of the Advisory Committee since last September, and let me know what further meetings are currently scheduled.

The Council as trustee

I note that the Board have been advised by Mr Robert Ham QC that the trustees of the charity are all the individual councillors as an unincorporated body, rather than the municipal corporation itself. It would be helpful if you could let me know whether the Council have sought further advice in the light of Mr Ham's Opinion and what is now the Council's own position on the matter.

A press article in the Daily Telegraph (7th March 1996) referred to the concern of individual councillors that, in the light of Mr Ham's advice, they might be personally liable to the charity. However, while the Attorney General can give no assurance that questions of personal liability will never arise, his concern at present is simply with how much of the deficit the charity should properly bear.

Yours sincerely



CATHERINE REAY
for The Treasury Solicitor