

Date: 11 February 2010

BM-2-9-9-2010

To: David Wood, John Crawford, Martin Matthews (MOT), Wayne Donnelly (MOT),

Cc: Peter Mersi, Vicky Robertson, Peter Marten, David Taylor, **some names deleted – privacy**

From: Richard Forgan

MEMO - KIWIRAIL NEXT STEPS & DUE DILIGENCE

Joint Ministers (English, Joyce and Power) met, on Wednesday 10 February 2010, with Treasury (NIU and COMU) and Ministry of Transport Officials. At that meeting it was agreed that Treasury and MoT would:

- Undertake a due diligence exercise on KiwiRail's business case (preferred and other options; excluding the metro component of KiwiRail's business);
- Engage, jointly with KiwiRail, with the major freight forwarders to seek to de-risk the Crown's investment;
- Further examine the public policy rationale for investment in KiwiRail, including the option value of preserving rail in the long term;
- Examine how the proposed Crown capital injection into KiwiRail could be re-scheduled to reduce the current front-loading;
- Examine how the capital injection could be structured and how KiwiRail could be monitored over time on the delivery of any agreed investment.

It was also agreed that the due diligence exercise needs to be largely concluded by 19 March, at a level of detail sufficient to determine capital contingencies for the budget.

Subsequently Treasury and MoT officials met to plan how the above workstreams would be managed and delivered. The memo records and follows up on that meeting, and provides action points where possible.

1 Informing KiwiRail

Joint Ministers agreed that Minister Joyce would inform KiwiRail of the exercise, its rationale, scope and timing. Suggested key messages are at Annex A.

2 Timetable

An outline timetable, tabled at the meeting with Ministers, is attached at Annex B.

3 Project Governance

The exercise will be a joint Treasury/MoT effort, overseen by a Steering Group. Membership:

- Martin Matthews
- Wayne Donnelly
- John Crawford
- Richard Forgan

Subsequent suggestion from Treasury:- Ivan Kwok should also join the Steering Group.

4 Project Director

A Project Director (Peter Marten, Treasury) will lead the work, overseeing and knitting together all of the workstreams.

5 Project Management

Key workstreams for 19 March delivery date:

a. *Due diligence on the business case and engagement with KiwiRail customers.*

Lead Agency:	Treasury
Project Manager:	Fiona Mules
Team:	[TBA from NIU, COMU, MoT]
Engineering advice:	[TBA – David Wood investigating]
Financial/Commercial:	[TBA – David Wood investigating – probably Deloitte (Paul Callow) or PwC (Bruce Wattie)]

Key questions we are seeking to answer:

- Will the proposed investment deliver the promised service improvements?
- How confident can we be that these service improvements will move freight on the relevant routes off road and onto rail?
- What is the best value investment option? (KiwiRail preferred option; short lines options; other; status quo).

Key aim:

- Obtain certainty over future revenues from KiwiRail customers

Minister Joyce will assist with engagement with freight forwarders, particularly opening contact and making Government's position clear.

Treasury will fund the cost of external consultants on this workstream.

b. *Public Policy Rationale*

Lead Agency:	MoT
Project Manager:	[TBA]
Team:	[MoT staff TBA, [deleted – privacy]]

This workstream will consider:

- What is the long-term option value of the national rail network?

- What is the net cost to the Crown of moving freight off relevant rail routes onto road (and if KiwiRail were to be successful, would there be a corresponding net benefit to the Crown?)
- What service improvements are likely over the next 10 years to road transport on relevant routes?

c. Linkages with Metro

Lead Agency: MoT
 Project Manager: [TBA]
 Team: [MoT staff TBA, names deleted – privacy]

The KiwiRail business case is about the freight market, with metro public transport not included. But this business is still within KiwiRail, and also relies on aggressive revenue projections. What are the risks of this business absorbing funds allocated in the business plan to freight?

Ongoing workstreams thereafter (much less certainty here, as direction and effort will in large part depend on work to 19 March:

a. Engagement with Freight Forwarders (de-risking)

Lead Agency: Treasury
 Project Manager: [TBA]
 Team: [TBA]

b. Capital Structuring, Monitoring Arrangements etc.

Lead Agency: Treasury
 Project Manager: [TBA]
 Team: [TBA]

6 Scope of Exercise

The exercise will consider not only KiwiRail’s preferred option for investment in the national network, but also:

- Short Line Options;
- Status Quo; and
- Other options as emerge from the due diligence work.

7 Project Office

Treasury will establish a project office for its own staff, MoT staff and external advisors, in No.1 The Terrace.

Annex A – Suggested Communications to KiwiRail

- a. Given the scale of the investment (\$4 billion programme, \$1.3 billion capital injection), Government needs to undertake thorough technical and commercial/financial due diligence before it makes any decisions.
- b. Nevertheless, time is pressing, so we are aiming for an exercise that concludes in March.
- c. MoT are continuing in the meantime with a place holder budget bid on KiwiRail's preferred option.
- d. All options (not just the preferred investment option) will be considered as part of the due diligence.
- e. The due diligence will be a joint Treasury/MoT exercise, and they will use external advisors to assist (engineering and commercial/financial).
- f. Any investment option which relies on substantial growth will be made substantially more attractive for the Crown if revenue risk is laid off to customers
- g. We would like a joint Ministers/KiwiRail/Officials approach to the relevant customers to i) assist with gaining confidence over the impact of improved service levels; and ii) obtain some real utilisation risk transfer to customers (i.e. firm commitments)

Annex B Outline Timetable

INDICATIVE TIMELINE FOR ASSESSING KIWIRAIL'S BUSINESS PLAN		
	Estimated number of weeks	Indicative dates
Stage 1		
Clarifying discussions with KRG management	2 weeks	By 26 February
Talk to key, large customers (mainly freight forwarders)	2 weeks	By 12 March
Analyse financial assumptions and projections	5 weeks (simultaneously)	By 19 March
Total for Stage 1:	5 weeks	19 March
Stage 2		
Build back the plan component by component	2 weeks	By 5 April
Compare preferred plan with alternative options	2 weeks	By 5 April
Total for Stage 2:	2 weeks	5 April
Stage 3		
Initial conclusions and discuss with KRG	1 week	By 16 April
Finalise report	1 week	By 23 April
Report to shareholding Ministers	1 week	By 30 April
Total for Stage 3:	3 weeks	30 April

NB: The above timeline could be shaved by two weeks (i.e. a report to Ministers on 16 April). However, the above timeline is already very tight given the size of the task, and achieving it two weeks earlier would depend on the engaging of external advisers without delay.