

# Britain's Railtrack: shareholders flex their muscles against government

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The High Court recently threw out the first ever class action suit, brought by 49,000 small shareholders and former employees in Railtrack, the failed corporation that used to own and operate Britain's privatised railway network, against the government.

The shareholders argued that the secretary of state for transport, Stephen Byers, had committed "misfeasance in public office," acted with "targeted malice" towards them and deliberately and dishonestly abused his powers with the express purpose of damaging their interests. This had impaired the value of their shares and the government had subsequently failed to pay proper compensation.

The shareholders claimed that the government had infringed their human rights when, in October 2001, it told Railtrack of its intention to refer the company to the High Court for a winding-up petition. They alleged that Byers had been planning to put Railtrack into administration for months as an alternative to paying an expensive compensation claim, while leading them to believe that he supported the financial restructuring plan being drawn up by Railtrack's advisors.

They sought additional compensation of £157 million from the government for refusing to continue to bail out Railtrack, pushing the company into administration, and then creating a new corporate entity, Network Rail, to own and operate the infrastructure. This compensation was over and above the £1.3 billion the government had paid to Railtrack's parent company and ultimately the shareholders in 2002 when it set up Network Rail.

Shareholders received about £2.50 per share from the government in compensation, but argued that they were entitled to £9 a share—the average share price over the previous three years. The government argued that it acted in the public interest by putting the interests of the travelling public and taxpayers above those of the shareholders. If the shareholders had suffered, it was because of the actions of the company's "remarkable history of mismanagement."

The High Court judge found that the shareholders had not shown that the transport secretary had deliberately engineered the company's bankruptcy to harm their interests or that he was a liar. The company's finances were a mess and it had "allowed the railways to become a complete shambles" and therefore the government had good public policy reasons for taking action against Railtrack. The decision meant that the shareholders must pay the government's legal costs of more than £2 million.

The record in fact shows that for four years the Labour government had bent over backwards to help Railtrack and had only acted against it when it became impossible not to do so.

The privatisation of the railways, one of the last and most unpopular acts of the Conservative government in 1996, was a massive financial gift to the City of London at public expense. The railways were split up into more than 100 companies. The infrastructure was split off from passenger and freight operations, whose franchisees would pay the infrastructure operator, Railtrack, to access the network. Never financially viable, the privatised train operators were given subsidies up to three times the level provided under the nationalised regime, most of which fed through to the train operators' shareholders and Railtrack.

While in opposition, Labour had verbally opposed privatisation. But once in power, it refused even to consider taking rail back into public ownership. Instead it proceeded to extend the privatisation of transport with its disastrous Public Private Partnership for National Air Traffic Services that went bust within three months and the ill-fated Public Private Partnership for London Underground.

As a sop to public opinion, it made a show of beefing up rail regulation by establishing the Strategic Rail Authority (SRA), whose top management were recruited from the privatised rail industry. The SRA failed so miserably that it was wound up earlier this year. It appointed a lawyer and friend of New Labour, Tom Winsor, as Rail Regulator, who claimed he could make the existing legal structures work to deliver an efficient railway.

However, fragmentation, outsourcing and subcontracting led to a rapid deterioration in both the infrastructure and passenger services, and a catastrophic decline in safety while the railway bosses grew rich at both passengers' and taxpayers' expense.

Railtrack became a byword for corporate greed and private sector incompetence. There was a public uproar in October 2000 after the fourth fatal crash in as many years directly attributable to Railtrack and its subcontractors' wilful neglect and incompetence, and the failure to heed the lessons of previous accidents.

In danger of breaching its statutory duty to provide a safe railway, Railtrack announced a £600 million programme of emergency track replacement and imposed, without any warning, speed restrictions that brought the railways to a virtual standstill in October 2000. It was forced to pay £591 million compensation to the train operators for late and cancelled services. The cost of the upgrade to the West Coast Main Line had spiralled out of control

from £2.5 billion to more than £10 billion. This resulted in the company announcing losses of £733 million for 2000/01 coupled with mounting debts and a funding gap of £5 billion for the period to 2006.

Railtrack was on the verge of collapse. Once again the government stepped in with a massive rescue package to fund one third of Railtrack's £15 billion investment programme, made extra cash available for the emergency repair programme and allowed track access charges to rise, necessitating further public subsidies and fare hikes.

Share prices rose 13 percent, but even this handout was not enough. The shareholders refused to stump up any cash to bail the company out and the railway bosses went back to the government with a begging bowl in spring 2001. Their financial difficulties notwithstanding, Railtrack announced dividend payouts of £124 million in May 2001 and £88 million in September 2001.

Within five years of privatisation, Railtrack had sacrificed the needs of a crucial industry to the requirements of its shareholders for dividends and run the rail network into the ground.

By the summer 2001, Railtrack had become an embarrassment for the Labour government and Byers began to cast around for a solution that would save it from criticism while maintaining its broader commitment to further privatisations.

Everything proceeded behind closed doors. No cabinet meeting ever discussed what should be done. Byers said the cabinet would "not necessarily have been informed if Railtrack's future was being discussed by [Prime Minister Tony] Blair and [Chancellor] Gordon Brown."

Blair essentially told Byers that he could do whatever he liked as long as he did not renationalise the railways.

The court proceedings showed that Railtrack was never financially viable and had cost the taxpayer more than £1 billion a year in indirect public subsidies and that the potential political fallout from this was the government's main concern.

Robinson told the court that he would never have taken the job four months before the corporation was put into administration if he had thought that the government would withdraw its financial support from Railtrack. Indeed, he continued, "it was a fundamental assumption that had been true since privatisation."

The government's lawyer in turn claimed that the company had threatened to put itself into administration in mid-September unless the government came up with £2.2 billion of extra funding, saying that the company's position was "we will die in front of your gates and our corpses will set up a most embarrassing stink."

At first, Whitehall officials thought they could get away with not paying compensation to the shareholders, arguing that Railtrack's debts made its shares all but worthless. Memos between civil servants and ministerial advisors referred dismissively to the small shareholders as "grannies" who would "lose their blouses." That did not matter, they said, since "they added no value to the company."

But the expropriation of the company was never an option for a government so totally dependent upon the support of big business as New Labour for its ongoing privatisation of public services. Financial institutions such as the pension funds traditionally depend upon the top 100 blue chip companies, including the

regulated private utilities, for a constant stream of dividends in order to make payments to pensioners. These major concerns owned three-quarters of Railtrack's shares, rather than small shareholders.

Byers had been forced to admit he had failed to tell the truth to a select committee of the House of Commons, an offence for which he could be suspended. He had told MPs he was "not aware" of discussions over a change in Railtrack's status before July 25, 2001. But documents showing that he had held discussions about a change in Railtrack's status as early as June 2001 contradicted his statement to MPs. He told the court he could not remember why he was untruthful to the Commons committee.

Written and unchallenged submissions from Rail Regulator Tom Winsor, now a partner in the law firm White & Chase, revealed that Byers admitted at a private House of Commons dinner that he had been prepared to pay Railtrack's shareholders £1 billion to "go quietly." In the end this had not been necessary as it had gone along with the government's proposals to ask for a winding-up order.

Winsor said that Byers had told him that Railtrack's bankruptcy was his idea. He also explained that Railtrack had the right to ask for a bailout from him rather than the Treasury, as the Rail Regulator was empowered under the 1993 Railways Act to keep the company afloat. He wrote in the *Financial Times* that "Railtrack's lifeline was protected by iron clad guarantees between the state and the private sector." In other words, the regulatory regime was there to protect the company—not the public—from a potentially rapacious private monopolist.

He complained that the government did not give him copies of the papers for the winding-up order until several days after the order was made. Emails from Treasury special advisors and civil servants spoke about a "Short Bill to take [the Regulator] out," thus "thwarting" the Regulator. Gordon Brown's special advisor, Shriti Vadera, described the Regulator as "a total wild card ... if he stands up and says he has a grand plan which would keep the company solvent, we are up the creek."

In the end, Railtrack saved the government from a political scandal by accepting the High Court's decision to wind up the company.

This time the High Court ruled in the government's favour, but the case sets a precedent for future class actions by shareholders, using the tort of malfeasance, to challenge the power of government to act in the broader public interest when it damages their interests.

The *Financial Times* expressed the hope that despite its failure, the case would deter any government from contemplating similar action in future. In other words, the financial elite is serving notice that it expects the government, if it is ever again confronted with the prospect of private providers of public utilities and services going under, will ensure that they are bailed out.



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