



Thursday 6 March 2008

STATEMENT

Government to Toll: Meet full terms of Access Agreement

The Government has given notice to Australian-based rail operator, Toll Holdings, that it will be required to meet the full provisions of the National Rail Access Agreement (NRAA), Finance Minister Michael Cullen confirmed today.

The NRAA is the agreement, administered by rail infrastructure company ONTRACK, which sets out the terms and conditions under which Toll operates on the New Zealand rail network.

The decision to apply the full terms of the NRAA follows the end of negotiations over a Crown purchase of Toll's New Zealand rail, ferry and intermodal business (but excluding its road transport and warehousing operations).

Dr Cullen said the Labour-led government had mandated ONTRACK to offer to purchase the rail business to better ensure the Government's goals for a nationwide transport network were met, as Toll appear unable to meet the costs of track access alongside investing in the rail business.

"I am disappointed to advise that Toll has chosen to reject our indicative offer. I believe that the offer was fair, equitable and reflected full value for the business.

"Their rejection of our offer suggests they have unrealistic expectations about both the Government's willingness to subsidise track access costs and the Government's willingness to spend taxpayers' money on acquiring the business.

"While negotiations have ceased, that does not mean that the Crown's openness to resolving these issues constructively and realistically is over.

"The Labour-led government remains open to Toll coming back with a more realistic response if it seeks to at some point in the future.

"I can't see that it is in either party's interest to allow the situation to drag on. Toll's business will most probably deteriorate in value and the rail business will be deprived of investment it badly needs," he said.

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Background

The NRAA was finalised between the Crown and Toll in 2004, after Toll acquired a controlling interest in Tranz Rail in October 2003.

The NRAA requires Toll to pay the efficient operating costs of the New Zealand rail network plus a capital charge to pay for the cost of replacing capital assets.

Meeting these obligations will, over time, require a significant increase in the level of payments by Toll.

The Government had worked with Toll for more than three years in an attempt to get a framework in place that would deliver a strong and efficient rail network.

During that time, the Crown paid, on the company's behalf, almost \$30 million in track access charges that Toll should have been paying and had not implemented other aspects of the NRAA while negotiations were underway.

The Government in 2003 endorsed Toll's purchase of the then ailing Tranz Rail because the Crown was assured at the time by Toll that it was in a position to pay the full access costs for the rail network and rebuild the national rail fleet.

It was because Toll provided these assurances in 2003 that the Government continued to grant Toll exclusive use of the network for 66 years. The Government said at the time that we would abide by the spirit and the detail of that commitment.

Instead, Toll asked for a \$60 million-a-year Kiwi taxpayer subsidy to enable the company to meet the obligations that Toll had freely entered into. We have no confidence that paying Toll \$60 million a year would be the end of their requests for further subsidies.

The recent Government-backed offer to Toll was broadly in line with the \$3.00 per share paid by Toll to take out the minority shareholders under the takeover offer completed last year.

The renegotiation of the NRAA effectively finished in the middle part of last year, and the parties have been actively discussing purchase since November 2007.

Questions & Answers

Q. Why is the Government offering to buy rail from Toll?

A. It is clear that Toll cannot meet the expectations we had when the Government reacquired the track and the NRAA regime was implemented. The regime was designed to give them freedom to operate and develop the rail business while paying the costs of maintaining and renewing the track infrastructure. As it happens, they have continually sought subsidies on the charges that they are obliged to pay under the NRAA and there have been no compensating benefits for the Government in terms of investment in the rail fleet or extension of rail's role in the transport sector. We cannot see that requests for subsidies will stop under the current ownership and contractual regime.

The Government believes it is in New Zealand's national interests to have a strong and growing rail sector. It believes this will best be achieved by the Government acquiring the rail assets and integrating rail activities into the national transport strategy.

Q. What happens if Toll doesn't want to sell?

A. Toll will continue as the operator of the rail business, but there will be no more subsidies.

Q. Will this not result in a more rundown rail sector?

A. I think it will be a less attractive outcome for the Government but it will still remain in Toll's interest to maximise the value of that business.

Q. How much did the Government offer them?

A. Most recently the Government indicated to Toll that it was willing to pay a price for the New Zealand business that was broadly in line with the \$3 per share price Toll paid to acquire the minority interests in 2007. The Government's offer was slightly below this level but one needs to take into consideration the movements in equity markets since that offer was launched. It should also be noted that the Government did not reach final negotiations with Toll. The offer was indicative and subject to due diligence investigations in a range of areas. The offer also envisaged that Toll would retain its road transport and warehousing operations.

- Q. What is ONTRACK's role in the process?
- A. ONTRACK is a State Owned Enterprise and the appropriate entity to undertake such an acquisition as an extension to its existing business. As the public would expect, ONTRACK has been regularly reporting to me on progress with negotiations.
- Q. What was Toll asking for?
- A. We received one counteroffer from Toll which was significantly in excess of the Government's indicative offer. The Government believes Toll's counteroffer is unrealistic and not related to the value of the business.
- Q. Although negotiations have ceased, is the Government willing to recommence negotiations if circumstances change?
- A. Yes. If Toll's value expectations become realistic the Government is willing to re-engage.
- Q. What is the plan if the rail business is bought?
- A. The Government wishes to see a rejuvenated rail business playing a greater role in New Zealand's transport sector. This will require greater investment and a commitment to improved capacity and service.
- Q. If the Crown acquired Toll's New Zealand rail business, what steps would it take to ensure it didn't revert to the inefficiencies and monopolistic practices of state-owned rail's past incarnation as NZ Rail?
- A. Not only has the transport industry become much more competitive over the past 30 years but processes and practices in the state sector have become more efficient and customer focused. The SOE model has proved that Government-owned companies operate efficiently and accountably. The Government would ensure ownership and management of the whole railway business would be subject to these principles of efficiency and accountability.
- Q. Will the Government use its law-making powers to acquire Toll?

- A. There are no plans at present. However, the Government regards the current arrangements as unsatisfactory. Some regulatory review of the rail regime may be required if rail is to maximise its potential contribution.
- Q. Was Monday's announcement on foreign ownership of strategic assets related to the current negotiations?
- A. No.
- Q. When did you give notice to Toll that the NRAA would be implemented in full?
- A. Toll has been advised verbally and ONTRACK will initiate the formal processes immediately.
- Q. Will you expect Toll to repay the \$30m it has been excused?
- A. No. We have been negotiating with Toll in a fair and reasonable manner and it was appropriate to suspend full enforcement for as long as I considered progress was being made.
- Q. Are there likely to be disputes over the requirements of the NRAA with respect to Toll?
- A. Past discussions indicate there are some areas where we may have a different interpretation of the agreement. The Crown's view on those areas is clear. If Toll has a different view, we will need to resolve those disputes, by litigation if necessary.
- Q. How much will Toll's payments rise if the Crown reverts to the full terms of the NRAA?
- A. Toll has been operating under a concessional regime whereby the Government has been paying some of the charges that Toll is required to pay. Last financial year Toll were charged \$48m for operating expenses and \$5.6m for the capital charge. Without subsidy that amount would be about \$56m plus \$5.6m. Looking forward it is important to remember that the NRAA had concessional arrangements for the first two or three years whereby the Government agreed to make investments in the network. Under the NRAA, Toll is required to pay for all capital replacement on the network and this will see the charges they pay increase substantially over the next few years.

Q. Why do the charges increase?

A. The NRAA provides for a concessional charging regime where renewals costs are not paid by Toll in the year they are incurred by ONTRACK, but amortised over a long period. This results in a charge that increases rapidly over time. ONTRACK's renewals costs are currently about \$70m per year, resulting in the capital charge expected to increase at about \$7m per year (i.e. this year \$12m, next year \$19m, year after \$26m etc.). These types of arrangements provide a short term cashflow benefit to Toll but do not relieve the obligation to pay the full costs over the longer term.

Q. What is covered by track access charges?

A. There are two parts to the charge – operating costs (mostly network maintenance) and replacement of worn-out capital assets (also called renewals).

Most New Zealanders know that there remains a lot of work to do to catch up on two decades of underinvestment in the rail infrastructure. While much has been done, there remains a backlog of outstanding work that has to be reduced. This is being completed against the backdrop of low unemployment and a busy construction sector which continue to place pressure on costs. ONTRACK is mandated to operate efficiently and I am confident that the processes ONTRACK's Board has in place ensures best value for money.

Q. What else happens under the NRAA?

A. As well as meeting their full financial obligations, Toll have a number of other commitments to meet service levels and ensure fair treatment of competitor freight forwarders who also use rail.