

WITHOUT PREJUDICE.

CONFIDENTIAL to:

Jon Jones-Pratt WSR PLC.

Mike Sherwood WRSA LTD.

Steve Williams WSSRT LTD.

Ian Young S &DT LTD

NOT FOR PUBLICATION

“Peaceful Somerset” (redacted)

4) Current Structure, Culture and Fundraising

4.1 The perception of many was that the joint statement issued by the WSR, the WSR and WSSRT indicated the two Charities support for the Washford eviction. Apparently, this was not the intent. It was supposed to recognise the PLC’s right to initiate legal proceeding without implying that either Charity supported one side over the other. Given the easily ignited passions of some of Charities’ members it generated some of the most extreme and unpleasant material even calling into question the future role of some of their own Trustees. It served only to confirm the factional nature of the existing structure.

4.2 Perhaps the most important challenge facing the railway is fundraising exacerbated by the Covid 19 crisis. I find it hard to conceive of a more inappropriate and inadequate regime than that the WSR relies on. In this I exclude the role of the WSSRT. That Charity seems to have a well-defined sense of its public benefit role as enshrined in its Articles. Its focus on its core educational purpose is clear and its attitude to the PLC is collaborative without being subservient.

4.3 Perhaps as the result of not too distant history the WSR seems to be more competitive. Clearly there are tensions over the proceeds of the transfer of its trading activities to the PLC where the approach is probably best described as combative on both sides.

I suggest that if support of the West Somerset Railway, which means currently the PLC, is the primary intention of the WSR then the PLC’s financial needs must take priority.

4.4 The most disconcerting feature is the unqualified description of the WSR as supporting the WSR. I’m sure that is what it intends but, in my view, it’s not what the very limited objects of the Charity permit. The WSR is in a similar position to the S and D Trust. It must pay very

careful attention to the Charity Commission guidance on relationships with non-charities ,especially in the way in which it represents its fundraising to potential donors.

Representing itself publicly as the fundraising arm of the West Somerset Railway, in order to secure the obvious benefits for charity grant funding and Gift Aid, appears to stretch its public benefit mission beyond reasonable interpretation.

4.5 There are fundamental defects in the present fundraising structure. Although the WSRA has commendably supported the PLC by financing rail replacement, at the PLC's request, it remains the case that it is the WSRA that decides what funds raised will be spent on. Indeed, were that not the case it would be a breach of its charitable status. However, spending priorities should be dictated by business need.

Tolerance of spending priorities being decided by another organisation ties managements' hands behind their backs undermining their duty to run the business responsibly and effectively.

It seems the WSRA has some very effective and committed fundraisers, to whom full credit must be due. However, there will always be the temptation to seek funds for projects attractive to donors. The determinant of how the railway develops can become driven by fundraising rather than strategic priorities. That causes disillusion for hard working fundraisers, who see their initiatives rebuffed, and confusion for potential donors. Furthermore, where funds are donated for specific projects they are, so far as the PLC is concerned, restricted funds. The restriction isn't applied by the donor (as is usually the case) but by the recipient Charity.

Current arrangements beg the question "Who is controlling the destiny of this business?" Fundraising should be driven by a clear set of strategic priorities, typically a ten-year capital plan, not determined by the availability of funding opportunities however attractive.

4.6 Understandably the PLC also seeks to raise funds where it controls their allocation. This can be via donations or share purchase. Both are tax inefficient because tax paying donors and shareholders are unable to confer Gift Aid benefit. Administration of a share register involves significant resource and can be spectacularly inefficient for small share purchases when future costs are taken into account.

There's an invitation to subscribe for shares on the WSR web site but the legality of that should be checked, if it hasn't already been done. There are complex regulations governing invitations to the public to buy shares including the need for a full prospectus.

It is also notable that the WSR web site states that the shares will be issued subject to the PLC Articles of Association. There is no link on the site to enable a prospective purchaser to view them and the conditions they attach to shares in the PLC.

4.7 Perhaps the most important point for an interested outsider like me is that it's all very confusing. Who am I donating to and for what? You all seem to be competing with each other for my money!

As long as such confusion reigns fundraising performance will be sub- optimal.

4.8 If funds raised by the Charities are represented as going generally to support the railway, (rather than their own projects) then I suspect there may be non-compliance with the Fundraising Code of Practice.

I recommend that those concerned should check whether they are compliant with the Fundraising Code of Practice especially clarity for prospective donors as to the beneficiary of their donations.

4.9 I can't help but stray into shark infested waters. I sense that there are those within the WRSA, possibly in positions of influence, who genuinely believe the railway should be on a different path and that they are better suited to guiding its future. At its most extreme it seems as if there might even be a desire to see the PLC and its current management fail. It manifests itself in suggestions that the railway should be run in an alternative more collegiate fashion with greater member influence, or even control. At its heart the WSR is a tourist business. I would hazard a guess that the percentage of paying enthusiasts it attracts might only just reach double figures. Yes, it needs to retain the goodwill and enthusiasm of volunteers, but the nature of its business model is commercial. As a tourist business its product is an authentic as possible nostalgic experience of a Great Western branch line adapted for compliance with 21st century regulation. Can it deliver that product and be the "community railway" that some desire? The PLC Directors already have the obligation, as part of their statutory duties, to take account of the interests of the local community. If "community railway" means one run by and for the community the answer must be No! That ethos would not fit comfortably with the delivery of the commercial product that the railway's viability depends on. However, emphasising the pivotal role heritage railways can play in their local community can be used to advantage in the search for funds. Securing external financial support can be a hard sell for an activity too easily dismissed as an opportunity for predominantly white middle-class members to indulge their hobby, Support for a business that sustains local employment, and the viability of other tourist businesses, is altogether a different proposition. The suggestion of agreed priorities and their monitoring is covered later.

For the meantime I suggest that the PLC must emphasize and enhance its role as a key contributor to and supporter of the Somerset tourist and business economy.

4.10 To those who aspire to the demise of the PLC, and its current Board, I can only say be careful what you wish for. If the PLC fails and goes into administration or liquidation its lending Bank holds security over all the PLC's physical assets. An administrator or liquidator acting for the Bank could not realistically sell the business as a heritage railway. The essential operating licence lies within the PLC and would not be transferable. It doesn't matter how much expertise there may be in the WSR or elsewhere. It would be impossible to have a new licenced structure in place to in time to keep the operation afloat. In the event of the demise of the PLC the obvious course for the Bank (who owe a fiduciary duty to their own shareholders) would be

to rip up the track for scrap, turn the track bed into a, no doubt, very attractive cycle path which could provide a substitute and more environmentally friendly tourist attraction. My advice to those who wish to see the back of the current PLC management must be:

“Back them or buy a Bike!”

4.11 Whether or not people like or approve of the current management of the PLC they are the only viable game in town. With a combined PLC shareholding of around 20% the two charity shareholders and Somerset County Council are not in a position to influence or dictate the direction of the PLC. I have not examined the share register to ascertain how the remaining shares are held but it would be very surprising if, on a proxy vote, the Chairman would not hold sufficient proxies to defeat any Shareholder rebellion. Shareholder control of companies is notoriously weak and subject to the overriding right of Directors to act in the best interest of the company as they see fit. Perhaps the frustration that engenders amongst critics is why social media is so negative. There is no other outlet for the disaffected and disillusioned. If they want to influence the direction of the railway then it's the old analogy of those seeking to urinate around tented accommodation. Better on the inside.....but to come in you must accept who's in charge of the tent.

4.12 Were it not for the current Board of the PLC the railway would in all probability already have ceased to exist. They took on an insolvent business and turned it round so at least it has a fighting chance of surviving the lockdown. Instead of personal attacks they deserve recognition for what has been achieved and, above all, support in future. I'm sorry if this causes distress to some. I'm not in this to be nice. I tell it as I see it.

5) Potential new structure

5.1 I believe there is growing realisation and acceptance that for tax benefits alone fundraising should be handled differently. There is no logical reason why the Charities that currently fundraise for their own limited objects should not continue to do. What is needed is a Charity that can act as a clear focus for the railway's core activities. Apart from Gift Aid on donations other benefits may include charitable rate relief, exclusion from corporation tax, VAT etc.

5.2 It's tempting to suggest that such a Charity should run the railway, or at least direct in detail how the PLC should do so. That would be a serious strategic mistake. To qualify for charitable status any charity has to fit within one of the charitable purposes listed in the Charities Act. Preservation of heritage in its own right is defined by reference to buildings so for operations like heritage railways, preserving artefacts and ambience, the normal overarching purpose is education of the public. There are limits on charitable trading. Understandably, with the tax benefits they enjoy, charities must not be in a position where they can compete against other business not having the same tax advantages. As a tourist business (and that really is the only viable role for a 26-mile-long railway in a low-density population tourist dependent area) the

railway competes with other tourist attractions. It needs clear distinction between its business and charitable activities. (Indeed, this is something the Charity Commission and Office of the Fundraising Regulator are focussing on.)

5.3 The railway also depends on the confidence of its regulators in the competence and professionalism of its managers. Something the WSR has recent experience of! The halcyon days of members' railway preservation societies, led by well-meaning but inexperienced and unqualified volunteers, are rightly destined for oblivion. As noted with regard to Washford adherence to the RM3 management model, with railway operations under the control of suitably experienced and qualified personnel, is essential. The individuals necessary tend to be employed professionals who could not easily serve on a Charity Board where Trustees must normally be unpaid volunteers.

5.4 Typically there are two alternative structures. One where the Charity owns the physical assets (but not the operating licences), and contracts with a company to run the railway as a service. In the other the operating company owns the assets and the Charity provides financial support to the extent of its permitted charitable purposes. The former allows more strategic co-ordination between fundraising and spending than the latter. There may also be significant tax benefits if the Charity owns the assets.

5.5 The complicating factor for any future structure is the old Irish travel advice to a visitor" *If I were you, I wouldn't start from here!*" The PLC comes with some formidable legal baggage. Its Articles of Association are unnecessarily complex and contain provisions in relation to its shares that are appropriate for a normal company situation where they are purchased as an investment. For most heritage railways shares are another form of donation. Any benefit to the shareholder is usually in the form of free or discounted travel on the railway. The shares have no value (something disappointed relatives of deceased heritage railway supporters often find hard to comprehend).

I would not recommend trying to transform the PLC into something else nor, with its current shareholding structure, is it a suitable vehicle to act as the operating company for a Charity. It's probably better to start with a clean sheet, create a new operating company (as a controlled subsidiary of a new Charity) with employee contracts transferred under TUPE regulations together with licences and anything else the operating company needs to run the railway. The existing PLC would become dormant.

5.6 A new members' Charity limited by guarantee would be created. It would be responsible for realisation of public benefit through education in the history and development of railways in West Somerset in particular. Day to day operation of the railway and its business would be delegated by a Services Agreement to the new operating company which would also undertake any commercial trading the Charity is legally excluded from. Such an arrangement is permissible under Charity Law. The Charity Trustees would set broad strategic objectives, but the

subsidiary's board would be free, within those objectives, to operate the business against a requirement to generate annual surpluses to be paid over to the Charity.

5.7 Any shares in the new operating company, apart from those owned by its parent Charity, should be non-voting. Ultimate control of the new operating subsidiary would, subject to delegated authority, lie with the Charity Trustees.

5.8 The Covid 19 crisis, and heritage railways' response to operating revenue shortfalls, has generated the traditional raft of appeals. Some have ramped up share issues. The option appears to exist of encouraging substantial capital investment through the issue of non-voting, redeemable preference shares carrying a modest fixed dividend subject to the realisation of annual surpluses. This may be a more attractive and affordable means of attracting capital than additional Loans. This may be a further advantage of using an operating/trading subsidiary as the preference share issuing capital raising vehicle.

5.9 The essential point is that such a re-structure cannot be forced on the PLC. It will take two (or in this case at least four) to tango. So even though some might prefer a Charity with greater day to day control over the railway it's hard to see why the PLC would ever agree to that.

It is suggested that the benefits of creating a new Charity, with a new controlled PLC operating subsidiary, are assessed as a matter of urgency.

5.10 The following principles are suggested as the basis for a new Charity/ operating subsidiary relationship:

- a) Simple Articles of Association. All voting shares in the subsidiary owned by the Charity.
- b) A Services Agreement between the Charity and its operating subsidiary authorises the subsidiary to run the railway and provide management and operational services with the objective of enabling the Charity to fulfil its charitable purposes.
- c) The Services Agreement includes clear delegations of financial and decision-making authority.
- d) The Charity nominates no more than two directors on the subsidiary's board. (Any appointment to both Boards should be minimised to avoid conflict of duty arising that would prevent such Directors from involvement in decision making on both Boards).
- e) The performance of all Directors/ Trustees would be subject to annual appraisal by a Nominations Committee.
- f) The Chairmen of each Board would be appointed by their Board colleagues and serve only for so long as they retained their colleagues' confidence.

g) Up to three Trustees of the Charity would be elected by its membership. The remainder (ideally not more than the Charity Commission recommended maximum of 6 or 7) would be volunteers recruited based on their proven experience and ability to run a Charity.

h) The PLC would hold the necessary operating licenses. The Lease of the track bed and ownership of heritage assets would be with the new Charity.

5.11 Underpinning such a structure should be a democratic Charity members' voting system. Heritage railways typically have members with huge emotional capital invested in the railway. There are often strongly held preferences and convictions. These lend themselves to proxy garnering for AGM's and EGM's with the risk that a special interest groups can amass enough proxy votes to force their agenda onto the organisation. One way of avoiding this is for that all material business AGM/EGM business to be decided by a Members' postal vote system ensuring one member one vote.

6. Potential new culture

6.1 A new structure for the WSR is not going to happen overnight. A culture change could occur quickly. It needs to be inclusive, collaborative and focussed on the railway's role as a key player in the local community.

6.2

It is suggested that the first stage is for the PLC to articulate clearly what its priorities and objectives are.

The reality of the current structure is that these are not subject to approval by the various supporting bodies but without their buy in the chances of securing the necessary volunteer commitment and support are much reduced.

6.3 The optimum vehicle for communication of priorities already exists in the form of the Partnership Development Group. This cannot realistically be a decision-making body, but it provides a mechanism for consultation and co-ordination. Its primary role should be to monitor progress against PLC priorities and help dismantle any roadblocks. Its effectiveness and respect will require chairmanship of a very high order.

6.4 *Accordingly it is suggested that the PDG be re-energised and encouraged in that new role with an independent Chair.*

7 What does success look like?

7.1 A West Somerset Railway members' Charitable Trust with a clear public benefit purpose able to fundraise with the benefit of charitable status.

7.2 A financially sound subsidiary delivering a safe heritage railway nostalgic experience as a valued part of the local tourist economy.

7.3 The existing Charities either (at their choice) subsumed into the main Charity or free to continue within their limited charitable objects.

7.4 *Peaceful Somerset, Harmonious Somerset, Successful Somerset.*

8 Postscript and Next Stage?

8.1 A personal thank you to all the individuals and organisations for the privilege of lifting the veil on your railway and the opportunity to make personal recommendations on behalf of the Heritage Railway Association. They are not a definitive road map. They merely outline the contours on which it could be drawn. Its draughtsmen would be the various member organisations of the West Somerset Railway family.

8.2 I am more than happy to facilitate a family discussion as the first stage of that design process.

In any event I hope this paper has been of help.

Good Luck!

John Bailey

23rd^t May 2020.