

Treasury Report: National Rail: Basis for Re-engaging with Tranz Rail

Date:	6 November 2002	Treasury Priority:	High
Security Level:	Commercial Sensitive	Report No:	T2002/1489

Action Sought

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Minister of Finance	Agree a set of objectives to guide any discussions with Tranz Rail.	ASAP, prior to any discussions with Tranz Rail.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact

Enclosure: No

6 November 2002

SH-8-4

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Purpose

1. We understand Tranz Rail is likely to write to you this week expressing a desire to recommence discussions with the Government on how rail fits in with the Government's overall land transport strategy.
2. This note sets out a suggested basis for a response to Tranz Rail and for preliminary discussions, should you agree.

Issue

3. The basis for re-engaging with Tranz Rail (the company) depends on the extent to which the company, in its current configuration, is able to meet the Government's objectives of:
 - Considering rail in a broader transport strategy;
 - Retaining network integrity;
 - Introducing alternative operators onto the network; and
 - Value for money.
4. Based on our previous experience we consider that the company will likely:
 - Want to engage with the Government on the issue of road/rail parity with a view to lobbying for an increase in road user charges or increased assistance to rail to correct the perceived imbalance;
 - Be receptive to some kind of ongoing subsidy arrangement for service provision or capital investment on unprofitable rail lines (such as Napier to Gisborne);
 - Be open to a discussion on Crown acquisition of infrastructure on favourable terms and conditions and on the basis that the company retains its position as dominant freight operator; and
 - Be opposed to any discussion on the operation of a wide-ranging competitive access regime.
5. The company is likely to want to establish the exact nature of the Government's rail objectives. We propose a strategy of:
 - Outlining the Government's objectives including those areas where there may be some room for flexibility (for example the distinction between open access versus alternative operators);
 - Invite the company to set out its objectives;

- Invite the company to propose a set of potential options that may meet both parties' objectives.
6. As a starting point, and based on our previous discussions with you, we would look to an agreement with the company securing;
 - The ability to retain the integrity of the network, expand it where desired, and purchase additional services on unprofitable lines;
 - The ability for alternative operators of passenger transport services, heritage operators and any other current operators to access the infrastructure at a reasonable cost.
 7. A central issue for Government is whether a set of agreements with Tranz Rail, that meets Government's objectives but does not include purchase of the network, would be acceptable. This depends on the extent to which Government's previously expressed preference to own the infrastructure is a bottom line [CAB (Min (02) 6/4 refers].
 8. At this stage officials will explore both the purchase of the infrastructure, and also a set of agreements that meets the Government's objectives without purchasing the infrastructure.
 9. A set of agreements that meets the Government's objectives could bundle together a set of rights and relationships and could include:
 - An agreement to a strategic alliance between the Crown and the company. Details of the alliance would include a requirement for parties to consult each other on substantive issues, opportunity for the Crown to purchase additional services, opportunity to collaborate for investment in strategic infrastructure, and a basis for information exchange between the parties;
 - An obligation for the company to maintain the minimum infrastructure integrity and rail service levels as specified contractually, for example, existing levels of service (this may or may not be achieved through a strengthening of the current lease); and/or
 - A negotiation/or arbitration process for the parties to follow in meeting the obligations set out above.
 10. Some flexibility would be required to let the level of the agreement to alter over time.
 11. The cost of meeting the agreement might be administered through Transfund to allow evaluation against the Government's wider land transport objectives.
 12. Tranz Rail is unlikely to offer to sell the network with open access. If Government wants the ability to introduce alternative freight operators onto the network in competition with the company then this is highly unlikely (based on previous discussions with Tranz Rail) to be able to be achieved without purchase of the entire company.
 13. We propose to investigate relatively briefly with Tranz Rail what shape of an agreement or transaction might be feasible, and report back to you so that all options can be considered.

Risks

14. We have previously provided you with a paper canvassing the broad issues that Government would need to consider in evaluating a third party approach to acquire the company [T2002/1241 refers].
15. Should a third party approach the Government at a time when Government has re-engaged with the company, the Crown would be in a strong but vulnerable negotiating position. This vulnerability arises from a heightened risk of the Crown (either through Ministers, their employees, or officials) being privy to inside information. This risk is very much case specific and would depend on the nature of any discussions either with the company or any potential third party.

Recommendation

16. It is recommended that you:

- a **agree** that Treasury officials re-engage with Tranz Rail to explore at a high level the extent to which a agreement/transaction with the company may meet the Government's national rail objectives;

Agreed/declined

b **note** that the company will likely:

- Want to engage with the Government on the issue of road/rail parity with a view to lobbying for an increase in road user charges or increased assistance to rail to correct the perceived imbalance;
- Be receptive to some kind of ongoing subsidy arrangement for service provision or capital investment on unprofitable rail lines (such as Napier to Gisborne);
- Be open to a discussion on Crown acquisition of infrastructure (on favourable terms and conditions) and on the basis that the company retains its position as dominant freight operator; and
- Be opposed to any discussion on the operation of a competitive access regime.

c **agree** that at this stage officials should explore with Tranz Rail an agreement or transaction that retains:

- The ability to retain the integrity of the network and services, expand it where desired, and purchase additional services on unprofitable lines;
- The ability for alternative operators of passenger transport services, heritage operators and any other current operators to access the infrastructure at a reasonable cost.

Agreed/declined

d **agree** that this might be achieved through purchase of the infrastructure or through a set of agreements.

Agreed/declined

e **note** that in conducting these discussions officials will indicate Government's preference for ownership of the infrastructure.

- f **agree** that if Tranz Rail continues to reject open access officials should explore with Tranz Rail a regime which allow alternative freight operators onto any line where Tranz Rail withdraws service, and would allow all Government support for particular services to be tendered among competing operators.

Agreed/declined

- g **note** that officials propose to investigate relatively briefly with Tranz Rail what shape of an agreement or transaction might be feasible, and report back to you so that all options can be considered.

Hon Dr Michael Cullen
Minister of Finance