Chris Hemsley
Deputy Director, Markets & Competition

Telephone: 0207 282 2071
E-mail: chris.hemsley@orr.gsi.gov.uk

3 July 2015

To: GB rail franchised TOCs and owner groups, ROSCOs, and funders

Dear Colleague

The Rolling Stock Leasing Market Investigation Order 2009 – review findings, April 2015

Introduction

1. We are writing to inform you of our findings following the consultation on the Rolling Stock Leasing Market Investigation Order that we published on 18 December 20141 ('the consultation').

2. The Order was amongst a number of remedies imposed by the Competition Commission (CC) in 2009 following its investigation into the rolling-stock market2; a market that accounts for around £1.5bn per year of leasing costs3. We committed to undertake a review of the Order at the time the CC’s remedies were published4 and more recently in our 2014/15 Business Plan5, as part of our work towards our strategic objective to promote an increasingly dynamic and commercially sustainable sector6.

3. The consultation asked for stakeholder views on the operation of the Order to date, and on any other important changes that had taken place since the Order came into force in 2010. Our full list of questions is included at [Annex A].

4. We were interested in the following key issues:

- **Compliance with the Order** – Full compliance by all ROSCOs is a clear prerequisite for an effective remedy. The Order requires ROSCOs, in specified circumstances, to submit compliance statements to ORR, who may then require the ROSCO to obtain an independent audit of compliance. A key purpose of the consultation was to determine whether or not there might be a case for ORR to consider taking steps around compliance, including the commissioning of compliance audits for one or more ROSCOs.

- **Efficacy of the Order** – we asked for stakeholder views on the efficacy of the CC’s order, any compliance issues notwithstanding.

- **Removal of non-discrimination Obligation** – we sought feedback on the impact of the ROSCOs’ undertakings to remove non-discrimination terms that followed the CC’s investigation.

- **Overall Outlook** – we asked stakeholders for evidence on how, if at all, leasing markets as a whole had changed since 2010.

5. The depth of our review was limited by the relatively small number of new leases that had been entered into since the Order, and the CC’s other remedies, came into force in 2010.

**Overview of consultation responses**

6. We received 14 consultation responses. Respondents included TOCs, ROSCOs, and other interested parties. We provide below an overview of the key messages that came out of these responses.

*Compliance with the Order*

7. The majority of respondents said that the ROSCOs had complied well with the requirements of the Order. For example, one TOC said, “Our experience is that the

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ROSCOs have been compliant…” and another that, “We have no evidence of non-compliance.”

8. TOCs provided us with evidence that raised at least the possibility of non-compliance in two specific examples. One of these examples related to a very specific issue that appeared to be unique to the circumstances of a particular class of rolling stock. The other example concerned difficulties that a TOC had experienced in negotiations with a particular ROSCO but where the final outcome of these negotiations had, from the TOC’s perspective, been broadly satisfactory.

Overall efficacy of the Order

9. Most respondents considered that the Order has had at least some positive impact on the market. For example, a ROSCO us that, “We believe that the Order has played an important role in bringing about a more effective and competitive market, in the context of the overall evolution of the market.” A TOC said that, “We consider the Order is effective and fit for purpose.”

10. There was, however, a note of caution running through most TOC responses. Relatively few stakeholders appeared to believe that the Order, taken alone, has the potential sufficiently to address the competition concerns identified by the CC. It was argued to us by some stakeholders that many of the key features identified by the CC as contributing towards an overall lack of competition had persisted. Key examples of the issues cited by stakeholders were the overall shortage of suitable available rolling stock at the time of bidding for franchises and the interaction between the franchise system and leasing of rolling stock.

11. For example, one TOC said: “… the Order has been effective in itself, but… further progress [in addressing market failures]… will be necessary to achieve full value…”. In respect of franchising, and another TOC that: “The most significant barrier to… competition remains the involvement of funders in prescribing [inputs] as opposed to specifying outputs…” and went on to say that, “… the Order has been effective in itself, but… further progress [in addressing market failures]… will be necessary to achieve full value…”.

12. ROSCOs, whilst recognising the objective of increasing transparency, commented that the Order imposed a level of additional administrative burden on them and suggested ways it might be streamlined and in which clarity over the requirements imposed by the Order could be improved. One ROSCO questioned whether TOCs were making sufficient use of the information provided for it to be fully “efficient”.
Removal of non-discrimination Obligation

13. The majority of TOC respondents told us that removal of the non-discrimination obligation had proved helpful to them when negotiating with ROSCOs. One TOC commented that it had “… found more readiness [of the ROSCOs] to engage with our requirements and that assists us to develop better franchise bids”. Another TOC said that this change, “…has enabled…engagement with ROSCOs to develop imaginative and cost effective proposals for franchise bids”. Another TOC told us that “We have found more readiness [of the ROSCOs] to engage with our requirements and that assists us to develop better franchise bids”.

14. One TOC alone amongst TOC respondents in arguing that this change had not had any impact on ROSCO behaviour, saying that “Overall, the removal of non-discrimination terms triggered no changes in the ROSCO’s approach. Our ability to develop a bid specific solution has not changed.”

Overall Outlook

15. The balance of TOC responses suggested a view that, whilst the Order and other remedies have had some positive impact, in the sample of franchise competitions that have been held since the remedies came into play there has been relatively little change in market conditions overall since 2010.

16. Some responses noted progress in some areas. For example, stakeholders anticipate that the delivery of new electrical multiple units (EMUs) through large investment schemes such as the IEP\(^8\) and Thameslink\(^9\) will lead to an increase in surplus EMU stock and hence in the choices available to TOCs. More than one TOC, however, noted that such changes will take place against a backdrop of increasing passenger numbers and a continued excess demand for diesel multiple units (DMUs).

17. Some TOCs expressed a view that that within the franchise competitions held since 2010 the prescriptiveness of rolling-stock specifications within franchises has been an issue that has not been addressed.

18. By contrast, ROSCO responses in the main argued that competition in the market has increased significantly since the CC’s investigation, as the features identified by the CC as restricting competition have either been removed or significantly reduced. Respondents cited the impact of the CC’s remedies, arguing that they have encouraged


TOCs to negotiate with ROSCOs in order to be able to make more compelling franchise bids. ROSCO respondents also noted that new suppliers have entered the market, potentially suggesting that entry barriers may not be as high as considered by the CC during its enquiry.

19. ROSCOs argued that greater competition has imposed constraints on their pricing and has made TOCs more likely to request tailored responses on matters such as modification proposals, flexible hand back terms (for new rolling stock and capital rental reductions etc). However, consultation responses did not provide detailed evidence on how, if at all, the overall lease terms that TOCs have been able to obtain from ROSCOs have changed since 2010 (i.e. whether they have become more or less favourable).

Summary and conclusions

20. In light of the evidence available and the consultation responses, we have reached the following conclusions:

- The Order has, in at least the large majority of cases, been complied with and been broadly successful on its own terms.
- ‘Relatively few responses suggested to us a widespread belief that the Order, without other changes, has the potential to deliver materially better outcomes than it has done already’ Stakeholder views on the impact of the removal of non-discrimination are in the main fairly positive.
- Views on the overall picture, i.e. the extent of change since 2010, are fairly mixed, with no very clear theme emerging from the relatively small number of consultation responses that we received.

21. Given the first two of these points, we do not intend to commission an audit of ROSCO compliance with the Order at this time. We will, however, keep the potential need for a review under consideration, and going forward will remain interested in any stakeholder representations on this issue.

22. ORR has a duty to keep under review the provision of railway services\textsuperscript{10}. This includes rolling stock which in line with our statutory duty we will continue to keep under review. With this in mind, we would welcome continuing discussion with interested stakeholders on this important aspect of the provision of railway services.

\textsuperscript{10} These responsibilities are set out in the Railways Act and the Railways Infrastructure (Access and Management) Regulations.
Yours sincerely

Chris Hemsley
Annex A – Stakeholder questions from ORR consultation letter dated 14 December 2014

Please supply us with your overall views, wherever possible with reference to the available evidence, on ROSCOs’ compliance with the Order that has been in effect since February 2010, and also on the combined effectiveness of the Order and the CC’s other remedies. Please do so with reference to the status quo that existed prior to the CC’s review.

We have suggested a list of specific questions for you to answer below, in addition to letting us know about any other considerations that you consider to be important.

**Background**

1. Please provide details of your exposure, as an organisation or individual, to the CC’s remedies, i.e. the experience that puts you in a position to comment on their effectiveness.
2. Please provide any evidence that you have on how, if at all, the overall lease terms that TOCs have been able to obtain from ROSCOs have changed (e.g. become more or less favourable) since 2010, with reference to specific examples as appropriate.
3. Please explain how, if at all, you think that any factors other than CC’s remedies (e.g. the introduction of new rolling stock, any changes to DfT’s approach to procuring franchises, and so on) have impacted on the market since 2010.
4. Please provide any relevant evidence that you have on the costs to stakeholders of complying with the Order.

**Removal of non-discrimination terms in ROSCO codes of practice**


5. Please provide your overall views on the effectiveness of this measure.
6. Please state whether, since the removal of the non-discrimination obligations, you have engaged in activity (e.g. particular negotiations) that you would not have
attempted had the non-discrimination obligations remained in place. Please describe these activities and explain what outcomes they led to in your view.

The Transparency Order


7. Please provide your overall views on the effectiveness and fitness-for-purpose of the Order and of whether the ROSCOs have been compliant with it.

8. Please provide any evidence that you have of how frequently the information supply necessitated by the Order has been used by franchised TOCs and would-be franchised TOCs. One way of responding to this request would be for TOCs to explain which of the activities that they have engaged in since 2010 and that would not have happened had the Order not been in place. Examples of such “activities” include making particular proposals to government for the use of rolling stock or entering into particular negotiations.

9. Please set out any important information that, in your view, the Order does not currently require ROSCOs to provide but that should be provided in order to enable you to properly assess the offers made to you by ROSCOs.