

Treasury Report: National Rail - Progressing Discussions with Tranz Rail

Date:	19 November 2002	Treasury Priority:	High
Security Level:	Commercial Sensitive	Report No:	T2002/1577

Action Sought

	Action Sought	Deadline
Minister of Finance	Approve the attached draft term sheets as a basis for a more proactive re-engagement with Tranz Rail.	ASAP

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact

Enclosure: Yes

19 November 2002

SH-8-4

Treasury Report: **National Rail - Progressing Discussions with Tranz Rail**

Purpose of Report

1. This report sets out a proposition, for your endorsement, to put to Tranz Rail in order to get the company engaged on national rail issues.

Analysis

2. While Tranz Rail has written to the Government seeking to re-engage in discussions on national rail issues, we understand that it has, as yet, no firm thinking on what kind of long-term relationship it wants with the Crown.
3. We are of the view that this lack of clarity is partly as a result of the senior management focus on the recent financial pressures on the company including the rights issue.
4. In order to progress discussions to enable the Ad-hoc Ministerial Committee on Rail Policy to consider the national rail issues prior to Christmas we suggest that we put two options to the company to help it work out quickly its likely response.
5. As set out to you in T2002/1489, there are two broad options for discussions direct with Tranz Rail that have the ability to meet the Government's national rail objectives;
 - Option One: Infrastructure and Services Partnership – an overarching partnership supported by a series of contractual arrangements for service provision and infrastructure investment. Tranz Rail is likely to consider this to be an onerous obligation with no benefit to itself. The Crown may need to consider offering Tranz Rail something in return. For example, an upfront payment, or access to a pool of resources to fund new projects or maintain existing service levels or infrastructure.
 - Option Two: Infrastructure Purchase – a purchase of the infrastructure on the basis that Tranz Rail retains its dominant freight rights but that alternative operators are able to access the infrastructure under certain circumstances. This option is not substantially different than the proposition considered for discussion with potential third parties.
6. Draft term sheets on each of these options are attached as annexes one and two for your approval.
7. As previously advised, our view is that Tranz Rail is unlikely to entertain an option where the Crown purchases the infrastructure with an open access regime. This is because the company's monopoly freight right goes to the heart of its value. The introduction of competing freight operators onto the network would therefore likely require acquisition of the whole company.
8. We propose to put these two options to the company in writing to provide a substantive basis for re-engagement. While there is some risk that the company could perceive this expression of interest from the Crown as placing it in a stronger negotiation position. We believe this is countered by the benefits of framing any potential for negotiations at an early stage. Left to its own devices, the company may not want to

substantively re-engage until after the Christmas period. We understand that this is unlikely to meet your timeframe.

9. It is our intention to gather as much information as possible about Tranz Rail's interests and objectives, to report to you prior to Christmas on these and other national rail options.
10. Tranz Rail is likely to raise the issue of road/rail pricing, which remains a major concern for it and has the potential to improve the economics of rail. At this stage we would simply indicate to Tranz Rail that the Ministry of Transport is progressing the study. We will report to you shortly on the interaction between the road/rail pricing issues and national rail issues.

Recommendation

11. It is recommended that you approve the attached draft term sheets as a basis for re-engaging with Tranz Rail on achieving the Government's national rail objectives.

Approved: yes/no

for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Annex One**Draft Option One: Infrastructure and Services Partnership**

- The Crown and Tranz Rail could agree an overarching partnership, supported by a set of contractual arrangements that document a set of rights and relationships.
- At the high level, a partnership between the Crown and Tranz Rail could include a requirement for parties to consult each other on specified substantive issues (such as investments, divestments and changes to service levels), the opportunity to jointly invest in strategic infrastructure, and a basis for information exchange between the parties.
- An obligation for the company to maintain a minimum infrastructure integrity and rail service level would be specified contractually - for example, existing levels of service (this may or may not be achieved through a strengthening of the current lease).
- Tranz Rail would be contractually obliged to notify the Crown, within a specified period, of its intention to cease or substantially reduce service levels. The Crown would have the ability to provide a subsidy to retain that service level in the form of Community Service Obligations (CSO). The company would be required to assess the financial impact of meeting the obligation. This financial impact would be made publicly available to allow for peer review by users, other participants and an independent reviewer. Once agreed by the Government, the cost of meeting the CSO would be the Government's. Where Tranz Rail and the Crown could not agree on the cost of meeting the CSO, the Crown would reserve the right to offer its subsidy to alternative operators.
- There would be the ability for the Crown to purchase additional services and for alternative non-freight operators to access the infrastructure.
- For infrastructure, there would be an opportunity for the Crown and Tranz Rail to collaborate on investment in strategic infrastructure – either the development of new lines, or investment in existing lines where that investment reduced the Government's burden for roading investment.

Annex Two**Draft Option Two: Infrastructure Purchase**

- The terms of this proposition must be broadly acceptable before any negotiations could proceed.
- The Crown would acquire the track infrastructure (the network) including tracks, tunnels, bridges, signals, wires, fibre optic network and other infrastructure required for the effective management and operation of the rail infrastructure. This would include all records and record systems associated with track and the staff and systems associated with train control. The Crown would take over relevant employment contracts of staff involved in the infrastructure operation. The Crown would also take over existing maintenance contracts.
- Tranz Rail would retain rail operations including its freight operator rights. The Crown would negotiate a minimum service level component into any access arrangement. Where service levels dropped below that specified in an agreement, the Crown would retain the ability to introduce alternative freight operators onto the network. Outside the freight operations, access to the track would be contestable (for example passenger transport, heritage operators etc).
- The network would be held by a Crown entity charged with responsibility for maintenance, track access and train control. The Auckland corridor would be incorporated into this.
- A Crown entity would maintain infrastructure at a certain minimum level (as set out in a Statement of Intent and other accountability documents). The Crown entity would also be responsible for making decisions about what maintenance is done.
- An access agreement setting out the terms and conditions for access would be agreed between the Crown and Tranz Rail (and other operators). The terms and conditions would specify the parts of the track to which access is provided, any restrictions to carriage, and the nature of the access charges.
- The level of access charges would provide a rate of return on the asset, and would recover the cost of maintenance. The access pricing methodology would likely to incorporate a two (or three) part tariff with an upfront entry fee to recover fixed costs combined with a per tonne/per kilometre usage charge.