

## **COMPETITION COMMISSION INQUIRY INTO ROLLING STOCK LEASING MARKET: SCOTTISH GOVERNMENT RESPONSE**

### **COMPETITION COMMISSION'S REPORT ON ROLLING STOCK LEASING MARKET: SCOTTISH GOVERNMENT RESPONSE**

This document responds to the recommendations made to Franchising Authorities in the Competition Commission's "Rolling Stock Leasing market investigation" Final Report, which was published on 7 April 2009.

#### **Rail Industry in Scotland**

The Railways Act 2005 devolved the responsibility for the majority of rail functions in Scotland, including the role of specification and funding of rail services through the Scotrail franchise and Network Rail's rail infrastructure throughout Scotland through the regulated High level Output Specification process operated by the Office of Rail Regulation.

The potential remedies that the Competition Commission have outlined are therefore equally relevant to Scotland and Scottish Ministers going forward.

The Office of Rail Regulation (ORR) is the GB wide economic and safety regulatory authority, performing the same function in relation to Scotland as for England and Wales.

#### **Rail Enhancement and Investment in Scotland**

Scottish Ministers invest in the railway in Scotland to foster economic growth as well as a mechanism for delivering social and environmental policy.

The purpose of the Scottish Government Economic Strategy is to focus the Scottish Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.. The strategy is underpinned by 5 key strategic objectives aimed at ensuring that prosperity and opportunities are available to everyone, and that future generations can enjoy a better quality of life too.

Scotland's National Transport Strategy provides an overarching strategy for transport and establishes the key strategic outcomes which Transport Scotland will ensure that transport infrastructure delivers against to support Scottish Government Objectives: improving journey times and connections; reducing emissions and improving the quality, accessibility and affordability of public transport.

It is within this wider role in respect of the prevailing policy market or wider needs that Transport Scotland will ensure that rail services are appropriately specified to respond to needs and that a fit for purpose whole rail system is delivered.

The Strategic Transport Projects Review is an evidence based, robust analysis of Scotland's transport system which has outlined those interventions that have been

assessed as being most likely to support the Government's purpose. Those rail development not included in the current High Level Output Specification will be incorporated into the next one, and the next franchise both of which will commence in 2014.

It is such an evidence based approach and long term consideration that, looks beyond both franchise periods and regulatory Control Periods, that Transport Scotland will wish to adopt to develop its future franchising arrangements and rolling stock investment options.

### **Scottish Franchise and Rolling Stock**

There is a single franchise in Scotland, which follows the prevailing franchising model adopted by the Strategic Rail Authority at the point of its let in 2004 of a 7 year franchise with the option to extend this duration, based on performance conditions, to 10 years. The benefits of this franchising approach being the ability to regularly test the market and provide the opportunity to seek innovation thus enabling maximum benefits to be secured at best value in the competitive market.

The Scotrail franchise has been extended to the full 10 year option to 2014.

Rolling stock is a key franchise asset; it is crucial to the provision of rail services plus additional rolling stock capacity will be necessary to deliver Transport Scotland's programme of rail investment projects.

Leasing costs of rolling stock comprise as significant portion of overall rail funding, which is met either by Government subsidy or by passenger revenue in Scotland.

Transport Scotland therefore has a significant interest in ensuring that there is a market that is capable of providing a future fleet size and composition that will meet Scottish needs , as well as having the same, significant interest as the Department for Transport, in ensuring that rolling stock leases are set at a fair, competitive level in order to protect both the taxpayer and the passenger in delivering those needs.

### **Competition Commission Recommendations**

The Competition Commission identified an adverse effect on competition in the secondary market for the leasing of rolling stock. It concluded that competition was restricted by a range of factors that restricted the choice of rolling stock available to Train Operating Companies when bidding for rail passenger franchises.

The Competition Commission's approach to remedying this effect is to focus on stimulating competition and to make recommendations that are practicable and reasonable. As a result, the following three recommendations have been made to franchising authorities regarding franchising arrangements which are aimed at encouraging proposals from Train Operating Companies on alternative rolling stock choices:

1. Introduce longer franchise terms (in the region of 12 to 15 years or longer), which would allow Train Operating Companies to realise 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 Train Operating Companies to exercise choice.

2. 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.
3. Ensure that franchise invitations to tender (ITTs) are specified in such a way that franchise bidders are allowed a choice of rolling stock.

In parallel, the Competition Commission will be requiring the rolling stock owners to remove the non-discrimination requirement from the Codes of Practice and provide a range of information when making lease rental offers; increasing the incentive and ability for Train Operating Companies to negotiate more effectively.

### **Scottish Government Response to Recommendations**

The Competition Commission recommends that changes to the franchising system should be made by franchising authorities wherever consistent with their functions and objective. The Scottish Government welcomes the flexibility and discretion that has been built in the recommendations as this enable Transport Scotland to fully consider the proportionality, benefit and impact of changes to the franchising system – in Scotland this need is heightened by virtue of the fact that there is only a single franchise operation, thereby limiting Transport Scotland's ability to consider opportunities and balance the resulting effects.

Through the development work for the next franchise, Transport Scotland will specifically consider franchise lengths and the evaluation and appraisal processes to capture the longer term benefits most appropriately.

### **Summary**

It is clear that there are features of the rolling stock leasing market that are having an adverse effect on competition, which the impact of is challenging to quantify in absolute terms but which has a consequential effect on the funding required to support passenger service operation.

The ability of Scottish Ministers to respond to prevailing policy, market or wider conditions in the design and procurement of rail services in Scotland is key to delivering a fit for purpose, effective and efficient whole rail system to support the Scottish Government's strategic objectives. The Competition Commission's acknowledgement that a range of factors, not just rolling stock, require to be considered in considering such changes is welcomed.

In the preparatory work for the next Scottish franchise, Transport Scotland will consider carefully the full range of options for stimulating competition in the supply of rolling stock alongside the wider factors and benefits that are necessary to consider when procuring rail services. Given the long term strategy for rail development in

Scotland and the long term appraisal and assessment processes that have supported its implementation, a key feature of this work will be how the certainty over future rolling stock requirements in Scotland can be most effectively translated into the passenger franchise.

The Scottish Government welcomes the equally long term focus, and packaged approach, that the Competition Commission has taken to its recommendations for remedy. We do so noting that the timing of the next Scottish franchising exercise affords Transport Scotland the opportunity to both consider the detail of whether and how the recommendations could be best implemented and the benefit of reviewing the effect of any arrangements made to franchising exercise across England & Wales in the interim. However, it is important to highlight that should exploration of different features of franchise design in Scotland not fully deliver against the Competition Commission's recommendations, or the benefits attributed to these recommendation not be fully realised Transport Scotland will seek to explore with the Office of Rail Regulation and the Department for Transport how these are monitored and supported most effectively and appropriately.