

Explanatory Note to accompany the Rolling Stock Leasing Market Investigation Order 2009

(This note is not part of the Order)

Introduction

1. On 7 April 2009, the Competition Commission (CC) published its report entitled *Rolling Stock Leasing market investigation* (the report)¹ on its investigation into the market for the leasing of rolling stock for franchised passenger services (the rolling stock leasing market) and the supply of related maintenance services in Great Britain. The report set out the CC's findings that there are features which adversely affect competition in connection with the leasing of rolling stock for franchised passenger services in Great Britain.
2. The report set out a package of remedies to address the adverse affects on competition that the CC found. Part of this package included requiring rolling stock lessors to provide train operating companies (TOCs) with a set list of information when making any offer to lease incumbent or alternative used rolling stock to operate on franchised passenger services. This would enhance TOCs' ability to exercise choice and negotiate with rolling stock lessors. The Rolling Stock Leasing Market Investigation Order 2009 (the Order) gives effect to this part of the package of remedies.

Status of this Explanatory Note

3. Nothing in this Explanatory Note is legally binding. In the event of a conflict between this Explanatory Note and any provision of the Order, the Order shall prevail.

Monitoring and review of the Order

4. The Order applies to a ROSCO that makes an Indicative Offer. We explain which enterprises fall within this definition of ROSCO in paragraph 15. We explain the term 'Indicative Offer' in paragraphs 16 to 18.
5. Section 67 of the Railways Act 1993 gives the Office of Rail Regulation (ORR) concurrent functions with the Office of Fair Trading (OFT) in relation to Part 4 of the Enterprise Act 2002 (the Act). Under [section 162](#) of the Act, the ORR has a general duty to monitor the operation of the Order. This includes the duty to consider, from time to time, whether the Order should be varied or revoked in the light of a change of circumstances. To allow the ORR to monitor and review the operation of the Order, Article 8 requires ROSCOs to provide the ORR with information under certain circumstances and Article 9 requires ROSCOs to provide the ORR with annual compliance statements.

¹www.competition-commission.org.uk/rep_pub/reports/2009/546roscos.htm.

Possible consequences of not complying with the Order

6. [Section 167](#) of the Act places a duty on any person to whom the Order applies to comply with it. Subject to the defences in the section, any person who suffers loss or damage due to a breach of this duty may bring an action.
7. [Section 167](#) of the Act also provides that the ORR, with its concurrent functions, and the CC can seek to enforce the Order by civil proceedings for an injunction or for any other appropriate relief or remedy.

Structure of the Order

8. The Order is divided into five parts.
 - (a) Part 1 contains general provisions, which include specifying when the Order comes into force, definitions that are used throughout the Order and the power to issue directions.
 - (b) Part 2 contains obligations on the ROSCO to provide certain information about the Proposed Lease to the Potential Lessee.
 - (c) Part 3 contains the obligation on the ROSCO to give a copy of the existing lease agreement to the Potential Lessee.
 - (d) Part 4 contains the compliance obligations on the ROSCO, which are to provide an annual compliance statement to the ORR, which might be required to be audited.
 - (e) Part 5 contains additional compliance obligations on the ROSCO in the event that a Potential Lessee has concerns that the Order has not been complied with.
9. The rest of this Explanatory Note deals with each of the ten articles to the Order and its accompanying eight schedules.

Part 1—General

Article 1 (Citation and commencement)

10. Article 1 gives the Order its name and sets out when it comes into force. The Order comes into force on 22 February 2010.

Article 2 (General interpretation, index of defined expressions, etc)

11. Article 2 contains the definitions applicable throughout the Order. Where special terms apply only to a particular article or schedule, they are defined in that article. Some key definitions are outlined below.
12. **Rolling Stock** is defined as any coach, locomotive, car, vehicle or similar type of unit that at the date of the Indicative Offer has operated or is currently operating on the railway network to enable the carriage of passengers in Great Britain. For the purposes of the Order, newly manufactured rolling stock or rolling stock that has only operated on a rail network outside of Great Britain would not fall within this definition of Rolling Stock.

13. **Specified Rolling Stock** is all the Rolling Stock that will be leased under a Proposed Lease. This might, for example, relate to a fleet of ten Class 158 units. A **Rolling Stock Item** is an item of Specified Rolling Stock with a unique Rolling Stock Number. So, for the fleet of ten Class 158 units, this would relate to each individual Class 158 unit being proposed.
14. A **Potential Lessee** is an enterprise seeking to lease Rolling Stock for use in providing passenger rail services under a Franchise Agreement. Enterprises that are selected to operate passenger rail services in Great Britain under a Franchise Agreement are typically referred to as TOCs in the rail industry. The definition of Potential Lessee does not include entities seeking to lease rolling stock for use in providing non-franchised passenger rail services (ie falling outside a franchise under the Railways Act 1993). This would include services operated under concessions granted by local authorities (as is the case at the time of making the Order with London Overground and Merseyrail Electrics Network) or under open access agreements.
15. A **ROSCO** is defined as an enterprise offering Rolling Stock for lease to a Potential Lessee. The definition of ROSCO in the Order is wider than that used in the report, where the term ROSCO was used to describe the companies that have evolved from the three rolling stock companies formed at the privatization of British Rail in 1994. At the time of making the Order, those enterprises that would have fallen within the definition of a ROSCO when they offered Rolling Stock to their current lessees include Angel Trains Limited, HSBC Rail (UK) Limited, Porterbrook Leasing Company Limited and Voyager Leasing Limited, all of which currently lease Rolling Stock for use in providing passenger rail services under a Franchise Agreement.
16. The definition of **Indicative Offer** is not limited to an offer being made in connection with a potential bid for the award of a Franchise Agreement but also includes an offer being made outside such time (for example, where Rolling Stock is required by a Potential Lessee for lease during a Franchise Term as a result of a movement of Rolling Stock proposed or required by the franchising authority).
17. An Indicative Offer does not include an offer by a TOC to sub-lease rolling stock that the TOC has leased from a ROSCO.
18. If a ROSCO makes an Indicative Offer on Rolling Stock and then subsequently makes another offer that differs from the Indicative Offer in terms of level of rent, quantity, specification and/or duration, then this offer constitutes a new and separate Indicative Offer.
19. **Heavy Maintenance** is defined as all Maintenance identified or defined as heavy maintenance and/or heavy repair in the Proposed Lease. If no such term or definition is used in the Proposed Lease, Heavy Maintenance is defined as the category or categories of Maintenance that would commonly be considered in the rolling stock industry to fall within the definition of heavy maintenance and/or heavy repair. At the time of making the Order heavy maintenance and/or heavy repair are commonly considered to include the examinations and work necessary to ensure the structural soundness of rolling stock throughout the duration of the lease, including:
 - (a) level 5 overhauls, including C3, C4, C6 and C6X overhauls, corrosion repairs and exterior repaints; and
 - (b) major component overhauls (for example, to bogies, wheelsets or traction motors).

20. The refuelling or the cleaning of the exterior of rolling stock is not usually considered as heavy maintenance and/or heavy repair.
21. A **Modification** is defined as an intentional alteration of the Characteristics of the Rolling Stock that is not Heavy Maintenance and not Light Maintenance. Current examples of a Modification include alterations to the Rolling Stock to improve safety and reliability (such as installation of 'on train' monitoring and recording systems) and alterations to enhance passenger safety, comfort or general experience (such as the installation of closed circuit television or passenger information systems).
22. The definition of **Durable Medium** includes a virtual or electronic data room which provides a means for the recipient to access the information remotely, provided that the recipient can store and reproduce the information.

Article 3 (Delegated powers of direction)

23. Article 3 is made under [section 87](#) of the Act as applied by [section 164\(2\)](#) of the Act.
24. Article 3 gives the CC power to give directions to a person for the purpose of carrying out, or ensuring compliance with, the Order. The directions can be addressed to an individual or company or can be addressed to the holder for the time being of an office in a company (for example, the Secretary).

Part 2—Information requirements

Article 4 (Obligation to obtain and give details of the Proposed Lease)

25. Article 4 sets out the requirement for the ROSCO to obtain and give details of the provisions of the Proposed Lease to the Potential Lessee.
26. Article 4.1 requires that the information described in Article 5 should be given to the Potential Lessee within the Information Period of ten Working Days from the date of an Indicative Offer provided that the information is in the ROSCO's possession, custody or control or can be obtained using the ROSCO's best efforts.
27. It is expected that there will be limited circumstances in which the ROSCO does not meet the requirements of Article 4.1(b)(i). Where the ROSCO is not able to give any specific item of information within the Information Period, Article 4.3 requires that the ROSCO shall give the Potential Lessee, by the end of the Information Period, a list of which item or items of information it has not given. Should the ROSCO obtain such information after the Information Period has expired it should give the Potential Lessee the information within three Working Days of obtaining such information.
28. Article 4.2 provides that information that has previously been given to the Potential Lessee in connection with a previous Indicative Offer, need not be given again to the Potential Lessee so long as the ROSCO notifies the Potential Lessee in writing that the information also applies to the current Indicative Offer.

Article 5 (Information to be given)

29. Article 5 sets out the information that the ROSCO is required to provide to a Potential Lessee.
30. Details of particular aspects of the information described in Article 5.2 are given in Schedules 1 to 6. The items of information in Article 5.2 include:

- (a) Article 5.2(a)—the Specified Rolling Stock and the particulars of each Rolling Stock Item. Schedule 1 covers the particulars of each Rolling Stock Item including the Rolling Stock Number, Class, name of manufacturer and Characteristics. In relation to requirement 1(g) of Schedule 1, this is intended to cover, but is not limited to, the routes on the franchise for which the Rolling Stock has been requested by the Potential Lessee.
- (b) Article 5.2(b)—Heavy Maintenance. Schedule 2 covers the details of Heavy Maintenance including a description of when Heavy Maintenance will be carried out; how long such Heavy Maintenance will take and what Heavy Maintenance will be undertaken. It is sufficient to describe what Heavy Maintenance will be undertaken by referring to relevant extracts of the document setting out the vehicle overhaul instructions or specifications.
- (c) Article 5.2(c)—Modification. Schedule 3 covers the details of any Modification including a description of when the Modification will be carried out; how long such Modification will take; what Modification will be undertaken; and whether the Proposed Lease requires that the Modification is carried out or provides an option for one of the parties to undertake such Modification. A required Modification would include those that are mandatory, for example to meet new safety regulations.
- (d) Article 5.2(d)—the name of each entity that will be *contractually* responsible under the Proposed Lease for Heavy Maintenance, Modification and Light Maintenance. As it is recognized that much of the Heavy Maintenance, Modification or Light Maintenance work is often outsourced to a third-party provider, the name of the entity specified in accordance with Article 5.2(d) will not necessarily be the entity that carries out the work. This clause will enable the Potential Lessee to understand whether in current industry terminology the Proposed Lease is a so-called wet lease, soggy lease or dry lease.
- (e) Articles 5.2(e) and 5.2(f)—the estimated balance of the Maintenance Reserve at the start and end of the Term.
- (f) Article 5.2(g)—details of how funds are released from the Maintenance Reserve to the Potential Lessee during the Term. This means the way in which payments are made from the ROSCO to the Potential Lessee to cover Heavy Maintenance that the Potential Lessee is responsible for carrying out and may include an explanation as to how any differences between actual and forecast expenditure are to be dealt with.
- (g) Article 5.2(h)(i)—the Capital Rent. Schedule 4 covers the details of the Capital Rent including an explanation of how the monetary amount of Capital Rent will be quoted (for example, setting out the level and profile of the payments over the Term), any related assumptions regarding the use of the Rolling Stock and the basis for any adjustments during the Term. For example, Capital Rent may be quoted as £x per Rolling Stock Item per month for the duration of the Term.

Schedule 4 also covers an explanation of the effect on the Capital Rent of any Modification that is proposed to be carried out, including whether the amount accounted for as a result of the Modification will be fixed or variable and whether the costs of the Modification are to be amortized over the Term or for a period longer than the Term. Whether or not the amount accounted for will be fixed or variable will depend on how the costs of the Modification are being allocated between the ROSCO and the Potential Lessee:

- (i) Where the amount is to be fixed, the ROSCO should quote what amount is incorporated into the Capital Rent, for example in the form of £x per Rolling Stock Item per month for the duration of the Term.
 - (ii) Where the amount is to be variable, the ROSCO might, for example, quote an estimate of the capital cost of £y and the effect this will have on the Capital Rent in the form of £x per Rolling Stock Item per month per pound of capital cost.
- (h) Article 5.2(h)(ii)—the Non-Capital Rent and Article 5.2(h)(iii)—the Maintenance Reserve Charge. Schedule 5 covers the details of the Non-Capital Rent and Schedule 6 covers the details of the Maintenance Reserve Charge. Both schedules set out the particulars of the details required to explain how the monetary amount of Non-Capital Rent or Maintenance Reserve Charge will be quoted and any related assumptions regarding the use of the Rolling Stock. This includes setting out the level and profile of the payments and the assumed mileage of the Rolling Stock during the Term. For example, Non-Capital Rent may be quoted as £x per Rolling Stock Item per month indexed to a specified cost index and based on a mileage assumption of y miles a year.
- (i) Article 5.2(h)(iv)—other amounts due, including the basis for any charges where a ROSCO does not operate a Maintenance Reserve.
 - (j) Article 5.2(i)—the Term of the Proposed Lease.
 - (k) Article 5.2(j)—other aspects of the Proposed Lease that will have a significant effect on the level of Capital Rent.
 - (l) Article 5.2(j)(iv)—specific penalties in this context could include liquidated damages but would not be limited to this category of penalty.

Article 6 (Obligation to give an estimate of the Short-Term Lease Premium)

- 31. Article 6 sets out an obligation on the ROSCO when making an Indicative Offer for a short-term lease to give a Potential Lessee an estimate of any short-term lease premium. A short-term lease is a Proposed Lease that has a Term shorter than the proposed Franchise Term or the remaining length of the Franchise Term (as appropriate).
- 32. An estimate of any short-term lease premium is calculated using the formula set out in Schedule 7.
- 33. The duration of both the Franchise Term and the Term do not include any time by which such terms could be extended through exercise of an option in accordance with the agreements. For example, if a Franchise Agreement provides for an initial term of seven years and allows for this to be extended for a further three years subject to the TOC meeting certain performance criteria, the short-term lease premium is calculated by comparing the quoted Capital Rent for the short-term lease with an estimate of the Capital Rent for a seven-year franchise not a ten-year franchise.
- 34. Article 6.2 provides that the requirement in Article 6.1 does not apply whenever a ROSCO is unable to offer a Proposed Lease with a Term having the same duration as the length of the Franchise Term because an Act of Parliament prevents it from doing so. An example of a previous occurrence is the Railway Safety Regulations 1999 which required Mark I rolling stock to be withdrawn and in such cases it was not

possible for ROSCOs to offer leases having the same duration as the Franchise Term.

Part 3—Provision of Lease Documents

Article 7 (Obligation to give a copy of the existing Lease Agreement)

35. Article 7 sets out the requirement for the ROSCO to provide a copy of the existing Lease Agreement to the Potential Lessee for the Rolling Stock on which the Indicative Offer has been made.
36. Article 7.1 requires that the copy of the existing Lease Agreement should be given to a Potential Lessee within the Information Period (ie within ten Working Days after the Indicative Offer). The existing Lease Agreement will usually be the Lease Agreement relevant to the Specified Rolling Stock that applies at the time of the Indicative Offer. However, where the Specified Rolling Stock is not on lease at the date of the Indicative Offer the existing Lease Agreement means the most recent Lease Agreement applying to the Specified Rolling Stock. The existing Lease Agreement should be provided irrespective of whether or not it relates to Rolling Stock that is or was being used to operate franchised or non-franchised passenger services. If Specified Rolling Stock is being compiled from Rolling Stock that is subject to a number of different existing Lease Agreements, all existing Lease Agreements relevant to the Specified Rolling Stock should be given to the Potential Lessee.
37. In accordance with Article 7.2, prior to giving the existing Lease Agreement(s), the ROSCO may only exclude from disclosure information falling within certain specified classes of information. If a ROSCO excludes information in accordance with Article 7.2, Article 7.3 requires it to indicate the information that has been excluded from the existing Lease Agreement and specify which class of information each such exclusion falls within. It will not be sufficient grounds for an exclusion to be made solely on the basis that a legal document that forms or has formed part of the existing Lease Agreement is no longer legally effective (for example, a side letter relating to the costs and funding of a Modification that has been fully rentalized).
38. Article 7.4 restricts the Potential Lessee from disclosing the existing Lease Agreement(s) to third parties or using it for purposes other than assessing the Indicative Offer. Information may only be disclosed to a third party with prior written consent from the ROSCO, where the third party is the Potential Lessee's agent or adviser, where disclosure is required by law, or where the information has already been disclosed to the public.

Part 4—Supply of information and submission of reports on compliance to the ORR

Article 8 (Supply of information to the ORR)

39. Article 8 sets out the requirement for information to be provided to the ORR under certain circumstances to enable it to monitor and review the operation of the Order or any provisions of the Order. It also provides that the ORR may publish such information to assist in its duty.

Article 9 (Provision of compliance statements to the ORR and auditing of compliance by an approved body)

40. Article 9 requires a ROSCO to submit to the ORR an annual compliance statement (similar to the template compliance statement in Schedule 8) by 31 January of the following year. For example, if a ROSCO makes any Indicative Offers in calendar year 2010, it will submit a compliance statement to the ORR by 31 January 2011 in relation to all Indicative Offers made in 2010.
41. Article 9.2 provides that the ROSCO shall obtain an audit of the compliance statement carried out by an approved body, if the ORR so directs. There is no automatic requirement for an audit to be carried out.

Part 5—Additional compliance obligations to Potential Lessee

Article 10 (Additional compliance obligations)

42. Article 10 sets out the steps a ROSCO must take in the event that it is notified in writing by a Potential Lessee that it has concerns that the ROSCO has failed to comply with any requirement of the Order. Article 10.5 notes that this does not suspend or defer any of the rights, duties and obligations in the Act. The Potential Lessee is not required to follow this process, but the expectation is that it would co-operate with the ROSCO with a view to resolving the issue it has raised and, for example, involve senior staff in any discussion or correspondence.