Pat Bowler

From: brian.roche@nz.pwc.com
Sent: Friday, 4 April 2008 10:11
To: djackson@tollnz.co.nz
Cc: Chris.Mackenzie@parliament.govt.nz; Pat Bowler
Subject: Re: FW: Requested mark up

Thanks David

Sorry I missed you yesterday but set out below is basically where we have got to.

Your marked up paper was really useful. The team has had the opportunity to review it and talk to Dr Cullen. He understood that the changes suggested by Toll were the sorts of issues which needed to be debated.

So the current position from our perspective is that we consider our response to your paper and meet with you later today. It may not take long but he wants to know/understand your response before he "triggers" our mandate to talk value. He also acknowledges your wish to get into the discussions on numbers - he is of the view that we should not do that until we have had the opportunity of discussing our response to your mark ups. I know that is not your preferred option but that's what Cabinet wanted.

Based on the discussion with him last evening he sees the process as follows:
- We (Chris Pat and myself) meet with you and or your representatives later today (there is a room available at the conference centre where I am meeting in Remuera);
- We report back to him so he can think about progress ;
- Subject to his views on progress, we would engage as soon as practicable next week on the number and process he has mandated;
- Meeting/discussions after that (potentially) with you and Paul to resolve any outstanding issues.

I recognise this is not your preferred process but, as I have said to you, getting a shared and agreed understanding on these issues is a "deal breaker" from our point of view. The scope of business and philosophy is absolutely fundamental to how the Crown view value - from our perspective value is not just the headline number, it's all the other factors which combine to create value and or cost. Irrespective of whether it has direct value impacts or not, the history of the relationship clearly demonstrates that a lack of clarity and understanding has merely confused, frustrated and added significant cost to the relationship. We need to avoid that.

Can you have a think about this and get back to Chris and or Pat - unfortunately I am in meetings until mid afternoon. If you are able to meet us this afternoon we will get you something in writing before then.

It would be very helpful if you were able to provide your response to the Toll action points agreed at our last meeting. (To assist on your action in relation to the process being followed for the separation of TTL , I suggest that Bruce Wattie and Pat meet with Grant and Greg on Monday. It would be good if you could confirm their availability).

Cheers

Brian

David Jackson <djackson@tollnz.co.nz>

03/04/2008 11:54

To Brian Roche/NZ/FAS/PwC@AsiaPac
cc Greg Steele <gsteele@tollnz.co.nz>, Grant Devonport <gdevonport@tollnz.co.nz>, John Ludeke (TOLL AU) <john_ludeke@toll.com.au>
Subject FW: Requested mark up

Brian,

Thank you for the meeting yesterday and the confirmation of the interim TAC arrangements.

Attached is our mark-up of the document as requested . As discussed yesterday, the issue around FCL services is fundamental to the retained business and we have attempted to arrive at a position that is consistent with the assumption around the value of the TTL business, enhance the industry in general and also deliver the governments objectives.

It is important to recap how an indicative value of $80 million was arrived at for TTL. On 23rd January we responded to William Peet, as to how the TTL business looks today and how it would look after transfer of both IMEX and CT terminals back into Rail. The assumed EBIT of the TTL business moved from around $13.4m to $9.3m. William Peet responded on 15th February that "...a business like TTL to sell for an EBIT multiple of 8- 12...on the information you have given us, the enterprise value of TTL could be around $80m".

It is our view that given both the strategic importance of the FCL business, and the impact to the earnings profile of TTL going forward, this could reduce the value of TTL by as much as $30 million. The contra is this value would then increase the future earnings of the Rail business, and we should expect to be paid for that increased value.

In closing, it is our intention now to enter into meaningful discussions around price. We have spent an enormous amount of time and effort in establishing the framework and general terms of an agreement which as it it stands today remains precariously placed given the significant distance the parties remain apart. It seems pointless and we are not prepared to waste anymore time on the general terms unless there is a clear indication the we both get to a commercial outcome that we can each live with.

Regards,

David.

[attachment "1 April 2008 The Rail Business.doc" deleted by Kate J Riley/NZ/FAS/PwC]

4 April 2008

The Rail Business

This document is intended to set out the basis on which TTL will be assured of ongoing customer relationships, rail service levels, rail rates and terminals, following completion. It is also intended to record the Crown's strategy for rail, and to confirm that the strategy is subject to change.

Section 1 contains a summary of the TTL business arrangements. Section 2 documents the arrangements in a form that can be included in the purchase and sale agreement that will facilitate the separation of TTL from the remainder of the rail business. Section 3 is the record of the Crown's strategy.

Section 1: Summary

Pre Signing

- There will be agreed lists of exclusive rail customers and exclusive TTL customers. A first draft is incorporated in section 2. There will be some customers who wish to contract with both RailCo and TTL.

Until December 2008

- RailCo will be locked out of all exclusive TTL business relationships, ie TTL own their agreed customer list and invoice those customers.

- Rail and TTL rates fixed except for FAF adjustments.

Until June 2009

- TTL will own all consolidation/deconsolidation, trucking not including rail, and warehousing business customers and will invoice those customers.

- RailCo is locked out of this business.

- TTL will be prohibited from transferring its customers from rail to road or using non-RailCo ships.

- TTL is RailCo's preferred partner unless a RailCo director determines that is not in RailCo's commercial interests.

- Rail service levels fixed in accordance with current TTL and third party [eg Mainfreight] service levels.

- TTL service levels to RailCo fixed at current levels.

- To recognise the preferred position provided to TTL by RailCo:

  - Toll cannot sell or assign these rights and obligations (apart from within Toll Holdings); and

  - RailCo will have pre-emptive rights if Toll sells TTL.

After June 2009

- Commercial and policy considerations will govern the relationships between TTL and RailCo.

Until June 2020

- Toll has terminal leases at agreed rates plus 3 yearly valuation adjustments.

Section 2: Documentation

1. Existing business will be split between TTL and the main rail business owned by Toll NZ Consolidated Ltd ("**RailCo**") by allocating the receivables, and liability to provide currently contracted services in a manner agreed by the parties. The Crown's suggestion is as follows:

RailCo Customers	TTL Customers
Smaller customers not allocated to TTL requiring FCL services	**Smaller customers** who have received any of the following services in the 3 months to 31 March 2008: Consolidation / deconsolidation FCL trucking not involving rail Warehousing

2. Other smaller customers not referred to in the table will be allocated by name, following due diligence confirming the services provided to them. Note that this allocation will be reviewed in due diligence and finalised in the documents.

3. The parties acknowledge that some customers of RailCo and TTL will require services to be provided by both businesses. Those customers will be identified as part of the due diligence and TTL separation, and the allocation of their business will be set out in detail in the TTL purchase agreement.

4. For Rail Services provided by RailCo following completion, RailCo will not:

   (a) at any time prior to 31 December 2008 (or later, if a bona fide longer term fixed price contract had been signed prior to 31 March 2008) provide directly or indirectly transport services to any of the customers which have been allocated exclusively to TTL in accordance with the procedure described in paragraphs 1 - 3;

   (b) at any time prior to 30 June 2009 provide directly or indirectly to any customers at all consolidation / deconsolidation, trucking not involving warehousing, or warehousing services.

5. For the purposes of clause 4:

   (a) the long term contracts referred to in clause 4(a) shall be identified in the course of due diligence and, if agreed, shall be included in a schedule to the TTL purchase agreement;

(b) the restraints in clause 4 shall not prevent RailCo or any Related Company, Crown entity or state-owned enterprise from providing rail transport services, but if such services are provided to a customer who also requires in addition the provision of consolidation / deconsolidation, trucking not involving warehousing or warehousing services, those additional services must be provided by a third party;

(c) if, in accordance with clause 3, some customers require services to be provided by both RailCo and TTL, the requirements of those customers will prevail over the provisions of this agreement and RailCo may provide services directly to those customers even though otherwise prohibited by clause 4.

6. For services provided by TTL following completion TTL:

(a) at any time prior to 31 December 2008 (or later if a bona fide longer term fixed price contract had been signed prior to 31 March 2008 and confirmed in due diligence), will not provide directly or indirectly transport services to any customers which have been allocated exclusively to RailCo in accordance with the procedure described in paragraphs 1 - 3;

(b) at any time prior to 30 June 2009:

(i) will not provide directly or indirectly to any customers at all any form of trucking services in substitution for any form of rail services;

(ii) will not be directly or indirectly interested, engaged or concerned in, advise or assist in the activity or business of providing transport of goods or people by sea between any two or more ports in New Zealand; and

(iii) will utilise only the ferry services operated by RailCo for itself or customers' freight.

7. For the purposes of clause 6(a):

(a) the long term contracts referred to in clause 6(a) shall be identified in the course of due diligence and, if agreed, shall be included in a schedule to the TTL purchase agreement; and

(b) if, in accordance with clause 3 some customers require services to be provided by both RailCo and TTL the requirements of those customers will prevail over the provisions of this agreement and TTL may provide services directly to those customers even though otherwise prohibited by clause 6.

8. If at any time after 31 December 2008 TTL shall request RailCo's co-operation in providing to an end customer a transport service or bundle of transport related services, RailCo shall provide that co-operation on terms which it considers commercially appropriate. However, if another transport operator shall also seek RailCo's co-operation on the provision of a similar transport service or bundle of transport services, RailCo shall be free to provide services in conjunction with that other operator.

9. If any such request shall be made by TTL in respect of transportation to be provided to the end customer at any time prior to 31 December 2008, RailCo shall not co-operate with any other transport operator unless RailCo has determined, and such determination has been confirmed or ratified by a member of the board of directors of RailCo, that it is in RailCo's commercial interests to provide transport services in conjunction with that other operator.

10. Until 31 December 2008 RailCo's wagon rates to TTL and TTL's trucking rates to RailCo (both by service type and volume) will be **[insert rates Toll agreed to provide on 2**

April, plus TTL's trucking rates to Toll Rail] plus FAF adjustment which shall form part of the sale contracts. Note that these rates will be confirmed in due diligence disclosure and compared to other forwarders, taking into account volume, service and terms. After 31 December 2008 the parties will be free to agree these rates as they think fit.

11. Until 30 June 2009, rail and trucking service levels, including equipment supply (actual vs ordered / agreed), on time arrival by corridor, and bookings vs travel by corridor will be as follows: **[insert Schedule Toll agreed on 2 April to provide, based on TTL and third party, (including Mainfreight) terms offered now by Toll Rail. To be confirmed in due diligence. These service levels must allow for changes such as fewer trains but each having higher capacity. Toll also to provide equivalent information for trucking services to RailCo].**

12. The areas and rentals to apply for six years for each terminal to be offered to TTL will be as follows: **[insert schedule Toll agreed to provide on 2 April]**. There will be a right of renewal for 6 years subject to use of rail. Rent will be reviewed each 3 years in accordance with market values set by a registered valuer.

13. There shall be no restriction on the parties agreeing to different rental areas and terms and conditions in respect of any proposal TTL may make after completion for individual terminal developments. However, TTL shall not have any preferred right to enter into such developments.

14. RailCo will have pre-emptive purchase rights if TTL at any time prior to 30 June 2009 offers to sell its assets, or if its shares are offered for sale.

15. The restraints contained in paragraph 4 shall terminate immediately upon Toll Group (NZ) Limited or Toll [Newco] Limited ceasing to be a wholly owned subsidiary of Toll Holdings Limited or Toll [Newco] Limited ceasing to carry on the Business, utilising the Assets and terminal leases, on its own behalf.

16. The restraints contained in paragraph 6 shall terminate immediately upon the business now carried on by Toll NZ Consolidated Limited (excluding the Business) ceasing to be carried on by a state-owned enterprise or Crown entity.

17. If Toll Holdings Limited, or a Related Company, wishes to offer for sale the Business, any substantial portion of the Business, or any shares in the Purchaser, then RailCo shall be offered the Business, substantial portion of the Business or shares in the Purchaser (as applicable) together with:

    (a) a proposed price;

    (b) the proposed terms of sale; and

    (c) a proposed sale process,

    and RailCo shall have one month to elect whether to accept that offer. If RailCo does not elect to accept that offer, Toll Holdings Limited or Related Company (as applicable), may sell the Business, substantial portion of the Business or shares (as applicable) within six months on identical terms to those offered to RailCo and at a price the same or higher than that offered to RailCo under clause 17.

Section 3: Crown's Strategy

- The rail business is a provider of freight services to major industrial and transport companies in New Zealand and operates in a competitive market. The Crown acknowledges that customers will ultimately decide what service they want, therefore the key determinant of its behaviour should be "what's the best solution for the customer":

  (i) RailCo will offer long term contracts to customers in an effort to guarantee baseload traffics (and revenue) to support the high fixed costs of maintaining the infrastructure and providing broad access for industry to the network.

  (ii) The rail customer base will continue to be centred on large customers operating on a one to one or few to few distribution model for each traffic. The rail business has no intention of entering the trucking / logistics / freight forwarding business.

  (iii) RailCo will service those customers who require rail as a core component of their freight distribution needs. RailCo will not own trucks. Any services to / from the railhead will be competitively contracted by the rail business or handled by the customer directly (at the customer's option).

- Commercial principles and transparency must apply.

- The rail business will not enter into any restraints of trade or arrangements that limit its future commercial freedom.

- While a transition period in the separation of TTL from the rail business is inevitable, there must be no ongoing non-commercial preference to TTL relative to other freight forwarders / logistics operators.

- The parties must co-operate to ensure that existing customer contracts with the Toll group of companies are executed as profitably as possible.

- The future rail and ferry business will be commercially operated on a commercial basis and in a manner supportive of the Government's transport and infrastructure policy direction.

Evolution of the Crown's strategy

This strategy will be adapted from time to time to meet the requirements of the New Zealand economy and government transport policy. These requirements may affect either RailCo or other participants in the transport industry.

The TTL asset sale agreement will contain the only commitments of ONTRACK, RailCo or the Crown, and no participant, including Toll Holdings Ltd or its subsidiaries should have any expectation of any constraint on the government's exercise of its prerogatives, nor any constraint on RailCo or its subsidiaries' conduct of its business, other than those expressly set out in the purchase agreement. That agreement will contain the provisions and constraints set out in section 2.