

Treasury Report: Establishment of TrackCo

Date:	1 March 2004	Treasury Priority:	Medium
Security Level:	IN-CONFIDENCE	Report No:	T2004/314

Action Sought

	Action Sought	Deadline
Minister of Finance	Refer paper to the Ad Hoc Ministerial Committee on Rail Policy	As soon as practicable

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact

Enclosure: No

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Executive Summary

A process has been agreed with Toll/Tranz Rail for the initial establishment of TrackCo. Tranz Rail has, of necessity, a significant role in this process but there are adequate mechanisms to ensure that the Crown's interests are protected and that the rights of Tranz Rail staff are respected. The agreed process and its rationale are described in this paper.

The paper also describes the reporting and governance structures to be used on the Crown side of the transaction to ensure that the government achieves its objectives to the maximum possible extent.

Recommended Action

We recommend that you **refer** this paper to members of the Ad Hoc Ministerial Committee on Rail Policy.

Agree/disagree

for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Treasury Report: Establishment of TrackCo

Purpose of Report

1. This document describes:
 - the agreed process for the separation of TrackCo and OpCo and the rationale for that process;
 - the methodology being used to ensure that the Crown's interests are protected during the creation of TrackCo; and
 - the reporting and governance structures to be used on the Crown side of the transaction to ensure that the government achieves its objectives to the maximum possible extent.

Introduction

2. As implementation of the rail network transfer proceeds, work on separation of Tranz Rail into OpCo and TrackCo is commencing. A high level structure for TrackCo has been agreed between the Crown and Tranz Rail, and Tranz Rail has started consultation with its staff about the changes.
3. The separation of OpCo and TrackCo inevitably impacts on the positions of some Tranz Rail staff. The most significant impact arises from the Crown decision to base TrackCo in Wellington. Several senior staff are significantly affected by this decision. We understand that the government has received communication from the rail union expressing the concerns of Tranz Rail staff about some aspects of the process to date.
4. The initial separation of TrackCo and OpCo of necessity falls to Tranz Rail to implement (the reasons for this are described later in the paper). The Crown's interests in the initial period are to:
 - ensure that TrackCo has the capacity and resources to perform the tasks required of it;
 - ensure that the rights of Tranz Rail's staff are respected; and
 - maintain the maximum flexibility possible for the new board of TrackCo/NZRC to implement the long-term structure of TrackCo.
5. To these ends project governance structures are being put in place to ensure that the Crown's interests are protected through this process. The governance structure and agreed process for separation of TrackCo from OpCo is described below.

Background

6. The government agreed to purchase the rail network infrastructure from Tranz Rail in order to achieve several specific objectives, namely:

- Maintaining continuity of existing rail services and minimisation of the chances of disruption to those services;
 - To regain control of the rail infrastructure; and
 - To enhance the viability of rail transport.
7. The government has other objectives for rail. These include:
- encouraging the movement of freight from road to rail;
 - maintaining provincial rail freight services; and
 - supporting rail passenger services.
8. Many of these objectives will be able to be achieved over time, once the network is in Crown hands. However, the purchase agreement is a negotiated document and as such required a number of compromises and concessions from the Crown. In addition, to achieve its objectives for rail the Crown has entered into a long-term business relationship with Tranz Rail. This relationship entails joint advancement of mutual goals and negotiation to determine the outcome when goals differ or conflict. The Crown will not achieve its preferred outcome in every aspect of these negotiations. Further, implementation of the Rail Network Transfer will involve trade-offs between competing objectives and will require additional compromise. This will constrain the government's ability to achieve certain objectives.

Governance of Implementation Project

9. Recognising that negotiations with Toll/Tranz Rail will be most successful if the Crown speaks with a single voice, the Minister of Finance has appointed Treasury, reporting through his office, to represent the Crown in this matter until TrackCo is in Crown control. In addition to appointing the lead agency, a structure and process is required to ensure that the Crown position is well considered, trade-offs are made explicit and decisions are approved at the appropriate level. Close Ministerial oversight is expected. This involves:
- sign-off on key decisions;
 - consultation on all substantive issues; and
 - progress reports on matters of lesser importance.
10. Processes have been established to ensure adequate consultation and to ensure that Ministerial approval is obtained for significant decisions. At the operational level the project is lead by a Steering Group consisting of Crown and Tranz Rail representatives. However, the Minister of Finance's agreement is sought before officials commit to major decisions. On minor issues the Minister of Finance's office is consulted. Officials indicate immediate support only where matters are not contentious.
11. We have agreed with Toll/Tranz Rail to increase the frequency of Steering Group meetings to ensure there are opportunities to bring significant issues to the Steering Group.

12. In addition to the Ministerial processes, at the officials' level there are three main mechanisms in place:
- Officials meet, or report to, the Minister of Finance's office regularly on progress and significant issues;
 - Officials from Treasury, Ministry of Transport and NZRC met weekly to ensure that the full range of Crown concerns are being considered and advanced; and
 - Drafts of significant documents are circulated for comment before finalisation.

TrackCo Establishment

13. The Crown and Tranz Rail agreed a process for the initial establishment TrackCo in the Heads of Agreement of 7 July 2003. The process that has been established and the rationale for that process are as follows. (Details of the relevant section of the agreement are provided in the *Additional Information* section below.)
14. At present there is no division or functional group within Tranz Rail corresponding to the entity known as TrackCo. In particular, some staff work on both OpCo and TrackCo functions and a unitary safety system covers both "below-rail" and "above-rail" operations.
15. The separation of TrackCo and OpCo involves:
- Separation of the Tranz Rail safety system into distinct OpCo and TrackCo systems;
 - Establishment of a structure to support the TrackCo safety system;
 - Identification of the skills required for TrackCo;
 - Development of an organisation structure to support and manage the skill base;
 - Identification of the appropriate staff to fill the positions;
 - Redefinition of individual job descriptions where staff are currently working across OpCo and TrackCo functions;
 - Appointment to positions; and
 - Staff relocation where required.
16. It is apparent that Tranz Rail must, of necessity, take a substantial role in this process. For example:
- The staff are currently all Tranz Rail employees;
 - The TrackCo-OpCo split cannot occur unless an approved safety system is in place;
 - The LTSA will not approve a new safety system in the absence of an appropriate organisation structure and suitably qualified staff appointed into the key positions;

- Knowledge of the existing safety system and the ability to separate it into “below-rail” and “above-rail” systems resides in Tranz Rail;
 - Staff cannot reasonably be transferred into a new organisation, or be asked to relocate, without some certainty about the position they are being offered.
17. In short, it would not be possible to separate TrackCo from OpCo and then create a TrackCo organisation structure. And because there is very limited expertise on New Zealand rail available outside of Tranz Rail a heavy reliance on Tranz Rail is unavoidable. These factors led the Crown to agree that Tranz Rail would have the lead role establishing the initial structure of TrackCo and carrying out the succession planning to effect a handover to the Crown.

Implementation

18. An issue has arisen with the way Tranz Rail is managing the separation of TrackCo and OpCo. We understand that the Rail & Maritime Union has written to the Prime Minister on the topic. We understand that Tranz Rail staff have several grievances. These include:
- a lack of consultation
 - a take-it-or-leave-it tone in communications
 - down-sizing of "branch offices"
19. Officials had been briefed at a high level on the Tranz Rail proposals but not on the detail Tranz Rail discussed with its staff. For example, there had been no discussion on what requirements there might be for a regional TrackCo presence. This is an area that should have been agreed with the Crown before staff were approached.
20. It appears that some of the staff problems have arisen because Tranz Rail has been attempting to meet its interpretation of the Crown's requirements. For example, the drive to relocate staff stems primarily from the government decision that TrackCo will be based in Wellington. However, some key/senior staff are unwilling to relocate or are unsettled by the uncertainty about their future position and prospects. Their response to Tranz Rail's proposals appears to have been greatly exacerbated by their perceptions about the HR approach of Tranz Rail.

Solutions

21. We consider that, if enacted properly, the Heads of Agreement provides sufficient mechanisms to safeguard the Crown's interests. However, it is also apparent that Tranz Rail had underestimated the need to communicate with the Crown and obtain Crown approval for significant decisions.
22. In relation to the specific staff issues that arose in mid-February, it appears that Tranz Rail may have unnecessarily aggravated staff concerns because of its desire to minimise its future track access charges. However, Tranz Rail may also have been underestimating the Crown's commitment to be a good employer, its determination to retain key staff and its willingness to carry the transition costs that this may entail. In summary, we believe that there are compromise solutions to the staff issues.

23. While the process needs to be led by Tranz Rail the Crown is not without control. This occurs at two levels: structure and individual personnel. The structure will be jointly agreed by Tranz Rail and the Crown.
24. In practice the high-level structure is unlikely to be problematic, with a simple three-branch solution on the table that should not unduly hinder the future TrackCo Chief Executive from making any changes they deem necessary. Some “boundary” issues remain about particular work groups that could arguably be in either TrackCo or OpCo. These groups are the mechanical engineers (who work primarily on rolling stock), the train driver training school and the helpline call centre. These issues are being worked through in consultation with the Minister of Finance’s office and we hope to reach a satisfactory conclusion shortly.
25. The second level of control is at the point of appointment of individuals. The majority of staff will simply retain their existing positions, but there are several key areas where the Crown will control the outcome. For example, the Chief Executive will be appointed by the new NZRC/TrackCo board. Where possible the second tier managers will be appointed by that new CE, although it may be necessary for Tranz Rail to appoint a manager of operations before then so that the safety system can be split.
26. The government’s decision to base TrackCo in Wellington means that some relocation of staff is required. If staff are unwilling to move this may mean redundancy. However, there are some senior staff that TrackCo would not wish to lose. In these cases attempts should be made to accommodate the individual’s preferences if possible. The government is paying for Tranz Rail’s restructuring costs and therefore is indirectly paying for staff relocation and redundancy costs. As the bill payer and eventual owner of TrackCo the Crown will be consulted about these cases and may have to become more involved.

Additional Information

27. In recognition of the practical constraints the Heads of Agreement (HOA) provided that in the Transition period Tranz Rail would be responsible for a number of management services, including:

Schedule 6, clause 6

- (k) establishing the structure of, and administering, the new organisation required to carry out the management functions;*
- (l) carrying out all necessary succession planning to effect a handover to the Crown or its nominee upon conclusion of the management agreement;*
- (m) developing and implementing all necessary arrangements to effect, so far as is reasonably possible, a separation of the operations of Tranz Rail post-Completion from the ongoing operation and maintenance of the Rail Network, Network Assets and Surrender Land;*

Tranz Rail’s performance in carrying out these functions is constrained by a number of “Guiding Principles”. Specifically;

Schedule 6, clause 2

(a) Tranz Rail will carry out its management functions pursuant to the Management Agreement so as to operate and maintain the Rail Network, Network Assets and Surrender Land in the same manner and to at least the same standard as was the case prior to Completion provided that Tranz Rail will comply with any specific directions of the Crown in respect to discharge of such functions so long as the associated costs are allowed for in the budget or are otherwise met by the Crown.

(b) Tranz Rail will maintain a high level of transparency in performing its management functions so as to enable identification of any potential conflict of interests and ensure that in discharge of such management functions Tranz Rail acts to the extent permitted by law in the interests of the Crown.

Tranz Rail will carry out its management functions in a manner that facilitates, so far as is reasonably possible, an effective and efficient hand over to the Crown (or its nominee) of the management functions carried out by Tranz Rail upon the conclusion of this agreement.