

T: 0300 244 4000  
E: scottish.ministers@gov.scot

Mr Edward Mountain MSP  
Convener  
Rural Economy and Connectivity Committee  
The Scottish Parliament  
EDINBURGH  
EH99 1SP

---

22 February 2018

Dear Convener

I am writing to update the Committee in light of this morning's communication by Serco Group of its financial returns for 2017.

That release made public that Serco's Accounts contain an onerous contract provision to cover the current and anticipated losses of Serco Caledonian Sleepers Limited.

Depressed financial performance in the early years of rail franchises in the UK is not unusual, and is consistent with our understanding of the franchisee's financial model whereby early investment is recovered later in the franchise term.

In recent months we have been working with Serco to understand Serco Caledonian Sleepers' position more fully. Discussions and information exchanged is in the context of a long term commercial contract and is protected by mutual contractual obligations of commercial confidentiality which both parties must respect.

The Caledonian Sleeper franchise remains an important part of Scotland's transport mix.

Following strong investment by the Scottish Government, both in terms of subsidy and capital grant, we have already seen a transformation of this service across the passenger experience, in the marketing and promotion of the service, in its Scottish SME supply chain, and in the procurement of new trains which will enter service later this year.

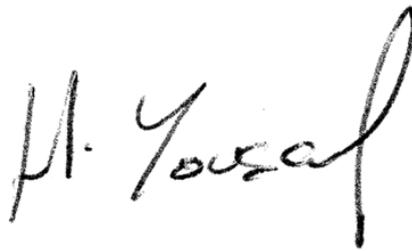
This franchise has seen patronage grow by 21% in its first two years. Revenues are strong, and there is clear demand – often months in advance – for the unique journeys offered by Caledonian Sleeper.

Serco is contracted to deliver the contract in the terms agreed in its Franchise Agreement with the Scottish Ministers Serco have confirmed they are committed to continuing the contract.

It is important to acknowledge that, in contracts of this type, risk-sharing mechanisms are inevitably included to reflect the significant complexities of long term projections and assumptions. In this case, after 7 years the franchisee can propose a contractual recalibration of the basis on which payments to it are calculated. Ministers can either accept that proposal or exercise their right to terminate the contract in response.

Similarly, the contract also includes a mechanism that, after 5 years, potentially shares exposure to losses. If Serco were to seek to rely on that mechanism to mitigate some of its projected losses, a key task for the Scottish Government will be to closely interrogate any claimed entitlement to such support, and that is what we will do.

Finally, I take this opportunity to confirm that I am committed to ensuring continued and sustainable delivery of this iconic service. The Scottish Government will continue to work with Serco to oversee their custodianship of this important service.

A handwritten signature in black ink, appearing to read 'H. Yousaf', written in a cursive style.

**HUMZA YOUSAF**