



Our ref: 0339140

26 June 2006

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Dear Barry

## Rail Funding Contract

You have requested that we review the proposed Funding Contract between Greater Wellington Regional Council and Toll NZ Consolidated Limited (**Toll**) for the provision of urban passenger Rail Services in the Wellington region (**the Contract**). Our comments are on the latest draft which is referred to as Draft 16, dated 26 June 2006. We understand some continuing discussions are occurring with Toll but that you do not expect any material changes from this version.

The Contract specifies the Rail Services required by Greater Wellington including specific timetables and fares. It requires Toll to provide those as efficiently and effectively as possible and to the prescribed minimum standards. In return Greater Wellington will in each year pay Toll an Operating Expense Contribution, being the difference between fares and other revenues, and the actual operating expenses. In addition, Toll will be paid a Fee. The Contract is for an initial period of 5 years but can be automatically extended for a further 5 giving a guaranteed term of 10 years.

We have reviewed your Report to the Policy Finance and Strategy Committee of Council in relation to the Contract. We confirm that your Report is an accurate summary of the main terms of the Contract, and appropriately highlights the main areas of risk.

In our view, the areas of most significant risk are financial and are:

- 1 First the commitment given to pay the Operating Expense Contribution. This is essentially a payment of the operating losses. Greater Wellington does not have direct control of the expenses and if they increase markedly, the annual payment by Greater Wellington will increase as a consequence. You have appropriately identified payments to ONTRACK for track access fees and Renewal Charges as being particularly problematic.
- 2 There is a commitment in the Contract to purchase the Ganz Mavag rolling stock at the end of the 10 year contract if it is not renewed. There is no certainty of the sum

payable. In addition there is no assurance of funding from Land Transport New Zealand.

The Contract includes by reference the initial 10 year Business Plan for the Metro business. This is to be approved by Greater Wellington and attached. The Business Plan is important. It essentially has contractual status as Toll are required to operate the business in accordance with that plan, and cannot carry out any activities that are not included in that plan.

The initial plan and also subsequent plans must also be approved by Land Transport New Zealand so they can be satisfied that it is consistent with the Business Case previously approved by them. The Contract should not be signed until you are satisfied with the Business Plan, and you have obtained confirmation that Land Transport New Zealand is also happy with the Business Plan.

We have reviewed the Procurement Procedure adopted by Land Transport New Zealand (reference 06/03/1744). In our opinion, the proposed Contract complies with that Procurement Procedure. For completeness, we recommend that you provide a copy of the final Contract to Land Transport New Zealand to obtain their confirmation that the Procurement Procedure is satisfied before you sign.

The Contract is very comprehensive. It provides detailed provisions requiring full disclosure, reporting and monitoring of the provision of the Rail Services. These provisions are very materially enhanced from current arrangements. We believe that the Contract will give Greater Wellington the ability to fully and effectively monitor the provision of the Rail Services.

The form of the Contract has been subject to intense negotiation over an extremely long period. As a consequence, some of the agreed terms are not particularly elegant. However, in our view none of this compromises the overall effectiveness of the Contract.

In our opinion, the Contract appropriately contains all usual features that we would expect in a contract of this nature. The reporting obligations of Toll and the monitoring ability of Greater Wellington is very comprehensive. Appropriate provisions for review, arbitration of disputes, monitoring compliance, and remedies for default are included.

Phillips Fox is of the opinion that the Contract is in a form we believe appropriate for execution by Council if it is satisfied about the financial implications and risks as outlined in your report.

Yours sincerely



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