
TO BE EXECUTED AS A DEED

FUNDING AND OUTPUTS AGREEMENT

SECRETARY OF STATE FOR TRANSPORT (1)
and
WELSH MINISTERS (2)

BETWEEN

- (1) **THE SECRETARY OF STATE FOR TRANSPORT** whose principal address is Great Minster House, 33 Horseferry Road, London SW1P 4DR (the "**Secretary of State**"); and
- (2) **WELSH MINISTERS** whose principal place of business is Crown Buildings, Cathays Park, Cardiff, CF10 3NQ ("**Welsh Ministers**") (including, as appropriate, Affiliates or subsidiaries of Welsh Ministers acting on its behalf).

each a "Party" and together the "Parties".

WHEREAS:

- (A) A Transfer of Functions Order under section 58(1) of the Government of Wales Act 2006 ("**TFO**") was made on 23 May 2018 to transfer certain Secretary of State franchising functions under the Railways Act 1993 (as amended) and the Railways Act 2005 (the "**Railways Acts**") to Welsh Ministers in order for Welsh Ministers to be the franchising authority in respect of the Welsh component of Welsh services and Wales-only services. The Secretary of State remains the franchising authority over English services insofar as they are specified in the Welsh franchise agreement.
- (B) By virtue of an agency agreement ("**Agency Agreement no. 3**") executed the same date as this Funding and Outputs Agreement (this "**Agreement**") between the Secretary of State and Welsh Ministers, the Secretary of State agrees that Welsh Ministers may act as agent of the Secretary of State in respect of franchising, certain ancillary and related matters concerning the England only services to the extent that they are specified in the Welsh franchise agreement.
- (C) The Parties agree to enter into this Agreement to set out the terms on which the Secretary of State will fund the operation of England only services specified in the Welsh franchise agreement and other funding matters between the Parties. Welsh Ministers and HM Treasury will enter into a separate funding agreement(s) regarding HM Treasury's block grant and the divestment of CVL infrastructure from Network Rail to Welsh Ministers.

NOW IT IS AGREED as follows:

1 DEFINITIONS AND INTERPRETATION

- 1.1 In this Agreement, unless the context requires otherwise,

- (a) the definitions set out in the Definitions Agreement shall apply; and
 - (b) words and expressions defined in the Welsh franchise agreement have the same meanings when used in this Agreement.
- 1.2 Words expressed in the singular shall include the plural and vice versa. Words referring to a particular gender include every gender.
- 1.3 References to any statute or statutory provision shall include: (i) any subordinate legislation made under it; (ii) any provision which it has modified or re-enacted (whether with or without modification); and (iii) any provision which subsequently supersedes it or re-enacts it (whether with or without modification), whether made before or after the date of this Agreement.
- 1.4 References to any relevant franchising authority, franchisee, franchise agreement or invitation to tender in this agreement are used as they are the terms used in the Railways Acts.

2 COMMENCEMENT VARIATION AND DURATION

- 2.1 The provisions of this Agreement shall commence, take effect and be binding on each of the Secretary of State and Welsh Ministers on and from the Effective Date and shall continue in force until the termination or expiry of the Welsh franchise agreement, unless otherwise terminated earlier by the mutual written consent of the Parties.
- 2.2 This Agreement shall be reviewed by the Parties in the event that the Current Franchise Agreement is extended and Welsh Ministers become the franchising authority for the Welsh component of Welsh services and Wales-only services. In such circumstances, the Parties will agree the best process by which to fund the Current Franchise Agreement including through continued use of provisions in the Joint Parties' Agreement for the duration of any such extension.
- 2.3 The Parties shall be entitled to review and amend this Agreement, provided that any amendment shall be in writing and agreed by both Parties.

3 OTHER RELATED AGREEMENTS

- 3.1 The Parties acknowledge their respective rights and obligations under:
- (a) Agency Agreement no. 3;
 - (b) The Operator of Last Resort (OLR) Subcontracting Agreement; and
 - (c) subject to such agreement being entered into, the Co-operation & Collaboration Agreement,

(together with the Definitions Agreement) which comprise the "**Wales & Borders Agreements**").

4 FUNDING FOR ENGLAND ONLY SERVICES

4.1 The funding settlement between the Secretary of State and Welsh Ministers on 31 March 2006 in respect of the Current Franchise Agreement committed the Secretary of State to pay the Current Franchise Operator for those services at the time identified as being wholly within England, with all remaining subsidy being paid by Welsh Ministers out of its Block Grant settlement that was increased accordingly.

4.2 In recognition of this long term funding settlement, which recognises the procurement of and payment for, England only services which will now be made by Welsh Ministers to the Franchisee, during the term of the Welsh franchise agreement, the Secretary of State shall pay:

- (a) From the Start Date of the Welsh franchise agreement to 31 March 2019 the sum of £2,043,300.28;
- (b) For the financial year 2019/2020 to the termination of the Welsh franchise agreement the annual sum of £4,413,045.00 (18/19 prices) (the "**England only services funding**");
- (c) For subsequent years, the England only services funding, indexed using the same methodology that applies to equivalent franchise payments for Wales & Border services in the Welsh franchise agreement; and
- (d) Any other payments as agreed pursuant to Clauses 6 and 7 and 8 of this Agreement.

5 ACCESS CHARGE ADJUSTMENT

Background – Current Franchise Agreement and payment arrangements

5.1 By way of background the Office of Rail and Road (**ORR**) reviews the unit rates for track access and other regulated charges (**ACs**) every five years periodically under a Periodic Review. The Current Franchise Agreement was let in 2003. One of the principle costs for the Current Franchise Operator was its ACs. The purpose of Clause 18.1 of the Current Franchise Agreement was to remove regulatory risk or regulatory opportunity arising from such ACs being changed such that the Current Franchise Operator made no windfall profit or suffered no unjustified loss as a result of any such changes over which it had no control. The baseline subsidy for the Current Franchise Agreement (and subsequent Block Grant settlement to Welsh Ministers to cover the baseline subsidy

payments for which they became responsible in 2006) was based on assumptions from the winning bidder and included Access Charges which were set at Control Period 2 (CP2) rates.

- 5.2 As noted in Clause 5.1 above, in 2006 funding for the operation of the majority of the services under the Current Franchise Agreement were transferred from the Secretary of State to HM Treasury as part of 2006 transfer settlement. Thereafter, the Secretary of State funded only the England only services that the Secretary of State had specified.
- 5.3 Pursuant to correspondence from the Secretary of State to Welsh Ministers dated 31 March 2006, the Secretary of State agreed to retain regulatory risk resulting from changes to the rate of Access Charges under Clause 18.1 of the Current Franchise Agreement. The responsibility for holding the Current Franchise Operator harmless was a matter that has remained directly between the Secretary of State and the Current Franchise Operator so that Welsh Ministers did not bear the cost (or benefit) of any such changes to the subsidy payments to the operator as they had not been funded for these (the **Access Charge Adjustment** or '**ACA**').
- 5.4 As a result of the Secretary of State agreeing to retain regulatory risk for the whole of the Current Franchise Agreement, successive ACAs have been made for each Control Period and these have resulted in annual net payments from the Current Franchise Operator to the Secretary of State (although it should be noted that this could have resulted in payments in the other direction from the Secretary of State to the Current Franchise Operator). As a result of this agreement, the Current Franchise Operator paid the sum of £69.85 million to the Secretary of State in 2017/2018 (the "**Baseline Access Charge Adjustment**") and the Secretary of State is expecting a total ACA of £53.7 million to be paid to him by Welsh Ministers, comprising of £28.89 million from the Current Franchise Operator for the remaining term of the Current Franchise Agreement (seven Reporting Periods) and £24.8 million from Welsh Ministers in 2018/2019 to reflect the assumptions set out in Clauses 5.5 and 5.7 below.
- 5.5 HM Treasury's Comprehensive Spending Review (**CSR**) for 2017-2020 assumed that the ACA would continue to result in payments from the Current Franchise Operator and any future Franchisee to the Secretary of State at broadly its current level – albeit there would be a further adjustment from the start of Control Period 6 in April 2019. In the event that the CSR for the period 2017-2020 ends before 2020 the Baseline Access Charge Adjustment will be amended accordingly.

Arrangements for the next Welsh franchise - Background

- 5.6 Bidders for the Welsh franchise were asked to bid on a mid-point CP5 assumption for Access Charges and it is assumed that from the Start Date of the Welsh franchise agreement on 14th October 2018 to 31st March 2019 there will be parity between assumed

and actual Access Charges, noting that the decision on actual access charges is to be taken by the ORR as part of the Periodic Review process set out in Clause 5.10 below. If this assumption holds true, this would mean that the ACA paid to or by the future Franchisee will be a nil sum. This means (all other things being equal), that the net subsidy paid to the Franchisee from the first day of operation will fall by an annualised amount of £69.85 million compared with that paid to the Current Franchise Operator in 2017/18. This reflects the changed (lower) rates for Access Charges in CP5 compared with CP2, which also formed the basis of the 2006 Block Grant funding settlement between the Secretary of State, HM Treasury and Welsh Ministers.

Arrangements for the Welsh franchise – 14th October 2018 – 31st March 2019

- 5.7 As a result Welsh Ministers will therefore pay the Secretary of State £24.8 million to cover the Baseline Access Charge Adjustment for the period from 14th October 2018 to 31st March 2019. This will be paid in advance by means of a DEL transfer. All references to DEL transfers in this Agreement shall be from the Secretary of State to Welsh Government.
- 5.8 If the Start Date of the new franchise is delayed from 14th October 2018 and the Current Franchise Agreement is extended, then the Parties will agree in the light of the circumstances prevailing at the time whether:
- (a) To leave the arrangement set out above in 5.7 unaltered; or
 - (b) To continue the payments direct from the Current Franchise Operator to the Secretary of state until the end of the extension period, in which case the sum above payable by Welsh Ministers to the Secretary of State will be adjusted accordingly to apply from the revised Start Date, such that the total received from both Parties remains £53.7 million.

Arrangements for the Welsh franchise – 1st April 2019 – 31st March 2020.

- 5.9 The Parties agree that for the final year of the CSR Welsh Ministers will pay the Baseline Access Charge Adjustment of £71.8 million. This is derived by taking the new assumptions for the Access Charge within the Welsh franchise agreement of £44.5 million from the Access Charges for 2019/2020 of £116.3 million assumed within the CSR.
- 5.10 The ORR is considering Control Period 6 rates (**PR18**) which will apply from 1st April 2019 to 31st March 2024 and which will have an impact on the subsidy paid by Welsh Ministers to the Franchisee. Under the devolution correspondence of 20 November 2014, the Secretary of State has committed to take the risk on the impact of the change of Control Period 6 rates (but not the impact of the changes to the volume of services).

- 5.11 The Secretary of State will therefore perform the calculation for the impact of the change on the Franchisee subsidy of PR18 (as he does for all affected train operators). This will have the effect of increasing or reducing the subsidy paid by Welsh Ministers to the Franchisee compared with that contracted in the Welsh franchise agreement.
- 5.12 Part of this calculation will separately identify the impact of the adjustment of CP6 rates (as opposed to volume) (**the PR18 Rates Adjustment**).
- 5.13 Any impact on English services from PR18 will be captured through this adjustment for the whole franchise, with the England-only funding payment continuing unchanged.
- 5.14 Welsh Ministers will pay the Secretary of State or the Secretary of State will pay Welsh Ministers the amount of the PR18 Rates Adjustment.
- 5.15 The net sum of the Baseline Access Charge Adjustment and the PR18 Rates Adjustment will be paid by means of a DEL transfer.

Arrangements for the Welsh franchise - 1st April 2020 to 31st March 2024

- 5.16 From the start of the next CSR, to take effect from 1st April 2020, the Baseline Access Charge Adjustment will cease to apply.
- 5.17 The PR18 Rates Adjustment will continue to be paid each year for the remainder of Control Period 6 and indexed in accordance with same methodology that applies to the Franchisee's payments, subject to Clause 5.18 below.
- 5.18 It is anticipated that during CP6 responsibility the Core Valley Lines (**CVL**) will transfer from Network Rail to Welsh Ministers. This is expected to change the level of Access Charges paid by the Franchisee and will therefore have an impact on the PR18 Rates Adjustment (**the CVL PR18 Adjustment**). The CVL PR18 Adjustment will be calculated on the same basis as that used to calculate the relative asset value of CVL as proportion of the Wales Route.
- 5.19 Any CVL PR18 Adjustment will apply from the date the CVL asset transfer takes place and will be added or subtracted from the PR18 Rates Adjustment from that date and will be paid by means of a DEL transfer.

Arrangements for the Welsh franchise - 1st April 2024 onwards

- 5.20 For Control Period 7 (and any subsequent Control Periods applicable during the term of the Welsh franchise agreement), the same arrangements as set out for Control Period 6 will apply and payments between the Parties will reflect the impact on subsidy paid by Welsh Ministers to the Franchisee of the changes to Access Charge rates in line with the principles above.

- 5.21 Similar arrangements will apply if the relevant Access Charge rates are amended out-with the five yearly Control Period cycle anticipated at the time of the agreement – for example if there is an Interim Charging Review.
- 5.22 If the Franchisee disputes the calculation performed by the Secretary of State with regards to Control Period changes, then Welsh Ministers will act on instruction from the Secretary of State through any dispute resolution process.
- 5.23 Should changes be made to the overall structure of Access Charges, Franchisee payments, Control Periods or the structure of the wider GB rail industry (for example if the funding for rail infrastructure and franchises in England changes) the Parties will work to agree such changes so as to hold each Party financially harmless in line with these principles.

6 OTHER PAYMENTS - SECRETARY OF STATE INITIATED VARIATIONS AND FARES CHANGES

- 6.1 Pursuant to paragraph 4.5 to Schedule 3 to Agency Agreement 3 the Secretary of State may initiate, agree and implement Variations to the Welsh franchise agreement for example in respect of English Services or to promote wider policy and strategic objectives such as High Speed 2 or changes to fares regulations in England. It is possible that such Variations may be initiated by the Secretary of State on behalf of other devolved authorities such as Sub-National Transport Bodies.
- 6.2 It is expected that the subsidy level (positive or negative) paid to the Franchisee by Welsh Ministers will be amended by the amount of the agreed impact of the Variation and that this would then be offset by matching payments or receipts between Secretary of State and Welsh Ministers.
- 6.3 If reasonable extra costs of Welsh Ministers from implementing such Variations are identified and agreed then these payments can be made by means of a DEL transfer.
- 6.4 It is acknowledged that if all the Parties, including Welsh Ministers, agree, it may be possible that Secretary of State may agree to enter into direct agreements and payments with the Franchisee in which case the above arrangements in 6.1, 6.2 and 6.3 would not be required.

7 OTHER PAYMENTS – OLR AND OTHER SECRETARY OF STATE SERVICES

- 7.1 It is acknowledged that as of the Start Date of the Welsh franchise agreement the Secretary of State will continue to undertake a number of franchise management functions for the Welsh franchise as part of its portfolio of franchises as Transport for Wales is unable to assume these franchise management functions from that date.

- 7.2 Welsh Ministers and the Secretary of State will enter into discussions about which franchise management functions will or will not transfer to Transport for Wales and by when.
- 7.3 As at the Effective Date the Secretary of State does not intend to identify the cost of such services or seek reimbursement from Welsh Ministers for them, but reserves the right to do so in future depending on the discussions at Clause 7.2.
- 7.4 Welsh Ministers will reimburse the Secretary of State the OLR costs as described in Clause 12 of the OLR Subcontracting Agreement.

8 VALLEY LINES

- 8.1 The Secretary of State confirms that he will pay to Welsh Ministers the sum of £125 million in 2014 prices to be used towards the costs of the Valley Lines scheme (the "**VL Payment**").
- 8.2 The Secretary of State and Welsh Ministers will agree the timing of the VL Payment but it is expected that the VL Payment will be made over time, proportionate to the rate of expenditure by Welsh Ministers on the planned upgrade to the Valley Lines.

9 OUTPUTS

- 9.1 In consideration of the Secretary of State payment for the England only services to Welsh Ministers, the Secretary of State is procuring, at a minimum
- (a) the provision of train services and station services within England as contractualised in the Welsh franchise agreement;
 - (b) to the level of operational and service quality performance as contractualised in the Welsh franchise agreement; and
 - (c) the supply each period of information on the financial, operational and service quality performance of the Welsh franchise and its performance against Committed Obligations, Milestones and Service Improvement Plans relevant to England as set out in paragraph 4 of Schedule 3 to Agency Agreement no. 3 as the Secretary of State may require from time to time.

10 DISPUTES

- 10.1 If either Party disputes the entitlement or amount of payment due under this Agreement the dispute shall be resolved in accordance with Clause 9 (Dispute Resolution Procedure) in Agency Agreement no. 3. Any such dispute shall not affect the obligation on either the Secretary of State or Welsh Ministers to pay the sums due under this Agreement pending the resolution of such dispute.

11 [REDACTED]

11.1 It is proposed that Welsh Ministers and Network Rail will enter into certain agreements regarding the divestment of CVL infrastructure (the **CVL Divestment Agreements**). At the time of execution of this Agreement the Secretary of State has not approved any of the CVL Divestment Agreements. [REDACTED]

[REDACTED]

12 FURTHER ASSURANCE

12.1 Each Party agrees to use all reasonable endeavours to do or procure to be done all such further acts and execute or procure the execution of all such documents as any other Party may from time to time reasonably require for the purpose of giving the other Party the full benefit of the provisions of this Agreement.

13 GOVERNING LAW AND JURISDICTION

13.1 This Agreement, and any non-contractual obligations arising out of or in connection with it, its subject matter and formation, shall be governed by and construed in accordance with the laws of England and Wales and, subject to the use of the Dispute resolution procedure set out in Clause 9 of Agency Agreement no. 3 the Parties irrevocably agree that the courts of England and Wales are to have exclusive jurisdiction to settle any Disputes (including any non-contractual Disputes) which may arise out of or in connection with this Agreement.

14 THIRD PARTY RIGHTS

14.1 A person who is not a party to this Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Agreement.

15 COUNTERPARTS

15.1 This Agreement may be executed in any number of counterparts or duplicates, each of which shall be an original and such counterparts or duplicates shall together constitute one and the same Agreement.

16 NO AGENCY OR PARTNERSHIP

16.1 Nothing in this Agreement shall be deemed to constitute a partnership between the Parties nor constitute any Party the agent of any other Party.

16.2 Neither Party shall act or describe itself as the agent of any other Party, nor shall it make or represent that it has authority to make any commitments on the behalf of any other Party except where expressly so permitted under Agency Agreement no. 3.

17 NO DELEGATION

17.1 No provision of this Agreement shall be construed as a delegation by any of the Parties of any of their respective functions or authority to any Party.

18 LEGALLY BINDING

18.1 The Parties agree that this Agreement shall be fully legally binding between the Parties.

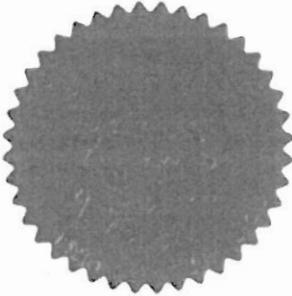
19 STATUTORY POWERS

19.1 Nothing contained or implied in this Agreement shall prejudice or affect the rights, powers, duties and obligations of each of the Parties in the exercise of their respective functions as may be amended, supplemented or increased from time to time and the rights, powers, duties and obligations of each of the Parties pursuant to their respective functions may be as fully and effectually exercised as if this Agreement had not been made.

IN WITNESS whereof the Parties hereto have executed this Agreement as a Deed the day and year first before written.

The Secretary of State

The corporate seal of the
SECRETARY OF STATE FOR TRANSPORT
hereto affixed is authenticated by:



.....
Authenticated by authority of the
Secretary of State for Transport

Welsh Ministers

Executed as a deed by applying the seal of Welsh Ministers.

The application of the seal of Welsh Ministers is AUTHENTICATED by Michael Clarke who is duly authorised for that purpose by the Director of Legal Services by authority of Welsh Ministers under section 90(2) of the Government of Wales Act 2006

Authenticated by authority of the
Director of Legal Services