



OFFICE OF **RAIL REGULATION**

Passenger rolling stock leasing markets

Scope of our market study and provisional timetable

July 2006

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1. Introduction

- 1.1 On 28 June 2006, the Office of Rail Regulation (ORR) received a detailed submission (the Complaint) from the Department for Transport (DfT) requesting us to refer the passenger rolling stock leasing market(s) to the Competition Commission (CC) for investigation under section 131 of the Enterprise Act 2002 (EA02).
- 1.2 The Complaint sets out a number of structural and behavioural features of passenger rolling stock leasing market(s), and discusses how these are capable of preventing, restricting or distorting competition in the passenger rolling stock market(s).
- 1.3 A Complaint to us relating to a significant sector of the railways must inevitably lead to serious consideration by us. After conducting an initial review of the Complaint, we have, therefore, decided to undertake a focused market study with a view to deciding whether or not to make a market investigation reference to the CC. We set out our reasons for undertaking a market study at paragraph 2.8 of section 2.
- 1.4 Given the possibility of a more detailed investigation by the CC following referral, we do not intend to prolong this study unduly. We are, therefore, keen to ensure that the study remains focused only on what is needed for us to consider whether or not the reference test has been reached¹. Our timetable and process has been designed to achieve this aim. More detail on the scope and focus of the study is contained at paragraphs 2.12 to 2.14.
- 1.5 We are inviting parties to register an interest in this study (see paragraph 3.8 below). However, given the focused nature of the study and the planned timescales, we may not contact all potentially interested third parties. We will, however, engage with all key stakeholders during the course of what we call our Inquiry Phase. The timetable in section 3 below indicates when this engagement is scheduled to occur.

¹ Whether we have reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition.

- 1.6 A reference to the CC is not the only possible outcome of our study, see *ORR's approach to reviewing markets* (<http://www.rail-reg.gov.uk/upload/pdf/282.pdf>). We may, for example, decide that at the end of the timetable period the scope of the review needs to be widened, and we need more time to consider the issues arising during the market study in more depth. We may also consider the appropriateness of taking undertakings in lieu of a reference². We consider, however, that we will not be in a position to consider the appropriateness or otherwise of, considering proposals for undertakings until after the Inquiry Phase has been completed. We would, therefore, consider premature an offer to have such discussions before at least September 2006.
- 1.7 It is our intention to publish our conclusions in November 2006, which may, depending on the circumstances of the case and the potential for the other outcomes described above, be in the form of a draft reference. The reference itself, on current timescales, is not likely to be made to the CC before February 2007.
- 1.8 Under the EA02 we have the power³ to refer any markets for the supply of services relating to railways to the CC for a market investigation⁴. We hold this power concurrently with the Office of Fair Trading (OFT), which has agreed, in the case of this particular complaint, that we are best placed to carry out the study.
- 1.9 This document lays out the scope of our study, our processes and provisional timetable and invites third parties to register their interest with us.

² Section 154 of the EA02.

³ Concurrently with the OFT – by virtue of section 67 of the Railways Act 1993 (as amended).

⁴ Other than the limited circumstances in which a ministerial reference can be made under section 132 of the EA02.

2. Scope of the market study

The Enterprise Act 2002

2.1 We have a concurrent power with the OFT to make a reference to the CC, under Part 4 of the EA02 in cases where we have:

“reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom”.

2.2 The EA02 defines a ‘feature’ of a market as:

- the structure of the market concerned or any aspect of that structure;
- any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services; or
- any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services. Conduct is described in the EA02 as including “any failure to act (whether or not intentional) and any other unintentional conduct”.

2.3 The market investigation provisions in the EA02 replaced the complex monopoly provisions in the Fair Trading Act 1973. Market investigation references focus on the functioning of a market as a whole, whereas the Competition Act 1998 (CA98) deals with abuses arising from the conduct of one or more firms within a market. However, in certain cases where the anti-competitive conduct of a single firm or a number of firms is associated with structural features, it may still be appropriate to make a reference to the CC.

2.4 Concurrent jurisdiction under the EA02 goes wider than the definition of railway services in section 82 of the Railways Act 1993, and includes services such as the leasing or maintenance of rolling stock as provided by the rolling stock leasing companies (ROSCOs).

Why we are conducting this market study

- 2.5 Our aim, as set out in our *Corporate Strategy 2006–2009* (<http://www.rail-reg.gov.uk/upload/pdf/280.pdf>), is to apply independent, fair and effective regulation to enable the railway to be safe, well maintained and efficient and to ensure that it provides value for money for users and for its funders.
- 2.6 We consider that a well developed and competitive supply market is vital to improving industry performance and efficiency, and we view the development of competition between private sector providers of rail services and equipment as an important means of improving efficiency and delivery over the medium to long term. Furthermore, we set out our intention to use our powers to carry out market studies where this is most likely to be effective.
- 2.7 Our processes for conducting market studies under the EAO2 are set out in *ORR's approach to reviewing markets* (<http://www.rail-reg.gov.uk/upload/pdf/282.pdf>).
- 2.8 The objective of this market study is to establish whether the market(s) for passenger rolling stock leasing are functioning effectively, or whether they have features or a combination of features that lead to consumer detriment. We consider that the following factors support our decision to undertake a market study:
- Evidence supplied by DfT suggesting a possible lack of effective competition;
 - The importance of rolling stock as an input into passenger rail markets; and
 - The need to establish certainty for investors in this sector.
- 2.9 When the industry was privatised in 1996 it was envisaged that the three ROSCOs would both compete with one another and that competition would emerge from new build, and the consequent displacement of useable rolling stock would create an excess of supply over demand. There has in fact been no large-scale market entry since privatisation and the market shares of each ROSCO have remained relatively stable over the last 10 years.
- 2.10 Passenger Rolling Stock lease payments are a significant proportion of the total costs to the rail industry. We understand that the rail industry pays over

£1 billion to ROSCOs to lease stock. Any widespread market failure in this sector would therefore lead to significant consumer detriment, and ultimately prevent or limit the Government in its aim of achieving best value for money for the taxpayer.

- 2.11 There has been a thorough modernisation of the UK fleet since privatisation, with the ROSCOs investing £4.2 billion since 1996 and bringing 4,500 new vehicles into service – which has undoubtedly brought significant benefit to the travelling public. It is important, going forwards, that the relationship between ROSCOs, the franchisees and ultimately the Government is built on a foundation of confidence, and that each party to the arrangements is securing value out of that relationship.

Scope of the market study

- 2.12 We do not intend to engage in an in-depth investigation of all features of the passenger rolling stock market(s). Given the receipt of a detailed complaint from government, we consider that this is a serious matter which would benefit from a focused market study designed to come to an early view, with full engagement with key stakeholders, on whether this is a matter which should be referred for more detailed scrutiny by the CC.
- 2.13 The initial scope of our study will focus on an assessment of:
- any features of the relevant market(s) that tend to restrict market entry and/or limit the extent of competition between existing players. This will include an assessment of the impact of factors including the Government's franchising process and the current maintenance regime; and
 - the extent to which measures of profitability can be used to make inferences about the competitiveness of these market(s), and which measures provide the most meaningful insights.
- 2.14 We intend to consider the scope for greater competition and the extent to which any such increase would be likely to confer benefits on the users and funders of the railways in the both in the short-term (renewal of pre-privatisation rolling stock leases) and in the longer term (when the post privatisation rolling stock leases come up for renewal).

Possible outcomes of our market study

- 2.15 Our study may not necessarily conclude that a market investigation reference to the CC is the most appropriate manner in which to proceed. There are a number of other potential options arising out of this review:
- (a) The market(s) has a clean bill of health;
 - (b) There are reasonable grounds to suspect there are structural issues which are capable of referral to the CC under section 131 of the EA02 or Undertakings accepted in lieu;
 - (c) We should conduct a longer market review (between six to twelve months) which includes among other things consulting on our view of the relevant economic market(s) and any competition concerns identified; or
 - (d) There is evidence which suggests we should launch an investigation under the CA98.

3. Our provisional timetable and process

Provisional timetable

- 3.1 As stated in chapter 2 above, one of our key objectives in this market study is to establish whether there are reasonable grounds to make a market investigation reference to the CC.
- 3.2 In order to reach this view, we intend to adopt as open and transparent a process as possible. We are publishing our provisional timetable in order to inform key parties when they can expect to engage with us, and when they should expect us to reach a conclusion.
- 3.3 We will conduct the market study along the following timetable

Time Line	Activity	
June 2006	Receipt of DfT complaint	
Inquiry Stage 1		
July 2006	Information requests to key stakeholders	
Inquiry Stage 2		
	Meetings with key stakeholders*	
	Early July	DFT
	Mid July	Train Operating Companies (TOCs)
	Mid July	ROSCOs
	Late July	Interested Third Parties
14 July 2006	Deadline for Third Parties to register interest	
Early – Mid August 2006	Deadline submission of written responses to information requests.	
November 2006	Consultation on provisional findings	

*ORR will make contact to schedule meetings with key parties

- 3.4 The meetings in July are primarily to assist parties in responding in writing to the information requests and are an opportunity for parties to seek clarity on what is being asked of them. Parties may also wish to indicate, at the meetings, whether there is additional evidence or information which they consider would be material to the study. It is entirely possible, therefore, that we will send out further individual information requests following each meeting and indeed hold further meetings.
- 3.5 Information provided to us may be disclosed in our conclusions. It is therefore important that any material provided to us, which is of a sensitive nature, is clearly identified and marked as confidential along with reasons explaining why the information is to be treated as confidential. A blanket claim of confidentiality on information submissions is not sufficient.
- 3.6 Part 9 of the EA02 restricts the disclosure of information that comes to us in connection with our functions under Part 4 of the EA02. However the EA02 also provides for a number of 'gateways' through which we have discretion to disclose information, in particular where we consider that the disclosure of information would facilitate the exercise of our statutory functions.
- 3.7 Currently we intend to consult on our findings in November 2006. As indicated previously, these findings could be in the form of a draft market reference, and they could also indicate that the scope of the study has broadened and we need more time to come to firm conclusions. It is unlikely that we would, should such an approach be considered appropriate, be in a position to consult on draft undertakings at that time.

Registering as a third party

- 3.8 We will be contacting key parties directly (for example ROSCOs, key TOCs and DfT). However, those who have a vested interest in the outcome of this market study and are likely to be able to positively contribute will be given the opportunity to register their interest. Registering interest with us means that you may be asked for information during our information gathering phase and/or that we will ask you for your views/opinions at various key stages. Interested parties may also be consulted in the event that we decide to proceed to a market investigation reference.

3.9 We would, therefore, like interested parties to register at the address below:

The Competition Team
Office of Rail Regulation
One Kemble Street
London WC2B 4AN

Or email

competition@orr.gsi.gov.uk

3.10 When registering as an interested party, you must clearly indicate the following:

- (a) Your name or your company name and ultimate ownership (for companies);
- (b) A brief summary of your activities or those of your company;
- (c) Your or your company's interest in the market study (for example, you may be a customer of either of the ROSCOs);
- (d) How you or your company can positively contribute to the market study.

3.11 Upon receipt of the details above, we will decide whether to accept your registration as an interested third party.

3.12 Please note that the deadline for registering as an interested third party is **14 July 2006**.