EUROPEAN COMMISSION

Brussels, 17.07.2002
C(2002)2622fin

Subject: State aid No N 356/2002 – United Kingdom
Network Rail

Sir,

Procedure

1. By letter of 30 May 2002 the United Kingdom authorities notified to the Commission a funding package, the purpose of which is to allow the restructuring of Railtrack plc¹ under the ownership of Network Rail, a new undertaking that will assume responsibility for ensuring that the main railway infrastructure network in Great Britain, including the Channel Tunnel Rail Link, is managed in the interests of all railway users. The notification was registered by the Secretariat-General of the Commission on 1 June 2002 under No N 356/2002.

2. By letter dated 19 June 2002 and received by the Secretariat-General of the Commission the same day, the UK authorities submitted additional information with regard to the notification. Subsequently, by letters dated 26 and 27 June 2002, further information was submitted to the Commission from the UK authorities.

General background

3. Following the privatisation of Britain’s railways, the ownership and operation of the track, signalling and major stations were transferred to a single company,

¹ Railtrack plc, the owner and operator of the principal national railway network infrastructure in Great Britain, was put under administration on 7 October 2001 since the company was considered to be (or likely to become) unable to pay its debts.

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United Kingdom
Railtrack plc. On 20 May 1996, the Department of Transport sold Railtrack plc through a stock market flotation. In the wake of the privatisation process, the British railway industry is structured as a series of individual private business that trade with each other under commercial contracts within an overall financial and economic regulatory framework.

4. In so far as the main rail infrastructure network is concerned, the key players are the Government, the Strategic Rail Authority (SRA), the Rail Regulator and Railtrack plc. The Government, through the Treasury and the Department for Transport, provides financial support that is channelled into the rail industry via SRA, which was set up by the Government to provide a focus and strategic direction for Britain’s railways.

5. The Rail Regulator is appointed by the Secretary of State but acts independently of the Government. The Rail Regulator’s statutory duties includes, *inter alia*, regulation of Railtrack plc as owner of the national rail network\(^2\), the issue, modification and enforcement of licenses, the approval of agreements for access to railway facilities, *e.g.* track and stations and promoting the use and development of the railways and promoting efficiency, economy and competition.

6. Railtrack plc is the owner and operator of the principal national railway network infrastructure in Great Britain, including tracks, signalling and associated infrastructure and stations. It holds a network license and its main activities are to provide train operating companies with access to track, to maintain and renew the railway infrastructure, to undertake major infrastructure projects and to manage timetabling, train planning and signalling for the rail network. Its activities are subject to a high degree of regulation. It is a wholly owned subsidiary of Railtrack Group, a private company whose shares are listed on the London Stock Exchange.

7. Railtrack plc’s financial position had for some time been increasingly unsustainable and in July/August 2001, it become clear that Railtrack plc was unlikely to have a sufficiently sound financial basis and cash-flow income to enable it to continue properly to carry out its licensed rail activities beyond November 2001 without further substantial public funding. In view of these financial difficulties, which could put the future of Great Britain’s rail network at risk, the UK Government decided to seek an order of the English High Court to place Railtrack plc under Administration in accordance with Section 60 of the Railways Act 1933, since it considered that Railtrack PLC was (or was likely to become) unable to pay its debts.

8. Subsequently, the English High Court of Justice issued, on 7 October 2001, a Railway Administration Order declaring that the business and property of Railtrack plc be managed by specially appointed railway administrators for the purpose of;

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\(^2\) This function includes regulation of Railtrack plc’s access charges, establishing Railtrack plc’s financial framework by way of periodic Charges Reviews and to ensure its accountability to the public interest.
a) the transfer to another company or (as respects different parts of its undertaking) to two or more different companies, as a going concern, of so much of [Railtrack plc’s] undertaking as it is necessary to transfer in order to ensure that the relevant activities may be properly carried on, and

b) the carrying on of those relevant activities pending the making of the transfer.

9. On 28 November 2001 the UK authorities notified to the Commission certain aid measures, the purpose of which were to rescue the business of Railtrack plc in administration and to ensure the continued safe operation of the rail infrastructure pending the transfer of Railtrack plc out of administration, i.e. the transfer of Railtrack plc’s relevant rail activities to a successor. Subsequently, on 13 February 2002, the Commission decided not to raise any objections to the notified rescue aid, as it was considered compatible with the EC-Treaty by virtue of Article 87.3 (c) of the Treaty. Essentially, the decision authorised the UK authorities to make available an amount of up to € 8,78 billion (£ 5,42 billion) for the period 7 October 2001 – 30 September 2002.

10. In accordance with their statutory duties, the Administrators of Railtrack plc must seek to transfer Railtrack plc’s activities as the main rail network operator. However, although the company Railtrack plc is in Administration, the shares of the company are still owned by its parent company, Railtrack Group, and it is therefore open to any person to make a bid to Railtrack Group for the acquisition of Railtrack plc.

11. Indeed, as from October 2001 and onwards it was clear that Railtrack Group and the administrators would seek and consider bids from any party. In order to ensure fairness between prospective bidders the Secretary of State issued guidelines as to matters that would be taken into account when evaluating bids. However, up to 3 May 2002, when Network Rail entered into a legally binding agreement in principle for the purchase of Railtrack plc, no other bids have been received, neither by by Railtrack Group, nor by the administrators. It should also be noted that on 25 March 2002, the Secretary of State confirmed to Parliament that the grant of £300 million would be available to any bidder that could deliver Railtrack plc’s early exit from administration.

12. Meanwhile, the UK Government contemplated alternative models to ensure the continued safe operation of the rail infrastructure network. It concluded that a continued private sector discipline in rail infrastructure management was desirable, but also that a company limited by shares might not be the most appropriate way to achieve an effective delivery of the public service interest inherent in the operation of the main railway infrastructure network. Shareholder pressure to generate share price growth was identified as a particular area of concern since Railtrack plc was perceived not to have focussed sufficiently on investing in the long-term state of the rail network and deferring expenditure on maintenance and renewals in favour of short-term share value growth.

13. Accordingly, the UK Government looked for a model that would be able to attract private sector management and provide operational independence in order to achieve private sector levels of efficiency; that had a separate legal personality from its members and limited liability; and that could facilitate the safe and effective management of the rail infrastructure in the national and Community interest, while avoiding the temptation to defer investment expenditure in favour of short-term growth.

14. A company limited by guarantee (CLG) was identified as offering this balance. A CLG has no equity and no dividends are paid. Therefore, there is no pressure from shareholders. The legal structure is tried and tested and can give role to all those with an interest in the continued effective operation of the rail network. Accordingly, and in the absence of interested undertakings willing to succeed Railtrack plc as the rail network manager, the UK Government decided to facilitate a bid by a CLG (Network Rail) for the acquisition of the shares of Railtrack plc from its parent company, Railtrack Group.

15. Network Rail is a company limited by guarantee (CLG) and is incorporated under the Companies Act 1985. The main difference between a CLG and a company limited by shares is that a new CLG does not obtain its initial capital from its members, as it does not have any share capital, and that the distribution of profits or assets to those members is prohibited. Accordingly, Network Rail members cannot convert their membership into economic rights on a voluntary winding up of the company, i.e. they cannot derive any economic benefits from their membership. In addition, no operational surplus may be distributed to the members. Instead, any surplus will be reinvested in the business of Network Rail.

16. Furthermore, the “guarantee” in a CLG is technically the replacement for the equity, i.e. a fallback facility in the event of the company’s insolvency. Conventionally, the guarantee is a nominal £1 but in the case of Network Rail, the fall-back mechanism for creditors and third parties consist in the financial support facilities that will be provided by the UK Government through the Strategic Rail Authority.

17. On 25 March 2002 Network Rail put forward a bid to Railtrack Group for the purchase of Railtrack plc and, in addition, the acquisition of the operating rights for the Channel Tunnel Rail Link (CTRL) and ST. Pancras station, which are currently held by Railtrack Group’s wholly owned subsidiary Railtrack UK limited (RTUK). The financial close of the bid is conditional on receipt of State aid approval or confirmation that no State aid is involved in this package.

**Description of the notified measures**

*Object of the measure*

18. The object of the notified measures is to allow for a comprehensive restructuring of railway infrastructure management in Great Britain in general. This is to be achieved through the provision of public financial support that will enable Railtrack plc to exit from administration under the ownership of Network Rail and to ensure that Network Rail has a sufficiently financially sound and secure basis to attract commercial debt finance to manage the main railway network of
Great Britain in the short-term. In the longer term, Network Rail’s income from track access charges will be securitised and the Commission will be informed of any necessary Government funding for these arrangements. Such long-term public support does however not forms part of this notification.

19. Essentially, the measures provide for public support towards Network Rail’s acquisition of Railtrack plc and the rights to operate the Channel Tunnel Rail Link and St. Pancras station from the Railtrack Group and to facilitate for Network Rail to raise commercial funding for the management of the Great Britain rail network, including the Channel Tunnel Rail Link.

Objectives and structure of Network Rail

20. According to Article 3.1 of Network Rail’s Memorandum of Association, its objectives are to either itself or through any subsidiary or undertaking carry on the business of acquiring, owning, managing, providing, operating and developing railway network services and station services in all their aspects.

21. Network Rail will have at least one direct subsidiary, Network Rail Holdings Limited (HoldCo), which will be wholly owned and newly incorporated. In addition, HoldCo will at least have one principal subsidiary, the acquired Railtrack plc (OpCo), which will become the new infrastructure manager. HoldCo and OpCo will both be companies limited by shares and fully owned (and controlled) by Network Rail. However, any dividends from these companies would accrue to Network Rail as sole shareholder and would not, therefore, leave the Network Rail Group. Moreover, Network Rail is prohibited to dispose of all or any of its shares in or control over its subsidiaries. In addition, HoldCo will likewise be prohibited to dispose of all or any part parts of its shares in or control over OpCo.

22. HoldCo’s activities are restricted to the acquisition of the shares in Railtrack plc, the acquisition of the right to operate the CTRL, to make borrowings under Network Rail’s Commercial Bridge Facility and from SRA under the SRA/HoldCo Facility, to enter into an intra-group loan with OpCo and ancillary activities.

23. Railtrack plc is currently responsible for the operation of the monopoly railway infrastructure in Great Britain in accordance with the terms of a Network Licence. The Network Licence requires Railtrack plc to, inter alia, secure the operation, maintenance, renewal, replacement, improvement, enhancement and development of the network in a timely, economic and efficient manner. Following the purchase of Railtrack plc by Network Rail, the conditions of the Network Licence will apply to OpCo. Furthermore, following Network Rail’s acquisition of Railtrack plc, the licence will restrict the type of business and activities OpCo may conduct to “Permitted Business” only.

24. Permitted business is (i) Network Business, i.e. the business of operating, maintaining, renewing and enhancing the main rail network in Great Britain, together with any service that is ancillary and necessary to that activity and (ii) Permitted Non-Network Business.
25. Permitted Non-Network Business comprises business other than the Network Business, which was transferred to Railtrack plc following its establishment as a commercial organisation in 1994. Historically, the most significant Permitted Non-Network Business has been Railtrack’s property development business. However, under the new license conditions, Permitted Non-Network Business will no longer include the property development business. On the contrary, OpCo will be able to undertake property development only with the Rail Regulators consent or under a de minimis provision, which is contained in the Network Licence. Furthermore, the revised licence conditions will include a prohibition on cross-subsidy between Network Business and other business.

26. It follows that Network Rail’s activities will be restricted to the operation, maintenance, renewal and enhancement of the main railway network in Great Britain and that it will have no other material activities. In particular, Network rail will not provide any train services (hauling of trains), as it is prohibited under the Network Licence to have any interest in the ownership or operation of any rail vehicle. Neither will it undertake any major infrastructure projects or enhancements, which in the future will be project financed through SRA.

Membership in Network Rail

27. The members of Network Rail will be drawn from a wide variety of stakeholders in the rail industry and public at large. They will have no economic interest in Network Rail and will receive no financial compensation for their role. There will be two general categories of members, Industry Members and Public Members. In addition, SRA will be a member of Network Rail and will have certain special membership rights, reflecting its role as funder and strategic planner for the rail industry.

28. Any person authorised by a licence to be the operator of railway assets (Licence Holder) may become an Industry Member if he complies with the application procedures set out in the Membership Policy. Accordingly, membership is open to any railway operator (new entrants as well as incumbents) in exactly the same way and is consequently non-discriminatory. However, no directors, senior employees or substantial shareholders of railway undertakings will be permitted to sit on Network Rail’s board.

29. Public Members will be drawn from a broad cross-section of the community and comprise public sector bodies as well as private sector bodies, e.g. local

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4 With the exclusion of the business of land exploitation from the Network Licence, the Permitted Non-Network Business will be negligible and compromise, e.g. intellectual property rights related to the network business (such as the national passenger train table), income from rail stations’ charges and other activities related to the Network Business.

5 All operators of railway assets are required to hold a licence and are entitled to membership by virtue of that licence. This includes operators of freight and passenger trains, network, stations and light maintenance depots. Moreover, the UK Government has confirmed that when Directive 2001/13 is implemented in the United Kingdom, any undertaking operating a railway asset in Great Britain on the basis of a licence that is valid throughout the territory of the European Community will be entitled to membership in Network Rail.
governments, Regional Development Agencies, rolling stock lessors and manufacturers, passenger groups, disabled groups and railway unions.

30. The Membership Policy requires that Public Members will at all time comprise a majority, although they will not amount to more than 75% of the total membership. On the other hand, at least 60% of the overall number of members must at all time be from the private sector (which may be either industry members or public members).

31. SRA will have special membership rights in respect of certain matters to ensure delivery of the various outputs for the maintenance, improvement and development of the network. These special rights are, *inter alia*, a continuous right to membership, the right to require an extraordinary general meeting of Network Rail, enhanced voting rights to ensure that the SRA director may not be removed by other members, the right to remove all other members (but not some only) in the event of a fundamental financial failure, an entrenched right to prevent changes being made to their special rights and certain other provisions of Network Rail’s articles of association.

32. A “Membership Selection Panel” (the Panel) will be established. Its purpose is to establish and maintain a balanced and diverse membership that is broadly reflective of the range of industry, community and other stakeholder perspectives that are to be served by Network Rail. The Panel shall, in particular, ensure that the composition of the members meets the requirements of applicable laws, including the EU Infrastructure Directives and to avoid that any one interest group obtains a dominant influence over the company. The Panel will comprise a majority of persons who are independent of Network Rail and any License Holder and its selection policy will follow written and published terms of reference.

33. The role of the members is to hold the board of directors to account for its management. They will pursue their role by receiving regular reports on the company’s performance, by participating in members’ conferences and in general meetings. It is not the role of the members to set the strategic direction or engage in the management of the company. On the contrary, the only powers of strategic significance that members as a whole will have is the powers to appoint directors nominated for election to the board and, if necessary, to remove directors. In addition, Network Rail’s constitution specifically provides that the board is not subject to direction from members as how the company should be run.

34. The Board of directors will have control of the management of the company. It will consist of executive directors (who exercise day-to-day authority and responsibility) and non-executive directors (who provide independence and experience).

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6 “Fundamental financial failure” is intended to focus on the extent of drawings on the Government support made available to Network Rail.

Network Rail Financing

35. Network Rail Group’s business, i.e. the operation, maintenance, renewal and enhancement of the main rail infrastructure network in Great Britain is expected to be financed by commercial borrowings. However, since Network Rail is a new company with no assets acquiring an insolvent business with as yet unquantifiable liabilities, the UK Government will make available financial support to enable them to raise money on a viable and sustainable basis. The public financial support will essentially consist of capped standby credit facilities to be drawn on in the event that Network Rail’s commercial debt servicing and repayment obligations cannot be met. In addition, a capped standby facility from the SRA will also provide Network Rail with stand-by financial reserves equivalent to equity capital in a public limited company.

36. Under the UK regulatory system for the rail infrastructure industry, the Rail Regulator determines, through a periodic Charges Review, the infrastructure manager’s level of expenditure for operating, maintaining and renewing the principal rail infrastructure network over a period of five years. 8 This periodic review is based on assumptions relating to, inter alia, the infrastructure manager’s level of income, expenditure and the expected level of efficiency improvements to be achieved during the control period.

37. Due to the fact that certain costs and expenditure for Railtrack plc that were not taken into account by the Rail Regulator in his latest Charges Review, 9 the level of income determined by him will not be enough to cover Network Rail’s expenditure through March 2006 when the next scheduled Charges Review is due to take place. Consequently, Network Rail will face a substantial shortfall in income in relation to expenditure up until the next Charges Review (hereinafter called legacy costs) and may thus, in the short to medium-term, face some particular financial problems and uncertainties that may affect potential lenders’ willingness to lend money.

38. Network Rail will procure a short-term bridging finance, the Commercial Bridge Facility, which will provide bridging finance until longer-term debt financing can be implemented. The Commercial Bridge Facility will serve to:

- fund part of the acquisition price of Railtrack plc and associated cost and expenses,

- fund the acquisition price for the right to operate the Channel Tunnel Link and St. Pancras station, and associated cost and expenses. 10

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8 The last periodic review carried out by the Rail Regulator covers the control period 2001-2006.

9 These costs and expenditure relates to, inter alia, the cost increase in maintenance and renewals required following the Hatfield accident of 17 October 2000, costs increases on the West Coast Mainline project and inadequate information about the condition of the network assets.

10 Network Rail has offered Railtrack Group £ 80 million for the right to operate, manage and maintain the CTRL and the concession to operate St. Pancras station.
- fund the subscription of shares in OpCo by HoldCo for the purpose of providing OpCo with funds for repayment of premium relating to legacy financing debt,

- repay certain of Railtrack plc’s existing financial creditors at the time of exit from Administration and associated costs and expenses\(^{11}\), and

- provide short-term working capital for Network Rail following acquisition and finance payment of interest under the Commercial Bridge Facility.

39. The Commercial Bridge Facility, which will amount to an aggregate principal amount of £ 9 billion to be borrowed by Network Rail Holdings Ltd (HoldCo), will be supported by the SRA/HoldCo Facility and a Direct Agreement (see below).

40. The European Investment Bank (EIB) and Kreditanstalt für Wiederaufbau (KfW) are current lenders to Railtrack plc guaranteed by Railtrack Group, with total amounts outstanding of approximately £ 1 050 billion. These loans are not to be repaid upon completion of the purchase of Railtrack plc. Instead, EIB and KfW will provide the same loan facilities to the Network Rail Group. These financing arrangements will be supported by SRA Standby Loans combined with a Put/Call option.

41. Furthermore, Network Rail will procure commercial borrowings to finance its legacy costs. These borrowing will be supported by three different public facilities, (i) the Legacy Working Capital Support Facility/Direct Agreement, (ii) the Legacy Project Support Agreement (LPSA) and (iii) Facility B.

42. Below follows a summary of the financial measures that the UK Government will provide in order to support Network Rail’s necessary funding requirements for the take-over of Railtrack plc and the continued operation and management of the principal rail infrastructure network in Great Britain.

<table>
<thead>
<tr>
<th>Government support measure</th>
<th>Purpose</th>
<th>Amount of principal (£ million) *</th>
</tr>
</thead>
<tbody>
<tr>
<td>SRA acquisition grant</td>
<td>Payment of part of the purchase price for the acquisition of Railtrack plc shares</td>
<td>£ 300 (£ 480)</td>
</tr>
<tr>
<td>Tax indemnity by DfT</td>
<td>Offset tax liabilities in respect of capital gains that arise in Railtrack Group as a result of the sale of Railtrack plc</td>
<td>£ 146 (£ 234)</td>
</tr>
<tr>
<td>SRA/HoldCo facility / SRA Direct Agreement</td>
<td>Supports the Commercial Bridge Facility</td>
<td>£ 9 000 (£ 14 400)</td>
</tr>
</tbody>
</table>

\(^{11}\) The largest single item being the repayment of the UK Government rescue loan, which was authorised by the Commission on 13 February 2002, NN 170/2001, OJ C 98 p. 36 of 23.4.2002.
<table>
<thead>
<tr>
<th>Description</th>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>SRA standby loans to OpC for the EIB/KfW facilities; Put/Call option</td>
<td>Support existing EIB/KfW loans</td>
<td>£ 1 050</td>
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<tr>
<td></td>
<td></td>
<td>(€ 1 680)</td>
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<tr>
<td>Legacy Working Capital Support / Direct Agreement</td>
<td>Support the funding of unremunerated legacy costs</td>
<td>up to £ 5 000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(€ 8 000)</td>
</tr>
<tr>
<td>Facility B of SRA/OpCo Facility</td>
<td>Fund unremunerated legacy costs (either directly or through support for</td>
<td>£ 3 000</td>
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<tr>
<td></td>
<td>commercial facilities)</td>
<td>(€ 4 800)</td>
</tr>
<tr>
<td>Facility A of SRA/OpCo Facility</td>
<td>Contingency buffer for cost overruns and shocks</td>
<td>£ 5 000</td>
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<td></td>
<td></td>
<td>(€ 8 000)</td>
</tr>
<tr>
<td><strong>Total support</strong></td>
<td></td>
<td>£ 23 496</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(€ 37 594)</td>
</tr>
<tr>
<td>Legacy Project Support Agreement **</td>
<td>Provides a stream of SRA grants to support raising of debt to finance</td>
<td>£ 6 000</td>
</tr>
<tr>
<td></td>
<td>unremunerated legacy costs</td>
<td>(€ 9 600)</td>
</tr>
</tbody>
</table>

* exchange rate € 1 = £ 1.6

** The total amount under each of the Legacy Project Support Agreement the Legacy Working Capital Support/Direct Agreement can never be called at the same time. Therefore, it does not increase the aggregate amount of the State aid package (see further below, para 54).

** SRA Acquisition Grant**

43. Network Rail and Railtrack Group have agreed on a price of £ 500 million, net of taxes, for the shares in Railtrack plc. Network Rail will raise this amount through an UK Government grant of £ 30012 million whereas the remaining £ 200 million will be provided by Network Rail through a commercial loan under the Commercial Bridge Facility, which is supported by the SRA/HoldCo Facility and the SRA Direct Agreement.

44. Before the establishment of Network Rail the UK Government, advised by its independent financial experts,13 conducted an analysis of statements made from institutions, shareholders in Railtrack Group and Railtrack Group itself, and from a number of large institutional shareholders to determine the range of commercial prices that a rational investor would be prepared to offer for the shares of Railtrack plc under the prevailing circumstances. [...]14 Subsequently, Network

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12 The UK Government, advised by its independent experts Mercer Management Consulting, has estimated that the economic value of an early exit from administration could amount to £ 650 million. It hence considered that a grant of £ 300 million to facilitate such an early exit was proportionate.

13 The investment bank Schroder Salomon Smith Barney.

14 Prior to Administration in October 2001, Railtrack plc represented over 80% of Railtrack Group’s net assets and over 95% of Railtrack Group’s turnover in statutory accounts. On 5 October 2001,
Rail made its own analysis and concluded [...]. Consequently, on 25 March 2002 Network Rail offered Railtrack Group £500 million for the shares in Railtrack plc. Following negotiations, the deal was closed on 27 June 2002. The UK Government submits that in view of the complicated and unusual circumstances surrounding the administration of Railtrack plc the price agreed is within the range that a commercial investor would be prepared to pay in order to acquire the shares of Railtrack plc. Indeed, the UK Government claims that the market price for Railtrack plc is the price that a purchaser is prepared to pay and the seller prepared to accept.\footnote{15}

\textit{Tax Indemnity by DfT}

45. As mentioned above, the agreed purchase price for Railtrack plc is free of tax. Consequently, the buyer would have to indemnify Railtrack Group for any potential tax liabilities in respect of capital gains that could arise as a result of the sale of the shares. Initially, it was anticipated that any such potential tax indemnity would be given by Network Rail to Railtrack Group in the Sale and Purchase Agreement and supported by a grant funding from the UK Government if a tax liability actually became payable. However, such a mechanism would potentially lead to additional tax costs and the UK Government therefore decided to structure this arrangement as a direct indemnity to Railtrack Group from the Government. Consequently, the UK Government will, if necessary, make available funds, or procure that funds are made available, to offset tax liabilities in respect of capital gains that could arise in Railtrack Group as a result of the sale of Railtrack plc in such a way that Railtrack Group receives and retains £ 500 million from the sale.

\textit{The SRA /HoldCo Facility and the SRA Direct Agreement}

46. Network Rail will cover its need for short-term financing through commercial borrowings, e.g. the Commercial Bridge Facility. The SRA/HoldCo Facility will provide specific support for the Commercial Bridge Facility and will be sized to match the amount due under the latter facility. The overall cap on the principal amount will however be £ 9 billion. The SRA/HoldCo Facility is structured as a loan of last resort and it is suggested that the facility will provide commercial lenders with confidence that, at a last resort, any indebtedness under the Commercial Bridge Facility will be repaid by HoldCo from drawings under the SRA/HoldCo Facility. The interest rate for drawings under the SRA/HoldCo Facility is the aggregate of LIBOR plus a margin of 1.5 % per annum.

47. The purpose of the Direct Agreement is to give Commercial Bridge Facility lenders certain direct rights in respect of the SRA/HoldCo Facility. It includes a Put Option whereby, in certain specific circumstances, the commercial lenders can require the SRA to purchase all amounts due to them by HoldCo. The Put

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It should be noted that following Network Rail’s bid the UK Government has received representations from two substantial Railtrack shareholder associations protesting at the substantial undervaluation of Railtrack plc, which has been reflected in the offer.
option reduces the risk to the banks, which will be reflected on the price offered by lenders for each facility. There is also a matching Call Option, which allows the SRA to require commercial lenders to sell to the SRA all amounts due to them from HoldCo.

48. Accordingly, the Direct Agreement, the SRA/HoldCo Facility and the Commercial Bridge Facility form a suite of inter-connecting agreements that ensure lenders that, at a last resort, any indebtedness under the Commercial Bridge Facility will be repaid either by (i) HoldCo from drawings under the SRA/HoldCo Facility or (ii) the lender putting the Commercial Bridge Facility to the SRA pursuant to the Direct Agreement or (iii) SRA exercising the Call Option.

49. Furthermore, due to the restrictions placed on HoldCo’s activities (para. 21) it will be unable to make acquisitions and investments in its own right or to invest in business other than OpCo. In addition, under the terms of the SRA/HoldCo Facility, HoldCo is obliged to apply all amounts borrowed under it towards repayment of the Commercial Bridge Facility indebtedness. As the Commercial Bridge Facility will be used either for the acquisition of Railtrack plc and the right to operate CTRL or to provide working capital for OpCo’s Permitted Business, SRA/HoldCo Facility can only be used for purposes that are directly related to the management and operation of Great Britain’s main rail infrastructure network by Network Rail Group.

EIB / KfW Facility

50. As noted above, the European Investment Bank (EIB) and Kreditanstalt für Wiederaufbau (KfW) are current lenders to Railtrack plc with total amounts outstanding of approximately £1 050 billion. These loans will be carried over to the Network Rail Group (OpCo) on essentially existing terms. SRA will guarantee the debt through the SRA Standby Loan Facility combined with a Call/Put option, whereby EIB and KfW may, under certain circumstances, put the outstanding debt to the SRA or SRA require them to sell to SRA all amounts due to them from OpCo (ex-Railtrack plc). Any funds raised against this facility must be used to refinance the existing EIB/KfW loans and may not be used for any other purposes.

Legacy costs

51. As noted above, Network Rail will, following the purchase of Railtrack plc, face costs and expenditure that were not taken into account by the Rail Regulator when he carried out his regulatory Charges Review for the period up to 2006. However, these costs need to be funded in order for Network Rail to deliver the outputs required by the Regulator in the same review. Consequently Network Rail will have to make commercial borrowings to meet this shortfall. The borrowings will be supported by three different public measures, (i) the Legacy Working Capital Support Facility/Direct Agreement, (ii) the Legacy Project Support Agreement (LPSA) and (iii) Facility B.

Legacy Project Support Agreement (LPSA)
52. The LPSA takes the form of a deferred grant and will provide a stream of income payable over 30 years, starting from 30 September 2004, which will allow Network Rail to finance the legacy costs it expects to incur in the period from 1 April 2003 up to the earlier of the next periodic Charges Review or 30 September 2004. Accordingly, the LPSA will provide Government support for losses actually incurred in respect of OpCo’s Permitted Business.

**Legacy Cost Working Capital Facility**

53. However, there is some uncertainty regarding the future level of grants payable under the LPSA, as it will depend on the costs that the Rail Regulator will take into account in his periodic Charges Review. Therefore, the support provided by the LPSA may not be sufficient to enable Network Rail to raise sufficient finance to cover its legacy costs prior to the next Charges’ Review. In order to provide more certainty of funding for Network Rail, the UK Government has put in place the Legacy Cost Working Capital Facility, which is a loan capped at £5 billion. This facility will be accompanied by a Direct Agreement between the commercial lenders and SRA.\(^\text{16}\) The interest rate on any drawings under this facility will amount to the aggregate of LIBOR and a margin of 1.5%. Moreover, any amount borrowed under this facility will be required to be applied towards expenditure to be incurred in respect of OpCo’s Permitted Business only.

**Facility B of the SRA/OpCo Facility**

54. Facility B is a loan facility from the SRA to Network Rail that is capped at £3 billion. The loan will be made available immediately and the interest rate to be paid on any drawings under this facility will amount to the aggregate of LIBOR plus a margin of 4%.

55. Under the terms of this facility, OpCo is required to apply all amounts borrowed towards either expenditure incurred or to be incurred in respect of its Permitted Business, and/or amounts incurred or to be incurred in respect of increased levels of network renewals greater than those provided for in the most recent periodic Charges Review.

56. The LPSA, the Legacy Working Capital Facility and Facility B cannot all be used at the same time. The SRA is required to give its approval for debts raised against the LPSA. If such approval is sought when there are already borrowings against the Legacy Working Capital Facility, the SRA will not give such approval unless the money already raised are first used to pay off borrowings against or under the Legacy Working Capital. On the other hand, if approval for a debt raised against the LPSA is sought when there are no such borrowings against the Legacy Working Capital Facility, then the condition for giving the approval will be a cancellation of the same amount available under the Legacy Working Capital Facility. Therefore, the total amount of public support available under a combination of the LPSA and the Legacy Working Capital Facility will not

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\(^{16}\) The direct agreement includes a “Put Option” whereby, in certain specific circumstances, the commercial lenders can require the SRA to purchase all amounts due to them by HoldCo and a matching “Call Option”, which allows SRA to require the commercial lenders to sell to the SRA all amounts due to the commercial lenders from HoldCo.
exceed £5 billion. Facility B can however be used together with either the LPSA grant or the Legacy Working Capital Facility.

*Facility A of the SRA/OpCo Facility*

57. The UK Government will make available a stand-by loan to Network Rail of up to a maximum of £5 billion. Its specific function is to act as a substitute for the equity buffer that would be present in a substantially capitalised company and any borrowings under it may be used towards Network Rail’s general corporate purposes. This facility will be structured as a loan of last resort with an interest rate amounting to the aggregate of LIBOR plus a margin of 6%. Given that this is a facility of last resort, Network Rail will be required to demonstrate that it has utilised all other available funds before any drawings may be made under this facility. In addition, if more than 5% of the Facility is drawn, the CEO and chairman are automatically dismissed and if more than 80% is drawn, all of the non-SRA members may be removed and the SRA will become the sole member of Network Rail.

*The acquisition of the rights to operate CTRL and St. Pancras station*

58. Following financial difficulties within the Railtrack Group and, in particular, the placing of Railtrack plc in Administration, the Railtrack Group will dispose of its interest in the CTRL project, held by RTUK, to a combination of London & Continental Railways (LCR) and Network Rail. Accordingly, LCR has made an offer to acquire the Section 1 assets for £295 million, while Network Rail has offered to pay £80 million for the right to operate the CTRL and St. Pancras station. Network Rail’s purchase of the operating rights is part of the overall package that Railtrack Group has agreed to sell to Network Rail. In return for operating and maintaining the CTRL, Network Rail will be entitled to have all its costs associated with operating the CTRL and St. Pancras reimbursed by LCR and to receive from LCR an annual fixed fee and an annual performance-related fee.

59. Railtrack Group, London & Continental Railways and the UK Government, each supported by its own expert advisers, produced their own range of estimates for the value of Railtrack Group’s interest in the CTRL. [...] The determination of the value within the range of these estimates was the result of discussion and negotiations between the interested parties. The final price agreed between Railtrack Group and Network Rail for the operating rights of the CTRL and St. Pancras station were within the range of these estimates.

60. Moreover, the operation of CTRL and St. Pancras station was to have been carried out by Railtrack plc rather than by RTUK, as the latter would not have had the resources to carry out this activity but this option is clearly no longer possible. On the other hand, there are significant advantages in the operation and maintenance of CTRL being carried out by the national infrastructure manager, as it will provide improvements in terms of efficiency, effectiveness and safety where the CTRL connects with the rest of the national rail network and provides economies of scale in relation to, *inter alia*, signalling arrangements.
61. The purchase price for the right to operate the CTRL and St. Pancras station will be raised by Network Rail under its Commercial Bridge Facility, supported by the SRA/HoldCo Facility provided by the UK Government.

Existing rescue aid

62. By decision of 13 February 2002, the Commission authorised the UK Government to make available loans (possibly replaced by guarantees) of an amount of up to £5.42 billion in order to rescue the business of Railtrack plc in Administration and to ensure the continued operation of the Great Britain rail network pending the transfer of Railtrack plc out of Administration.\textsuperscript{17} The aid measure required, amongst others, Railtrack plc to procure that any Government liability under a guarantee was released, terminated and discharged in full on the earlier of the date of the transfer of Railtrack’s relevant activities to a successor, the discharge of the Railway Administration Order or on 30 September 2002.

63. An initial rescue loan was replaced in March 2002 by commercial bank facilities backed by a Government guarantee. However, in order to implement the restructuring measures now notified it is necessary to extend the Government support cleared in the aforementioned decision until such time as Railtrack plc has been brought out of the Administration and commercial borrowings has been raised by Network Rail for the purpose of repaying or refinancing existing debts of Railtrack plc.

64. Accordingly, the UK Government requests the rescue aid measure to be amended so as to allow that the Government’s liability under the guarantee is released, terminated and discharged in full of the earlier of 28 days after the date of the discharge of Railtrack plc from the Railway Administration Order or on 30 November 2002.

United Kingdom submissions

65. The UK Government holds the view that the notified arrangements do not constitute aid within the meaning of Article 87.1 of the Treaty. It claims that the railway network in Great Britain is essentially a natural monopoly and that there is no developed market in the EU for railway infrastructure management. In any event, the regulatory regime and the financial framework ringfence the support measures and ensures that it can only be used for the management and operation of the principal rail infrastructure network in Great Britain. Accordingly, the UK Government argues that the financial support provided can not distort or threaten to distort competition in a way which affects trade between Member States.

66. In the alternative, the UK Government claims that the arrangements may be considered compatible with the Treaty as they provide the minimum necessary to enable the provision of a service of general economic interest in accordance with Article 86.2 of the Treaty and for the co-ordination of transport under Article 73. Finally, the UK Government submits that the measures may be exempted by virtue of Article 87.3 (c) of the Treaty.

Assessment of the aid measure

Existence of aid

67. According to Article 87.1 of the EC Treaty shall, save as otherwise provided in the Treaty, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods be incompatible with the common market, insofar it affects trade between Member States.

68. It follows that in order to ascertain whether the financial measures provided by the Strategic Rail Authority (SRA) to Network Rail constitute aid within the meaning of Article 87.1 of the Treaty, the Commission has to assess whether the financial support:

- is granted by the State or through State resources,
- favours certain undertakings or the production of certain goods,
- distort or threatens to distort competition and,
- affects trade between Member States.

Transfer of State resources

69. The UK Government, through the Strategic Rail Authority, will provide Network Rail with financial support, the purpose of which is to bring Railtrack plc under the ownership of Network Rail, out of administration and to allow Network Rail to raise the funds necessary in order for it to manage the main rail infrastructure network in Great Britain on a sound financial basis. Accordingly, Network Rail will benefit from a transfer of State resources.

Favouring certain undertakings or the production of certain goods

70. The Commission holds the view that, in general, State funding for the construction or management of transport infrastructure is not to be regarded as aid within the meaning of Article 87.1 of the Treaty, if access to the infrastructure is open to all potential users on non-discriminatory terms. However, if the body managing the infrastructure is pursuing an economic activity, any State grant to that body has to be examined for State aid implications, as the grant may provide a potential competitive advantage to the beneficiary.

71. The financial measures that the UK Government will make available will support either Network Rail’s acquisition costs for Railtrack plc and the right to operate the Channel Tunnel Rail Link or support the commercial borrowings that Network Rail must raise for it to be able to manage and operate the Great Britain rail network on a financially sound and secure basis.

72. Network Rail, through its subsidiary OpCo, will upon acquisition of Railtrack plc become the new infrastructure manager of the principal rail network in Great Britain.

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Britain and hence responsible for operating, maintaining and renewing the railway network. Therefore, it is responsible for providing rail passenger and rail freight operators with essential rail services, such as access to the tracks and associated infrastructure against a fee (access charges). Since the provision of rail services is a distinct market, Network Rail must be considered to carry out an economic activity and is thus an undertaking within the meaning of Article 87.1 of the Treaty.

73. The Commission recalls that the UK Government has decided to entrust Network Rail (a company limited by guarantee) to manage the main rail infrastructure network in Great Britain on a not-for-profit basis in the general and public interest. It follows that the acquisition costs incurred on Network Rail are a prerequisite and absolutely necessary in order to enable it to go forward and fulfil the task that has been entrusted to it, i.e. to provide the safe, efficient and effective management of Great Britain’s main rail infrastructure network on a financially sound and secure basis in the general and public interest. The Commission is therefore satisfied that the public funding made available for the acquisition costs forms a fundamental and integrated part of the overall restructuring of rail infrastructure management in Great Britain.

74. Furthermore, it is noted that the acquisition cost, including the tax indemnity, is the result of commercial negotiations between Network Rail and the current owner, Railtrack Group. The Commission is satisfied that the purchase price does not amount to an overcompensation for Railtrack Group and that the price paid is within the range that a commercial investor would have been prepared to pay. It hence follows that the UK Government’s funding package does not involve any State aid to Railtrack Group and that Network Rail is the sole beneficiary of the financial support in question.

Distortion of competition

75. Within the European Union the operation and management of the main national rail infrastructure network is considered to be confined to the territory of a Member State. Moreover, given the “essentially facility” nature of the main rail infrastructure network for which high investments costs would make the replication prohibitively expensive, the operation and management of any given integrated rail infrastructure network may be characterised as a “natural monopoly” within this territory. It follows that there is no competition on the market for operating and managing the national rail network.

76. Moreover, the responsibility to operate and manage the main national railway networks was and, with the exception of the United Kingdom until this date, is still the responsibility of the State, either through an administrative body or by a public undertaking, in many cases under a statutory monopoly. Furthermore, EU-legislation requires the separation of rail infrastructure management and rail traffic operations in order to ensure, amongst other, fair and non-discriminatory access to the infrastructure for train operators. Member States are however not

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required to open up the operation and management of the rail infrastructure network to competition. It follows that, as a general rule, there is no competition for the market of operating the national rail network.

77. The only exception however occurred in 1996 when the United Kingdom privatised the then wholly State owned company Railtrack plc by floating the company’s shares on the stock market and, consequently introduced competition for operating and managing the rail network in Great Britain. Following Railtrack plc’s financial failure, the continuous deterioration of this network and the lack of competitors interested in taking over Railtrack plc’s business, the UK Government has decided to entrust the management to a Company Limited by Guarantee, Network rail, which will operate the main rail network in Great Britain under the conditions of a Network Licence that is unlimited in duration.

78. Accordingly, the UK Government has thus effectively closed the market for operating the main rail network in Great Britain to competition (which it opened up in 1996) and will align its rail infrastructure management model to the structure prevailing in other Member States of the European Union, including those Member States that have opened up their markets for rail service operations to competition, e.g. Sweden. Network Rail, including its subsidiaries, is established with the objective to carry on the business of acquiring, owning, managing, providing, operating and developing the principal railway network and stations in Great Britain in all their aspects. In particular, it will assume the responsibility of managing the main rail infrastructure network in Great Britain in accordance with a Network Licence. The licence explicitly restricts its activities to the sole core business activity of operating, maintaining, renewing and enhancing the main national rail network in Great Britain (Network Business) and, to a negligible degree, other ancillary activities (Permitted Non-Network Business). The Network License also prohibits cross-subsidisation between the Network Business and any other business activity of OpCo and, under Network Rail’s constitution, any surplus must be re-invested into its core business.

79. Furthermore, all public facilities made available to Network Rail has been ringfenced as to ensure that any money received, or borrowed against the facilities, must and will be used to support only Network Rail’s Permitted Business under the Network License. Consequently the funding package made available by the UK Government may be used only for purposes that are directly related to the management and operation of the Great Britain main rail infrastructure network and cannot “leak” into any other market.

80. Accordingly, the Commission finds that the financial funding made available to Network Rail by the UK Government are confined to the management and operation of the main national railway network in Great Britain and associated services. Since this market has been effectively closed for competition the public support is not liable to distort competition.

Affect on trade between Member States

81. The Commission recalls that according to established case law, any public financial support, which strengthens the position of an undertaking as compared
to other undertakings competing in intra-community trade is considered to affect trade between Member States.  

82. Following the UK Government’s decision to entrust Network Rail with the right to operate the monopoly rail network in Great Britain, management and operation of the main rail infrastructure networks within the EU will be carried out in 15 geographically closed and separated markets that are not subject to competition, neither on the market, nor for the market.

83. Furthermore, Network Rail has no equity, it will not distribute any dividends (having no shareholders) and any surplus must be re-invested into its business. Therefore, there is no economic value in Network Rail. In addition, neither of Network Rail’s subsidiaries can be taken over by other commercial actors as the regulatory regime prohibits the disposing of any shares or control in them. Network Rail can therefore neither be acquired by another commercial entity, nor transfer the right to operate the rail network to another undertaking. The Commission also notes the fact that the subsidies in question is confined to Network Rail’s infrastructure management activities of the main railway network and associated activities in Great Britain only.

84. It follows that the public financial support made available to Network Rail is not liable to affect intra-community trade.

85. In light of the above considerations, the Commission concludes that the public support made available to Network Rail does not constitute aid within the meaning of Article 87.1 of the EC Treaty.

86. The Commission has in several previous decision found that public support made available to Network Rail’s predecessor, Railtrack plc, have constituted State aid within the meaning of Article 87.1 of the Treaty. However, the special characteristics of Network Rail, the restrictions placed on its activities and, in particular, the effective closure of the market for operating the main rail network in Great Britain to competition, lead the Commission to conclude that the public support made available to Network Rail, in this particular case, does not constitute aid within the meaning of Article 87.1 of the Treaty.

87. Finally, as regards the UK Government’s request for an amendment to the conditions attached to the State guarantees issued in accordance with the Commission’s decision of 13 February 2002 authorising rescue aid to Railtrack plc, the Commission notes the following. The Commission concluded in the aforementioned decision that the loans and/or guarantees provided by the UK authorities were to be reimbursed within a period of twelve months from the last instalment to Railtrack plc and therefore fulfilled the requirements laid down in the Commission’s Guidelines on rescue and restructuring aid.

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88. It follows that an amendment to these repayment conditions, the purpose of which is to allow that the Government's liability under a guarantee issued in March 2002 is released, terminated and discharged in full of the earlier of 28 days after the date of the discharge of Railtrack plc from the Railway Administration Order or on 30 November 2002, falls within the Commission’s decision of 13 February 2002 and therefore requires no additional authorisation.

Decision

The Commission has accordingly decided:

- to consider that the notified measure does not constitute state aid within the meaning of Article 87.1 of the EC treaty and not to raise any objections.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://europa.eu.int/comm/secretariat_general/sgb/state_aids/. Your request should be sent by registered letter or fax to:

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Yours faithfully,

For the Commission

Loyola de Palacio
Vice-president