The Privatisation of Railtrack

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The *Railways Act 1993* provided the legal framework for the privatisation of British Rail and the introduction of a new structure for the rail industry. Since April 1994, when many of the changes were introduced, the industry has changed radically. The Act and the new arrangements are described in Library Research Paper 95/96 *Rail Privatisation: a Progress Report*. British Rail has been split into over 100 companies and by the end of March 1996, nearly 40 rail businesses had been sold to the private sector. Franchises have been awarded for the first six private train operating companies and progress on these is described in Library Research Paper 96/21 *Rail Passenger Franchises*. On 1 April 1994 Railtrack became a separate Government owned company and it is to be sold to the private sector in May 1996. This paper describes the main features of the company and the proposal to privatise it.

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Summary

The first part of the paper describes Railtrack. On 1 April 1994 Railtrack became a separate government owned company which owns and manages the vast majority of track, signalling and other infrastructure of Britain's railways. Railtrack is in charge of coordinating train movements through central timetabling, train planning and signalling and is also responsible for the safety of the operational network. It operates the rail network, including signalling, and provides electricity for traction to train operators. Train operators are granted access rights to the track and are charged for that access. Railtrack does not receive direct revenue subsidy from the government but it is indirectly dependent on the significant amount of public sector support received by the train passenger operating companies (TOCs) who in turn pay access charges to Railtrack. In the year ended 31 March 1995, the TOCs paid £1,955 million to Railtrack for access to track and major stations, 85 per cent of Railtrack's total income.

The responsibilities and activities of the Rail Regulator are also described as he has a significant role in deciding the legal and economic context in which Railtrack operates. The Regulator approves access agreements between Railtrack and the train operators by which the latter acquire the right to use the track, stations and light maintenance depots and may also modify them. In January 1995 he reduced the access charges for the franchised passenger services and there will be a further review of access charges in 2000 with the conclusions to be reflected in all access agreements for franchised passenger services from 1 April 2001.

The second part of the paper covers the Government's plans for the privatisation of Railtrack. The idea of selling Railtrack to the private sector was scarcely mentioned when the Government first set out its plans for privatisation of the railways. The priority was to transfer the train services to the private sector and only after that process was completed would Railtrack follow. However in November 1994 Dr. Mawhinney announced that the Government intended to "privatise Railtrack within the lifetime of this Parliament" and in his speech to the Conservative Party Conference in October 1995, Sir George Young confirmed that the company would be floated in the Spring of 1996. The views of the Opposition Parties on the proposals are given as well as details of the flotation.

Abbreviations

ATOC	Association of Train Operating Companies
BR	British Rail
BRIS	British Rail Infrastructure Services
CRUCC	Central Rail Users' Consultative Committee
EFC	External Finance Contribution
EFL	External Financing Limit
EPS	European Passenger Services Ltd
EU	European Union
HSE	Health and Safety Executive
IMU	Infrastructure Maintenance Unit
ITT	Invitation to Tender
MDC	Metropolitan District Council
MEBO	Management and Employee Buyout
MBO	Management Buyout
MRG	Metropolitan Railway Grant
NLF	National Loans Fund
OPRAF	Office of Passenger Rail Franchising
PQD	Pre-qualification document
PSR	Passenger Service Requirement
PTA	Passenger Transport Authority
PTE	Passenger Transport Executive
PSO	Public Service Obligation
ROSCO	Rolling Stock Leasing Company
RSC	Railway Safety Case
RSG	Revenue Support Grant
RUCC	Rail Users' Consultative Committee
TOC	Train Operating Company
TOU	Train Operating Unit
TRU	Track Renewal Unit
WCML	West Coast Main Line

CONTENTS

I Introduction

The *Railways Act 1993* provided the legal framework for the privatisation of British Rail and the introduction of a new structure for the rail industry. The Act received Royal Assent in November 1993 and many of the principal changes were brought into effect on 1 April 1994.

The core of the Government's proposals was the greater involvement of the private sector in the running of the railways through the sale of British Rail's freight and parcels businesses and the progressive contracting out of the management of passenger services by a new Franchising Authority. The principal organisational means of achieving these objectives was the separation of responsibilities for track and operations, which was to be effected by the division of BR into a body known as Railtrack on the one hand, and a residual BR operating company with the task of running those services not yet franchised, on the other. A Regulator would oversee the charges to be levied by Railtrack for the use of the infrastructure.

The structure of the whole industry has changed radically in the two years since April 1994. The responsibility for a large amount of decision taking in the industry has now been transferred from the Secretary of State to the two new statutory officers, the Rail Regulator and the Franchising Director. British Rail has been split up into about 100 companies and by the end of March 1996, 39 rail businesses had been sold to the private sector or the sales had been agreed. The first six private train operating companies have been announced and the award of franchises for the others is under discussion. Railtrack became a separate Government owned company and it has been announced that it will be sold to the private sector in May 1996.

When the original scheme for rail privatisation was unveiled in 1992 the idea of selling Railtrack to the private sector was scarcely mentioned. The priority was to transfer the train services to the private sector and only after that process was completed would Railtrack follow. At the time John MacGregor, then Transport Secretary, thought the step could be ten years away. During the committee stage of the *Railways Bill* Roger Freeman, the Railways Minister, declared "Railtrack will be in the public sector for the foreseeable future."[1] In November 1994 Dr. Mawhinney announced the Government intended to "privatise Railtrack within the lifetime of this Parliament."[2] In his speech to the Conservative Party Conference in October 1995, Sir George Young confirmed the company would be floated in the Spring of 1996.

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1 Standing Committee B 23.2.93 c. 400

2 HC Deb 24.11.96 cc 729-739

II The Company

A. Railtrack

Railtrack became a separate Government owned company on 1 April 1994 when the track, signalling and freeholds of stations, other buildings and operational land were transferred to it. It employs about 11,500 people (of whom 6,000 are signalmen and supervisory staff) organised in eight geographical zones. It owns and manages the vast majority of track, signalling and other infrastructure of Britain's railways. Train operators are granted access rights to the track and are charged for that access. Railtrack is in charge of coordinating train movements through central timetabling, train planning and signalling and is also responsible for the safety of the operational network. It operates the rail network, including signalling, and provides electricity for traction to train operators. The current chairman is Robert Horton.

Railtrack is the freeholder of passenger train stations and light maintenance depots, which generally it leases to private sector operators. In most cases, stations and depots are leased to the passenger train operator which runs most of the services through the station or makes greatest use of the depot. Railtrack initially retains responsibility for operating the 14 large mainline stations which have potential for commercial trading or property development and aims to involve private sector operators as early as possible in developing these stations. It also has a property portfolio including, as well as the stations, operational railway land, buildings and installations which it took over from British Rail.

Railtrack owns:

- some 10,000 route miles
- some 2,500 stations
- some 90 light maintenance depots
- over 40,000 bridges, viaducts and tunnels
- over 9,000 level crossings

At 31 March 1995 the net book value of Railtrack's tangible fixed assets was given in the 1994/95 annual report, the latest to be published, as £4,284 million. This included investment properties, other land and buildings, track, signalling systems, electrification, other infrastructure and plant and machinery. Before depreciation the March 1995 figure was £6,207 million. Net assets after indebtedness was taken into account were given as £1,479 million.

A Factsheet published in January 1996 gave figures at 30 September 1995. Net book value was £4,349 million and net assets after indebtedness was £1,601 million.[3]

Income

Railtrack was set up as a commercial undertaking and is required to earn a specified rate of return set by the Government while it is in the public sector. Its main sources of revenue are the charges it levies on train operators for track access and the lease income it receives for stations and depots. Track access payments come from the operators of passenger services, freight operators and open access passenger services. This latter category comprise special services such as excursion trains and also the recently formed EPS which runs trains to Paris and Brussels through the Channel Tunnel. In addition Railtrack also obtains rental income from retail lettings at major stations, from letting arches and other commercial property and from property disposals and developments. Track access income from franchised passenger services provides the major part of Railtrack's income. In the year 1994/95, this amounted to 86 per cent of turnover. The 1994/95 accounts show income of £2,275 million, an operating profit of £305 million and pre-tax profit of £189 million. The equivalent figures for the six months to 30 September 1995 are £1,139 million, £151 million and £98 million.[4]

Costs

Railtrack must fund the maintenance and investment in the rail infrastructure, including track and stations, and it incurs other operating costs, for example in providing signalling on the network and supplying electricity for traction. The maintenance and renewal work is contracted out. Total costs in 1994/95 were £1,970 million and in the six months to 30 September 1995 they were £988 million.[5]

Investment

On 18 December 1995, Railtrack published its first 10-year Network Management Statement in which it said it expected to spend over £1 billion a year for 10 years on the maintenance and renewal of its assets. It intends to replace 2,900 miles of sleepers and 1,400 miles of rails, renew dozens of bridges and upgrade stations and depots. Further improvements will be made to signalling and control equipment, some of which is 40 years old. Investment in the existing

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[3] Railtrack Annual Report 1994/95; Railtrack Factsheet 29 January 1996

[4] *ibid*

[5] *ibid*

infrastructure will be mainly funded by the track access charges already set for the next five years.

Investment over the past ten years was:

Capital spending on track & property infrastructure
£ million

	cash	1995/96 prices
1986/87	460	711
1987/88	539	791
1988/89	521	717
1989/90	661	850
1990/91	695	827
1991/92	862	966
1992/93	938	1,010
1993/94	825	863
1994/95	695	714
1995/96	780	780

Note: figures to 1993/94 include spending on track renewal, signalling and track projects, electrification, telecoms, terminals (which includes some international spending), depots and other. The 1994/95 figure does not include any international spending and the 1995/96 figure is estimated.

Sources: HC Deb 15 Jan 1996 c402/3w, GDP deflator at 16 Apr 1996

Railtrack needs to spend money on maintenance to meet its contractual and statutory obligations but it has said it will also undertake projects to improve the network. However any enhancements to the network will have to be largely funded either through additional access charges to be agreed with train operators who may benefit from the project or through cost savings. Railtrack may also be eligible for contributions to the costs of specific projects from public sector bodies, including the European Union and local authorities.

The sum set aside for investment does not cover the large projects such as Thameslink 2000 or the renewal of the West Coast Main Line. Thameslink 2000 aims to expand the capacity of the current Thameslink routes and it is hoped construction will start in 1998. Project costs are estimated in the region of £650 million and are expected to be financed by Railtrack's debt facilities. Railtrack is developing, in association with the train operators, a major programme of renewal of the core infrastructure of the WCML, the main arterial rail link joining London, the West Midlands, the North West and Scotland. Expenditure over a period of 10 years includes a projected expenditure of £857 million on signalling and electrification schemes.

Subsidy

The railway industry has been dependent upon financial support paid by successive governments to supplement passenger and freight revenues and to fund investment in the railway infrastructure. Railtrack does not receive direct revenue subsidy from the government but it is indirectly dependent on the significant amount of public sector support received by the train operating companies who in turn pay access charges to Railtrack. In the year ended 31 March 1995, the TOCs had total passenger receipts of £2,153 million and received total public sector financial support of £2,009 million (£1,805 million in 1995/96). In the same year the TOCs paid £1,955 million to Railtrack for access to track and major stations.

Until the company is privatised, it is subject to external financing limits set by the government. This is calculated as the difference between the cash a nationalised industry spends and the cash generated from its operations. Before 1 April 1994 British Rail was set a single EFL for all its activities. Expenditure in excess of income was met by government grant and borrowing from the National Loans Fund. As a result of the restructuring, BR and Railtrack no longer have external finance requirements but cash surpluses known as external finance contributions. In 1994/95 Railtrack paid an EFC of £316 million.

On 1 April 1994 British Rail's debt was apportioned between British Rail and Railtrack in the proportion 40:60 which left Railtrack with debt of nearly £2 billion. Railtrack has a mix of different debt but according to the 1994/95 annual report the total at 31 March 1995 was about £1.6 billion of which about £1.3 billion was owed to the National Loans Fund. As a public sector company, Railtrack was able to raise funds by borrowing from the NLF but this cannot pass to the private sector. Section 106 of the *Railways Act 1993* allows for the debt to be restructured. By 30 September 1995 the total had been reduced to £1.5 billion.

Subsidy to Railway Industry

In answer to a PQ John Watts gave the following figures for 1995/96 for Government subsidy to the rail industry as a whole:[6]

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6 PQ HC Deb 26.3.96 c.554W

Mr. Riddick: To ask the Secretary of State for Transport if he has set revised figures for external finance limits and contributions for the railway industries; and what estimates he has made of proceeds from the sales of businesses and the external finance contributions lost when those businesses were sold.

Mr. Watt: The revised figures for 1995-96 are as follows:

	£ million
Grants	1,805
BR EFC	-730
Railtrack EFC	-114
BR/Railtrack EFL	961
Privatisation effects	-980
Total national rail	-19
EPS + Union Railways	317
Total rail	298

1. EFC means external financing contribution. EFL means external financing limit.
2. Grants include support to passenger rail services paid by the Franchising Director and metropolitan railway grant, including approximately £70 million of grant paid by the Scottish Office in support of passenger transport executive services in Scotland.
3. Privatisation effects is an estimate of the proceeds from sales of rail businesses less their EFC's. Proceeds are forecast to be some £1,280 million, of which some £740 million is attributable to sale of the rolling stock lease companies, some £133 million to the sale of British Rail Telecommunications Ltd and some £30 million to the sale of British Rail Maintenance Ltd. Proceeds may be subject to adjustments when completion accounts are agreed. Lost EFC's in 1995-96 are forecast to be approximately, £300 million. Total of proceeds from the sale of the rolling stock lease companies will comprise approximately a further £1 billion in 1996-97 and a deferred consideration of up to £80 million.
4. The EPS and Union Railways EFL was increased in year by calls on the Reserve of £197 million. The EFL set at the beginning of the current financial year covered only the period 1 April 1995 to 30 September 1995.

Contracts and Performance Regimes

Now that there are so many separate companies in the rail industry, the relationship between Railtrack and its customers and principal suppliers is governed primarily by contractual agreements. The most complex ones are the track access agreements, the major station access agreements, the leases of stations (other than the major stations), the light maintenance depots and other rail facilities and the maintenance and renewal contracts.

Railtrack's principal contracts with its customers and the Infrastructure Maintenance Units (IMUs) and Track Renewal Units (TRUs) include performance regimes which provide financial incentives to the parties aimed at improving the punctuality and reliability of the services. Railtrack will be responsible for any disruption on the network caused by the condition of the network, train timetabling and control of train movements, the performance of other train operators, the actions of third parties and other external influences such as the weather. A train operator will be responsible for all disruption to services it causes, for example as a result of the mechanical failure of its trains.

The Rail Regulator has agreed that Railtrack will receive an additional sum (£75 million for 1995/96) in access charge supplements payable by each TOC to cover what it may have to pay out in these circumstances. If there was a complete cessation of services on an average weekday the pathfinder prospectus issued for the flotation of Railtrack estimates that it would cost Railtrack about £12 million.

B. The Rail Regulator and Track Access Agreements

Railtrack's activities are subject to a high degree of regulation under both the *Railways Act 1993* and its network and station licences. The Rail Regulator therefore has a significant role in deciding the legal and economic background in which Railtrack and the franchisees operate.

The Secretary of State appoints the Regulator for a five year period and once appointed he cannot be removed except for "incapacity or misbehaviour." John Swift was appointed in December 1993. He is guided in his duties by the statutory requirements set out in section 4(1) of the *Railways Act* and until 31 December 1996, he also has a duty to take into account any guidance given him by the Secretary of State (section 4(5)(a)). A General Authority under section 8 and Guidance under section 4(5)(a) were given to the Regulator in March 1994. He is required to act in accordance with certain duties designed to protect users of the network but which also include a requirement not to make it unduly difficult for network operators to finance their activities and to have regard to the financial position of the Franchising Director and of Railtrack.

The Regulator is responsible for issuing licences to railway operators. In general all companies operating railway assets will need to be licensed and the Regulator is responsible for enforcing licence conditions concerning such matters as policing, the environment, insurance requirements and through ticketing. No track, train, station or depot may be operated without a licence.

He also approves access agreements between Railtrack and the train operators by which the latter acquire the right to use the track, stations and light maintenance depots, and he may modify them. The restructuring of the railway industry centres on the separation of the ownership of the track from that of the train operations. The track, stations and signalling infrastructure is owned by Railtrack while the operation of the train services are, or will be, franchised to other privatised companies. Each of these have to pay access charges to Railtrack for the use of its infrastructure. Under the *Railways Act 1993* section 18, access agreements have to be approved by the Regulator. Under section 21 the Regulator may prepare and publish model clauses for inclusion in access agreements.

The Regulator has to approve each access agreement on its own merits but in October 1994 he thought it helpful to issue a policy statement on the criteria he would adopt in approving agreements. This was updated in March 1995.[7] The aim is to ensure that agreements are reached which protect the interests of travellers, promote the development of the rail network, and enable companies providing railway services to provide for the future. The guidance includes the following comments:

- Access agreements must be flexible enough to allow for flexible railway operations without the need continually to consult the Regulator, but they should also ensure his intentions cannot be flouted.

- Agreements must contain "reopener provisions" to allow changes to be made to, for example, franchise periods and levels of charges, after the Regulator updates his policy statements.

- Timetables which make it difficult for Railtrack to franchise routes to other operators would be subject to close scrutiny. Operators and Railtrack may agree times of first and last trains; maximum journey times and fastest journey times; key connections.

- Rules on charging and competition to reflect the Regulator's policy statements on these issues. The Regulator has produced draft model clauses on this.

- Railtrack will be expected to show that it has plans to renew track which matches the sums it sets aside for depreciation in its accounts. Agreements must also include clauses which provide an incentive to Railtrack to improve the performance of the track network.

- Railtrack and the train operators must negotiate agreements which compensate the train operators if maintenance work takes longer than planned and they are unable to use the track.

- Train operators will be expected to adopt flexible computer networks which do not tie them into expensive and inappropriate systems.

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[7] Office of the Rail Regulator *Criteria for the Approval of Passenger Track Access Agreements* 2nd edition March 1995

In December 1994 the Office published a similar policy statement setting out the principles and processes the Regulator was likely to adopt in approving freight track access agreements.[8]

Railtrack's main source of revenue is the charge it levies on train operators for track access. In both 1994/95 and the six months to September 1995 94 per cent of Railtrack's turnover arose from passenger and freight charges. The initial access contracts put in place with British Rail on 1 April 1994 were not subject to the Regulator's approval but it was agreed between the Regulator and the Secretary of State for Transport that the new train operating companies should have their own individual access agreements with Railtrack, even before they were franchised. The Treasury had originally valued BR's fixed assets at £6.5 billion and demanded that Railtrack earn an annual return of 5.1 per cent, rising to 8 per cent after four years. The level of track access charges which would have been necessary to meet those charges would have meant that almost all the passenger services would be loss making and so reliant on subsidy.

In July 1994 the Regulator issued a consultation document on passenger access charges and his conclusions were published in two stages, the first covering the structure of the charges[9] and the second the level of charges.[10]

It was in this latter policy document, *Railtrack's Access Charges for Franchised Passenger Services: The Future Level of Charges*, that the Regulator concluded that charges should be rebased in 1995-96 with an overall reduction in access charges for franchised passenger services of 8% in real terms compared with 1994-95. Individual track access charges for franchised passenger services should fall by 2% a year in real terms from 1996-97 onwards, broadly in line with the reduction in Railtrack's overall costs. There should be a further review of access charges in 2000 with the conclusions to be reflected in all access agreements for franchised passenger services from 1 April 2001. Additional charges will be levied for the use of stations and to fund specific new investment projects. A system of performance-related

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8 Office of the Rail Regulator *Criteria and Procedures for the Approval of Freight Track Access Agreements* December 1994

9 Office of the Rail Regulator *Railtrack's Track Access Charges for Franchised Passenger Services: Developing the Structure of Charges: a Policy statement* November 1994

10 Office of the Rail Regulator *Railtrack's Access Charges for Franchised Passenger Services*: *The Future Level of Charges* January 1995

payments will also be used to reflect achievement of quality of service objectives, for example the punctuality of trains.

Charges to freight and open-access passenger operators are negotiated directly and reflect the value to operators of using rail infrastructure and also recover at least the marginal costs.[11]

In his paper on the structure of charges the Regulator was most concerned about the need for greater transparency of charges, the possible need for a mechanism for operators to share with Railtrack risks of reduced profits if their revenues fell, and the desirability of achieving greater variability of access charges. In respect of the level of the charges, the Regulator was most concerned with the scope for improvements in efficiency, the relationship between depreciation charges and renewals spending, and the appropriate return on Railtrack's assets. He was not persuaded that Railtrack needed to earn an 8% real return on the modern equivalent asset value (MEAV) of its assets to be able to finance its activities. Instead of taking a view of a particular capital value, he considered the profile of charges which were needed to balance their activities. He considered a reduction in charges and profits could be achieved without making it unduly difficult for Railtrack to finance its activities, whether in the public or private sector.

The Regulator considered his proposed level of income would generate sufficient cash flow to enable Railtrack to maintain the existing capability of the rail network and also to invest £3.5 billion (at 1995/96 prices) for investment in the renewal of the network over the period to 2001. He has said he intends to monitor Railtrack to ensure it does significantly increase the amount it spends on the infrastructure.[12] Railtrack has agreed it will publish on a regular basis key performance indicators showing the capability and reliability of the network.[13]

The Government announced on 14 January 1996 that it would set up two committees to resolve disputes between the privatised companies in the hope of avoiding costly and time

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11 Office of the Rail Regulator *Framework for the Approval of Railtrack's Access charges for Freight Services: a policy statement* February 1995

12 Office of the Rail Regulator *Investment in the Enhancement of the Rail Network* March 1996

13 Department of Transport press notice 23.2.96 "John Watts welcomes publication of new network quality indicators"

consuming legal actions.[14] One committee is intended to resolve disputes about track access charges and timetables between train operators and Railtrack while the second will consider all other issues including liability for claims. In the past such disputes would have been resolved internally within British Rail.

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14 *Financial Times* 15.1.96 "Railtrack wants to retire geriatric system"

III Privatisation

A. Government Statements

When railway privatisation was first discussed, there does not seem to have been any specific intention of transferring the track authority to the private sector. The first mention of the possibility of privatising it appears to be in October 1992 in a consultation document on *Franchising*. This commented: "It may be possible for track to be sold outright to the private sector," subject to the general right of access being preserved for passenger services and to the oversight of the Regulator.[15] The Secretary of State for Transport confirmed this point in a debate in January 1993 when he said "Tracking and signalling will remain in public ownership, although in the long term privatisation of that is not ruled out."[16] The following month the commitment to eventual privatisation had hardened and the following paragraph appeared in another consultation document:[17]

> "2.1 Railtrack will be the owner and manager of railway infrastructure. It will for the present be in the public sector. But from the outset Railtrack will be independent of British Rail. In the longer term, the Government wishes to see the private sector owning as much as possible of the railway, and in the Railways Bill is seeking powers to allow the future privatisation of all infrastructure currently owned by British Rail."

There was no specific mention of Railtrack in the *Railways Bill* although by implication it is covered by Part II of the Bill which enables the Secretary of State to restructure BR as he thinks best. Nor did Railtrack feature much in debate in Committee although it was referred to from time to time. For example, clause 103 (later section 113) specifically stated that the principal objective of the Secretary of State was to ensure railway services were performed by the private sector. Reference was made to Railtrack and Roger Freeman said:[18]

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15 Department of Transport consultation document *Franchising* October 1992

16 HC Deb 12.1.93 c. 790

17 Department of Transport consultation document *Gaining Access to the Railway Network* February 1993

18 Standing Committee B 16.3.93 c.783

> "Finally, on infrastructure, Railtrack will initially be in the public sector, supported by the Government through capital financing and seeking to cover its revenue costs through revenue charges. We hope that ultimately the infrastructure itself can be transferred to the private sector, but I cannot forecast when that will be. It will be subject to substantial regulation. Bearing in mind the experience in the United States where, subject to regulation, utilities can be passed from the public to the private sector, I hope that we can follow suit."

The Bill was eventually passed on 4 November 1993 and received Royal Assent the following day. No further legislation is needed to sell Railtrack to the private sector.

Initially the intention seems to have been to adopt a gradualist approach to the privatisation of Railtrack. The track authority was to earn a commercial return on its assets by charging for line use. At the time the chairman, Mr. Horton, emphasised the importance of greater freedom from Treasury constraints on capital spending. The new company intended to attract private capital and to behave as far as possible like "a commercially driven plc."[19] The privatisation of Railtrack seemed to be a longer term objective although the Government's intention was always that Railtrack should be profitable and so a suitable candidate for privatisation.

By May 1994, there was talk of Railtrack being privatised "before the next election"[20] but following the signallers' strike, public mention of the idea rather disappeared.[21] However at the Conservative Party Conference in 1994, Dr. Mawhinney was saying:

> "Our country needs a modern and efficient railway. We will get it by privatising Railtrack, franchising services and selling other parts of British Rail."

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19 *Financial Times* 7.10.93 "Station plan may affect rail sell-off"

20 *Financial Times* 23.5.94 "Sale of Railtrack may raise £3.5bn before next election"

21 *Financial Times* 6.8.94 "A funny way to run a railway"
Times 10.8.94 "Signallers' strikes derail flawed privatisation plans"

Dr. Mawhinney announced the next month that Railtrack would be privatised "within the lifetime of this Parliament" on the grounds that it would offer:[22]

> "the best future for Railtrack, for passengers and freight and for train operators. It will allow greater use of private sector skills in managing the network, improving Railtrack stations, delivering efficient track maintenance and encouraging investment in the upgrading of railway lines. It will provide even greater scope for private capital to be injected into better facilities."

On 11 October 1995 Sir George Young, the present Transport Secretary, confirmed Railtrack would be floated in Spring 1996.

The cost of preparing for rail privatisation was given in a series of PQs at the end of 1995: [23]

£ million

	1991-92	1992-93	1993-94	1994-95	1995-96[1]	1996-97[1]
Dept of Transport	1.0	6.7	13.5	14.2	24.6	5.3
BR			92.4	85.0[2]		
Railtrack				46.0	30.0	
OPRAF			2.4	16.6	11.0	10.0
Rail Regulator			1.4	9.0	10.0	7.0

[1] *estimated figures. Excludes the main sale costs for the flotation of Railtrack*
[2] *estimated cost to 30 September 1995*

Payments made to consultants by the Department totalled £35.4 million at 22 November 1995.[24]

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22 HC Deb 24.11.94 c. 729

23 PQ HC Deb 30.10.95 cc 33-4W; PQ HC Deb 22.11.95 cc 141-3W

24 PQ HC Deb 22.11.95 c. 142

B. The Opposition Parties

1. The Labour Party

The Labour Party is opposed to the privatisation of the railways including the sale of Railtrack and has campaigned to prevent it happening. It wants to see a "publicly owned and publicly accountable" railway but is not prepared to promise large sums of money to buy back the company once it has been sold. A Labour Government will aim to create a "cohesive and responsible public railway service." This will involve three instruments of control- regulation, subsidy and a gradual increase in public ownership.[25] The Labour Party's policy towards Railtrack had to be included in the prospectus for the privatisation and the Shadow Transport Secretary, Clare Short, set it out in a speech on 29 March:[26]

> "Our starting point in looking at Railtrack's future is how best we can meet the country's transport needs and how we can achieve less reliance on the roads. We believe privatisation is incompatible with the transport strategy the country needs.
>
> The Government's privatisation of the railways is unique:
>
> • it involves a continuing commitment to provide high levels of public subsidy
> • and extensive regulatory powers over the privatised companies
>
> I want to make it clear today that we will use those powers and take additional ones to achieve our objectives.
>
> Specifically, should the flotation of Railtrack PLC proceed, the incoming Labour Government will make good its commitment to a publicly owned and publicly accountable railway by taking the following steps:
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> 1) through regulation, it will seek an integrated railway system. It will amend the Railways Act 1993 to enhance the accountability of the Rail Regulator to the Secretary of State; strengthen the powers of the Regulator to ensure that the system and its assets are managed efficiently in the public interest; and take measures to ensure the public get the best value for money from the public subsidies going to the railways including in particular fair access charges to encourage the more intensive use of the track; and ensuring the proceeds from investment in property development are re-invested in the railway system.

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[25] *Financial Times* 12.4.96 "A better route for Railtrack" by Clare Short MP

[26] Labour Party press notice 29 March 1996

2) reconstitute British Rail as a fully publicly owned, publicly accountable company holding the public's interest in the rail network and charged with encouraging and fostering partnership between public and private finance in the rail network on a long term basis to secure future investment; and

3) dependent on the availability of resources, and as priorities allow, seek by appropriate means, to extend public ownership and control over Railtrack.

On coming to office Labour will therefore set in place a structured programme to return the railway system to an integrated whole. Every step in the programme will be led by the need to mobilise higher levels of investment in order to secure more intensive use of rail.

Labour is confident that its programme for rail can be carried through using the power to regulate, the power of the public subsidy and the power to acquire ownership. We do not believe that the public will or should be willing to continue to provide an annual input of public funds of as much as £2 billion without proper public accountability, and a fair return on public investment.

Potential investors in Railtrack should be aware that a future Labour government will pursue its public interest objectives for the railway by the use of existing mechanisms in the regulatory and contractual arrangements which presently apply to Railtrack. I am today spelling out in some detail Labour's approach to the regulatory regime. I do so in order that institutions contemplating investment in Railtrack can be absolutely clear about Labour's intentions and make their judgements accordingly.

The regulatory arrangements that are already in place give the Rail Regulator considerable powers to secure changes to the regime as it applies to Railtrack, if necessary against Railtrack's wishes. Those changes may be made so as to alter Railtrack's obligations and thus its priorities, in order to achieve the objectives of the public interest.

The powers of the Rail Regulator are central to the achievement of the objectives of a Labour Government. The Regulator will be the immediate instrument of change. Some changes will require to be made in relation to the duties, control and accountability of the Rail Regulator. These changes will be made by primary legislation early in the life of the Labour Government. In legislative terms, the changes are very simple indeed. In political and economic terms, they will be very important. The effect of the changes will be that the Rail Regulator will be made answerable to the Secretary of State to a far greater extent than is now the case. The powers of the Secretary of State to remove the Regulator from office will also be widened.

The degree of control exercisable by the Secretary of State will not prejudice the ability of the Regulator to take a long-term view of the affairs of the company and the industry as a whole. However, matters of public policy are properly the concern of an elected government, and the relationship between the Secretary of State and the Regulator will be adjusted to reflect that fact. Once that has happened, the new Labour government will have at its disposal substantial instruments for achieving its policy objectives for Railtrack.

These include the direction of Railtrack's investment spending, controls on its access charges, restrictions on disposals of its valuable land assets and the clawback of substantially all of its property disposal income. The powers will also be used to make Railtrack far more responsive to its dependent users including in matters of safety. They will be used to review - and if necessary alter - the economic arrangements which impose financial penalties on Railtrack for delays and cancellations, and in other areas. These are things which are at the heart of Railtrack's business. They may change substantially,

Railtrack's present obligations to invest in the network are not sufficient. The new Labour Government will impose a greater degree of regulatory control on how Railtrack spends the money it receives from train operators, which are themselves financed by the taxpayer through the Franchising Director's budget.

The existing power of the Regulator would enable the following to be done:

- First, an appropriate amendment of Railtrack's network licence will be made to ensure that Railtrack carries out the investment assumptions made by the Regulator when setting track and station access charges. That obligation will be enforceable by the Regulator.

- Second, train operators will be encouraged to apply for changes to their track access contracts in order to impose on Railtrack contractually enforceable investment obligations. The Regulator will give the appropriate signals to train operators in relation to his willingness to approve the necessary changes. Under the existing mechanisms for amending track access contracts, these are changes which can be made against Railtrack's will.

- Third, changes will be made to the Access Conditions for track, stations and depots in order to impose on Railtrack greater obligations to invest in the railway assets of which it is custodian. Adjustments will also be made to the right of Railtrack to require those wishing to promote alterations of the network, stations and depots to make payments to Railtrack. These rule changes will be made using the existing powers of the Regulator unilaterally to effect changes.

- Fourth, the right of Railtrack to block changes which are in the interests of the industry and the public as a whole will be severely curtailed. Its right to retain extra profits from these changes will also be constrained to a significant extent.

There is no question of existing contracts being cancelled *against the wishes of the parties to them*. Rather, the mechanisms which the existing contracts *already provide for* will be used to their full potential.

The exercise of these powers will not involve the expenditure of public money-indeed transaction costs will be reduced as the fragmented industry is brought back together."

2. The Liberal Democrats

In March 1996 the Liberal Democrats issued the document, *Railtrack: a National Asset*, which reaffirms the Party's policy that the rail network should remain in public control within an integrated national transport system and proposes that fresh guidelines be given to the Rail Regulator. It also proposes that "Having put in place the new regulatory system we will then move to make an offer to take controlling interest in the company, at a price no greater than that at which the shares were issued." The document also includes policies to allow franchises to manage track, signalling and stations provided they commit to renewing their assets and to enable the contractors maintaining the railway to have their contracts supervised by the TOCs. It also proposes that Railtrack, the Franchising Director and British Rail should be combined into one body to own the freehold of the railway infrastructure, to procure services and investment and to plan the railway contribution to integrated transport and land use strategies.

C. The Flotation

1. The Pathfinder Prospectus

The 250 page pathfinder prospectus was issued to financial institutions on 15 April 1996 and gave more definite information about the future company after privatisation.

* The Government will sell virtually all the shares in Railtrack. It will retain a few for stabilising the market immediately after the company goes public but it will not retain a golden share as it believes its influence is preserved in the company's licence conditions.

* The UK public offer is expected to represent not less than 30 per cent of the shares sold, but this could be increased depending on demand.

* Private investors will buy their shares at a discount to the offer to institutions although the size of the discount will not be known until 1 May. An initial investment of 190p in a minimum of 200 shares will be needed. Those who have registered with a share shop will be given preference over those who have not registered. Additional incentives include either a 15p discount off the share price up to a maximum of 800 shares provided they are held until the second instalment is paid, or one free bonus share for every 15 bought and held until 31 May 1999 up to a maximum of 1,200 shares (ie 80 bonus shares).

* Shareholders on the register in September 1996 will receive a total of about £69 million in dividends. This will be paid out of last year's profits when the company was still in public ownership. This and the other incentives make the first year yield on the partly paid shares close to 20 per cent.

* There is no conventional share option scheme for senior executives but they could receive an annual bonus of up to 40 per cent of their salaries if they meet individual and corporate performance targets. Under a complex scheme referred to as the Railtrack Deferred Bonus Performance Plan directors can invest half this sum, ie 20 per cent, in shares for three years which could increased by 250 per cent if annual earnings per share rise 12.5 per cent

or more. If other financial performance targets are met the amount could be increased a further twofold, theoretically almost doubling directors' salaries.

* The prospectus indicates that the company can generate an average of £200 million a year in property income over the next five years before the regulator's income-sharing regime (requiring 25 per cent of income to be handed to the train operators) takes effect. This means Railtrack will be able to keep the proceeds of most property development with only a very large development pushing it above the threshold.

* According to the prospectus Railtrack had outstanding borrowing or indebtedness of £594 million on 31 March 1996. This comprised unsecured debentures of £585 million together with obligations under finance leases and hire purchase contracts of £9 million. Prior to this Railtrack owed £1.2 billion to the National Loans Fund, £0.2 billion to PTEs and had loans under finance leases and HP contracts of £9 million. The NLF loan was cancelled on the 29 March and the PTE loans were transferred to a company wholly owned by HM Government on the 31 March. In exchange Railtrack issued the debentures to the Treasury. It would therefore appear that the Government has written off about £874 million of Railtrack's debt. The government's intention is to sell the bonds by the end of 1996.

* Assuming these changes had taken place, the net assets shown on 30 September 1995 as £1,601 million would be revalued at £2,445 million.

2. Some dates

14 March 1994	Dewe Rogerson appointed marketing advisers for the flotation.
8 August 1994	WRCS (Wight Collins Rutherford Scott) appointed advertising agency.
23 December 1994	SBC Warburg confirmed as global coordinator for the sale.
25 September 1995	Railtrack employee share offers announced to include free shares worth approximately £160 for each eligible Railtrack employee, plus a further £2 worth of shares for each year of continuous service in the

rail industry. Details were later given in answer to a PQ (HC Deb 24.10.95 c. 581W):

> **Mr. Watts:** My right hon. Friend announced on 25 September the Railtrack employee share offers as part of the intended stock market flotation of Railtrack. The offers include:
>
> free shares for each eligible Railtrack employee worth approximately £160 at the offer price plus a further £2 worth of shares for each year of continuous service in the rail industry;
>
> a matching offer of two free shares for every one purchased by eligible Railtrack employees up to a maximum value of approximately £250— that is, free shares of up to approximately £500;
>
> discount of 20 per cent. for eligible Railtrack employees on up to approximately £1,400 worth of shares at the offer price-— that is, a discount of up to £280;
>
> priority over shares offered to the public to the value of approximately £18,000 at the offer price, including the shares purchased through the discount offer.
>
> The priority offer, excluding the discount element, will also be offered to Railtrack pensioners.
>
> It is too early to say how many shares will be issued or what the total value will be or how many employees and directors will be eligible. This will depend on the share price, the level of take-up and the number of eligible employees and directors at the time.
>
> There will be no share options for Railtrack directors.

11 October 1995 — The Secretary of State for Transport confirmed Railtrack would be floated in the Spring.

3 January 1996 — It was announced the flotation would be in May. In answer to a PQ Mr. Watts said the Government expected to offer at least 51% of the equity in Railtrack. The UK public offer is expected to represent not less than 30 per cent of the shares available in the offer with the

	possibility of this amount being increased in the event of a strong retail demand. (HC Deb 9.1.96 c.29W)
20 January 1996	Report that the Rail Regulator has agreed Railtrack should keep 75 per cent of its property profits. The train operating companies will receive the remaining 25 per cent of profits in the form of a rebate on their track access charges.[27]
31 January 1996	Merrill Lynch and UBS appointed to work alongside SBC Warburg as global managers to market shares to institutional investors.
21 February 1996	Six investment banks named to act as co-managers for the issue - Credit Lyonnais, Robert Fleming, James Capel (part of the HSBC Group), Nikko, Schroder Wertheim and WestLB. These six will not be able to market the shares worldwide.
15 March 1996	Report that Railtrack is close to finalising a loan facility of £2-2.5 billion to finance its long term major projects. It is likely to be for 5 years.[28] In February the Government said Railtrack would take on construction costs of the £650 million Thameslink 2000 project. It also faces the cost of upgrading the West Coast line.
26 March 1996	Advertising campaign, devised by agency WRCS, launched. Individuals can register.
15 April 1996	Pathfinder prospectus issued to financial institutions.
1 May 1996	Prospectus published with the anticipated range of the issue price.
20 May 1996	Dealing starts.

[27] *Financial Times* 20.1.96 "Property profits will be split"

[28] *Financial Times* 15.3.96 "Railtrack close to loan financing deal"

IV Conclusion

Railtrack plays a central role in the restructured railway industry as the owner of substantially all the rail infrastructure in the country. Rail travel only represents about 5 per cent of the transport market but this could increase with more efficient and technological management of the service, an increasing environmental awareness of the costs of road transport and a reduction in government expenditure on the roads.

The railway as a whole is loss making and depends on subsidies paid by the Franchising Director to the train operating companies. These are set by the Regulator who under the present legislation has considerable independence of government. There are four ways in which Railtrack could increase profits: from job cuts; from greater efficiency as its new investment is agreed, for example in signalling where the number of boxes will be reduced; from cost savings each time a repair or renewal contract comes up for renegotiation (the theory is that maintenance will be contracted out to private companies which will compete with each other and so force down prices); and through increased use of the railways. However any increase in the use of rail is unlikely to benefit Railtrack as the train operators have considerable spare capacity before they will require any additional expansion of the network.

The success or otherwise of the sale of Railtrack to the private sector will largely depend on the views taken by the stockbrokers and financial advisers. It will be sold as a utility stock with more opportunities for cost cutting and little scope for increasing revenue. Investors may be concerned at the lack of a performance record and the newness of the system in which it will be operating as well as the political uncertainties.

V Further Reading

Debates in the House of Commons since April 1992:

1. Debate on privatisation, HC Deb 11.5.92 cc 374-466
2. Debate on the white paper, HC Deb 29.10.92 cc 1162-1238
3. Debate on privatisation of the railways, HC Deb 12.1.93 cc 771-869
4. Debate on Second Reading of the Railways Bill, HC Deb 2.2.93 cc 154-279
5. Debate on through ticketing, HC Deb 18.1.95 cc 715-790
6. Debate on passenger services under rail privatisation, HC Deb 7.2.95 cc 201-253
7. Debate on the Metropolitan Railway Grant, HC Deb 18.7.95 cc 1493-1512
8. Debate on rail privatisation HC Deb 18.10.95 cc 358-412
9. Debate on Railtrack HC Deb 17.4.96 cc 720-816

Official papers and reports:

1. *New Opportunities for Railways* Cm 2102 - July 1992
2. Department of Transport *Gaining Access to the Railway Network* February 1993
3. Transport Select Committee *The Future of the Railways in the Light of the Government's White Paper Proposals* April 1993 HC 246 1992/93
4. Department of Transport *Britain's Railways: A New Era* March 1994
5. Railtrack *Track Access Charges* April 1994

6. Office of the Rail Regulator *Railtrack's Track Access Charges for Franchised Passenger Services: Developing the Structure of Charges* November 1994

7. Office of the Rail Regulator *Criteria and Procedures for the Approval of Freight Track Access Agreements* December 1994

8. Statement by Dr. Mawhinney on the future of Railtrack HC Deb 24.11.94 cc 729-739

9. Office of the Rail Regulator *Railtrack's Access Charges for Franchised Passenger Services: The Future Level of Charges* January 1995

10. Office of the Rail Regulator *Framework for the Approval of Railtrack's Access charges for Freight Services* February 1995

11. Office of the Rail Regulator *Criteria for the Approval of Passenger Track Access Agreements* 2nd edition March 1995

12. Transport Committee *Railway Finances* 5.7.95 - HC 206-I,II, 1994/95

13. Transport Committee *Government's Observations on the Fourth Report of the Committee* 29.11.95 - HC 71, 1995/96

14. Department of Transport *Annual Report 1995* p. 21

15. Office of the Rail Regulator *Annual Report 1994/95*

16. Railtrack *Annual Report 1994/95*

Pamphlet and periodical articles since 1994:

1. *Economic Affairs* February 1994 "Rail privatisation: a platform for success"

2. Ed. Prof. Beesley *Regulation Utilities: The Way Forward,* IEA 1994 Ch 7 "The regulation of Britain's privatised railways"

3. Christopher Foster *The Economics of Rail Privatisation* Centre for the Study of Regulated Industries April 1994

4. *Modern Railways* April 1994 "Train and track costs will double BR subsidy"

5. *Rail Privatisation News* 1995

6. *The House Magazine* 10 April 1995 "Full steam ahead" by Robert Horton

7. *Accountancy Age* 8 June 1995 "Signals stay at Danger"

8. *Accountancy Age* 8 February 1996 "Off the Rails"

9. *Investors Chronicle* 9 February 1996 "Ticket to Ride, Price Unknown"

Recent papers on related subjects have been:

Transport

96/37	London Regional Transport Bill [Bill 68 of 1995/96]	08.03.96
96/21	Rail Passenger Franchises	06.02.96
95/96	Rail Privatisation: a Progress Report	06.09.95
95/2	Channel Tunnel Rail Link Bill [Bill 3 of 1994/95]	10.01.95