



News Release

16/09

7 April 2009

ROLLING STOCK LEASING MARKET INVESTIGATION— FINAL REPORT

The Competition Commission (CC) has published the final report from its inquiry into the market for the leasing of rolling stock for franchised passenger services, and has set out a number of measures designed to improve competition in the market.

In its final report published today at www.competition-commission.org.uk the CC has concluded that competition in the market for the leasing of rolling stock is restricted by the limited number of alternative fleets available to train operating companies (TOCs) when bidding for rail passenger franchises. The CC has identified several factors which in combination have restricted the choice of rolling stock available for lease at the point franchises are being let, including: technical and operational factors which limit interoperability; costs and risks in switching rolling stock or introducing new rolling stock; and aspects of the way in which the franchising system currently operates. TOCs have in many cases little incentive or ability to negotiate with rolling stock lessors (ROSCOs) and ROSCOs in turn have little incentive to compete with each other.

In order to address the competition problems that it has found, the CC is making a number of recommendations to the Department for Transport (DfT) and Transport Scotland aimed at improving competition and choice in the market, as well as introducing other changes itself. The package of remedies is as follows:

- recommendations to the franchising authorities to make changes to the franchise system, wherever consistent with their other functions and objectives, to:
 - introduce longer franchise terms (in the region of 12 to 15 years or longer), which would allow TOCs to realize the benefits and recover the costs of switching to alternative new or used rolling stock over a longer period, which should increase the incentives and ability for TOCs to exercise choice;
 - assess the benefits of alternative new or used rolling stock proposals beyond the franchise term and across other franchises when evaluating franchise bids. This will encourage a wider choice of rolling stock to be considered in franchise proposals, irrespective of franchise length; and

- ensure that franchise invitations to tender (ITTs) are specified in such a way that franchise bidders are allowed a choice of rolling stock;
- requiring the ROSCOs to remove non-discrimination requirements from the Codes of Practice,¹ which would provide greater incentives for the TOCs to seek improved terms from the ROSCOs; and
- requiring rolling stock lessors to provide TOCs with a set list of information when making a lease rental offer for used rolling stock, which would give TOCs the ability to negotiate more effectively.

Inquiry chairman and CC Deputy Chairman, Diana Guy, said:

Although we have found that there is active rivalry between ROSCOs for the leasing of new rolling stock at its first lease, there is frequently little competition when existing stock comes up for re-leasing. The fundamental problem stems from the lack of alternatives to the incumbent fleets when TOCs are putting together their franchise bids, and we have therefore sought to develop measures to remedy this. We believe that our package of measures will increase the scope for competition.

The measures we are proposing share a common aim which is to increase the opportunity and incentives for TOCs to consider a wider range of alternatives when leasing stock. This will in turn place greater pressure on the ROSCOs to compete. For example, longer franchises, considering the benefits of alternative rolling stock beyond the franchise and looser specification of franchises will all help enable TOCs to give greater consideration to new or alternative used rolling stock rather than simply leasing the incumbent stock, as happens frequently now.

We will also bring in measures to improve the incentives and ability for TOCs to try and negotiate better deals. All of this will increase competitive pressures on the ROSCOs, and so create a more flexible and competitive market.

We recognize that the unusual nature of the rolling stock market makes it unlikely that competition can ever be fully effective. For example, it is not possible to change the technical and operational factors that often mean rolling stock cannot be used on other lines or services. To some extent, the choices for TOCs in this market will always be limited.

This is also an uncertain time for the industry with programmes to acquire additional fleets of rolling stock, proposals to develop the rail infrastructure, changes in the ways that new rolling stock is procured, and developments in the general economy which may affect passenger demand and the financing of rolling stock.

In spite of this, we consider that there are ways in which this market can move some way towards a more competitive market where customers have greater choice and freedom to exercise choice. In particular, we consider there is room

¹Each ROSCO has a Code of Practice in place which includes a set of commitments which govern that ROSCO's relationship with existing and prospective customers. These commitments include a set of requirements that the ROSCO will not discriminate in the terms it offers bidders to a franchise, with the consequence that, in practice, any TOC that asks for a specific package of rolling stock is offered the same terms, and so TOCs have little incentive to seek better terms as its rivals will also receive the same benefit.

for a more flexible approach by the franchising authorities, which will allow greater competition without undermining the other important considerations they need to have in mind.

We fully accept that franchising authorities must take into account a wide range of public policy considerations, apart from competition in the rolling stock leasing market. Our recommendations have been designed to allow sufficient flexibility and discretion so that franchising authorities can choose how best to gain the benefits of greater competition in the leasing of rolling stock without compromising the successful operation of franchises. Our judgements, based on a desire to promote competition in the leasing of rolling stock, are not intended to inhibit the DfT taking other actions in pursuit of its other functions and objectives.

We have looked carefully at how the competition problems have affected TOCs, and at the claims made by the DfT that the ROSCOs have been overcharging, particularly for leases of the old British Rail rolling stock. We have found that TOCs have in many cases not been able to choose which fleets would best suit the needs of each franchise and costs faced by TOCs (and hence taxpayers) could be higher than they should be. However, due to the unusual nature of the market, we have been unable to find a robust way to evaluate the returns made by the ROSCOs or to place any reliance on calculations of overcharging.

Our approach to remedying the problems we have found is to bring in measures that will stimulate competition, as opposed to ones which deal with the outcomes resulting from restricted competition, such as price controls. Having examined several alternative forms of controlling lease rentals, we see very significant practical difficulties in designing and enforcing this type of remedy, and we anticipate that this would create damaging distortions in the market. Price controls would have to be applied on a fleet by fleet basis; identifying appropriate prices at this level would be difficult and would be unlike any price control regime in use in other industries.

The CC published its provisional findings report on the rolling stock market in August 2008. Since then it has been discussing potential recommendations and measures to improve competition with the rolling stock lessors, TOCs, the DfT, Transport Scotland and other interested parties. In December 2008, the CC published its proposed decision on which of these remedies it planned to recommend or introduce.

Notes for editors

1. The CC is an independent public body, which carries out investigations into mergers, markets and the regulated industries.
2. The Office of Rail Regulation (ORR) referred the rolling stock market for investigation by the CC in April 2007. The CC has been carrying out its own comprehensive investigation to see if any features of this market prevent, restrict or distort competition and, if so, what action might be taken to remedy the position.
3. Passenger rolling stock in the UK is predominantly owned by three ROSCOs: Angel Trains Limited, HSBC Rail (UK) Limited and Porterbrook Leasing Company Limited. The ROSCOs were created at privatization to own the fleets of ex-British Rail passenger vehicles, which are leased to TOCs.

4. The members of the Rolling Stock inquiry group are Diana Guy (Group Chairman and CC Deputy Chairman), Laurence Elks, John Smith, Anthony Stern and Professor Catherine Waddams.
5. Under the Enterprise Act 2002 the Office of Fair Trading (OFT) or a sectoral regulator such as the ORR can make a market investigation reference to the CC if it has reasonable grounds for suspecting that competition is not working effectively in that market.
6. Market investigation references are intended to focus on the functioning of a market as a whole rather than the conduct of a single firm in a market.
7. Enquiries should be directed to Rory Taylor or Siobhan Allen on 020 7271 0242, email rory.taylor@cc.gsi.gov.uk or siobhan.allen@cc.gsi.gov.uk.