

Entry

Introduction

1. In this appendix we consider entry into the leasing of rolling stock.¹
2. First, we consider the extent of entry since privatization² and second, we assess barriers to entry and exit.
3. Usually we consider whether the threat of entry *or* expansion can act as a constraint in preventing a firm from exercising market power.³ In terms of expansion, we noted that although, in principle, each ROSCO could expand by purchasing used rolling stock from another ROSCO thereby changing market concentration, the ROSCOs cannot expand the overall supply of used rolling stock as this supply is fixed. The only mechanism for expansion of supply by the ROSCOs is through the introduction of new rolling stock, which we discuss in Section 5 of the report.

Entry since privatization

4. Entry into the market for the leasing of rolling stock can be achieved through a firm not already in the market purchasing either used rolling stock or new rolling stock such that the structure of the market changes.⁴
5. In this section we examine the extent of entry into the market for the leasing of franchised passenger rolling stock since privatization through (a) the purchase of used rolling stock and (b) the purchase of new rolling stock. We then consider the interest of third parties in entering the market for the leasing of rolling stock to franchised passenger operators in Great Britain.

Purchasing used rolling stock and leasing to TOCs

6. Since privatization, there have been no examples of new entrants purchasing used rolling stock and leasing it to TOCs. Angel and HSBC stated that since privatization they had received no formal offers from potential new entrants to purchase used rolling stock. Porterbrook noted that it had had a large quantity of Intercity coaches for sale for some time, but with interest only from companies operating outside the UK.⁵ We consider the sale of small amounts of rolling stock to TOCs for self-supply in Appendix 2.2.

¹We have not considered the extent of self-supply by TOCs or the use of alternative funding structures such as the Intercity Express Programme in this appendix. We have considered the extent of self-supply in Appendix 2.2 and the possible *future* use of alternative funding structures in Section 2 of the main report.

²With the exception of changes in ownership, we note that there has been no exit by rolling stock lessors since privatization.

³See CC3, June 2003, paragraph 3.17.

⁴Although ownership of the three ROSCOs has changed since privatization, none of these changes has led to entry because the structure of the market has not changed. In contrast, entry would occur if a new firm bought *some* used rolling stock from an existing ROSCO with the purpose of leasing it to franchised passenger operators in Great Britain, and so creating an additional competitor in the market and a change in market concentration.

⁵An exception is that, at the request of GNER, Porterbrook sold ten HSTs to Angel Trains for £[§<] per vehicle in September 2002.

Purchasing new rolling stock and leasing to TOCs

7. There have been two instances of companies other than the ROSCOs purchasing new rolling stock since privatization: Voyager Leasing⁶ and QW Rail Leasing.⁷ Only Voyager Leasing entered into the leasing of rolling stock for franchised passenger services, but we have considered both instances of purchasing new rolling stock in this section.⁸ In addition, the DfT has set up a new company 'Diesel Trains Limited' to procure 202 new DMU vehicles which will then be leased to TOCs (see paragraph 5.54). However, the DfT stated that it does not see itself as, and does not wish to be, a long-term owner of trains and that it is envisaged that this company (or the assets and related contracts) will be sold on to a financier. Moreover, DfT stated that it is not setting up Diesel Trains Limited in order for it to act as a rival for, or to compete against, current rolling stock leasing companies.

Voyager Leasing

8. When Virgin won the Cross Country franchise in January 1997, NatWest⁹ was appointed as financier to arrange for the funding of investment in a fleet of new rolling stock, to be built by Bombardier.¹⁰ Seventy-eight Class 220 and 221 DEMU trains comprising 352 vehicles¹¹ were purchased and leased to Lombard Leasing Contracts Limited, a subsidiary of NatWest, which became the operating lessor of the rolling stock to Virgin.¹² Residual value risk was shared between various parties ([REDACTED]).¹³
9. In July 2000, Lombard's interest as operating lessor was transferred to Voyager Leasing. At this time half of the trains were sold to Halifax.¹⁴ Halifax and Lombard, each owning half of the trains, then entered into head lease arrangements with Voyager Leasing. Voyager Leasing is a limited recourse special purpose vehicle (SPV),¹⁵ with Lombard managing the transaction. During 2000, Lombard's parent company, NatWest, was acquired by RBS, which also owned Angel.¹⁶
10. The operation of Voyager Leasing differs from the three ROSCOs in the following ways:
- (a) Voyager Leasing leases only Class 220 and 221 vehicles and its financing structure was constituted as a tax-efficient financing vehicle. [REDACTED]
 - (b) Voyager Leasing does not have a dedicated day-to-day management team. It has contracted the maintenance function out to the vehicles' manufacturer, Bombardier. Angel was contracted to complete Voyager Leasing's regulatory filings and provide technical support until December 2008 when the contract

⁶Voyager Leasing Limited.

⁷QW Rail Leasing Limited.

⁸We discuss Sovereign Trains, which is effectively self-supplying rolling stock to Grand Central, in paragraph 18.

⁹National Westminster Bank plc, which is now part of RBS.

¹⁰A competition was initially run to find the train manufacturer, followed by a competition for the financier.

¹¹There are 34 Class 220s, comprising 136 vehicles, and 44 Class 221s, comprising 216 vehicles. These are known as 'Voyagers' and 'Super Voyagers' respectively.

¹²The Cross Country franchise was re-let in November 2007 as New Cross Country and won by Arriva. Following a franchise remapping as part of the 'Midlands Three' franchises, the Voyager rolling stock is now divided between the New Cross Country franchise and the West Coast franchise (although it is still serving the same routes).

¹³[REDACTED]

¹⁴Halifax Leasing (September) Limited, now part of Halifax Bank of Scotland (HBoS).

¹⁵An SPV is a legal entity created for a limited purpose, usually for the acquisition and/or financing of a project. Limited recourse refers to the fact that the head lessee's claims on Voyager Leasing are limited to the amounts Voyager Leasing receives from the sub-lessee of the rolling stock (ie Virgin).

¹⁶In August 2008 RBS sold Angel to a consortium of investors, which included Babcock and Brown European Infrastructure Fund, AMP Capital Investors, Deutsche Bank and funds advised by Access Capital Advisers.

expired. Angel stated that it has not had any further involvement with Voyager Leasing since December 2008.

(c) Voyager Leasing was able to enter with a longer than average lease for its rolling stock. Virgin told us that the length of the Cross Country franchise, which was a 15-year franchise (running until 2012),¹⁷ was one factor that enabled Voyager Leasing to enter the market.

11. The DfT questioned the independence of Voyager Leasing from Angel when both businesses were owned by RBS. Angel stated that its business was run as a separate business from Voyager Leasing—although Angel had a contract to provide technical services to Voyager Leasing in respect of part of the fleet, it was specifically precluded from taking any part in commercial activities (for example, negotiating rental prices). Angel also added that, as half of the trains were owned by HBoS, which it considered to be a new entrant, any decisions over use of the fleet had been independent. Voyager Leasing submitted that it had competed with Angel for the provision of rolling stock to the New Cross Country franchise awarded in November 2007.

QW Rail Leasing

12. QW Rail Leasing leases rolling stock to LOROL¹⁸ for operation on the London Rail Concession.¹⁹ The leasing of rolling stock to LOROL falls outside our reference market as the London Rail Concession is not a rail franchise under section 23(1) of the Railways Act 1993. However, we consider it a useful example of how a new entrant might enter the market for leasing of franchised passenger rolling stock and set out some details below.

13. From November 2007, TfL assumed responsibility for London Overground services comprising the London Rail Concession.²⁰ TfL stated that under the terms of the Concession, it assumed responsibility for procuring rolling stock²¹ which would be leased²² to LOROL for day-to-day operation.

14. Having initially purchased new Class 378 Electrostars²³ for use by LOROL, TfL undertook a competitive procurement process for refinancing the rolling stock, in which it approached the three ROSCOs and other financial institutions. QW Rail Leasing, a joint venture between Sumitomo Mitsui Banking Corporation (SMBC) and National Australia Bank (NAB), was successful and a lease was agreed in December 2007. Under the terms of the lease, the rolling stock is committed for use on the concession until 2027, at which point TfL can either hand the trains back to the lessor

¹⁷This franchise was subsequently curtailed by the DfT and terminated in November 2007.

¹⁸London Overground Rail Operations Limited, formerly MTR Laing, a 50/50 joint venture between MTR Corporation and Laing Rail (now DB Regio).

¹⁹Comprising the North London Railway previously run by Silverlink Metro and the extended East London Railway which is scheduled to open in 2009/10.

²⁰TfL is different from the DfT and Transport Scotland and the Welsh Assembly Government in that it has powers which allow it to borrow provided that (a) it is for capital expenditure, (b) it is repaying the sum within the asset life, and (c) it is prudent to do so.

²¹TfL will also be responsible for setting fares and deciding service levels. It will therefore take on revenue risk.

²²Leased through an operating lease at nominal cost. There would be no benefit to TfL in leasing the rolling stock to the concessionaire at anything more than a nominal amount as any financing costs would simply be passed back to TfL as increased concession payments.

²³In August 2006, TfL signed a £223 million contract with Bombardier to manufacture 44 Class 378 Electrostars. Twenty-four dual-voltage three-car trains will be used on the North London Railway from 2009 and 20 four-car trains will be used on the East London Railway when it opens in 2010. In July 2007, it announced that it had placed an additional £36 million order for an extra 36 rail carriages to be built by Bombardier. The new TfL rolling stock will displace some existing ROSCO-owned rolling stock on the North London line. In the interim period before the new rolling stock is ready, LOROL will lease 12 Angel Class 150s, 69 HSBC Class 313s and 9 Angel Class 508s, which are currently in operation on the London Overground lines.

with no residual value risk to TfL or secure the use of the trains through purchasing or leasing for up to the remainder of their useful life.

15. Whilst QW Rail does have other leasing business, to date it has not entered into other passenger rolling stock leases. The TfL approach is different to that presently adopted by the DfT in passenger franchised services in that the initial lease term is 20 years.

Interest of third parties in entering leasing of rolling stock

16. The ROSCOs provided us with the names of third parties which they considered as potential entrants. We contacted these parties to enquire about whether they have been interested or are currently interested in entering the leasing of rolling stock to franchised passenger operators in Great Britain.
17. Five companies [REDACTED] out of the 13 respondents confirmed having been actively interested in leasing passenger franchised rolling stock in Great Britain. Of those interested, HBoS and SMBC currently lease rolling stock through Voyager Leasing and QW Rail Leasing respectively (see paragraphs 7 to 15).²⁴
18. Two non-financial institutions had also considered entry into leasing of rolling stock:
 - (a) EWS²⁵—however, its role in passenger franchised rolling stock is at present limited to provision of a small number of locomotives that would otherwise be under-utilized. It has not entered into any lease agreements with TOCs for passenger rolling stock; and
 - (b) Sovereign Trains—it is trying to gain a foothold in new rolling stock leasing opportunities. However, it is currently in the very early stages of development.²⁶
19. We examined the extent to which third parties have been involved in bidding for the right to lease new rolling stock. The only non-ROSCO bidders for previous new rolling stock leases that we were made aware of were as follows:
 - (a) [REDACTED], which made a bid to finance new Class 172 rolling stock on the Chiltern franchise; however, we were told that [REDACTED] quoted a price which was between 45 and 50 per cent higher than the two bidding ROSCOs (Angel and Porterbrook); and
 - (b) HSH Nordbank, which made an indicative offer for a new Class 350 fleet on West Midlands. However, a TOC told us that the offer was significantly less attractive than that proposed by the successful ROSCO (Porterbrook) so it was not pursued any further.

Summary of entry since privatization

20. Our analysis established that:

²⁴Some of the interested parties have also subsequently formed part of the consortia that purchased two of the ROSCOs. These changes of ownership (described in section 3) are not an example of entry.

²⁵EWS primarily operates as a freight rail company.

²⁶Sovereign Trains currently only leases rolling stock to Grand Central. This is effectively self-supply because both Grand Central and Sovereign Trains are controlled by Equishare. Grand Central's role is to run an open access train service between London and a number of northern cities, particularly routes from Bradford and Sunderland; Sovereign Trains owns the rolling stock and leases it to Grand Central.

- (a) There are no examples of new entrants purchasing any significant amounts of used rolling stock from the ROSCOs.
- (b) Although a number of companies have shown an interest in entering the market for leasing of rolling stock to passenger franchised operators in Great Britain through the purchase of new rolling stock, the only example of entry falling within our terms of reference is Voyager Leasing, which was transaction-specific.²⁷ In addition, QW Rail Leasing is an instance of entry into the leasing of rolling stock to a non-franchised passenger service.

Barriers to entry and exit

21. Barriers to entry and exit are features that may prevent or restrict potential entrants from exploiting profitable opportunities in a market.²⁸ In this section, we first consider barriers to entry and exit to the market for the leasing of rolling stock both in terms of used and new rolling stock. Second, we consider reasons why potential entrants have not purchased used rolling stock from the ROSCOs.

Factors deterring entry into leasing of rolling stock

22. There are a number of factors that deter potential entrants from purchasing either used or new rolling stock:
- (a) perception of asset re-lease and political risks;
 - (b) economies of scale and scope and portfolio benefits;
 - (c) financial barriers;
 - (d) industry and technical expertise;
 - (e) the franchising process; and
 - (f) costs of exit.
23. We consider each of these in turn. We set out our views on barriers to entry in Section 6 of the report.

Perception of asset re-lease and political risks

24. Both HSBC and Porterbrook told us that the extent of residual value risk (asset re-lease risk)²⁹ and, particularly, political risk³⁰ (for example, changing franchise lengths) has been and remains the main deterrent to entry. Angel agreed with these submissions.
25. To demonstrate the ease of entering leasing of rolling stock, Porterbrook cited its own experience in entering the market(s) for leasing of rolling stock in Continental Europe. However, we noted that the underlying asset re-lease and political risks in Continental Europe are different from Great Britain because the market in Great

²⁷We noted in paragraph 7 the DfT have set up a new leasing company Diesel Trains Limited, but we do not know at this stage who will ultimately become the lessor for these vehicles.

²⁸See [CC3, paragraphs 3.22 to 3.35](#).

²⁹This risk is created by the asset life being 30 to 35 years and the franchise terms being generally only seven years long.

³⁰Porterbrook referred to 'ever-changing policy approaches'.

Britain has a wide diversity of relatively small fleets. This means that rolling stock may be less interoperable than in Continental Europe, such that asset re-lease risk may be higher in Great Britain. Furthermore, although some continental jurisdictions have forms of franchising of passenger services, there are differences between these jurisdictions and the franchising system in Great Britain.

26. The ORR considered³¹ that residual value risks and political risks might have deterred entry. For example, it noted that in the Mark I slam door replacement programme, all bidders outside of the three ROSCOs dropped out when the SRA asked bidders to offer prices for leases of fewer than 20 years, rather than the 20 years proposed initially. Angel submitted that this withdrawal of bidders was caused by residual value (asset re-lease) and political risks, whilst noting that other factors may also have contributed.
27. We noted that the perception of asset re-lease and political risks on the part of potential entrants is likely to be very different from the understanding that the incumbent ROSCOs have developed over time. Although potential entrants can engage consultants, such as Quasar Associates,³² with a detailed understanding of the market, incumbents are likely to have an advantage in understanding and managing these risks effectively. Four TOCs (Laing (now DB Regio), SercoNed, Virgin and National Express) considered that one reason why prospective competitors were unable to match the ROSCOs' bids on new rolling stock was their difficulty in understanding residual value risk. For example, Laing (now DB Regio) recalled that [redacted] made an uncompetitively high bid of capital rentals for new rolling stock on the Chiltern franchise (see paragraph 19) because it failed to understand how to mitigate risks. One ROSCO (Angel) stated that the absence of new entrants demonstrated that existing prices were in fact competitive.

Economies of scale and scope and portfolio benefits

28. In this section we consider two further advantages that incumbent ROSCOs may have over potential new entrants:
 - (a) economies of scale; and
 - (b) portfolio benefits (allowing the diversification of risk).
29. HSBC recognized that both economies of scale and diversification of risk were important factors for any new entrant to the market.
30. *Economies of scale and scope* are relevant where overheads are large and can be spread over a large fleet or portfolio of rolling stock, thereby lowering unit costs. These overheads include central overhead costs and also the cost of maintaining an engineering team to deal with (among many things) maintenance and procurement issues. Porterbrook disagreed that economies of scale would be a material barrier to entry. It cited evidence of starting its own business in other European countries with one to five orders and the successful bid from QW Rail Leasing for a single fleet on the London Rail Concession.
31. *Portfolio benefits* refer in this case to the ability of a ROSCO to spread different types of risk across a well-diversified portfolio of rolling stock. A ROSCO with only one type

³¹The leasing of rolling stock for franchised passenger services—ORR's reasons for making a market investigation reference to the Competition Commission, 26 April 2007, paragraph 4.24.

³²Quasar Associates is a consultancy that advises TOCs on franchise bid submissions to the DfT.

of rolling stock fleet is unable to spread asset re-lease risk and faces the risk that its entire fleet could go off-lease at a re-leasing point. Portfolio benefits are likely to be particularly advantageous when spreading the potential risks associated with investing in expensive new rolling stock, for example operating risk (unforeseen maintenance costs) or delivery risk (not delivered on time or to budget). Porterbrook submitted that a new entrant could significantly mitigate a number of risks by procuring generic, proven rolling stock and in such circumstances could conceivably face lower residual value risk than incumbent ROSCOs.

32. Third parties cited portfolio benefits as a barrier to entry:

(a) First submitted that the main reasons for its lack of success in encouraging new entrants were 'the risks of holding a small number of vehicles which does not allow any portfolio benefits; problems of realising the residual value risk at the end of the lease and the specialized nature of the business'.

(b) Stagecoach, National Express, HSH Nordbank and Babcock & Brown each noted the disadvantage of not holding a portfolio of rolling stock as an important reason for the lack of entry.

(c) Quasar Associates noted that it could take considerable time to build a portfolio of rolling stock because of the intermittent nature of new rolling stock leasing opportunities. However, Quasar Associates also considered that recent interest in new rolling stock opportunities suggested that portfolio issues and economies of scale are not that significant.

33. The extent of advantage created by portfolio benefits depends to some degree on whether the rolling stock leasing company is viewed in a stand-alone context or as part of a wider portfolio of assets. In the former case, portfolio benefits will be relevant because the portfolio of assets is limited to the rolling stock. However, in the latter case, rolling stock is seen as one set of assets among other assets and so the risks may be capable of being more easily diversified. This would be the case particularly where a financial institution owns the rolling stock. We noted that Voyager Leasing entered with a single fleet but, as set out in paragraphs 8 to 11, this was a unique financing structure and in circumstances where there was a long franchise and a longer procurement process (see paragraphs 43 and 44).

Financial barriers

34. There are three ways in which financial issues may act as a barrier to entry: (a) access to finance, (b) delay in reaching profitability, and (c) tax capacity.

Access to finance

35. The DfT submitted that access to very large amounts of competitively-priced funding was required in order to operate as a ROSCO. HSBC also considered that access to finance and risk equity were key requirements for a company to enter the market for the leasing of rolling stock. However, we noted that access to capital at low cost is not likely to act as a significant barrier to entry to financial institutions, which have traditionally been able to access finance easily.

Delay in reaching profitability

36. Given the extent of investment in new rolling stock and accounting depreciation methods, it may take a considerable period of time to start earning an accounting

profit.³³ HSBC submitted that accounting depreciation methods might act as a disincentive to some new entrants because straight-line depreciation effectively prevents any profits being earned on new rolling stock until at least five years after it has been leased. When combined with a three-year build period for new rolling stock, this creates an eight-year period where no accounting profit is earned. HSBC further stated that a new entrant would require a business plan to be implemented over a significant period of years in order to build up the required critical mass. It added that, given that rolling stock typically has a useful economic life of 30 to 35 years, an investor would need to be prepared to invest for the long term.

37. An HSBC internal document stated that:

there has not been a full 'assault' on this market by new entrants primarily due to the very specialist nature of this business, the need for full engineering support, and the often extremely long lead in times that are required before any deal can be consummated. It can take up to 5 years following marketing, negotiation and build period before a relationship becomes income earning. This is seen as a major barrier to entry for any new competitors to this market, given the carrying costs that a business holds.

38. In contrast to new entrants, all three ROSCOs avoided the initial accounting losses that would be faced by a new entrant because they took over a portfolio of rolling stock, the vast majority of which was mid-life, on-lease and income-earning from day one.

Tax capacity

39. ROSCOs' rolling stock leases are presently classified as operating leases for accounting purposes, such that the leased asset appears as an asset on each ROSCO's balance sheet and the ROSCO claims a capital allowance. Under the current UK tax regime, entrants need to have UK operations with taxable profits in order to take advantage of such capital allowances. The amount of annual capital allowances for rolling stock is due to change. On 31 December 2010 the annual capital allowances for rolling stock will reduce from 20 to 10 per cent.³⁴ The effect of the removal of the exemption will be to decrease the cash-flow benefit of capital allowances on new rolling stock.

40. Babcock & Brown, HSH Nordbank and National Express stated that tax capacity was a key barrier to entry because few companies had a large enough tax capacity to be able to offset the capital allowances efficiently. Babcock & Brown suggested that these few companies were, in its opinion, limited to the major UK banking institutions.³⁵ DVB Bank AG also noted that non-UK banking institutions, although they might be able to overcome other financial barriers, would suffer from a lack of UK tax capacity. We note that two of the three ROSCOs have recently been sold to

³³We discuss profitability in Section 6 of the report.

³⁴A long-life asset is one which is expected to have a useful economic life of at least 25 years. However, certain classes of assets, including ships and 'railway assets' (which includes rolling stock), are not currently counted as long-life assets, and so expenditure on acquisition of these assets attracts the capital allowances of 'normal' assets, which is 20 per cent a year. The exemption for ships and rolling stock will end on 31 December 2010 so that all expenditure on new rolling stock after then will be counted as long-life asset expenditure and will attract a 10 per cent annual capital allowance. Expenditure on rolling stock incurred before then will still benefit from the 20 per cent annual capital allowance.

³⁵Babcock & Brown considered that three of the largest banks, Lloyds TSB, HBoS and Barclays, had not entered because of the significant economies of scale and scope available to the existing ROSCOs (see paragraphs 28 to 33). We also noted that Babcock & Brown is itself part of the recent consortium of investors that have purchased Angel from RBS, and Lloyds TSB are part of the consortium that acquired Porterbrook in December 2008.

consortia comprising companies other than UK banks, suggesting that entrants do not necessarily have to be UK banking institutions.

Industry and technical expertise

41. All three ROSCOs stated that access to industry and technical expertise is an important prerequisite for entry. We noted that each ROSCO has teams of staff that have considerable experience in dealing with the procurement, contract negotiation, engineering, maintenance and modification of rolling stock. Seven out of eight TOCs listed industry knowledge as being a vital requirement when considering entry. Knowledge of rolling stock maintenance is also important in managing customer relationships, managing risk and ensuring that the asset remains attractive over the entire asset life.
42. We noted that there are a number of third party sources for industry expertise, ranging from companies like Quasar Associates, which provide advice on lease negotiations for example, to manufacturers and third party maintainers with engineering and maintenance expertise. Voyager Leasing took the route of entering into a form of partnership with a third party manufacturer in order to gain access to technical skills. New financiers have also proposed to work with technical consultants when putting in bids for new rolling stock (for example, the IEP). Porterbrook considered that such expertise could be sourced from consultants. Although Porterbrook noted that engineering expertise might be costly as supply in this sector was tight, it did not consider it a barrier to entry and noted that it had outsourced to consultancies on a regular basis. HSBC also considered that the required technical and commercial expertise was available for a prospective rolling stock lessor. However, it was not clear to us that buying in technical consultancy services would provide a wholly satisfactory means for a prospective new entrant to acquire the necessary expertise to compete effectively.

The franchising process

43. We noted that Voyager Leasing had entered with a new fleet of rolling stock with maintenance risks externalized to the manufacturer and a lengthy contractual commitment from Virgin. Further the procurement of the fleet was conducted over a period after the franchise award and was therefore not constrained by tight bidding deadlines for the franchise.
44. In contrast, there have been no new entrants through new rolling stock procured at the point of a franchise re-let. The franchise process appears to have made it more difficult for potential competitors to enter the market because:
 - (a) The tight bidding deadlines that accompany the franchise ITTs lend themselves to the incumbent ROSCOs which have in-house resources and industry knowledge.
 - (b) In developing bid proposals during the course of the franchising process, a new entrant is unlikely to be able to draw upon the same relationships with the manufacturer and TOCs as the ROSCOs.
 - (c) The franchise length may create a higher perceived residual value risk for an entrant without the extent of portfolio held by the ROSCOs.

Costs of exit

45. An entrant will want to have the ability to exit the business in the future. Exit from this industry requires a buyer for the rolling stock assets, such that asset disposal is effectively a business sale. It is not clear that there are many sunk costs which may prevent such an 'exit' from the market. However, we noted that all the banks have at some point since acquisition had the rolling stock leasing businesses for sale and have had difficulty in finding buyers at the prices being asked. Porterbrook cited political risk as a major factor in deterring interest when trying to sell its business, and [REDACTED].³⁶

Reasons for potential entrants not purchasing used rolling stock

46. In this section we consider reasons why potential entrants have not purchased *used* rolling stock from the ROSCOs. Any hypothetical transaction for the sale of used rolling stock by a ROSCO to a new entrant would only occur if the new owner would expect to make a satisfactory return at a price at which the ROSCO would be prepared to sell the rolling stock.
47. Porterbrook stated that 'it is not clear why any ROSCO would sell existing rolling stock to a new entrant', but identified those occasions on which it had sold existing rolling stock and the circumstances in which it did so. HSBC, on the other hand, said that it would be prepared to sell its assets to any suitable counterparty (including other ROSCOs) if acceptable terms were agreed. Angel told us that it had never been approached by a potential new entrant with a view to purchasing its rolling stock.
48. We noted a number of additional factors to those discussed in paragraphs 22 to 45 that have deterred the purchase of used rolling stock by potential entrants.
49. First, we considered that a ROSCO lacks any strong incentive to sell fleets of its rolling stock to a potential entrant because it would take into account that selling rolling stock may in certain circumstances increase competition against its own remaining rolling stock (if the rolling stock sold is substitutable for some of that ROSCO's remaining rolling stock). To compensate for this, a ROSCO might be expected to place a higher required sale price on the rolling stock than it would do if such considerations were absent.
50. Second, further to the discussion in paragraphs 24 to 27, potential entrants do not have experience of evaluating the level of risk in the rolling stock leasing market and we would expect them to be more conservative in their valuation of the used rolling stock.
51. Third, any used rolling stock is very unlikely to have a manufacturer's warranty so a new entrant has to find a solution to managing and monitoring maintenance. This can be achieved through contracting out to a third party but will not be in the form of 'turnkey' arrangements³⁷ that manufacturers have been willing to offer when supplying new rolling stock. The maintenance costs and risks are therefore higher for the entrant than the ROSCOs, which have an established team dealing with the supervision of maintenance services on used rolling stock.

³⁶Although both Angel and Porterbrook have been sold to a consortium of investors, these sale processes did not persuade us that exit was a straightforward process.

³⁷Turnkey arrangements are where the rolling stock is supplied by the manufacturer in a form that is ready for use and does not require additional maintenance by the operator.

52. Fourth, further to the discussion in paragraphs 28 to 33, entrants do not have a portfolio of used rolling stock against which to manage the risk relating to a particular fleet (thus decreasing the price we expect that they would be prepared to pay). Conversely, ROSCOs may derive important portfolio benefits from holding certain fleets of used rolling stock (thus increasing the sale price we expect that they would require).