News Release

22/08 7 August 2008

ROLLING STOCK LEASING MARKET INVESTIGATION
PROVISIONAL FINDINGS

The very limited number of rolling stock options available to train operating companies (TOCs) when bidding for rail passenger franchises is restricting competition in the market for the leasing of rolling stock. This is the conclusion reached by the Competition Commission (CC) in its provisional findings on the market for the leasing of rolling stock for franchised passenger services.

In the report summary published today at www.competition-commission.org.uk, the CC has provisionally found that a lack of rivalry results from the interaction of several factors which restrict choice or the ability of TOCs to exercise choice when it comes to leasing vehicles from the rolling stock companies (ROSCOs). These include the shortage of vehicles available for lease at the point franchises are being let, technical and operational factors which limit interoperability, and costs and risks in switching rolling stock or introducing new rolling stock. This lack of choice is reinforced by the way in which the franchising system currently operates which restricts opportunities for competition and in some cases is applied in ways that further constrain choice. The full report will be published on Friday 8 August.

Given the adverse effect on competition which the CC has found, the CC is required under the Enterprise Act to consider remedies and has today also published a notice of possible remedies. The majority of the remedies being considered involve recommendations to the Department for Transport (DfT) to introduce a greater degree of flexibility, where appropriate, in the franchising system or the procurement of leased rolling stock with the objective of achieving a greater degree of choice in rolling stock for train operators.

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

> With the powers we have under the Enterprise Act, we have been able to carry out a far more detailed review of the passenger rolling stock market than has been attempted before. As part of our work, we have, for example, examined each re-lease of rolling stock since privatization.
>
> We have found that there is active rivalry between ROSCOs for the leasing of new rolling stock at its first lease. However, there is frequently little or no competition to the existing, incumbent fleet of rolling stock on particular services

when franchises are being re-let and new leases for rolling stock must be negotiated.

There are a number of reasons for this, but the fundamental problem stems from the lack of alternatives to the incumbent fleets when TOCs are putting together their franchise bids. This results from the high current demand for rolling stock relative to the number of available vehicles, limited interoperability, the costs involved in switching to new or alternative used rolling stock, and other factors. We also found that the nature of the franchising system was important in reducing the potential for rivalry between ROSCOs.

The DfT now plays a central role in the specification and award of passenger rail franchises and is increasingly taking responsibility for the procurement and allocation of rolling stock. Given the very substantial sums of public money absorbed by the railways in this country, we understand and respect the motivation of the DfT in seeking to exercise control and to ensure value for money. The result has, however, been to place additional constraints on the scope for competition in the rolling stock leasing market.

Whilst the CC has not identified concerns with competition for maintenance services, the CC has identified a number of factors which restrict competition for the leasing of rolling stock, including:

- Technical and operational factors restrict the degree of potential competition between fleets of rolling stock.

- Detailed specification by the DfT during the franchising process often means that the only available and suitable rolling stock is that currently used by the incumbent operator.

- The option to buy new rolling stock is sometimes not supported by the DfT during the bidding process because of the higher costs involved, and the length of franchises can also discourage such long-term investment. As such, the option of new stock offers a limited competitive constraint on the rolling stock market.

- There is a shortage of spare rolling stock, and because franchises are not awarded simultaneously, potential alternatives are often unavailable for considerable periods due to their being leased elsewhere.

- The relatively high cost of short-term leases may discourage TOCs from entering into such leases to cover the period until new or alternative used stock becomes available.

- The costs, lead times and deliverability risks involved in switching to alternative used or new rolling stock discourages TOCs from switching to other rolling stock.

- Given the shortage of spare capacity, there is a very low risk that rolling stock will fail to be leased eventually, which in some cases weakens the ROSCOs' incentives to compete with their rivals on rental rates.

- Barriers to entry into the leasing of rolling stock are high.

Because of the shortage of alternative rolling stock options, it is likely that rentals are higher for used rolling stock than they would be in a more competitive market. Additionally, TOCs will suffer from a restriction of choice, as they may be unable to lease the rolling stock that they would otherwise choose. However, we also note that in many cases lease rentals have fallen compared with the levels set at privatization. The effect of the existing industry Codes of Practice and the threat of more specific regulation appears to have largely prevented the ROSCOs from raising rentals, except where there is further investment in rolling stock or a short-term lease.

Along with the provisional findings, the CC has also published a notice of remedies outlining potential measures which the CC itself might take and recommendations it might make to the DfT for improving competition. The CC will consider responses to both documents before publishing its final report in January 2009.

The CC would like to hear views on the provisional findings report and the notice of possible remedies in writing, by 12 September 2008. To submit evidence, please email roscos@cc.gsi.gov.uk or write to:

The Inquiry Manager (Rolling Stock market investigation)
Competition Commission
Victoria House
Southampton Row
LONDON
WC1B 4AD

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. Enquiries should be directed to Rory Taylor on 020 7271 0242 or rory.taylor@cc.gsi.gov.uk.

5. 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.

6. 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.

7. 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.