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Contracting Out – The Privatisation of the British Railway System and its Implications for Germany

Dieser Beitrag analysiert die kontroverse Privatisierung des staatlichen britischen Bahnunternehmens British Rail Mitte der 1990er Jahre. Neben dem eigentlichen Privatisierungsverfahren und der Funktionsweise des privatisierten Bahnsystems werden auch einige häufige Kritikpunkte betrachtet, unter anderem Sicherheit, Preis-Leistungs-Verhältnis und Angebotsqualität. Abschließend erfolgt ein Vergleich mit dem Eisenbahnwesen in Deutschland seit der Bahnreform 1994. Im Angesicht aktueller Ereignisse wie der S-Bahn-Krise in Berlin haben die in Großbritannien gemachten Erfahrungen auch für Deutschland praktische Relevanz.

I. Introduction

The provision of public services by entities different from the state, namely the market and the voluntary sector, is a model that has gained momentum in the recent decades.[1] Nevertheless, "privatisation" is still a topic that attracts controversy.[2] Recent British history offers a number of notable examples of the state "contracting out", one of which is the privatisation of the railway system.

British Rail (*BR*) was a state-owned railway enterprise founded in 1947 as *British Railways* and dissolved in the mid-1990s. It was replaced by private service providers bound by franchise agreements. Whether this privatisation was successful or not is still a subject of heated debate.[3]

Based on the analysis of the case, this paper is dedicated to provide a legal, economical and regulative overview on how states involve the market to provide public services. After a brief introduction on concepts of the New Public Management, the privatisation process of *BR* is analysed. It is followed by a discussion of the *status quo* in Britain and, as a comparison, in Germany. A concluding section sums up key points and draws out recommendations for further development.

II. Terminology

1. Public Services

The concept of public services originated from France where it is known as "service public". In European Union law and policies, public services are categorised as services of general interest (SGI) and services of general economic interest (SGEI).

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1 *Green/Haskel*, The Role of Privatisation, in: Freeman/Card/Blundell (Eds.), Seeking a Premier Economy: The Economic Effects of British Economic Reforms, 1980-2000 (National Bureau of Economic Research Conference Report), 2004, 63 (72).

2 *Rhodes*, The Hollowing Out of the State: The Changing Nature of the Public Service in Britain, The Political Quarterly 1994, 138 (151).

3 This can not only be seen from the existence of *Bring Back British Rail*, a group formed by critical rail passengers and railway employees, http://www.bringbackbritishrail.org (accessed 16/02/2013).

According to the European Commission,[4] SGIs are services, whether "economic" or not (*i.e.* social), that the Member States regard as being of particular importance to citizens, and which they therefore subject to specific public service obligations, such as public education or policing. SGEIs are a special case of SGIs, namely *economic* activities that were identified as particularly important and in need of public intervention.[5] Such SGEIs are, *inter alia*, postal services, electricity, gas, water supply, and waste treatment (see art. 17 (1) of Directive 2006/123/EC[6] on the freedom of services). According to this definition, *British Rail*'s passenger transport services belonged to the SGEIs.

Not only the economic aspects, but also the compliance with European law, especially Directive 91/440/EEC on the development of the Community's railways, Directive 2001/14/EC on the allocation of railway infrastructure capacity, and Regulation (EC) No. 1370/2007 on public passenger transport services, must be considered in the assessment whether the privatisation has been successful. The aforementioned European legislation requires the separate accounting of train services and infrastructure,[7] non-discriminatory access to rail infrastructure, and defines how authorities can procure passenger rail services by public service contracts.

2. Privatisation

Privatisation is an umbrella term encompassing different issues. The root word "private" originates from Latin *privare* (meaning *separate*, *bereave* or *deprive*).[8] Separation is indeed the key characteristic of privatisation, as privatisation is a "process by which the production of goods or services is removed from the government sector of the economy".[9] Not only is the sale of shares in a previously state-owned business a kind of privatisation, but also the use of private businesses to perform tasks formerly carried out by the government.[10]

4 *European Commission*, Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest (07/12/2010), SEC(2010) 1545 final, p. 15.

5 *European Commission* (n. 4), p. 15.

6 Full title: Directive 2006/123/EC of the European Parliament and the Council of 12 December 2006 on services in the internal market.

7 Art. 1 Dash 2 of Directive 91/440/EEC mandates separate accounting but does not require an organisational or institutional separation of train and track operators. Therefore, vertically integrated structures as in Germany do comply with European law. The institutional separation of the network from train operators was originally planned for the Fourth Railway Package but as of January 2013, the draft only requires "Chinese walls" (a mere organisational and financial independence) and thus does not require the separation of vertically integrated structures, see *Kallas* (*Vice-President of the European Commission*), European Railways at a Junction: The Commission Adopts Proposals for a Fourth Railway Package, http://ec.europa.eu/commission_2010-2014/kallas/headlines/news/2013/01/fourth-railway-package_en.htm (accessed 16/02/2013).

8 "Private", in: Oxford Dictionary of English, 3rd edn. 2010.

9 *Pirie*, Privatization, in: Henderson (Ed.), The Concise Encyclopedia of Economics, 1st edn. 2002.

10 For a brief overview, see *Thiele* in this issue of GreifRecht, 1 ff.

3. New Public Management

Privatisation is often concurrently mentioned with the term New Public Management (NPM). Traditional public management consisted of statutes and administrative decisions, with the actors being the administration and the citizens. Government agencies held monopolies in industries such as energy generation, postal services, telecommunications, and public transport. Under the NPM approach, the citizens are treated as customers instead. Competition is fostered as the market replaced most functions of the law. The underlying belief was that NPM is more efficient than traditional public management.[11]

As UK governments were traditionally strong advocates of the private sector model of management, the UK is considered to be "a pacesetter" in the adoption of NPM, whereas many other OECD countries have also adopted this approach. Reviewing the changes in the UK in the 1980s, the key elements of NPM are the unbundling of the public sector into corporatized units organised by product, increased contract-based competitive procurement, stress on private management styles, and greater emphasis on output controls.[12]

While some authors argue that unsuitable private sector management styles were imposed upon the public sector,[13] the NPM concept has played a central role in recent decades, having paved the way for large-scale privatisations by unbundling the public sector and introducing contract-based competitive provision of services.

4. Contracting Out

A key element of NPM is contract-based competitive provision, a form of privatisation of formerly governmental services.

In the 1970s, virtually all government services to the public in Britain – central as well as local – were provided by government employees.[14] Almost a decade after the Conservatives came to office in 1979, the *Thatcher* government introduced compulsory contracting out under the Local Government Act 1988 for tasks such as building cleaning, street cleaning and refuse collection.[15] In addition to that, many formerly state-owned enterprises were privatised in this period, including bus and coach, telecommunications, gas and electricity industries. In total, about 50% of the formerly nationalised industries were privatised until 1991 – 650,000 employees and about 4% of the British GDP.[16]

11 *Lapsley*, New Public Management: The Cruellest Invention of the Human Spirit?, ABACUS 2009, 1 (2); *Hood*, The New "Public Management" in the 1980s: Variations On A Theme, Accounting, Organizations and Society 1995, 93.

12 *Lapsley* (n. 11), ABACUS 2009, 1 (2-3); *Hood* (n. 11), Accounting, Organizations and Society 1995, 93 (94).

13 *Lapsley* (n. 11), ABACUS 2009, 1 (13).

14 *Green/Haskel*, in: Freeman/Card/Blundell (Eds.) (n. 1), 63 (66).

15 *Rhodes* (n. 2), The Political Quarterly 1994, 138 (141).

16 *Rhodes* (n. 2), The Political Quarterly 1994, 138 (139).

Meanwhile, the then European Economic Community started regulating the procedure of public procurement in the early 1970s. The Directive 77/62/EEC made public tendering compulsory for orders exceeding the value threshold of 200,000 European Units of Account. European public procurement law now consists of provisions in the TFEU (such as the principle of non-discrimination, Art. 18 TFEU, and the freedom to provide services, Art. 56 TFEU) as well as certain directives, mainly Directive 2004/17/EC (the Sector Directive coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors) and Directive 2004/18/EC (the Public Contracts Directive applicable to the awarding of public works, public supply and public service contracts).

In 1988, Sweden split its state railway company into an infrastructure company and a train operating company, which was a worldwide first.[17] The Swedish move led to the European Community adopting Council Directive 91/440/EEC on 29/07/1991. Art. 6 of the Directive mandates the separation of the accounting of rail infrastructure and train services as to allow competition.

5. Criticism

It was commonly believed that the establishment of a free market for public services – if possible at all – would automatically encourage efficiency.[18] In addition, not only the State itself, but also "a significant part of the electorate saw privatisation as an easy way to make money"[19] as the shares of newly privatised companies usually outperformed the general development of the stock market. Others criticised that privatisation would amount to an erosion of the State.[20] It is noted that service delivery under the new pattern would inevitably cause institutional fragmentation and subsequently inefficiencies.[21] Also, accountability and democratic legitimation are allegedly lost.[22]

The analysis of the case of the British railways, which represents one of the most controversial[23] privatisations in recent history, is helpful in judging whether the criticism is justified.

III. The British Railway System Before 1994

1. Historical Development

In the 19th century, railway operations generally were privately initiated, both in Britain and elsewhere.[24] From about 120 small private railway companies, four big private companies – the so-called "Big Four" –, were founded under the 1921 Railways Act.[25] During the Second World War the British government seized the full control over rail transport.[26] The Transport Act 1947 nationalised the "Big Four" and created the British Transport Commission as head of the nationalised *British Railways*.[27]

Over the following decades, the railway's importance for the economy steadily declined as mass motorisation took off. The year 1962 brought with it an organisational change, with a *British Railways Board* founded as a distinct public corporation, supposedly offering more managerial freedom.[28] By 1973, rail transport only accounted for 7% of passenger miles travelled in the UK.[29]

2. State of British Rail

With the decline of *BR*'s economical importance in mind, it is no surprise that the Conservative *Major* government of 1992 had the following opinion on *British Rail*:

„As an organisation, *BR* combines the classic shortcomings of the traditional nationalised industry. It is an entrenched monopoly. That means too little responsiveness to customers' needs, whether passenger or freight; no real competition; and too little diversity and innovation."[30]

IV. The Privatisation of British Rail

After a series of privatisation projects in other fields and the diagnosis of the *British Rail* state of affairs, the British Government began privatising *British Rail* in the early 1990s.

1. The New Structure of the British Railways – The Railways Act 1993

The first step in privatising *British Rail* was the adoption of the Railways Act 1993, which created a new structure in the railway sector in Great Britain.

BR was disintegrated into train operating companies (TOCs) running services on franchise contracts with the Government, rolling stock companies (ROSCOs) renting out rolling stock to TOCs (as the TOCs were for-

17 *Jansson/Cardebring*, Swedish Railway Policy 1979-88, Journal of Transport Economics and Policy 1989, 329 (334).

18 *Glaister*, British Rail Privatisation – Competition Destroyed by Politics (Centre for the Study of Regulated Industries, CRI Occasional Paper 23), p. 7, http://www.bath.ac.uk/management/cri/pubpdf/Occasional_Papers/23_Glaister.pdf (accessed 16/02/2013); *Green/Haskel*, in: Freeman/Card/Blundell (Eds.) (n. 1), 63 (72).

19 *Green/Haskel*, in: Freeman/Card/Blundell (Eds.) (n. 1), 63 (74).

20 *Rhodes* (n. 2), The Political Quarterly 1994, 138 (140).

21 *Rhodes* (n. 2), The Political Quarterly 1994, 138 (146).

22 *Rhodes* (n. 2), The Political Quarterly 1994, 138 (147).

23 The British railways are a regular object of probably undeserved ridicule in other countries such as Germany, see *Lange*, Trainspotting: Geschichten für geplagte S-Bahn-Fahrer – Mutterland des Kapitalismus, Der Tagesspiegel of 05/01/2011, http://www.tagesspiegel.de/kultur/geschichten-fuer-geplagte-s-bahn-fahrer/3690118.html (accessed 16/02/2013).

24 *Glaister*, bath.ac.uk (n. 18), p. 3.

25 *Wolmar*, On the Wrong Line: How Ideology and Incompetence Wrecked Britain's Railways, 2005, p. 15.

26 *Glaister*, bath.ac.uk (n. 18), p. 5; *Wolmar* (n. 25), p. 21.

27 *Gourvish*, British Rail 1974-1997: From Integration to Privatisation, 2002, p. 2; *Glaister*, bath.ac.uk (n. 18), p. 5.

28 *Glaister*, bath.ac.uk (n. 18), p. 6.

29 *Gourvish* (n. 27), p. 4.

30 House of Commons Debates (02/02/1993:124).

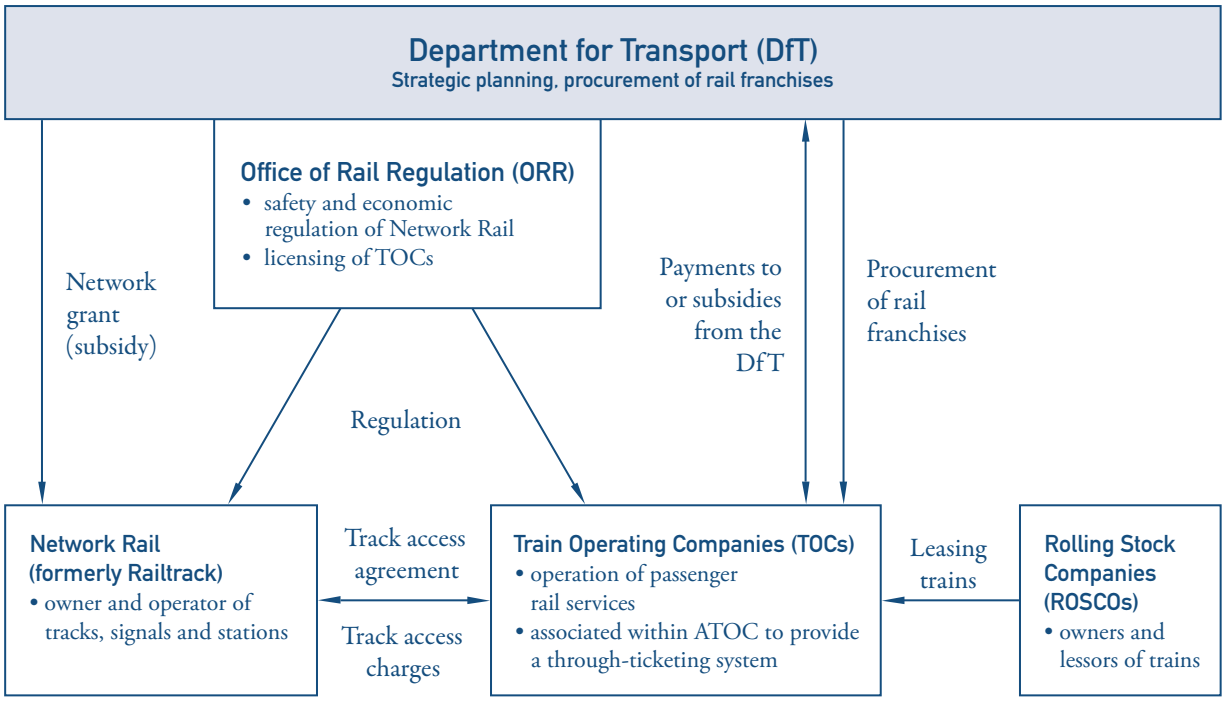

Figure: The Passenger Rail Industry in Britain (2013)

med without substantial assets as to ease market entry), and *Railtrack* as an infrastructure manager separated from train operations.[31]

The Railways Act 1993 was subsequently amended by the Transport Act 2000, the Railways and Transport Safety Act 2003, the Railways Act 2005 and other statutes. While some changes were made by these statutes, today's structure is still essentially the same as in 1997 except for the fact that *Railtrack* was renationalised under the name of *Network Rail*.[32]

2. The Franchise System

Franchising as a concept originated in the private sector in the mid 20th century in the United States. It means that a franchisee acquires a licence to use a business's brands as well as knowledge and a business plan from a franchisor. The franchisee acts as a *de facto* subsidiary of the franchisor while accepting commercial risk.[33] The "franchise" word is also used by the Railways Act 1993 and within the British railway industry as many elements of the public service contracts awarded to TOCs, such as the specifications regarding the capacity and frequency of services, resemble the private sector flavour of franchising.

In 1994, passenger train services were divided into 25 TOCs matching *BR*'s former profit centres.[34] These "shadow franchises" were independent subsidiaries of *BR* and put to tender in waves, with the main criterion being the highest premium payment, or the lowest subsidy requested for operation.[35]

Eventually, these were merged by the government regulators into today's 19 franchises.[36] These franchises cover local services in entire regions or high speed services on certain main lines. Each of these franchises is assigned to one separate TOC. The bulk of the rolling stock required by TOCs is leased from the ROSCOs, and TOCs pay *Network Rail* for access to track and stations.[37] All services are jointly marketed under the *National Rail* brand and, with few exceptions, tickets for any TOC's services are sold by all TOCs. Network-wide timetabling and ticket revenue distribution are ensured by the *Rail Settlement Plan* (RSP), a sub-organisation of the *Association of Train Operating Companies* (ATOC).[38]

Most TOCs in the UK are backed by foreign railway companies or domestic bus and coach companies, such

31 *Gourvish*, Britain's Railways 1997-2005: Labour's Strategic Experiment, 2008, p. 1.

32 *Gourvish* (n. 31), p. 284; the *Railtrack* case is further discussed in IV. 2. b).

33 *Norton*, An Empirical Look at Franchising as an Organizational Form, Journal of Business 1988, 197 (198); concerning franchising in general, see *Skaupy*, Zu den Begriffen "Franchise", "Franchisevereinbarungen" und "Franchising", NJW 1992, 1785 ff.

34 *Gourvish* (n. 27), p. 414; *Wolmar* (n. 25), p. 72.

35 *Gourvish* (n. 27), p. 441.

36 A current list of rail franchises is found in *Brown et al.*, The Brown Review of the Rail Franchising Programme (Cm 8526), 2013, p. 82.

37 *Gourvish* (n. 31), p. 2.

38 *Hatano*, Complexity versus Choice: UK Rail Fares, Japan Railway & Transport Review 2004, 26 (29).

as *Deutsche Bahn*, *Keolis/SNCF* (France) or *First Group* and *Stagecoach* (both from the UK).

a) The Bidding Process – The Procedure for Choosing the Service Provider

Franchises are generally awarded for about 7 to 15 years until they are retendered[39] by the Department for Transport (DfT) as required by s. 23 Railways Act 1993.[40] On a successful franchise award, the Secretary of State for Transport concludes a franchise agreement with the winning bidder.[41]

About a year before expiration of the franchise, the authority will issue an *Invitation to Tender* (s. 26 Railways Act 1993).[42] This document specifies the services that must be provided. Specifications are often very detailed, not only dictating particular routes and time slots that must be served but also the type of rolling stock, thereby restricting the choice of the bidding companies.[43] Bidding companies will negotiate with the ROSCOs for conditional lease agreements.[44] Bids are submitted to the DfT. With consent from the Secretary of State for Transport, a franchise agreement is concluded with the winning bidder and preparations for handing over the operation will be initiated.

A successful bidder will take over the TOC operating the franchise including its assets (s. 27 Railways Act 1993). Train services will run continuously and there will be no gaps in train operation. Employees of the TOC will be taken over under TUPE (Transfer of Undertakings (Protection of Employment) Regulations 1981) agreements, retaining their level of remuneration.[45]

b) Franchise Cancellation – Managing Failing Railway Companies

With franchisees accepting commercial risk, it must be considered if and when a franchise can fail, *i.e.* be irregularly cancelled, and what the government's role is in such a case.

Private companies providing public services cannot usually be left unsupervised to the market, with consequences such as bankruptcy emerging, as the bankruptcy and subsequent interruption of the services may cause more damage to the economy than the state bailing out the failed private company at the taxpayer's expense. The franchising authority also has the duty to secure the provision of passenger rail services when a franchise agreement ends but no further agreement has been concluded (s. 30 Railways Act 1993).

In 2001, shortly after the Hatfield crash,[46] the privately-held track and station infrastructure company *Railtrack* went bankrupt. After being put into railway administration (s. 59 Railways Act 1993), a special form of bankruptcy, a new company *Network Rail* was founded as a not-for-profit successor company, essentially owned by the State.[47]

In the last decade, several companies were stripped of their franchises by means of termination of the franchise contract. This happened to *Connex* (now *Veolia*) in 2000 and 2003 with the South Central and Southeastern franchises due to financial difficulties and quality issues.[48] *Great North Eastern Railway* (*GNER*) was stripped of its East Coast franchise in 2007 as its parent company *Sea Containers* filed for bankruptcy protection.[49] The franchise was put to tender and awarded to *National Express* which subsequently, in late 2009, announced that it would no longer pay franchise fees for the unprofitable East Coast franchise as the DfT would not renegotiate the contract. As a result, DfT terminated the East Coast contract, with the franchise being taken over by *Directly Operated Railways*, a state-owned holding company, until it is retendered.[50]

c) Non-discrimination in EU Law and Open Access Providers

According to art. 8 and art. 10 of the aforementioned European Council directive 91/440/EEC, EU member states are obliged to ensure the principle of non-discrimination regarding the access of railway track infrastructure.

Therefore, it was made possible by the British Government to establish so-called *open access providers* that operate train services independently of any franchise. They are not bound by restrictions in a franchise agreement

39 *Demellweek*, Last stop for the rail franchise regime?, ECLR 2010, 530 (531).

40 Rail franchising has been devolved to the Welsh Assembly Government for the *Wales Trains* franchise only and Transport Scotland for the *ScotRail* franchise only.

41 Franchise agreements are published in: Public register of rail passenger franchise agreements, https://www.gov.uk/government/organisations/department-for-transport/series/public-register-of-rail-passenger-franchise-agreements (accessed 16/02/2013).

42 For an example of an Invitation to Tender, see *Department for Transport*, InterCity West Coast Invitation to Tender (20/01/2012), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/4178/invitation-to-tender-main-document.pdf (accessed 16/02/2013).

43 *Demellweek* (n. 39), ECLR 2010, 530 (531).

44 *Ibid.*

45 *East Coast*, East Coast Main Line Company Pledges To Improve Services And Invest For The Future (13/11/2009), http://www.mediacentre.eastcoast.co.uk/Press-Releases/east-coast-main-line-company-pledges-to-improve-services-and-invest-for-the-future-1f4.aspx (accessed 16/02/2013).

46 The question of safety on the British railway is discussed in detail in V. 2.

47 *Gourvish* (n. 31), p. 179.

48 *BBC News*, Train firm loses franchise, 27/06/2003, http://news.bbc.co.uk/2/hi/uk_news/england/3024804.stm (accessed 16/02/2013); *Barker*, Connex is stripped of its rail franchise, The Telegraph of 25/10/2000, http://www.telegraph.co.uk/news/uknews/1371681/Connex-is-stripped-of-its-rail-franchise.html (accessed 16/02/2013).

49 *National Audit Office*, The InterCity East Coast Passenger Rail Franchise (Report by the Comptroller and Auditor General, HC 824, Session 2010-2011), 2011, p. 4.

50 *National Audit Office* (n. 49), p. 7.

but are freely bidding for rail timetable slots.[51] They also do not receive any state subsidies.

Open access operators increase competition and are more flexible in offering services without franchise restrictions. However their economic importance in Britain is small, with *First Hull Trains* and *Grand Central* being the only notable passenger open access TOCs. The *Wrexham & Shropshire* open access TOC was shut down by parent company *Deutsche Bahn* in early 2011 as its operations were economically unviable.[52]

3. National Rail Conditions of Carriage and Passenger's Charters

As passenger rail services are now carried out by a multitude of railway companies, *ATOC* introduced the National Rail Conditions of Carriage (NRCoC)[53] to ensure a consistent travel experience.

The NRCoC is a set of regular contract terms setting out the rights and duties of travellers on all *National Rail* services. All rail travel is subject to the regulations of the NRCoC and therefore it declares that the purchase of a train ticket amounts to contracting with all TOCs whose services can be used. It also regulates more technical issues such as penalty fares or the question of breaking and resuming journeys.

Each TOC has its own passenger's charter. They grant specific rights to the passenger that exceed statutory requirements. Such a passenger's charter[54] usually contains a mission statement of the TOC, standards of service covering punctuality and reliability (based on the franchise agreement), customer service commitments (regarding telephone enquiries, reservations, assistance for disabled passengers etc.), compensation for delays ("Delay Repay" schemes),[55] and customer service contact details.

These passengers' charters are not entirely voluntary. The Delay Repay schemes, for example, are often required by the *Invitation to Tender* and subsequently the franchise agreement. Nevertheless passenger's charters are a convenient means of informing passengers of their rights.

V. Discussion

After having taken a look at the privatised British railway system, various questions arise.

51 *Butcher*, Quick guide to the railways (UK Parliament Briefing Paper SN4128), 2012, p. 9.

52 *Milmo*, Wrexham & Shropshire rail operator shuts after severe losses in profit, The Guardian of 26/01/2011, http://www.guardian.co.uk/uk/2011/jan/26/wrexham-and-shropshire-railways-close (accessed 16/02/2013).

53 *National Rail Enquiries*, Conditions of Carriage, May 2012, http://www.nationalrail.co.uk/times_fares/nrcc/ (accessed 16/02/2013).

54 As an example: *Northern Rail*, Passenger's Charter, http://www.northernrail.org/northern/passengercharter/intro (accessed 16/02/2013).

55 The Delay Repay schemes must not fall short of the regulations laid out in Regulation (EC) No. 1371/2007 on rail passengers' rights and obligations. In practice the minimum standards set by the Regulation are usually exceeded, as required by franchise agreements.

1. Competition in the British Railway System

Among the questions are whether there actually is a market and whether competition does exist or not.

On the consumer side, competition does exist as different TOCs may operate on the same or neighbouring routes.[56] *On-the-track competition* has led to increases in service frequency as well as price cuts.[57] Due to the design of the franchising system, the extent of this competition is naturally limited and little can be improved, except for making open access operations more attractive.[58] The state is benefitting from *off-the-track competition* as franchises put to tender regularly receive several serious bids and subsequently, state subsidies went down.[59]

Railway employees have not suffered a salary decline. In 2010, it was concluded that the salary costs in the rail industry have risen by 31% since privatisation whereas the average earnings index had only grown by 15%.[60] This can be attributed to full employment in the South East leading to recruiting difficulties and shortages of specialist staff, as well as a lack of incentive on the part of franchisees to reduce staff costs, a desire to recruit the best staff, and strong unions.[61] The UK rail industry's average salary level is almost 20% higher than in Germany or Sweden.[62] Staff numbers have also risen due to increases in traffic volume.[63]

A problem has however been identified for the TOCs in the oligopoly of the three major ROSCOs[64] and the fact that the detailed Invitations to Tender often require specific rolling stock to be used.[65] While ROSCOs were established to simplify the market entry to competitors,[66] the role of ROSCOs in general is controversial as they

56 As an example, see *Greater Anglia*, Switch and save, http://www.greateranglia.co.uk/tickets-fares/season-tickets/choosing-your-season-ticket/season-direct (accessed 16/02/2013).

57 *Preston*, An Overview of Public Transport in the UK and Forecasts for the New Millennium (Sixth International Conference on Competition and Ownership in Land Passenger Transport, Cape Town, 20/09/1999), http://www.thredbo-conference-series.org/downloads/thredbo6_papers/thredbo6-plenary-Preston.pdf, p. 7 (accessed 16/02/2013).

58 In fact, increasing the competition even more may cause cherry picking (*i.e.* peak frequency enhancements) that amount to TOCs providing "too much service at too high a price", a classical outcome of oligopolies, as discussed by *Preston* (n. 57), p. 7.

59 *Preston* (n. 57), p. 8.

60 *Smith/Nash/Drew*, Aggregate Level Analysis of Train Operating Company Average Salary and Productivity Performance (06/10/2010), http://www.railwaysarchive.co.uk/documents/rvfm-aecom-people-march2011.pdf, p. 84 (accessed 29/01/2013).

61 *AECOM/University of Leeds/fcp*, Achieving Value for Money from People in the GB Rail Industry – Theme H Benchmarking, 2011, http://www.railwaysarchive.co.uk/documents/rvfm-aecom-people-march2011.pdf, p. 7 (accessed 29/01/2013).

62 *AECOM/University of Leeds et al.* (n. 61), p. 35.

63 *Gourvish* (n. 31), p. 157.

64 While a fourth company, *Voyager Leasing Limited*, does exist, its market share of 3% makes it negligible.

65 See the report of the *Competition Commission*, Rolling Stock Leasing market investigation: Final report (07/04/2009) for a detailed analysis on the rolling stock market.

66 *Preston* (n. 57), p. 9.

inherited older rolling stock that *BR* already considered to be written off[67] and their revenues are practically guaranteed by the design of the current system that requires TOCs to rent rolling stock, as opposed to buying it.[68] Competition is also weak due to the fact that British rolling stock is significantly different from continental rolling stock, and there are even incompatibilities in Britain itself regarding power supply, weight and loading gauge.[69] When the UK Competition Commission (CC) carried out an investigation in the rolling stock leasing market in 2009 and found the aforementioned issues, it recommended changes to the franchising policy, including the specification of Invitations to Tender in a way that allows bidders a choice of rolling stock.[70]

2. Safety

Safety and service quality in the privatised British railway system are major targets of criticism. In the late 1990s and early 2000s, several major train accidents raised a public debate on whether privatisation caused a decline in safety.[71]

One of the most infamous incidents took place on the *East Coast Main Line* near Hatfield, Hertfordshire, on 17/10/2000, when an InterCity 225 train derailed with four fatalities due to a broken rail. Other fatal train crashes that caught the medias' attention took place at Watford Junction (1996), Southall (1997), Ladbroke Grove (1999) (with 31 fatalities) and Potters Bar (2002).

These accidents can, however, be attributed to maintenance deficits accumulated during the *BR* era,[72] including the non-implementation of Automatic Train Protection (ATP) for cost reasons when similar train protection systems were already common in other European countries.[73] Statistical analysis does not back the assumption that the British railways became less safe after privatisation; the safety record has actually continued to improve.[74]

3. Price and Quality

In popular opinion, privatisation is often blamed for a perceived decline in quality and price hikes.[75] But a closer look at the facts raises doubts on this claim. Much of the stock in service in the 1990s was either refurbished or withdrawn in recent years in order to provide a higher quality travel experience, with the result that Britain has one of Europe's youngest fleets of rail vehicles,[76] due to stricter franchise requirements as well as increased competition.

Regarding fares, a lesser known fact is that the pricing of Off-Peak Return tickets and season tickets is subject to governmental regulation by the DfT (and, where applicable, Transport Scotland or the Welsh Assembly). The maximal amount by which regulated fares can rise is capped at the Retail Price Index plus 6%.[77] As many rail passengers have resorted to booking cheaper (unregulated) Advance tickets in the last years, the average spending on rail tickets has not increased at the same pace as regulated fares did.[78]

4. Failed TOCs and Government Intervention

The renationalisation of failed TOCs such as *Connex Southeastern* and *National Express East Coast* was widely considered to be an expensive bail-out[79] although the sums of Government financial support for the rail industry have not been noticeably influenced by these failures; in fact, financial support to the industry has fallen every year since 2006/2007.[80]

In an entirely free market, participants would renegotiate contracts if it becomes clear that the current terms cannot be enforced. This is however not allowed under EU procurement law that requires public bodies to launch a full retendering process if the changes would amount to the conclusion of an entirely new contract.[81]

Given the fact that rail transport is a service of general economic interest and, in many cases, relies on subsidies and is often not profitable in itself, it is not a feasible option to leave the provision of rail services entirely to the

67 *Wolmar* (n. 25), p. 60. However, much of the stock in service is now either recently refurbished or newly procured so nowadays this argument only holds value to a limited extent.

68 See *Demellweek* (n. 39), ECLR 2010, 530 (531).

69 *Competition Commission* (n. 65), p. 47.

70 *Competition Commission* (n. 65), p. 198.

71 See *Harper*, Analysis, The Guardian of 17/10/2000, http://www.guardian.co.uk/uk/2000/oct/17/hatfield.transport2 (accessed 16/02/2013) as an example. This article was written shortly after the Hatfield accident.

72 *Pollitt/Smith*, The restructuring and privatisation of British Rail: was it really that bad?, Fiscal Studies 2002, 463 (494). *Speirs/Johnson*, Safety Culture in the face of industrial change: a case study from the UK Rail Industry, 29/05/2002, p. 11, http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.15.3243&rep=rep1&type=pdf (accessed 16/02/2013) note that *BR* had major problems recruiting suitably skilled personnel in the last decade of its existence.

73 *Gourvish* (n. 27), p. 353.

74 *Gourvish* (n. 31), p. 286; *Evans*, Fatal train accidents on Europe's railways: 1980-2009, Accident Analysis and Prevention 2011, 391 (395).

75 *Gourvish* (n. 31), p. 286.

76 *Bigland*, Rolling stock companies, RAIL 2010, Issue 658, 43.

77 *Office of Rail Regulation*, Fares, http://www.rail-reg.gov.uk/server/show/nav.2726 (accessed 16/02/2013).

78 *Cohen*, Evolvi: Average U.K. Rail Fare Paid In 2012 Increased For First Time Since 2005, BusinessTravelNews of 28/01/2013, http://www.businesstravelnews.com/Travel-Management/Evolvi-Average-U-K--Rail-Fare-Paid-In-2012-Increased-For-First-Time-Since-2005/?ida=Rail&a=proc (accessed 16/02/2013).

79 *Cecil/Prynn*, National Express East Coast bail out to cost taxpayer £700m, Evening Standard of 01/07/2009, http://www.thisislondon.co.uk/standard/article-23714401-national-express-east-coast-bail-out-to-cost-taxpayer-700m.do (accessed 16/02/2013).

80 Financial support to franchisees is now on an all-time low, see *Brown et al.* (n. 36), p. 78 (Figure 13).

81 In the *Pressetext* case (*Pressetext Nachrichtenagentur GmbH v. Republik Österreich (Bund)* Case C-454/06, European Court reports 2008 Page I-04401 ECJ), the ECJ defined criteria for changes that amount to a new contract.

market without governmental influence.[82] The *status quo* therefore must be considered the lesser evil.

5. Outlook: DfT reviewing the franchise system

A review after the *East Coast* failure has yielded a DfT whitepaper called "The Future of Rail Franchising", released in January 2010. It recommended longer franchise durations of at least ten years, as this makes a financial payback of investments over the life of the franchise more probable.[83] The report suggests alternative risk-sharing mechanisms as to prevent more TOC failures. Instead of fixed franchise payments or subsidies, these could be linked to external economic factors including the British GDP or the Central London employment rate.[84]

In May 2011, the so-called *McNulty* report, commissioned by the DfT and the Office of Rail Regulation (ORR), was published, focusing on value for money. It concluded that while "in many ways, the GB rail structure established in the 1990s has delivered good results", there are still inefficiencies that need to be addressed in order to improve value for money for passengers and taxpayers.[85]

The *InterCity West Coast* franchising process (that was cancelled in October 2012 due to technical flaws in the way the competition was conducted)[86] already aimed at a longer franchising period of 13 years and 4 months.[87] Other pending franchising processes were then paused by the DfT in order to once again order independent reviews on the rail franchising system. The *Brown* review was released in January 2013. Based on the findings that passenger numbers have grown by 92% since privatisation, Britain's railways are now the second safest in Europe and punctuality as well as passenger satisfaction have significantly improved, it is concluded that the privatisation ultimately was successful.[88] While there is no credible case for major structural change, a significant number of key areas require attention. One of those key areas is the evaluation of bids where financial robustness, deliverability and proposals for improving service quality are to be given more consideration than in the past.[89]

The cancellation of the *West Coast* competition shows that the rail franchising system in Britain is still in a constant state of flux.

VI. A Comparison with Germany

Unlike Britain, the German state(s) held a substantial stake in railway operations since the 19th century. Public railways were operated by the states of the German Empire until 1920, when the new Weimar Republic established a nationwide state railway company, *Deutsche Reichsbahn*.[90] Some private railway companies existed, and were operating mostly minor branch routes. When Germany was divided after World War II, railway operations were split between the government agencies *Deutsche Bundesbahn* (*DB*, West Germany) and *Deutsche Reichsbahn* (*DR*, East Germany).[91]

Based on the recommendations of a governmental railway commission founded in 1989 to examine the future of *DB* and *DR*,[92] on 01/01/1994, *DB* and *DR* were merged into *Deutsche Bahn AG* (*DB AG*), a stock corporation with the Federal Republic as the only shareholder. Safety regulation is now in the hands of the Federal Railway Authority (*Eisenbahn-Bundesamt*) and economic regulation regarding the access to the rail network is carried out by the Federal Network Agency (*Bundesnetzagentur*).

The legal basis of the German railway reform of 1994 was the Railway System Reorganisation Act (*Eisenbahnneuordnungsgesetz – ENeuOG*)[93]. The Act consists of several sub-acts regarding the merger of *DB* and *DR*, the establishment of *Deutsche Bahn* as a stock corporation, the establishment of the Federal Railway Authority as a regulator, the introduction of rail franchising for local and regional rail services in Germany, and the General Railways Act (*Allgemeines Eisenbahngesetz – AEG*) that defines rights and duties of TOCs (*Eisenbahnverkehrsunternehmen*).

DB AG is a vertically integrated railway company. It is the owner of most of the railway infrastructure in Germany, with the bulk of tracks and stations managed by its divisions *DB Netz AG* and *DB Station & Service AG*. The TOC and freight activities are bundled within *DB Mobility Logistics AG*, the corporate parent of *DB Regio AG* (suburban and regional services), *DB Fernverkehr AG* (intercity and international services), *DB Schenker* (logistics and transportation), and *Arriva* (operations in other European countries including the UK, Sweden, Denmark and Poland).[94]

82 But exactly this is advocated by *Glaister* (n. 18), p. 55.

83 *Department for Transport*, The Future of Rail Franchising, 2010, p. 10.

84 *Department for Transport* (n. 83), p. 29.

85 *McNulty et al.*, Realising the Potential of GB Rail – Report of the Rail Value for Money Study – Summary Report, 2011, p. 4.

86 The *West Coast* franchise is currently run by *Virgin Trains* who have been running it from the mid-1990s. After a bidding process conducted in 2012 it was planned to offer *First Group* a franchise contract, however the DfT cancelled the competition on 03/10/2012 as the assessment of the risks of the bids was flawed, see *Department for Transport*, West Coast Main Line franchise competition cancelled (03/10/2012), https://www.gov.uk/government/news/west-coast-main-line-franchise-competition-cancelled (accessed 16/02/2013).

87 See Section 3.1 of the ICWC Invitation to Tender (n. 42).

88 *Brown et al.* (n. 36), p. 5 and Appendix C.

89 *Brown et al.* (n. 36), p. 9.

90 *Raschke*, Der SPNV als Gegenstand der Bahnprivatisierung, LKV 2009, 21.

91 *Möstl*, in: Maunz/Dürig, Grundgesetz Kommentar, 66th suppl. 2012, Art. 87e GG marginal note 34.

92 *Engartner*, Die Privatisierung der Deutschen Bahn: Über die Implementierung marktorientierter Verkehrspolitik, 2008, p. 136.

93 Dated 27/12/1993, BGBl. I, 2378.

94 *Deutsche Bahn*, Konzern – Geschäftsfelder, http://www.deutschebahn.com/de/konzern/geschaeftsfelder/ (accessed 16/02/2013).

1. Rail Franchising in Germany

Rail franchising in Germany was introduced with the Local Public Transport Regionalisation Act (*RegG*),[95] a sub-act of the Railway System Reorganisation Act,[96] that became applicable in 1996. According to § 3 *RegG*, the states are responsible for the provision of suburban and regional rail services. They are generally obliged to put these to tender. To fulfil this responsibility, some states have established local transport procurement agencies (*Landesnahverkehrsgesellschaften*)[97] whereas this task has been devolved to the Passenger Transport Executives (*Verkehrsverbünde* – PTE) in other states.[98]

Rail public service contracts in Germany are more restrictive than in Britain. As PTEs serve as fare associations, franchises awarded by PTEs are regularly gross cost contracts (as opposed to net cost contracts),[99] leading to less entrepreneurial freedom and a weakened incentive to increase the capacity or improve the quality of the service to attract more customers.

Most local services are still operated by *DB Regio*, whereas some franchises have been awarded to competitors.[100] A major obstacle to the market entry is the fact that bidders are usually expected to acquire rolling stock at their own cost as a rental market for rolling stock is almost non-existent in Germany. To alleviate this problem, Lower Saxony's local transport procurement agency has – as the first such organisation in Germany – opted to acquire rolling stock itself and to adopt the role of a ROSCO.[101]

As opposed to suburban and regional rail, the provision of intercity and international train services is under the responsibility of the federal government[102] and thus these services are generally operated by *DB Fernverkehr*. A handful of open access TOCs also exist.[103] The success of open access TOCs in Germany is hampered by the facts that Travel Centres in railway stations as well as most self-service ticket machines are operated by *DB Vertrieb* which has a factual monopoly,[104] that there is no such institution as the Rail Settlement Plan for intercity rail travel in Germany (despite § 12 Abs. 1 *AEG* requiring TOCs to participate in through-ticketing schemes),[105] and there are no industry-wide National Conditions of Carriage.[106]

Despite the fact that tendering processes have yielded significant savings for Germany's strained federal state budgets,[107] many franchises were not put to tender and direct franchise awarding (*Direktvergabe*) to *DB AG* was commonplace.[108] Only in February 2011 the Federal Court of Justice ruled that direct franchise awarding is not permitted by law under regular circumstances.[109] There are certain case groups where direct franchise awarding is still acceptable, such as a danger of service disruption or minor amendments to already existing contracts.[110]

2. The S-Bahn Berlin Case

After a derailment of a *S-Bahn* (suburban rail) train in Berlin on 01/05/2009, federal authorities found out that the maintenance of rolling stock was systematically neglected. On 20/06/2009, the Federal Railway Authority ordered that large parts of the affected rolling stock be pulled out of service for maintenance. The resulting lack of operational rolling stock caused services with full train length to only commence again in 2013.[111]

The *S-Bahn Berlin* franchise has been directly awarded to *DB AG* in 1994 without a formal tendering process,[112]

95 *Gesetz zur Regionalisierung des öffentlichen Personennahverkehrs* (*Regionalisierungsgesetz*; *RegG*) of 27/12/1993, BGBl. I, 2378.

96 See Art. 4 *ENeuOG*.

97 Examples would be the *Nahverkehrsgesellschaft Baden-Württemberg* and the *Landesnahverkehrsgesellschaft Niedersachsen*.

98 PTEs in Germany are established by local authorities (towns and districts), and in some cases the *Länder*. Some PTEs only serve as fare associations, whereas some PTEs also procure public transport services, such as the *Verkehrsverbund Rhein-Ruhr* and the *Verkehrsverbund Berlin-Brandenburg*.

99 With gross cost contracts, the transport company is paid a certain guaranteed amount by the state or the PTE, intended to cover the costs of the operation and a profit margin. Income from ticket sales would first go to the PTE. With net cost contracts, the transport company has direct access to the income from ticket sales and, depending on the profitability of the franchise and the offer it has made in the bidding process, either receives subsidies from the state or pays a premium.

100 *Engartner* (n. 92), p. 164.

101 OLG Celle, NZBau 2005, 52 confirmed the compliance of this model with German law.

102 *Knecht*, Streichungen beim Schienenpersonenfernverkehr – welche Pflichten hat der Bund?, NVwZ 2003, 932.

103 The "open access" term is somewhat out of place as no intercity services are subject to franchising. Nevertheless, *InterConnex* and *Hamburg-Köln-Express* are acting as *de facto* open access TOCs as they are competing with incumbent *Deutsche Bahn*.

104 *DB Vertrieb*'s contracts with non-*DB* TOCs include unfavourable conditions, as described by *Eilmes/Berschin/Schaaffkamp/Grün*, SPNV-Tarif und -Vertrieb zwischen Verbundgedanken, Vertriebsmonopol und Unternehmertum, IR 2010, 342 (344).

105 Through-ticketing is only possible within PTE areas and for regional railways (by the *Tarifverband der Bundeseigenen und Nichtbundeseigenen Eisenbahnen*). Most customers use regional railways before or after their intercity journey, but if such a customer wants to use an open access intercity service, through-ticketing is not available and he or she must inevitably split tickets. Splitting tickets may deny the customer compensation for delays, or even render Advance tickets invalid for travel if the customer misses a connecting train.

106 Each TOC has its own Conditions of Carriage that differ regarding issues such as break of journey or the carriage of bicycles and pets.

107 *Rechten/Röbke*, Voraussetzungsfreie Direktvergabe von SPNV-Leistungen möglich?, NZBau 2010, 680 (682).

108 *Engartner* (n. 92), p. 163. § 15 Abs. 2 *AEG* was formerly interpreted by courts in a way that putting franchises to tender was not compulsory, OLG Brandenburg, NZBau 2003, 688.

109 BGH, NZBau 2011, 175.

110 *Polster*, Die Zukunft der (Direkt-)Vergabe von SPNV-Aufträgen, NZBau 2011, 209.

111 *Rundfunk Berlin-Brandenburg*, S-Bahn erhält Betriebsgenehmigung für 15 Jahre (07/12/2012), https://www.rbb-online.de/nachrichten/wirtschaft/2012_12/s_bahn_erhaelt_betriebsgenehmigung.html (accessed 16/02/2013).

112 *IHK Berlin*, Die Zukunft der Berliner S-Bahn, 2011, p. 4.

with the franchise agreement renewed in 2004.[113] Calls for the franchise to be terminated early were dismissed by the authorities as "infeasible" as the TOC's parent company *DB AG* is the owner of all suitable rolling stock.[114] *S-Bahn* tunnels in Berlin have smaller gauge profiles that do not match those of main line trains[115] and therefore new rolling stock cannot be procured at short notice. A new franchisee would therefore not be able to commence services without preparation.

The State Government of Berlin published a contract notice in the Official Journal of the EU in July 2012, declaring its intent to put the operation of the Berlin *Ringbahn*, part of the *S-Bahn* network, to tender, with the new franchise period starting from 2017.[116] Whereas Invitations to Tender in Britain are issued about a year before expiration of the franchise, such a tendering process requires significantly more preparation in Germany due to the lack of a ROSCO system and the need for the TOC to procure rolling stock. Passenger's organisation *IGEB* suspects that a new shortage of rolling stock may commence when the current franchise ends in 2017.[117]

3. Outlook

The parent company *Deutsche Bahn* itself is slated for privatisation. As a long term goal it was intended by the German Government to keep the infrastructure in state ownership and privatise *DB Mobility Logistics AG*, the train operation and logistics division, only.[118]

While the British ROSCO system has been considered inefficient by some, it would certainly have prevented the deadlock that was observed in Berlin and allowed competitors to enter the market with significantly less effort. Britain has opted to dissolve *BR* – at the potential cost of know-how and technology going to other countries –, but this may have helped in creating healthy competition, whereas in Germany, a factual monopoly is intended to be privatised with unclear long-term dangers.[119]

VII. Conclusion

The main problem that the *BR* privatisation, and many other privatisations of its kind, sought to alleviate was the inefficiency that thrived on the static principles of traditional public management. Despite all the positive developments such as increased service frequency, the British railway system still exhibits weaknesses, such as limited competition among the ROSCOs and the surprisingly high number of failing TOCs.

However, the privatised British railway system's advantages prevail. Privatisation has introduced competition to an extent that is feasible and desirable. The State is in charge of the entire lifecycle of a franchise, from the Invitation to Tender with service specifications up to an emergency nationalisation, if required. Failure of a TOC does not cause disruption to services, and such failures in the recent past have not increased the total levels of Government financial support for the rail industry. The franchising system ensures that the decision where to provide services is in the hands of the contracting state, and rural areas are not forgotten. The concept of open access TOCs is pretty much secondary, so a cherry-picking scenario where the market for profitable routes is seized by open access TOCs, leaving only unprofitable routes to the state's franchising process, is improbable. Consumer interests are protected to a very large extent. Railway employees' salaries have not dropped after privatisation but are rising at a comparatively fast pace.

The planned European Fourth Railway Package will open domestic passenger markets in countries such as France and Spain that have yet seen little competition, require financial independence of the infrastructure managers from any train operators (but not vertical disintegration), and make tendering processes mandatory if the State concludes public service rail contracts.[120] Still it does neither address the *Achilles* heel of the German model that is the rolling stock procurement nor other issues such as missing through-ticketing. As the privatised British rail industry is considered to be largely successful, it may serve as a reference for involving the market in the provision of public services in other countries – and the German passengers and taxpayers definitely deserve a better deal.

113 As opposed to Britain where franchise agreements are published by the DfT, the S-Bahn Berlin agreement of 2004 was only published in 2012 by *Der Tagesspiegel* newspaper, http://www.tagesspiegel.de/berlin/fuer-alle-einsehbar-s-bahn-geheimvertrag-wurde-veroeffentlicht/6270004.html (accessed 16/02/2013).

114 *Verkehrsverbund Berlin-Brandenburg*, Häufig gestellte Fragen zur S-Bahn-Krise, http://web.archive.org/web/20111105170029/http://www.vbbonline.de/index.php?cat=1&sCat=543&par=481 (as per 05/11/2011, retrieved from the Internet Archive *WayBackMachine* on 16/02/2013).

115 *DB Netz AG*, Sonderbestimmungen für den Betrieb der Berliner S-Bahn (13/12/2009), Railway Standard 432.0494 Section 1 para. 1.

116 See the Invitation to Tender D-Berlin: Öffentlicher Schienentransport/öffentliche Schienenbeförderung (23/07/2012), OJ 2012/S 144-241103.

117 *IGEB*, Spätestens 2018 wieder Fahrzeugmangel bei der S-Bahn (06/01/2013), http://www.igeb.org/pressedienst/igebpresse_20130106.html (accessed 16/02/2013).

118 The current German Coalition Agreement (*German Coalition Government*, Wachstum. Bildung. Zusammenhalt. Der Koalitionsvertrag zwischen CDU, CSU und FDP., 2009, p. 37) mentions a "step-by-step privatisation of the transport and logistics department of Deutsche Bahn when the capital markets' condition allows it".

119 See *Engartner* (n. 92), p. 225, for a critical discussion on the asset sale privatisation of the monopoly-holding railway company of New Zealand, *Tranzrail*.

120 *Kallas* (n. 7).