

Department for Transport (DfT) Documents on Central Railway

This note explains from the Company's point of view the context of the papers recently released to Central Railway under the Freedom of Information Act, key extracts of which are attached hereto.

The papers released under the FOI Act give important insights into the Government's assessment of the Central Railway project at two key stages:

- The conclusions reached by the DfT in January-March 2003 following a review by the SRA and the subsequent recommendation to Ministers
- A further examination by the DfT between June 2003 and January 2004 focusing on the financeability of the project

SRA Review and DfT Conclusion

The SRA had already conducted a high level review of the project which had concluded that there were no technical "showstoppers". Nevertheless the project was not a priority for the SRA and, even though Central Railway did not require any public subsidy, the SRA had recommended that Ministers should not support the Parliamentary Bill that the project would require to proceed.

In spite of this recommendation, the then Minister for Transport John Spellar MP asked the SRA to conduct a further and more detailed review of the Central Railway project in 2002. This was to enable Ministers to make their decision on whether to support a Parliamentary Bill for the project. The decision was to be for the DfT, not for the SRA.

The SRA told the DfT at the commencement of the review that it did not support the project and this was borne out in its discussions with the Company throughout the course of the review. The SRA's report was submitted to

Ministers in September 2002 without being discussed with Central Railway. A second report, at the request of Ministers, focusing on construction and operational impacts on the existing railway was submitted to the DfT in November 2002. The first SRA report submitted in September 2002 has now been made public under a separate FOI application.

The SRA provided both reports to Central Railway less than one working day before the Company was due to discuss them with the Minister. The principal areas covered by the review were:

- **Revenues:** this was the subject of a detailed review by the SRA's consultants based on the SRA's own freight model and independent verification. The conclusion was that revenues would be well within the range required to make the project commercially viable. The market share figure suggested by the SRA was in fact slightly higher than the projected figure previously adopted by Central Railway's management.

- **Construction cost:** this was not considered in detail during the review but when it provided the Company with its report the SRA said that it had hired a second set of consultants who had never met the Company or its advisers but believed the project's capital costs would be roughly twice that projected by the Company. The SRA was never able to explain how this figure was arrived at or indeed who the consultants were and it was never raised in any subsequent discussions with the Government.
- **Operational impacts:** the SRA identified several aspects of the project that could impact on the existing railway either during construction or when Central Railway was operational.

It was the operational impacts on the existing railway that were the principal concern of the Minister when he met the Company to discuss the SRA report in November 2002. However, the SRA had not discussed these potential impacts with Central Railway to see if there was a way of dealing with them. The Minister therefore asked the Company to meet the SRA to discuss its specific concerns and to see if they could be resolved satisfactorily.

The SRA was reluctant to engage in a further dialogue with Central Railway to enable the Company to solve the problems that the report had identified. Nevertheless the DfT instructed them to do so and this process took place in early 2003.

The outcome was then assessed by DfT officials and led to the advice to Ministers from the Railways Directorate of the DfT contained in the memo to Alistair Darling, Secretary of State for Transport in March 2003. This memo, part of the papers now released under the FOI Act, advises Ministers that the concerns identified by the SRA had already been dealt with satisfactorily or could be dealt with by the Government making certain stipulations on the project proceeding (for example that the Company's route should not run through Manchester Victoria).

This memo and a subsequent one in July 2003 advised Ministers that there were therefore no technical or operational obstacles to the project going ahead, and that it met important policy objectives by adding to capacity and removing large numbers of lorries from motorways. For these reasons, the memo points out, the project was broadly supported by Number 10. Although the headline recommendation has been removed from the March memo before its release to the public, it is clear to the Company that senior officials in DfT concluded that the project could proceed subject to certain stipulations.

The documents note that the French Government of the day had written to the British Government in support of the project.

Feasibility of Financing Central Railway in the Capital Markets

Following this advice, Alistair Darling asked Central Railway to provide further evidence that the project could be financed in the private sector, in the form of comfort/support letters from banks and potential partners. The Company provided a file of letters from a range of banks and other financial institutions and contractors.

The DfT's response to these letters is described in the papers now released under the FOI Act including the memo to Ministers in July 2003 and subsequent emails between officials. Officials commented that a substantial number of banks and financial institutions had looked at Central Railway's proposals and a good proportion had been willing to write letters of support, which they concluded was "quite a step forward". They concluded that it was not possible to be definitive either way on whether the project could be financed but that there remained uncertainties, in particular about equity.

Officials said that, in the absence of detailed testing of the business case and the assumptions underlying it, which they recognised was not realistic at this stage of the project, the things that would enable them to advise Ministers that the project was financeable would be either or both:

- a) an independent assessment that the project could secure an investment grade credit rating;
- b) a strong industry partner willing to put in a significant amount of equity during the approvals phase.

Ministers concluded that there was not sufficient evidence that the project would be financeable and that there was a risk that the Government could be asked to step in to rescue the project if it failed at a later date. In March 2004, they informed Central Railway that in view of the uncertainty over financing they would not support a hybrid Bill in Parliament.

Conclusion

Central Railway's view of the DfT documents is that they demonstrate that officials believed that the project would make a significant contribution to policy objectives, and that operational or construction impacts on the existing railway had either been dealt with or could be resolved satisfactorily.

The outstanding issue is finance.

The Company's view is that it would be premature to seek an indicative credit rating

for the project, although Central Railway has held exploratory discussions with ratings agencies with a view to an indicative rating at the appropriate stage. This was discussed with officials and, as far as we understand, was accepted by them. In any case, the letters received by Central Railway from major financial institutions offered an independent assessment of the commercial viability of the project and were as much as could reasonably be expected at this stage of the project.

As regards strategic investors, it was always the Company's intention to bring in partners at the necessary stages. The Company would be pleased to explore a partnership with one or more strategic investors during the approvals phase of the project if that would give comfort to Government as long as it was consistent with sound financial controls and did not undermine the fundamental commercial rationale for the project. We believe that these principles are in the interest of potential strategic investors, existing Central Railway shareholders and Government alike.

Central Railway
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