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Russell George MS
Chair
Economy, Infrastructure and Skills Committee
Welsh Parliament
Cardiff Bay
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10 March 2021

Dear Russell, Members of the Senedd,

During the statement made on 3rd November 2020 by the Minister for Economy, Transport and North Wales regarding the future of rail, the Minister made a commitment for TfW to write to Members regarding the costs and values of assets associated with the transfer of rail into public ownership.

I am therefore writing to Members to update you on these costs and values, and to provide some further context to the decision making at that time.

As you will recall, in March 2020, the COVID19 pandemic reached the UK, and as a result, government lockdown restrictions were introduced in an attempt to contain the pandemic and mitigate its health impacts. This resulted in passenger revenues dropping by c90% thus placing the operator (Keolis Amey Wales, operator of Transport for Wales Rail Services) in an unsustainable financial position. In order to stabilise the contract and ensure the ongoing delivery of passenger operations, an Emergency Measures Agreement (EMA) was entered into whereby all revenue and cost risk transferred to the Authority, WG, under the management of Transport for Wales (TfW). This was a broadly similar arrangement to that which the UK Department for Transport (DfT) had entered into for its managed train operating companies.

Whilst the EMA provided short-term stability to the contract, it was not considered to be a long-term or medium-term solution. As a result, in close collaboration with WG, TfW embarked upon a robust optioneering process to identify the most appropriate option which would ensure continuity of rail services and ensure that the rail infrastructure transformation work necessary for the South Wales Metro – a key objective of WG and TfW – would continue to be delivered whilst limiting disruption. The optioneering took into account not only the delivery of WG's

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objectives but also addressed other critical criteria such as value for money, safety and legal compliance. Following this rigorous process, it was determined that the preferred option was:

1. Activation of the 'Operator of Last Resort' mechanism for the delivery of passenger rail services.
2. A 'step in' of the existing infrastructure sub-contract with Amey Keolis Infrastructure Ltd (AKIL) to TfW to continue to deliver infrastructure management on the CVL and CVL Transformation services.
3. Entry into a joint venture arrangement with Amey and Keolis to secure access to Intellectual Property (IP), licenses, technical support and to bolster the integration of new rolling stock to the transformed core valleys lines.

The overriding strategy for the approach to the COVID-19 related issues was to achieve a managed exit and smooth transition of rail services to TfWRL, to protect, as far as possible, the timetable for the delivery of the CVL Transformation Programme through continuity of the Amey project delivery team, and to ensure that the transformed infrastructure and new rolling stock can be implemented to plan. The preferred option is designed to deliver this objective.

The alternative option was the Operator and Development Partner (ODP) returning to ODP Grant Agreement terms if the terms of the ODP GA termination and future arrangements could not be agreed, resulting in termination through an "Event of Default" arising through the ODP running out of cash within a short time period (at the time estimated to be around 4 to 6 weeks), and the implementation of the contingency option: OLR (via TfWRL) and the Infrastructure Manager of Last Resort (IMLR) who would assume responsibility for IM on the CVL and the provision of CVL Transformation services. This option is described as an "unmanaged exit". Alternative options were considered, but due to the uncertainty of revenue linked to the Covid-19 impact, and the difficulty in contractualising the apportionment of risk, these options were not pursued.

The costs to WG of implementing the preferred option were assessed to satisfy State Aid requirements. The cost of "unmanaged exit" was assessed to be considerably higher than the costs to WG of the preferred "managed exit" option. There were also a number of other disbenefits in addition to the financial disbenefits associated with the "unmanaged exit". The cost to WG of a termination through an event of default (an 'unmanaged termination') was estimated to be

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between £124m and £155m (if the Parental Company Support had yet to be drawn by the ODP and called by WG). Alternatively, if the full PCS Facility had already been drawn by the ODP prior to exit, the cost would have between £159m and £190m.

If litigation settlement costs and other risks had been included, the cost to WG could have been higher than these estimated figures. The key risks with an unmanaged exit related to very significant delay impacts on the CVL Transformation, including the risk of loss of European Regional Development (ERD) Funding. An unmanaged termination would have likely created other risks in addition to the to the CVL Transformation programme disruption costs. These include risks associated with industrial relations, service disruption, settling any litigation with the ODP, rolling stock delays and consequential severe penalties, as well as loss of key personnel.

As a result, from a purely financial perspective, a managed termination was clearly the option which created the lowest cost outcome and (through the minimisation of risk of CVL programme delays and litigation) the least risk, and therefore was recommended to represent the best value for money, aside from the additional benefits which have been derived from the new operating model.

The net cost associated with the preferred option, as outlined above currently totals £16.1m (still subject to final audit assurance), which includes net assets necessary to continue to operate services effectively, the fee for the ongoing joint venture with Keolis Amey, the value for IP and access to systems necessary for integration of future services, and OLR mobilisation costs. As part of the transfer, and included within the £16.1m net cost, TfWRL have secured fixed assets necessary to run the business and these have a value of £28.5m.

I hope this information finds you well, and should you have further questions on any of the above detail, please do not hesitate to contact me.

Yours sincerely,

James Price.

James Price
Prif Weithredwr / Chief Executive