

## The Mersey Gateway Public Inquiry 2009

### PROOF OF EVIDENCE OF DR ANNE STAFFORD & PROFESSOR JEAN SHAOUL

#### **Introduction**

1. This proof of evidence is from Dr Anne Stafford and Professor Jean Shaoul.

Anne Stafford is a member of the Association of Chartered Certified Accountants who started lecturing in 1990 and is currently at Manchester University Business School. Her research expertise is in critical and historical analysis of institutions and accountability including research into the private finance initiative and public private partnerships.

Jean Shaoul is an economist and Professor of Public Accountability at Manchester University Business School. Her research expertise is in business and public policy and finance. She uses financial information from the corporate and public sectors to evaluate public policy decisions and inform wider economic and social issues from a public accountability perspective.

#### **Background to our interest in the scheme**

2. We became interested in the Runcorn Bridge as part of our ongoing research into the use of private finance in public infrastructure, known generically as the Private Finance Initiative (PFI) and Public Private Partnerships (PPP). The policy is also known as Design Build Finance and Operate (DBFO) and concessions in the roads sector. Our work has been funded and published by the Association of Chartered and Certified Accountants<sup>1</sup> and the Institute of Chartered Accountants for Scotland.<sup>2</sup> We have looked at the cost and outcomes of transport schemes in general and road concessions in particular both in Britain and internationally, and published separately and jointly in peer reviewed internal journals. We are recognised internationally as authorities on PPPs in general, and roads and hospitals in particular.

#### **The basis of our opposition to the scheme**

3. Firstly, our work has consistently shown that the use of private finance for public infrastructure, however the projects are configured financially, adds substantially to the overall cost and this is necessarily reflected in either the charges to the public sector via shadow tolls and availability payments, or the toll charges to users. Even schemes involving user charges usually involve some explicit or implicit public support in order to make them commercially viable and therefore attractive to the private sector. The rationale has usually been that the risk transferred to the private sector justifies the additional cost of private over public finance. But our own and other studies have shown that it is difficult to see what risks have in practice been transferred that justify the additional cost of private finance.

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<sup>1</sup> SHAOUL, J., STAFFORD, A., STAPLETON, P., and MACDONALD, P. (2008) "*Financial black holes: accounting for privately financed roads in the UK*", ICAS, Edinburgh.

<sup>2</sup> EDWARDS, P., SHAOUL, J., STAFFORD, A., and ARBLASTER, L., "*An Evaluation of the Operation of the Private Finance Initiative in Roads and Hospitals*", published by the Association of Chartered and Certified Accountants, November 2004.

4. When things go wrong, the public sector has either to renegotiate the deal or take it over, picking up the bill for the private sector's debt, which is often significantly larger than the project's construction cost<sup>3</sup>. In essence therefore, when things go well, the public sector and the user pay dearly for 'risk transfer', and when there are problems, the taxpayers and/or the users pick up the tab as risk is spread in unanticipated ways<sup>4</sup>. Either way, such schemes are not a good use of the taxpayers or users' money.
5. Secondly, the lack of clear, consistent and useful financial information is of concern. Our studies have shown that both the public authorities and the companies involved have routinely failed to provide the necessary financial detail both before and after financial close<sup>5</sup>. Furthermore, when pressed under *Freedom of Information* to provide the information that would enable a proper understanding of the costs and benefits to the various parties involved, they hide behind the veil of 'commercial in confidence'. In other words, there is a lack of transparency. The public has every right to believe that where there is a lack of transparency, it is because there is something to hide: the absence of useful financial information masks the arrangements that privilege the private partner at the public's expense. In any event, the public is paying and they have a right to know about the financial decisions being made on their behalf.
6. There is a lack of evidence demonstrating that the New Mersey Gateway will have the requisite traffic flows to make it both commercially viable and affordable to the public, given the high construction and financing costs. Our analysis of this and other cases suggests that the cost of private finance will add enormously to the overall cost of the project and hence the tolls. It can only be made viable and affordable by some combination of public support and very high toll charges. But high tolls could deter users and make the scheme unviable, leading the concessionaire to hand back the keys and forcing the public authority to assume responsibility for its debt and interest charges, necessarily higher than under public finance. While the public authorities in these types of schemes always start by saying that there will be little or no public support for the project, the financial realpolitik dictates otherwise. Like the Skye Bridge, the government is proposing to make some funds available for this bridge. But like Skye, it could end up paying more than the bridge cost to build in order to support a financially ill conceived scheme. The bridge could be provided much more cheaply, if the government made up the difference, either with a capital grant or public debt, to the benefit of road users and taxpayers alike.
7. This submission focuses on the financial costs of the project to the various stakeholders, including financiers, taxpayers and users, of procuring the bridge with private as opposed to public finance.

## The Mersey Gateway

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<sup>3</sup> ACERATE, B., SHAOUL, J., and STAFFORD, A. (2009) "Taking its toll: the cost of using private finance to build and operate roads in Spain", *Public Money and Management*, Vol 29, No 1, pp 19-26.

<sup>4</sup> EDWARDS, P., and SHAOUL, J. (2003) "Partnerships: For Better for Worse?" *Accounting, Auditing and Accountability Journal*, Vol. 16, No 3, pp397-421.

<sup>5</sup> SHAOUL, J., STAFFORD, A., STAPLETON, P., and MACDONALD, P. (2008) "*Financial black holes: accounting for privately financed roads in the UK*", ICAS, Edinburgh.

8. We explain our understanding of the Mersey Gateway project, its structure and cost, and set out the broader financial implications. This submission relies upon the evidence released by the project director, Steve Nicholson of Halton Council<sup>6</sup>, and Richard Threlfall of KPMG LLP, financial advisors to Halton Council, who believes that the proposal is financially viable.
9. However, it must be said at the outset, there are a number of problems that make it difficult to understand the costs. Firstly, while there are many documents relating to the project on the Council's website, it is difficult for an external user to determine the most relevant ones. Secondly, the financial information in the public domain is scanty to say the least, and is insufficient to understand fully how the scheme will operate. Thirdly, the different sources provide inconsistent data that are difficult to reconcile. For example, there is an economic appraisal report and it is not at all clear that it uses the same financial assumptions and data as the project sponsor. For example, it assumes toll revenues at 2006 prices without VAT that appear to be lower than the Mersey Tunnel charges.
10. This poor, inadequate and inconsistent financial information is itself a cause for concern since it prevents an informed public debate. It is a matter of some concern that KPMG can submit a report stating that it believes the scheme is commercially viable without providing any evidence to demonstrate that this is indeed the case.
11. The experience of a number of failed rail franchises<sup>7</sup> and PFI projects (London Underground<sup>8</sup>, National Air Traffic Services<sup>9</sup>), to name but a few of those of which we have worked on, demonstrates that their business cases were overoptimistic. They were never viable. Yet they were all signed off by expensive consultants hired by both parties, the private sector and the public authority. Furthermore, it was not a case of being wise after the event. It was possible to see prior to financial close, even without the benefit of detailed financial data, but relying on publicly available information such as the annual report and accounts of the organisations concerned, that these schemes were not viable. In the event, we were proved right.
12. This is because the public authorities are not independent. Given government policy that refuses to make public money available and will only approve PFI if it can be demonstrated that it is likely to deliver value for money and be financially viable, then everyone colludes to show that it will. Financial advisors produce the case that will please their clients. They too are not independent but have a vested interest in the growth of PFI. A number of them have equity stakes in some projects and/or are major subcontractors.

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<sup>6</sup> Nicholson, S (2009) Mersey Gateway: proof of evidence, sponsor, [http://www.persona.uk.com/mersey/HBC\\_docs/Proofs/HBC-02-1P.pdf](http://www.persona.uk.com/mersey/HBC_docs/Proofs/HBC-02-1P.pdf), accessed May 20/05/2009

<sup>7</sup> SHAOUL, J. (2006) "The cost of operating Britain's privatised railways", *Public Money and Management*, Vol. 26, No.3, pp151-158.

<sup>8</sup> SHAOUL, J. (2002) "A Financial Appraisal of London Underground Public Private Partnership", *Public Money and Management*, Vol. 22, No.2, April-June.

<sup>9</sup> SHAOUL, J. (2003) "Financial analysis of the National Air Traffic Services Public Private Partnership", *Public Money and Management*, Vol. 3, No 23, July, pp185-194.

13. It is important to understand the source of the problem. The turn to private finance was justified in terms of the value for money to be derived from the greater efficiency and innovation of the private sector and the transfer of some of the risks to the private sector. But the private sector has a higher cost of capital than the public sector, where capital includes both debt, which carries a higher interest charge than government debt, and equity, which requires a higher return than debt because equity capital is perceived as more risky. This is important in the context of roads and bridges, where the capital as opposed to the operating cost is typically high. The financial viability of such projects depends upon their ability to generate sufficient cash revenues to recover the full costs over the life of the contract, including the cost of debt and equity, under conditions where the demand is rarely sufficient to recover costs. This is after all why most infrastructure and public services have been provided by the state: they are simply too financially risky to be provided commercially on a universal and comprehensive basis.
14. In the context of private finance with user charges, tolls add to both construction and operating costs. Since tolls must cover the cost of debt and equity, the toll charges will be a function of traffic volume and loan period: high volume roads can be repaid within a relatively short period, whereas low volume roads will take longer to repay. Even under conditions of high volumes, political realities may dictate low tolls spread over a longer period. But should traffic flows be low or lower than predicted, then the roads and bridges will operate below capacity, making them difficult to fund. This then necessitates some combination of higher tolls, capital grants and public subsidy. British and international experience has reflected these financial realities. Franchises (Britain) and road concessions (Spain, Mexico and numerous other countries) have had to be renegotiated, bailed out or taken back into public ownership. In the context of Britain, it was these considerations that lay behind the government's original contribution to the capital costs of the Skye Bridge, the high tolls, and the Scottish Executive's subsidy of the tolls, payment of VAT charges and the ultimate decision to terminate the contract.

### **The project**

15. The Mersey Gateway is to be structured as a concession whereby the private sector partner, typically a consortium, will build the bridge and adjacent roads. It will operate and maintain the bridge and roads, including also the existing Runcorn Bridge, which will be redesigned to allow only two lanes of traffic, one in each direction, and will also be tolled and de-linked to ensure that users do not avoid the toll road. This is the first time that a free bridge has been tolled.
16. The Department of Transport will provide PFI credits in the form of an annual payment or revenue support for the public authority for the project, an amount equal to £123m. It is however unclear what price levels are being used and/or whether this is discounted to a present value. The New Gateway website indicates this constitutes an operating subsidy of £8m a year, implying a total cash payment of £240m and therefore the £123m may be the present value of £240m. The North West Regional Funding allocation (RFA) will provide a capital grant of £86m (cash). The rest of the money will come from user charges. The user charges are not to be controlled via the contract or externally regulated, although it is expected that tolls will rise by the retail price index plus 1%.

17. The concessionaire will be a consortium of several companies, typically including a financial institution and construction and maintenance companies, known as a special purpose vehicle (SPV), which is a shell company, with no employees that subcontracts elements of the contracts to sister companies. This structure is important to understand. It will be financed primarily by debt and have no recourse to its parent companies.
18. Halton Council has carried out a financial forecast, which it has not published as the financial model is 'commercially confidential'. This forecast predicts a financial surplus over and above the private sector's costs and its interest and dividends, which would be returned to the Council. Such a model is based on estimates before: (i) this Inquiry, which could result in changes to the proposals; (ii) putting out an invitation to tender and (iii) getting involved in detailed negotiations with the preferred bidder. Past experience on road and hospital projects tells us that each one of those stages could well introduce additional costs<sup>10</sup>. To put it in context, this estimate is essentially the same as the builder who tells you that it normally costs £X to do a loft conversion for your house, before he has seen the house or understood what you want. As everyone knows, the specification will change and the cost will increase significantly before the price is agreed. It is therefore impossible to place any reliance on this estimate. That in turn means that the surplus will disappear and/or the tolls will increase.
19. The DfT's approval for the project depends upon satisfying several criteria: value for money and affordability. The first, the broader economic value for money test, requires that the benefits should be greater than the costs. But this in turn depends upon a financial model which is not in the public domain or based upon demonstrably realistic figures. As explained earlier, it is not clear that the two documents are using the same data and assumptions.
20. The second is the affordability of the project. This depends upon the capital cost of the scheme, operating and maintenance costs, and financing costs (debt and equity) and how all this translates into tolls charges and whether there will be a need for further public support.

### **Capital cost**

21. According to the project sponsor, the construction of the bridge and new links/corridors is estimated at £390m. Further costs that have occurred since, such as design development increases, inflation and construction and land risk allowances bring the total to £604m, excluding VAT, in 2007 prices. Several points arise. First, it is not clear how much of these costs will be borne by the project and thus the private partners, although it appears that the intention is that the private sector will bear the full cost. Second, since the SPV will be subcontracting the construction to its sister company, it will have to pay VAT charges. While the exact amount is unclear, at 17.5% this could add another £100m to the SPV's cost which will have to be recouped via the toll charges. Thirdly, the capital costs are themselves higher than they would otherwise have been due to the need to funnel traffic into the tolled bridge and other associated

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<sup>10</sup> FROUD, J., and SHAOUL, J. (2001) "Appraising and Evaluating PFI for NHS Hospitals", *Financial Accountability and Management*, Vol. 17, No 3, August, pp247-270.

changes to toll and de-link the existing bridge. Thus the need to toll the bridge and make it financially attractive to the private sector has increased the capital cost. This, in part at least, accounts for the rising cost of the bridge.

22. This capital cost of £390m is higher than the estimate of £202m provided by Gifford, the engineering consultants, in January 2004 and higher than the £230m cited by the Council in 2006<sup>11</sup>. Even with the government's required optimism bias to allow for cost overruns, this brought the cost to £335m. This implies a cost rise of £55m or 16% increase in three years.
23. But in November 2004, Halton Council Executive Board was told that an untolled bridge would cost about £750m. The construction of a tolled bridge is necessarily more expensive than an untolled bridge since the design must include tolling plazas and lanes on approaches as well as tolling equipment, yet the latest estimate is lower than the cost of an untolled bridge. Nowhere however are these changes explained and/or reconciled, creating great uncertainty as to the veracity of the £604m figure.
24. Yet another source of information on the New Mersey Gateway Website, dated 2007 provides yet another costing. It says that total project costs (construction) will be £431m, subject to inflation at 6% pa (presumably until completion in 2015). Again, the project sponsor does not explain why the £604m differs from this.

### **Total public support**

25. Various sources confirm an £86m capital grant and £123m PFI credits. The New Mersey Gateway Website describes the PFI credits as an operating subsidy of £8m a year for 30 years. This equates to £240m over 30 years. In effect, the government is providing £326m (£240m + £86m), albeit the £240m is spread over 30 years, an amount equal to 76% of the construction costs, which have risen due to the tolling and the need to make the scheme commercially attractive.

### **Projected revenues**

26. The projected toll charges and revenues are unclear. Halton Council itself produces a range of figures as to possible toll charges which vary from slightly less than the Tunnels to nearly double. But a toll charge higher than the Tunnels will serve to further displace traffic east and west.
27. Mott Macdonald (Vol 2, Tables 7.71-72) provide revenue data, based upon the existing Mersey Tunnel charges and traffic forecasts for the first 15 years only, equal to £674m. Simply extending these forecasts on the basis of 1.5% annual traffic growth suggests £1.4bn over 30 years. But these revenues make no allowance for inflation. The Council proposes that the toll charges will rise at 1% above the retail price index, which will serve to increase charges and thus

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<sup>11</sup> Mersey Gateway Project (2006) Market Consultation, preliminary project information document, Halton Borough Council, p 19

revenues quite considerably by the end of the concession. By way of example, assuming inflation of 3%, then revenues would rise to £3bn or so.

28. The Council has made a provision in the Toll Order for a substantial increase in tolls over the Mersey Tunnel charges. The Council envisages that it will receive some small part of the revenues, about £500,000 pa according to the project sponsor. It says it will use 'its share of toll revenue' to fund discounts for local residents, disabled users and frequent users<sup>12</sup>. So in effect, its share will be recycled back to the concessionaire and there will be no net gain to the Council. However, there is a *caveat* that such subsidies and revenue sharing will be subject to ensuring the overall viability of the scheme. Finally, another source<sup>13</sup> indicates that the bidders will be allowed to set out their proposals for charges, which is the norm in such schemes.

29. From the perspective of the road user however, it should be noted that Mott Macdonald's projections exclude VAT, which EU regulations require as this is a private road. Thus toll charges/revenues will be even higher.

### Operating and maintenance costs

30. Annual operating costs are expected to be £8.39m<sup>14</sup> or £251m over 30 years. It is unclear what the maintenance (heavy duty maintenance that is done infrequently) costs are. But this is unlikely to be less than £250m over the life of the project. Furthermore, the bridges would have to be handed back to the Council in good repair at termination, implying some maintenance expenditure towards the end of the contract.

### Financing costs

31. Our analysis of completed private finance projects, the Dartford Crossings and Skye Bridge, shows that the total cost of finance over the 16 year period of their contracts was at least double the concessionaire's construction costs<sup>15</sup>. Over 30 years, this will be higher again, as any one who has ever taken out a mortgage can confirm. (Typically, the borrower pays three times the principal over the life of the mortgage). It is difficult to know which figure for construction costs to use, but total finance costs will not be less than £1.5bn, more than the £1.4bn revenue projected by Mott Macdonald. This of course assumes that the concessionaire will be able to get private finance in the present circumstances. While the M25 has been able to do so, it was not without difficulty, even though the payments will be made by the Highways Agency rather than road users, and thus are *de facto* guaranteed.

32. To cover all the costs, operating, maintenance and financing, the toll charges will have to yield a revenue of at least £250m + £1.5bn + several hundred million for

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<sup>12</sup>Mersey Gateway Project (2006) Market Consultation, preliminary project information document, Halton Borough Council

<sup>13</sup>Mersey Gateway Project (2006) Market Consultation, preliminary project information document, Halton Borough Council

<sup>14</sup>Mersey Gateway Project (2006) Market Consultation, preliminary project information document, Halton Borough Council, p19

<sup>15</sup>SHAOLU, J., STAFFORD, A., STAPLETON, P., and MACDONALD, P. (2008) "Financial black holes: accounting for privately financed roads in the UK", ICAS, Edinburgh.

maintenance. While there will be public support in the form of PFI credits, at £8m a year, this will not make a significant contribution or difference to the toll charges. Thus the revenues will have to be significantly higher, 50% or so, than Mott Macdonald's estimates, even without any inflation. In terms of toll charges therefore, tolls will have to be greater than the Tunnel charges and higher again due to VAT.

33. It is disturbing that the consultants and advisors believe that Mott Macdonald's revenue projections will deliver a scheme that is financially viable. It can only be made to work by higher tolls and/or greater public support. But further public support would be better spent providing the upfront capital cost rather than subsidising payments to the banks.
34. There is a further point about the projected traffic flows. According to the Mersey Tunnel Users Association, the eight tolled lanes of the Mersey Tunnels carried less traffic than the four lanes of the untolled Runcorn bridge at the end of 2003. Indeed Halton Council recognises this. As a result of the redesign of the Runcorn bridge, the two bridges combined are expected to carry only 74,255 vpd in 2015, compared to 84,000 vpd in 2006, a reduction of 12%, according to document considered by the Warrington Executive Board, based upon information from Halton Council. But since the traffic crossing the Mersey is not expected to decline, traffic will be displaced further east to Warrington and the M60 and West to the Tunnels. But this in turn means that there is to be an expensive new bridge that will reduce overall capacity. This is a phenomenon that has already been observed with PFI hospitals where the first wave PFI hospitals were smaller than the ones they replaced.
35. There is however a further question. What is the purpose of a bridge that proposes lower capacity and how does this fit with the original purpose of the bridge, which was to relieve congestion on the existing bridge<sup>16</sup>?
36. But in terms of the toll charges, this lower volume of users will have to provide about £2bn, excluding VAT, in revenues over 30 years. Should traffic fall for whatever reason, then the scheme will be unviable without further toll increases or public subsidies.

### **Two completed concessions: Skye and Dartford**

37. The Skye Bridge case demonstrates that in freestanding projects with user charges, there are risks to the public purse. In the case of Skye, public opposition to the tolls was so great that ultimately the public authority had to bear the costs it had sought to transfer to the private sector, which had become much greater as a result of private finance. That is, the move to private finance may create additional risks for the public sector, as the experience of some toll roads in other countries has shown, and these risks are ultimately a political issue. The corollary of this is that the private partners' rewards may not be commensurate with either the risks actually borne or the additional risks created.

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<sup>16</sup> Mersey Gateway Project (2006) Market Consultation, preliminary project information document, Halton Borough Council



The government has now acknowledged that schemes such as the Skye Bridge are unlikely to be suitable for private finance in that they transfer demand risk<sup>17</sup>. But the new Mersey Gateway project seeks to transfer demand risk, something that the private sector can neither manage or control.

38. It is instructive to recall how the government had sought via the contract to mitigate demand risk for the Skye Bridge Company (SBL). Firstly, the Scottish Office extended the period of the concession to 27 years beyond the intended maximum of 20 years to ensure SBL could recover its costs. Secondly, under a 'safety net' provision, SBL would be able to raise tolls by 30% above the rate of inflation if toll revenues fell below a sum corresponding to 1990 traffic levels, implying a toll charge higher than ferry fares in 1991. Yet the Scottish Office's stated objective was that charges should be no higher than the ferry charges. The Scottish Office thereby ensured that SBL's revenue risk was low, with the risk falling on the road users. Indeed, the NAO admitted as much, reporting that both the Scottish Office and the company believed that the concession was likely to end within 14 to 17 years. More importantly, these revenue protection measures constituted a form of guarantee by the government, despite its original objective of no disguised government guarantees<sup>18</sup> that served to reduce the concessionaire's financing costs<sup>19</sup>.
39. The Dartford Crossings were successful due to high and much higher than expected traffic flows. The tolls were relatively low and stable. It shows that the key to successful projects (and low tolls) lies in high volumes relative to construction and financing costs. Several other factors were important in the design of the concession. The concessionaire was a not for profit company, so no dividends were payable to the parent companies. This served to reduce the cost of finance and thus the toll charges. The Dartford project also included three crossings. That may be justified from a traffic management and operational perspective, but it reinforces the point that making new road schemes viable may entail bundling new construction work with existing high volume roads. One of the tunnels was essentially "given" to the company since it had been fully paid for, while the other had £45m debt outstanding. Without the tunnels, the toll charges would have had to be very much higher. Thus even the most "successful" schemes rely on public support. Moreover, that support may not be widely known to the public at large.
40. This is why the Mersey Gateway's concessionaire will also have access to two revenue streams in return for financing the construction of the new bridge: it provides the only chance of making the concession commercially viable. However, the probability of success in this case is low.
41. But the higher cost of private over public finance meant that both Skye and Dartford charged tolls which were higher than they would otherwise have been if financed with public debt. With toll schemes it is the road users not the taxpayers who pay. But private finance for public goods with wider external benefits and

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<sup>17</sup> Treasury (2003), *PFI: Meeting the Investment challenge*, HM Treasury, London.

<sup>18</sup> Department of Transport (1989), *New roads by new means: bringing in private finance*, consultation paper, Department of Transport, CM 698, HMSO, London.

<sup>19</sup> National Audit Office (1997), *The Skye Bridge*, Report of Comptroller and Auditor General, HC 5, Session 1997-98, The Stationery Office, London.

problems creates an additional cost. In the case of the Skye Bridge, those costs were so high (relative to revenue) that the state had to step in with taxpayers' money: £34m for subsidies, VAT and the termination fee, costs that the road users would otherwise have borne. This was higher than the construction cost of the bridge which the then government had said it could not afford. Thus, where traffic flows are low relative to the construction cost, the users – and/or the company - are unable to bear the cost and the costs ultimately fall back on the taxpayer, as the international experience in Spain and Mexico also demonstrates<sup>20</sup>.

## **M6 toll road**

42. The M6 toll road provides further evidence to confirm the point. In 1989, the government proposed that a new road, now known as the M6 toll road, to relieve congestion in the Birmingham area, be built as a privately funded and financed venture. The concession, signed in 1992, would run for 53 years, expected to be three years construction and 50 years operation. In the event, the scheme was delayed by the longest ever public inquiry into a road and further legal challenges, and opened at the end of 2003, with a construction cost of about £700m. With its charges unregulated, the road operator originally set its prices to minimise its future maintenance costs by pricing heavy goods vehicles off the road.
43. By 2006, revenues, including those from the service station, were £51m. This was widely acknowledged to be less than expected due to lower than forecast traffic volumes. Intended to relieve congestion for north-south traffic, the new toll road still carries only 20 percent of the traffic on the existing motorway, despite reducing its charges for heavy goods vehicles from £11 to £7, although traffic has been rising and has reached 50,000 on an average working day (company's website). Indeed, the new road is so free of traffic that, according to press reports, drivers regularly break the speed limit, which is rarely if ever enforced.
44. Operating expenditure took 53% of revenues, and most of this was the non-cash charge associated with depreciation. The company was financed by debt, which at £819m was considerably more than the construction cost of the road (about £700m). The interest payable to service the debt was £45m, an effective interest rate of 5%. This is as yet low and only marginally more than the cost of public debt. This may increase, as typically the interest payments are deliberately set low in the early years when revenues may be low. After paying interest, the company made a post tax loss of £21m in 2006.
45. With construction complete and the road evidently costing less than expected since the debt was larger than the cost of construction, the company refinanced its debt in June 2006, taking on a larger debt that would release about £350m cash for investments elsewhere. Anxious to increase the low traffic volume, the concessionaire came to an agreement with the government to use £110m of the proceeds to finance the construction of two new road developments that would

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<sup>20</sup> Acerete, B, J Shaoul and A Stafford (2009), 'Taking its toll: the private financing of roads in Spain', *Public Money and Management*, January.

feed into the M6 toll road, which would not themselves be tolled. This could be expected to increase revenues.

46. But access to both the strategic case and the contract for the new road was denied under Freedom of Information for reasons of commercial confidentiality. However, the Highways Agency did confirm in a telephone conversation what was implicit in the announcement: that the project had been agreed without either advertisement or competition. Instead, the contract arose from an unsolicited proposal by the concessionaire, before the road had even been designed or won planning approval. According to the Highways Agency, this was only a contract to finance the construction and maintenance and not a contract to build the road. Notwithstanding the fact that the road would be built without charge to the public purse and it was unclear that any procurement rule has been broken, this meant that the new road had jumped the capital prioritisation queue as a result of an unsolicited proposal. Moreover, the route in terms of traffic management makes little sense. In other words, further initiatives have been taken to make a private road viable that may not have been justified on broader economic grounds.

## **Conclusion**

47. It is not clear that the New Mersey Gateway will have the requisite traffic flows to make it both commercially viable and affordable to the public. The evidence presented above suggests that the cost of private finance will add enormously to the overall cost of the project and hence the tolls. This is particularly egregious, since like Skye, the government is proposing to make funds available for the bridge. The bridge could be provided much more cheaply, if the government made up the difference, either with a capital grant or public debt, to the benefit of road users and taxpayers alike.