The ROSCO racket:

Why it's time to take control of UK rolling stock

An RMT Report

Introduction: the ROSCOs' record of failure

87% of the rolling stock on Britain's railways is owned by three companies, known as the ROSCOs (Rolling Stock Companies). When British Rail was privatised in 1993, these three companies were formed by the Conservative government and handed BR's stock of 11,250 vehicles, assets which had been funded by public investment. The ROSCOs then leased their vehicles to the train operating companies (TOCs) who controlled the franchises. The theory was that they would generate competition and mobilise private sector expertise and capital to drive innovation. In fact they have largely failed to do this.

The high costs of rolling stock investment, the absence of surplus vehicles on privatisation and the fact that vehicles are rarely easily interchangeable between different parts of the railway meant that the three ROSCOs gained and have maintained a largely unassailable position, carving up the market in leasing to the TOCs between them. In addition, the leasing model that the ROSCOs were handed at privatisation effectively deters them from investing in new rolling stock in a sustained way. On privatisation, the ROSCOs were set up to offer operating leases rather than finance leases. This meant that the ROSCOs continued to own the asset at the end of the lease and remained responsible for ensuring that the asset was capable of being re-leased. The ROSCOs' assets have a life of around 30 years, while the franchises which lease them are generally between 5 and 10 years in length. The ROSCOs have an interest in maintaining the life of their asset for as long as possible. The TOCs invest little capital and with the length of their franchises give them little incentive to commission new rolling stock. Consequently, as the as the Office for Road and Rail (ORR) acknowledged, the ROSCOs 'rarely engage in genuinely speculative new build'.[1]

The consequence of this model of rolling stock provision is that three companies operate an effective monopoly of leasing to the Train Operating Companies while neither party has much incentive to invest in new rolling stock. For the ROSCOs, the nightmare scenario is being left with surplus stock off-lease, especially if these are assets which have plenty of operating years left. As Mary Grant, CEO of Porterbrook said in 2018, investment in new trains 'will create a form of surplus in the short term . . . The model is not sustainable if there is a continuous cycle of a new train comes in and seven years later it might be displaced.'[2] For rail passengers this has meant that the average age of rolling stock has risen since privatisation, while high leasing costs are passed onto the

[1] *The leasing of rolling stock for franchised passenger services: ORR's reasons for making a market investigation reference to the competition commission*, Office of Rail Regulation, 26 April 2007, pp. 73-74, https://orr.gov.uk/__data/assets/pdf_file/0011/2027/325.pdf

[2] https://www.ft.com/content/be2c0598-9bec-11e8-9702-5946bae86e6d

taxpayer through the subsidies demanded by TOCs as compensation and onto passengers through higher fares.[3]

The problems with the rolling stock market are well understood by government, civil servants and the wider industry. In 2006, the Department for Transport, under a Labour government, made a complaint to the Office of Rail Regulation (ORR) alleging that the rolling stock market prevented or restricted competition. The ORR then referred a case to the Competition Commission, which concluded that while there were problems, these could be accommodated by minor tweaks to the system. The Labour government was disappointed in this response and looked to cut through the problems through a series of procurements that largely by-passed the ROSCOs, putting together private sector consortia to finance, with government backing, the manufacture of new rolling stock for InterCity and Thameslink. These investments were picked up and continued by the Conservative administrations after 2010. As the Permanent Secretary at the Department of Transport told the Public Accounts Committee recently, 'we are likely to get better results than …. asking three companies with different owners, objectives and agendas to co-operate to buy £2.5 billion-worth of trains. Above all, I am concerned about delivery driving value for passengers and taxpayers, and adopting such a hypothetical alternative appears to be a sure recipe for non-delivery. Those companies have different objectives, and the franchises typically last for seven years, and in some cases a bit longer. The trains, assets and services will be there for a generation—25 or 30 years.'[4]

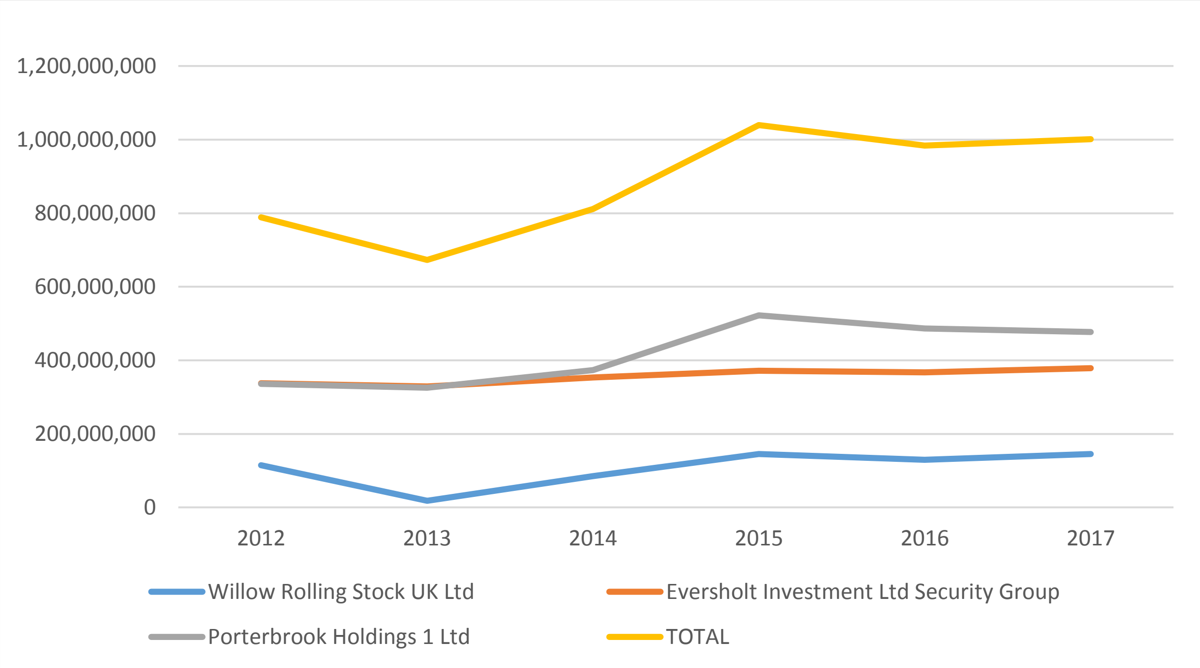
Yet these government attempts to circumvent the ROSCOs themselves involve complex PFI schemes that hand publicly backed assets to private investors and which have been critically scrutinised by the National Audit Office. Worst of all, they leave the ROSCOs firmly in place. In summary, for all the growing understanding that the market for the provision of rolling stock is failing, little has changed since 2011.

- ROSCO revenues have risen steadily since 2012, from around £800 million in 2012 to around £1 billion in 2017 (Figure1). The average industry revenue per year is £880 million.
- Department for Transport (DfT) data shows that the average age of rolling stock on the railways has risen since privatisation, from 16 years in the last year before privatisation to almost 20 years in 2017/18.[5]

[3] *The leasing of rolling stock for franchised passenger services: ORR's reasons for making a market investigation reference to the competition commission*, Office of Rail Regulation, 26 April 2007, pp. 73-74.
[4] Philip Rutnam, Permanent Secretary, Department for Transport, evidence to Public Accounts Committee: Procuring new trains, HC 674, Monday 13 October 2014, (http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/procuring-new-trains/oral/14576.html)
[5] http://dataportal.orr.gov.uk/displayreport/html/html/ab2f70d4-d415-4dea-b8ea-bf9925011260

- The ROSCOs still own 87% of the existing fleet on the network.[6]
- Both the absolute amount and the proportion of expenditure that train operating companies devote to rolling stock charges have steadily increased since 2013, rising by 24% from 12% to 15.5% in 2018 (see Appendix I).

Figure 1: ROSCO Revenues, 2012-18 (£)



Now, RMT research can reveal some of the cost of that inaction:

- Between 2012 and 2018, the ROSCOs passed on a total of **£1.2 billion** to their parent companies or owners in the form of dividend payments. To put that in context, three companies paid out the same amount as all the Train Operating Companies managed across 20 franchises over a five year period between 2012 and 2017.
- This is likely to be only part of the value they extract as the ROSCOs also use internal group financing and complex group structures to funnel money up towards shareholders in the form of interest payments to overseas parent companies.
- The ROSCOs are now owned by a group of investment vehicles associated with financial services companies or profiting from the global market in privatised infrastructure assets.
- The ROSCOs also use complex group structures involving intermediaries in low tax regimes like Luxembourg and tax havens like the Cayman Islands. At least one of the ROSCOs

[6] *Long-Term Passenger Rolling Stock Strategy for the Rail Industry*, Sixth Edition, March 2018, p. 16.

owners, AMP Capital, features in the LuxLeaks from 2014, showing that in 2008 and 2009 they were using a web of Luxembourg-based companies to shuffle money up their ownership chain from their subsidiary company, Angel Trains, without paying tax.

Researching ROSCO profits:

RMT conducted an analysis of the company accounts of the ROSCOs since 2012. The ROSCOs all use multi-company group structures so the analysis was conducted using the accounts of the top company based in the UK. In the case of Porterbrook, this was Porterbrook Rail Finance Ltd, until the ownership of the group changed in 2014, whereupon a new group holding company was formed called Porterbrook Holdings I Ltd. For Angel trains, the main leasing company is Angel Trains Ltd, but the top accounting company in the UK is Willow Rolling Stock UK Ltd. The top UK company of the Eversholt Group is Eversholt investment Security Ltd.

Dividend payments:

The dividends which flow out of the ROSCOs are impressive. RMT analysis of dividend payments between 2012 and 2018 show that the ROSCO's passed on a total of £1.2 billion to their shareholders. To put that in context, these three companies paid dividends worth as much as all the dividend payments TOCs managed across more than 20 franchises over a five year period between 2012 and 2017.

Table1: ROSCO dividends 2012-2018

ROSCO	Dividends paid 2012-2018 (£)
Porterbrook	445,538,000
Angel	615,500,000
Eversholt	208,669,982
TOTAL	1,269,707,982

Source: company accounts for Willow Rolling Stock UK Ltd, Eversholt Investment Ltd Security Group, Porterbrook Rail Finance Ltd and Porterbrook Holdings I Ltd, between 2012 and 2018. Analysis by RMT.

These dividends represent a very high proportion of the profits being made. To see this, we need to look below the top accounting company at the leasing companies themselves. The accounts of

Angel's main leasing company, Angel Trains Ltd, show that on average the company passed on around 100% of its gross profits in dividends to its parent company.

Table 2: Dividends as a percentage of profits

Angel Trains Ltd	£m						
	2012	2013	2014	2015	2016	2017	2018	TOTAL/ AVERAGE
Revenue	340.7	336.2	349.3	276.0	448.7	392.0	421.1	2,564.0
Gross profit	167.8	162.0	163.8	133.2	223.7	191.5	224.2	1,266.2
Dividends	859.6	18.0	85.0	60.0	95.0	65.3	147.0	1,329.9
Dividends as % of gross profit	512%	11%	52%	45%	42%	34%	66%	105%

Source: Company accounts for Angel Trains Ltd between 2012 and 2018. Analysis by RMT.

This high ratio of dividends to profits reinforces the point that the ROSCO's have a problem claiming that they are major investors in UK rolling stock. In fact, as we saw above, the lack of investment in new rolling stock has driven government toward direct procurement using private finance. As the rail industry's *Long-Term Passenger Rolling Stock Strategy* document states, of the 7817 vehicles committed for delivery throughout Control Periods (CPs) 5 and 6, more than 5,000, or 71%, will be financed by parties other than the three ROSCOs. That means that of the almost 8000 new vehicles being introduced to the network in over the course of CPs 5 and 6, only around 2000 will be financed by the ROSCOs.[7]

The dividend payments the ROSCOs have made to their overseas parent companies between 2012 and 2018 would have financed the capital costs for a further 700 vehicles. For scale, this is more than enough to fund the demand for rolling stock on High Speed 2 over Control Period 7. But the dividend payments are only part of the story.[8]

[7] *Long-Term Passenger Rolling Stock Strategy for the Rail Industry*, Sixth Edition, March 2018, p. 28.
[8] Capital costs for vehicles have been calculated using the figures in *the Long-Term Passenger Rolling Stock Strategy*, which state that the 7187 new vehicles being introduced in CPs 5 and 6 will have a capital cost of £13.8 billion. See p. 28.

Interest on intra-group lending:

Besides the dividend payments they make, the ROSCOs have other ways of extracting value from their operations. The company groups are set up to allow complex webs of inter-group lending and finance which are very hard to unpick. Each ROSCO has its own investment vehicle, for example and much of their past borrowing from banks was from the same banks that owned them. However, we can get some idea of the role that intra-group finance plays and the kind of flows of money that take place by looking at the interest payments made by Eversholt Investment Ltd Security Group to a loan from its parent in Luxembourg. Between 2012 and 2018, interest payments on this loan amounted to almost £328 million, more than its dividend payments over the same period and enough to finance the capital costs for 172 new vehicles.

Table 3: Interest on intra-group loans, Eversholt Group

Interest on intergroup loan from parent company Eversholt UK Rails Ltd/Eversholt Investment Group (SARL)	
2012	£55,432,563
2013	£53,029,059
2014	£49,773,000
2015	£23,749,000
2016	£50,085,000
2017	£48,023,000
2018	£47,891,000
Total	£327,982,622

Source: Company accounts for Eversholt Investment Ltd Security Group. Analysis by RMT

Most of the details of interest payments on intra-group loans are concealed within company accounts and consolidated group financial statements, so we will probably never know the true scale of the value extraction which has taken place under the rule of the ROSCOs.

Where does the money go? Global infrastructure fund ownership and low tax regimes:

After having changed hands several times, the three ROSCOs are now owned by large asset management funds working for investment banks and institutional investors focused on the market in infrastructure such as ports, toll roads, airports, water and electricity companies and rail. Porterbrook's owners are a consortium of investment funds which includes Allianz Capital, the private equity arm of German financial services giant, Allianz Group, specialist infrastructure investment funds like the Utilities Trust of Australia and the Alberta Investment Management Corporation which is the investment arm of Canadian pension and endowment funds. Angel is majority owned by AMP Capital, the investment arm of Australian financial services conglomerate AMP Group. Eversholt is owned by CK Hutchison Holdings Ltd, a multinational infrastructure investment conglomerate. [9]

Infrastructure investments are attractive to these funds because they tend to be characterised by low investment costs, predictable income, low exposure to economic cycles or market volatility and high barriers to market entry that prevent competition and allow the companies to raise prices over time. In other words, they are reliable sources of income based on services that people will always need which are relatively easy to monopolise. From this perspective, the ROSCOs fit the bill perfectly.[10]

Table 4: The ROSCOs' overseas parent companies

Rosco	Major shareholder	Registered	Ultimate Parent
Porterbrook	Allianz Infrastructure Luxembourg I	Luxembourg	Allianz Capital Partners, the investment of arm of Allianz Group, the German multinational insurance and financial services giant.
	PIP4 Thomas LP on behalf of AIMCo	Canada	AIMco is the Alberta Investment Management Corporation which is an investment vehicle for Alberta pension funds and endowments.

[9] https://www.railwaygazette.com/news/business/single-view/view/amp-capital-takes-majority-stake-in-angel-trains.html; https://www.railwaygazette.com/news/business/single-view/view/consortium-agrees-to-buy-porterbrook.html;

[10] See, for example, https://www.ftadviser.com/2013/02/28/investments/alternative-investments/what-sets-infrastructure-funds-apart-8Glwzs5LZ1uI7d9IlmzhPI/article.html. See also, Dexter Whitfield, *Global Auction of Public Assets: Public Sector Alternatives to the infrastructure market and PPPs* (Spokesman, Nottingham, 2010), pp. 91-97.

	Utilities Trust of Australia International Pty Ltd	Australia	Utilities Trust of Australia (UTA) was set up as an infrastructure investment fund by Hastings Funds Management, now Vantage Infrastructure. In 2018, UTA appointed New Zealand based infrastructure investment fund Morrison and Co to manage their investments, including Porterbrook.
Angel Trains (Willow Topco Ltd – registered in Jersey)	AMP Capital Investors (Angel Trains Topco) S.a.r.l	Luxembourg	AMP Capital Investors owns 65% of Angel Trains. AMP Capital Investors is part of AMP Capital, an investment arm of the Australian financial services firm AMP Group Ltd. AMP Capital also has a minority holding from the banking arm of Mitsubishi.
Eversholt Investment Ltd Security Group	UK Rails S.a.r.l.	Luxembourg	UK Rails S.a.r.l. is jointly owned by CK Infrastructure Holdings Limited and CK Hutchison Holdings Limited, which is registered in the Cayman Islands.

As Table 4 shows, the ROSCOs and their owners also make use of a number of companies based in Luxembourg. As research from the International Consortium of Investigative Journalists showed in 2014, many large firms use affiliate companies based in Luxembourg to move money around their groups without paying tax. These Luxembourg companies become lending agents within the Group, issuing loans to subsidiaries based in countries where the business operations are taking place. These loans are then repaid to the Luxembourg-based companies which in turn shuffle the money between each other, incurring little or no tax while in Luxembourg, before being passed on as interest repayments to a parent based elsewhere, sometimes ultimately finishing up in tax havens like Jersey and the Cayman Islands.[11]

[11] For an explanation of how these tax schemes based in Luxembourg work, see the Guardian reports here: https://www.theguardian.com/business/2014/nov/05/-sp-luxembourg-tax-files-tax-avoidance-industrial-scale ; For the original document leaks, see the International Consortium of Investigative Journalists' website: https://www.icij.org/investigations/luxembourg-leaks/

The presence of companies based in Luxembourg, Jersey and the Cayman Islands and the knowledge that intra-group lending is taking place involving large amounts of money inevitably creates the suspicion that this is part of a tax strategy by the ROSCOs to supplement the dividends they are paying with loan repayments that pass through low tax regimes and into tax havens. This suspicion is given more weight by the fact that at least one ROSCO does appear to have been involved in such a scheme. The leaking of papers from a Pricewaterhousecooper (*Pwc*) employee in 2014 released hundreds of documents into the public domain containing details of many tax agreements in Luxembourg. Among them was a document showing that AMP Capital, who at that time owned a 37% stake in Angel Trains, were using a complex system of subsidiaries in Luxembourg in what looks like a form of tax avoidance.

The LuxLeaks documents showed AMP Capital Investors securing consent from the tax offices in the Grand Duchy of Luxembourg for a series of group structures in which the objective was to enable the passage of money up the ownership chain without paying tax. In Luxembourg, interest payments between companies are not taxed. Over 2008 and 2009, AMP Capital sought and secured agreement for the establishment and liquidation of a series of companies whose sole objective was to create a series of different kinds of loans through various intermediaries who ultimately lend on to Angel Trains companies. Interest payments from Angel companies are then passed through the various loans between the Luxembourg companies, incurring zero taxation in the process. In 2009, for example, AMP Capital Investors (REST European Investors) No. 2, lent £94 million to another Luxembourg subsidiary, AMP Capital Investors (REST European Investors) No. 3, which was then lent on in a series of debt tranches to Willow Topco, Angel Trains UK and Angel Trains EU. This debt incurred an interest rate of 1%, meaning that almost £1million in interest payments on these loans alone was also finding its way across the borders into Luxembourg every year, tax free. Other forms of lending between AMP's Angel investment subsidiaries are also visible, but the documents don't allow scrutiny at a sufficient level of detail. As we noted above, AMP now owns 65% of Angel and it still has companies registered in Luxembourg. It seems highly unlikely that AMP's value extraction and money-shuffling exercise has done anything but expand since 2010.[12]

[12] The documents can be searched here: https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/ and the files downloaded here: https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/ here: https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/ and here: https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/

Conclusion

We will probably never know exactly how much money the ROSCO's and their owners have made out of our privatised rail system. This report has aimed to shed a little light on what is a very opaque world of profit extraction. It is clear however, that very large fortunes are being made and sustained on the back of a mode of provision that is widely recognised to have failed. While franchise failure has rightly received much public attention, the demand for public ownership of our privatised railway must extend to taking control of our rolling stock and ending, once and for all, the ROSCOs' racket.

Appendix 1: Components of TOC expenditure

Table 1: Changes in nominal and relative values of components of TOC expenditure, 2013-2018

£m	2013/14	2014/15	2015/16	2016/17	2017/18
Staff costs	2,452.69	2,603.12	2,801.43	2,937.42	3,079.00
Rolling stock charges	1,268.52	1,329.14	1,419.39	1,815.52	1,990.00
Franchise payments to government	1,254.68	1,563.61	3,018.75	3,211.74	2,934.00
Corporation tax	63.63	66.90	80.75	67.14	53.00
Other including Network Rail charges	4,514.44	4,111.87	4,195.54	4,148.33	4,419.00
Franchised train operator expenditure	10,143.27	10,236.68	12,104.75	12,573.60	12,857.00
Staff costs as % of expenditure	24.2%	25.4%	23.1%	23.4%	23.9%
Rolling stock charges as % of expenditure	12.5%	13.0%	11.7%	14.4%	15.5%
Tax as % of expenditure	0.63%	0.65%	0.67%	0.53%	0.41%
NR charges as % of expenditure	45%	40%	35%	33%	34%
Franchise payments as a %	12%	15%	25%	26%	23%

Figure 2: Components of TOC expenditure in nominal values, 2013-2018

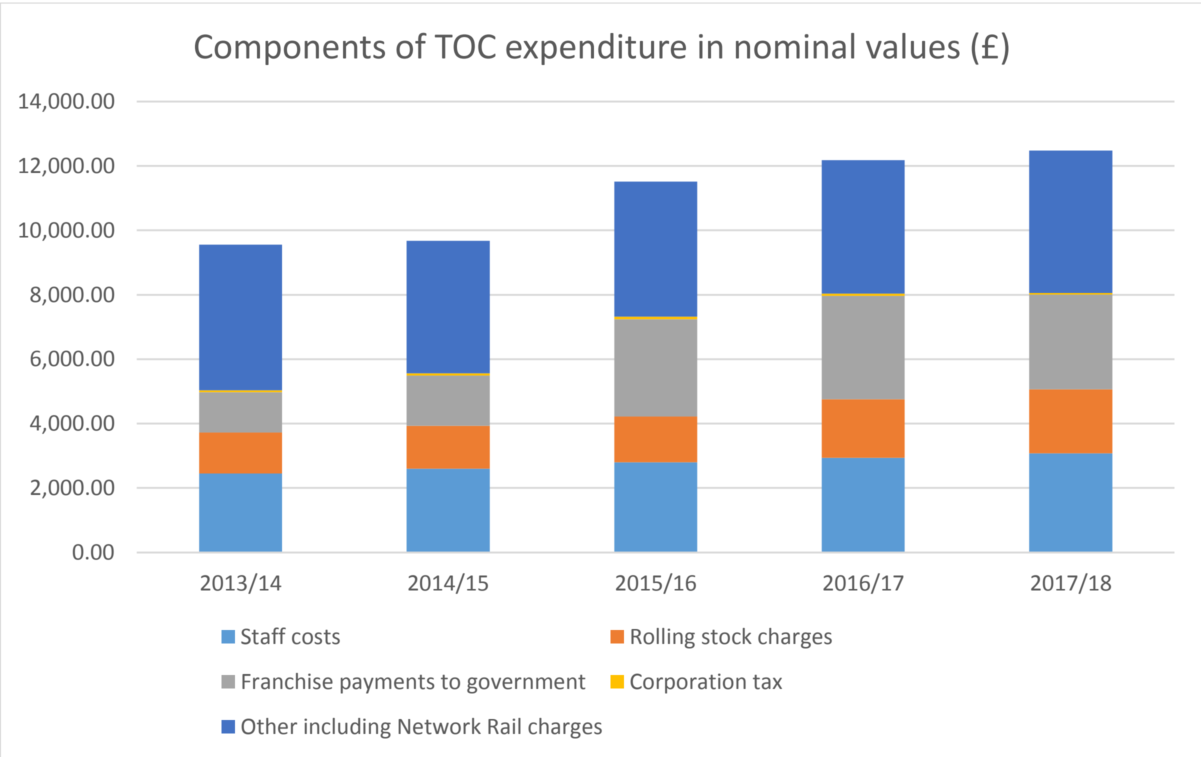


Figure 3: Components of TOC expenditure in percentage terms, 2013-2018