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# **Rail Services in the Wellington Region**

## **A Public/Private Partnership**

**The attached documents are in draft format. They have not been formally adopted by the Wellington Regional Council. Some changes are expected following negotiations with the preferred partner for the Wellington Commuter Rail Service. Until the documents are approved by the Wellington Regional Council and executed, they should be treated as confidential.**

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The Wellington Regional Council (WRC) has statutory responsibility for the provision of public transport in the Wellington Region. In discharging this responsibility, WRC's objective is to purchase safe, fair and reliable transport services (including rail, bus and ferry services) in the Wellington Region at least cost to the regional ratepayer. Services purchased are those which are deemed necessary for the community but which would not otherwise be provided on a commercial basis. Within the broad range of services purchased, rail is seen as having a special place.

WRC's Regional Land Transport Strategy (RLTS) includes the following objectives of relevance to rail services:

- To maintain urban rail as an arterial priority in the public transport network.
- To improve the accessibility of passenger transport.
- To enhance the quality, reliability and priority of public transport facilities and services.
- To improve the interchange between bus, rail, car and cycle.
- To improve pedestrian and cycle access to key public routes.
- To develop a public transport system which is environmentally and economically sustainable at least cost.
- To price the public transport network to encourage its efficient use.

WRC is very mindful of the significance of a quality rail service to the achievement of its overall transport objectives.

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## 2.0 Background/Context

The WRC has historically purchased rail services via a rail service contract with Tranz Rail Ltd. Under this arrangement the WRC has been unable to gain sufficient assurance that:

- it is receiving value for money in relation to the significant level of ratepayers' and taxpayers' money invested in rail services each year, and
- the rail operator is committed to providing quality services over the longer term. This lack of long term commitment was borne out when during the second half of 2000 Tranz Rail Ltd publicly announced that it intends to exit from all passenger services, including Tranz Metro (Wellington). Tranz Rail Ltd has more recently announced the sale of its Tranz Scenic operation.

These issues mean that the WRC has difficulty achieving its objectives under its RLTS. Further, the WRC is concerned that as the future of the rail service depends on continual reinvestment in the assets of the business, the quality of service is likely to deteriorate quickly unless a new owner is found who is committed to the long term sustainability of passenger rail in the Region.

As the majority funder of the rail service, WRC currently has two broad options available to it:

- ⇒ Take a "hands off" approach, await the sale of Tranz Metro (Wellington) to a new operator and negotiate a new rail services contract with that new operator.
- ⇒ Take a "hands on" approach in order to secure the key assets necessary to provide a rail service over the long term.

### 3.0 WRC's Public/Private Partnership Proposal

WRC has concluded that in the circumstances the most effective means of ensuring that it is able to discharge its responsibilities for the provision of public transport in the Wellington Region is to secure a managed change in ownership of the Tranz Metro business with the WRC itself taking an ownership interest in the business for a period (this phase is called “gaining control”). The mechanisms for achieving this will be:

- the establishment of a company in partnership with a private sector rail operator, that will purchase the Tranz Metro (Wellington) business and then operate the rail service
- the acquisition by the Government or the Council of the access rights to the rail corridor and associated infrastructure (eg. track, signals, overhead wires and stations)
- the granting of access rights to the operating company (Wellington Regional Rail Ltd).

The Council intends that its ownership interest in the operating company would be for a transition period only. It will review its ownership interest with a view to selling it at the end of the transition period. (5 years)

The need for the Council to adopt a model involving an ownership interest reflects its dissatisfaction with the contractual relationship with the incumbent operator, its concern that it is likely to be at a commercial disadvantage in establishing a new contract with a new operator and the risks to the Council of achieving its RLTS objectives while a private sector operator has effective and unregulated control over the monopoly asset, access to the rail corridor and associated infrastructure.

The Council considers that taking a temporary ownership position will give it the opportunity to set in place the framework and relationships needed to allow it to purchase rail services solely through an arms length contractual relationship on an equal footing with the rail services operator. Therefore, the Council will be looking to exit its ownership interest once it is satisfied, and only when it is satisfied, that the necessary checks and balances are in place that will ensure it can meet its RLTS objectives solely through contract, as opposed to ownership.

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## 4.0 Why has WRC chosen the PPP Approach

The WRC's key objectives are to secure a much improved rail contract (with back to back funding from Transfund) and to see public sector control over the key monopoly assets.

The key question is WRC ownership of all or any part of the passenger rail system required to achieve these two key objectives?

The public/private partnership approach has been favoured by the WRC as it provides the right balance of:

- public control over key monopoly assets
- transparency and accountability of the various parties
- day to day decision making being made on sound commercial principles
- risk management

It is seen as the best solution to the current problem whereby the public sector is exposed to a private sector monopoly provider. The starting point for any analysis is the private sector Rail operator currently controls all of the assets and is in a strong monopoly position and yet the service requires significant ongoing subsidy.

Taking an ownership interest in any business normally means increased risk. However, it is important to appreciate that as the major funder of the passenger rail service the Regional Council is already exposed to a high level of risk. In other words a nil ownership position is far from riskless under the current circumstances.

Ironically perhaps, in this particular case, ownership (for a period of time) is seen by the Regional Council as a means of reducing its overall level of risk associated with the appropriate and prudent use of ratepayers' money over the long term.

## 5.0 Key Features of the Public/Private Partnership Model

- The process to select a partner will be contestable.
- Once a partner has been selected the WRC and the partner will together negotiate the acquisition of either the Tranz Metro (Wellington) business as a whole, or the key components of the business.
- The WRC and the partner will establish a company (Wellington Regional Rail Ltd) with capital contributed equally by the two partners. The WRC will retain 'contingent control' in the event that the two partners cannot agree and an impasse is reached. The WRC will own a 'C class' share that will entitle it to appoint an additional director to the Board in certain limited circumstances.
- The assets of Tranz Metro (Wellington) may include the right to use the track. If this is the case this access right will be sold by Wellington Regional Rail Ltd to the WRC, which will secure the key monopoly asset in public ownership. Control over track access will then go hand in hand with WRC's statutory role in purchasing passenger rail services via contract.

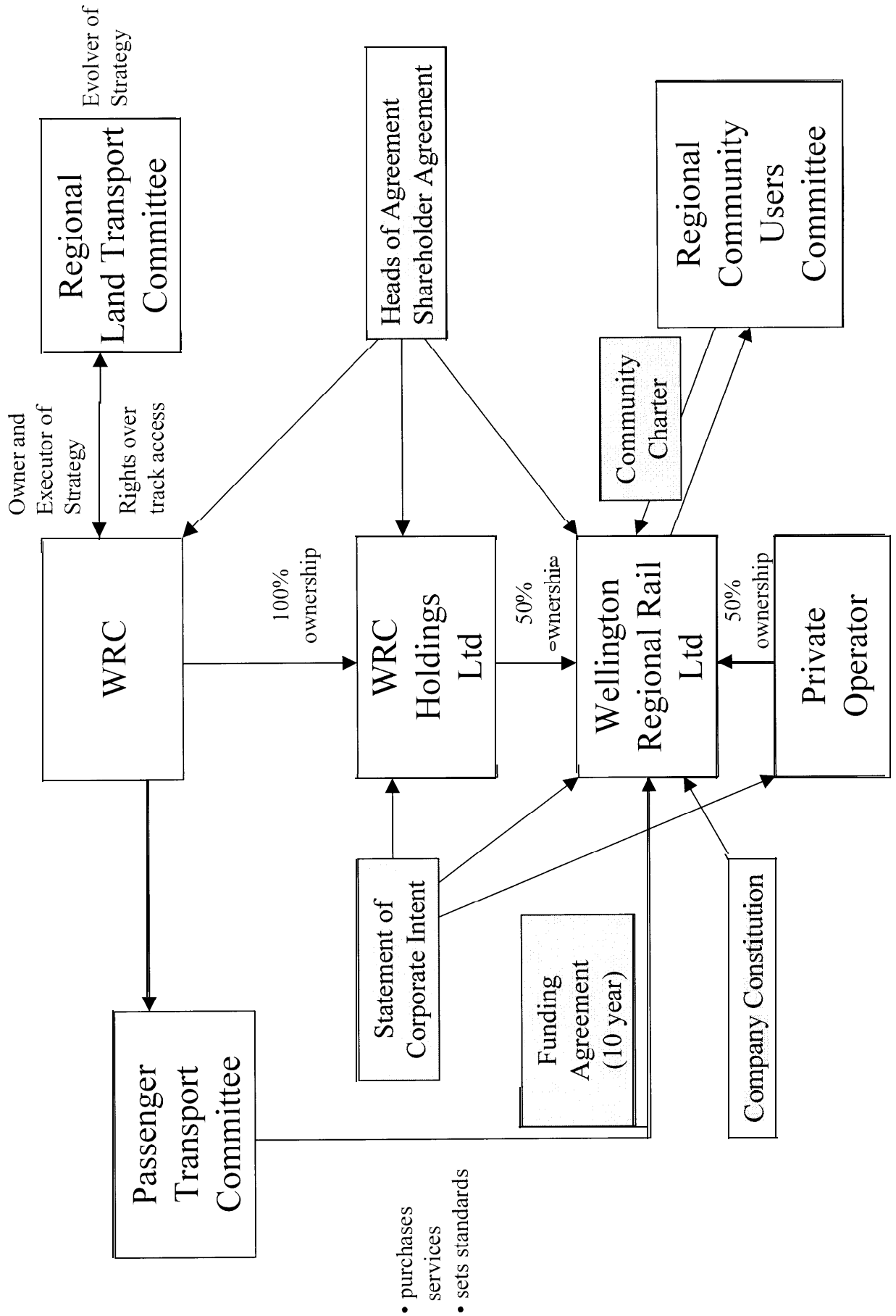
N.B. The issue of access to the rail corridor and associated infrastructure (e.g. track, signals, overhead wires) is a critical issue that is yet to be determined pending the outcome of current negotiations between Tranz Rail Ltd and the Crown.

- A rail service contract (Funding Agreement) between the WRC and Wellington Regional Rail Ltd will be put in place. This will include rigorous requirements for long term asset management and information disclosure. Further, the rate of return that the shareholders of Wellington Regional Rail Ltd will be able to generate (whoever they may be) will be capped. The contract is structured on the basis of a 30 year commitment with formal reviews after each 10 year period. The rail service contract includes "buy back" clauses that incentivise Wellington Regional Rail Ltd to invest in long term assets and that provide the WRC as funder with the ability to seek an alternative Rail operator in future.
- Wellington Regional Rail Ltd will be responsible for all aspects of service delivery including safety and the ongoing maintenance and enhancement of the infrastructure.
- Wellington Regional Rail Ltd will be expected to have a degree of transparency about its operations and will be expected to operate in accordance with a Community Charter.
- A Regional Community Users Committee will be set up to monitor the performance of Wellington Regional Rail Ltd relative to the requirements in the Community Charter on behalf of the Regional community.
- The WRC intends to review its continuing ownership interest in Wellington Regional Rail Ltd after five years.
- WRC will continue to control the key monopoly asset of the right to use the track even after sale of its ownership interest in Wellington Regional Rail Ltd.

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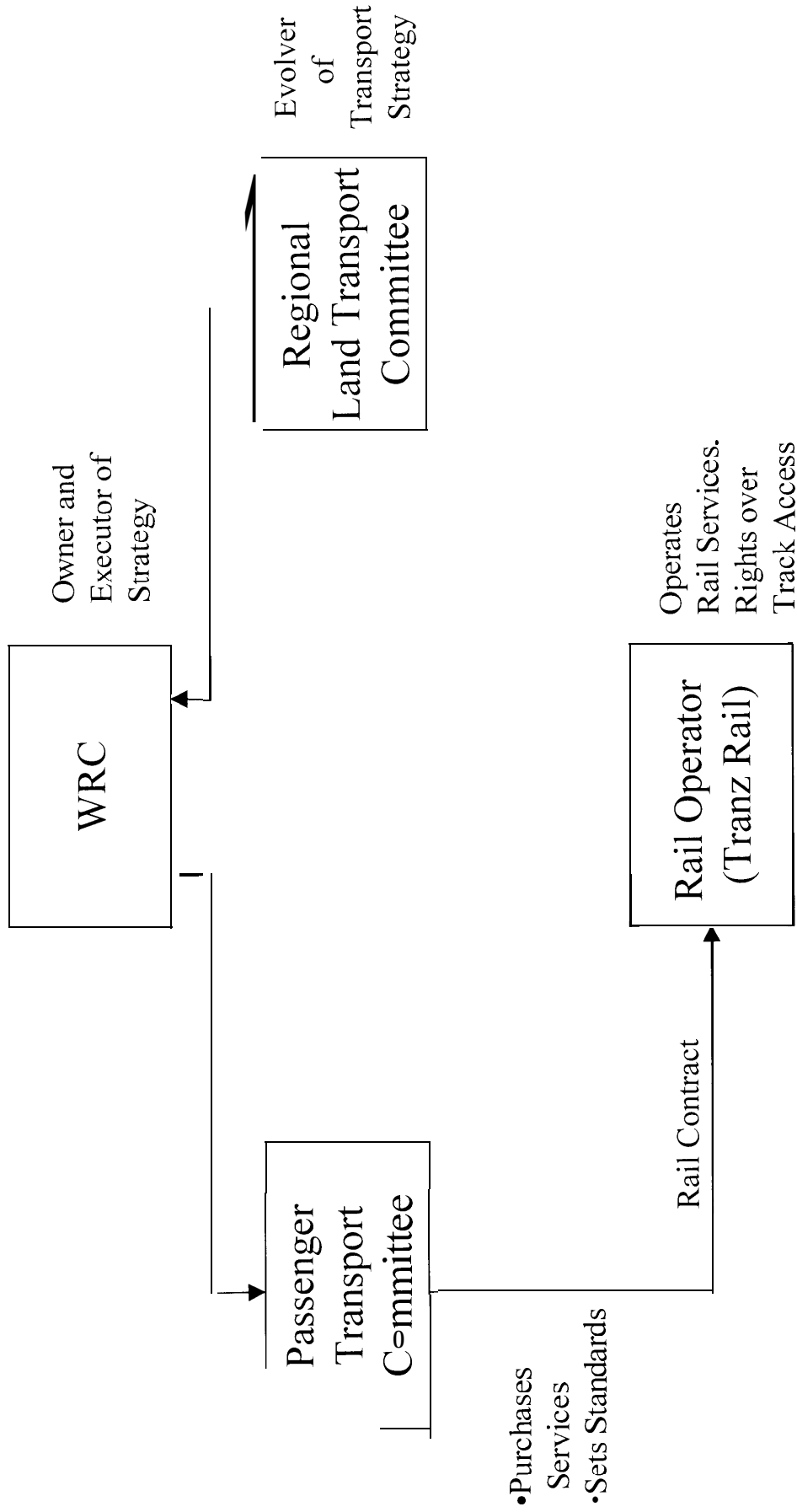
The following two diagrams contrast the current situation with the intended situation under the public/private partnership approach, and also highlight where new documentation will be required.

# Overview of WRC's Public Private Partnership Approach





# Current Situation



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## 6.0 Overview of Key Documentation underpinning the Public/Private Partnership

The following suite of documents will give effect to and regulate the WRC's public/private partnership model.

Document	Parties Affected
(1) Funding Agreement for the provision of suburban rail services for the Wellington Region	<ul style="list-style-type: none"> <li>• WRC's Passenger Transport Committee</li> <li>• Wellington Regional Rail Ltd</li> <li>• Transfund NZ</li> </ul>
(2) Passenger Train Services in the Wellington Region - Community Charter 2001	<ul style="list-style-type: none"> <li>• Regional Community Users Committee</li> <li>• Wellington Regional Rail Ltd</li> <li>• WRC's Passenger Transport Committee</li> </ul>
(3) Ownership documents (strategic) (a) Heads of Agreement  (b) Shareholders' agreement  (c) Company Constitution  (d) Statement of Corporate Intent	<ul style="list-style-type: none"> <li>• WRC Holdings Ltd</li> <li>• Private Operator</li> <li>• WRC</li> <li>• WRC Holdings Ltd</li> <li>• Private Operator</li> <li>• WRC</li> <li>• WRC Holdings Ltd</li> <li>• Private Operator</li> <li>• Wellington Regional Rail Ltd</li> <li>• WRC Holdings Ltd</li> <li>• Private Operator</li> <li>• Wellington Regional Rail Ltd</li> <li>• Public</li> </ul>
(4) Ownership documents: (operational) (a) Business Plan *  (b) Corridor/Infrastructure Lease Agreement *  (c) Corridor/Infrastructure Sub Lease Agreement *	<ul style="list-style-type: none"> <li>• WRC Holdings Ltd</li> <li>• Private Operator</li> <li>• Wellington Regional Rail Ltd</li> <li>• New Zealand Railways Corporation or Tranz Rail Ltd</li> <li>• WRC Holdings Ltd/WRC</li> <li>• WRC Holdings Ltd/WRC</li> <li>• Wellington Regional Rail Ltd</li> </ul>

\* These documents cannot be developed at this stage. It is expected that the business plan will provide the detail upon which the Statement of Corporate Intent will be built. The content of the lease and sublease of the corridor and associated infrastructure will depend on the nature of track access negotiated. These documents 4(a), (b) and (c) will be developed later in the process.

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There are a number of key aspects of each document as follows:

#### 6.1 Funding Agreement

Once the public/private partnership entity has been formed and due diligence completed, the entity will need to enter into a Funding Agreement with the Regional Council. It is expected that about half of the company's revenue will come through this Funding Agreement.

The agreement sets out the level of service required and how it will be paid for. The Funding Agreement provides for half of what may be termed "super profits" of the company to be rebated to the Regional Council, as funder.

The agreement requires extensive information disclosure, something that is lacking under the present arrangement with Tranz Rail, and transparent long term asset management planning.

The agreement also provides the Regional Council, as funder, with the ability to buy back the key assets (e.g. rolling stock) at the end of the contract period, or earlier if the Rail operator is in breach of the Rail contract.

The buy back provisions serve two important purposes:

- They provide an incentive for the Rail operator to invest in assets in the knowledge that they will be able to receive compensation for unused service potential at the end of the contract period.
- They provide the WRC, as funder, with the ability to gain control of all key assets which will provide the WRC with the ability to contract with another operator should it chose to do so.

#### 6.2 Heads of Agreement

This agreement sets the scene for establishing the public/private partnership entity, but recognises that a number of issues must be satisfactorily resolved before the entity can be formed. In effect, it captures the partnership intent (the "Engagement" phase). Clause 2 of the Heads of Agreement outlines that the Regional Council will be undertaking a public consultation process prior to any irrevocable commitment to purchase the Tranz Metro business.

Also, several important issues need to be agreed between the parties as outlined in clause 6. Apart from some specific clauses, the Heads of Agreement is non binding on the parties which allows either party to withdraw should they wish. However, it is expected the parties will sign the Heads of Agreement in good faith, having some expectation that the process may be completed.

The participants to the Heads of Agreement are the Regional Council, its subsidiary company, WRC Holdings Ltd, and the proposed private sector partner.

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### 6.3 Shareholders' Agreement

Once reasonable progress has been made on the purchasing of Tranz Metro (Wellington), and the resolution of other business issues, it will be appropriate for the Heads of Agreement to be superseded by a more comprehensive document. This document will be the Shareholders' Agreement. (The "Marriage" Phase) The Regional Council has made it clear that it wishes to keep open the options for the future. Clause 15 indicates that after five years, the Regional Council will consider its ongoing ownership position.

As the company will be a LATE, it will have a number of reporting requirements under the LATE legislation, and these have been included in the agreement.

### 6.4 Constitution of Wellington Regional Rail Ltd

The primary objectives of Wellington Regional Rail Limited will be to:

- Operate as an efficient and effective rail passenger transport provider;
- Provide high quality, safe, reliable, sustainable passenger rail transport services to the Wellington region;
- Operate as a responsible business and effectively manage risk;
- Protect the investment of, and provide a reasonable commercial return to, its shareholders;
- Deliver value for public funds and protect the interests of the stakeholders
- Be publicly accountable through transparency of information, while not compromising commercial sensitivity.

The constituent of the company reflects these as required outcomes.

The Constitution is similar to any company constitution for this type of business, but with a number of specific exceptions.

The ordinary shares would be held equally by WRC Holdings Ltd and the private sector partner. This enables each party to appoint three Directors. There is also one special share called a C share that will be held by the Regional Council. This gives the Council the right to appoint an additional Director under specific circumstances that are outlined in the eighth schedule of the Constitution. Appointment of a Director by utilising the rights of the C share is likely to signify that the whole concept of an equal partnership has become dysfunctional. Under these circumstances the appointment of an additional Director will ensure that the day-to-day business of the company can continue. Under normal circumstances, company resolutions are passed by a majority of the Directors and the Chair does not have a casting vote. Many of the key decisions of the company require unanimous support of Directors and therefore the C share does not affect this situation.

Elected representatives of the Council are not permitted to be Directors.

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6.5 Other Documents

There are two other documents in the suite. These are the Community Charter which is self explanatory, and a Statement of Corporate Intent that will be expanded once the Funding Agreement, Shareholders' Agreement and Company Constitution are finalised.

The potential private sector partners have had the opportunity to comment on the draft documents. It is expected there will be further changes once negotiations are completed with the preferred partner.