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Report to the Policy, Finance and Strategy Committee
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Scenarios and Contingencies – Suburban Rail Passenger Transport Services

1. Purpose

To represent to the Committee possible actions and scenarios which may result if sale and purchase negotiations between the Joint Venture partners and Tranz Rail irrevocably breakdown.

2. Background

The Committee is aware that discussions between Tranz Rail and the Joint Venture Partners on the prospective sale and purchase agreement for Tranz Metro Wellington have broken down. The current status is that the Joint Venture Partners are absolutely unwilling to make an indicative bid for Tranz Metro Wellington as required by Tranz Rail. Tranz Rail has noted this position and the Managing Director has indicated that he would consult with a sub-committee of his Board on the matter and respond to the Joint Venture partners accordingly. A response from Tranz Rail was expected last week. However, to date no response has been received. It is clear that the Joint Venture partners' position is a non-negotiable one for all the reasons outlined by the Council Chairperson in briefing documentation and Council media releases. In short, WRC Holdings Ltd as a partner to the Joint Venture, has made it clear that it cannot possibly contemplate making any form of bid for an entity as ill-defined and speculative as Tranz Metro Wellington without first conducting due diligence in full. While Tranz Rail is endeavouring to paint a picture of the Joint Venture not operating in a normal commercial manner, Tranz Rail have failed to acknowledge two important points:

- Indicative bids are normal in situations where a standalone legal entity has been operating and has been subject to full accountability processes, e.g. statutory audit (not the case here).
- Indicative bids are normal in situations where there is more than one bidder (not the case here);

Tranz Rail may respond to the current impasse by either:

- a) Accepting the Joint Venture partners' position and agreeing to the conduct of due diligence at an early date; or
- b) Refusing to accept the Joint Venture partners' position, thereby terminating sale negotiations with the Joint Venture.

Given that the Joint Venture partners' position is non-negotiable, there appear to be no other options.

Therefore, it is appropriate for the Committee to consider the possible scenarios which may eventuate as a result of Tranz Rail making either of the decisions described above.

3. **Comment**

Should Tranz Rail accede to the Joint Venture partners' request, due diligence will be able to commence and the sale and purchase process can further progress to the point where a reliable estimate of the net worth of Tranz Metro Wellington can be established. This is by far the most straightforward scenario and one which would be completely in line with Council resolutions to date, on the matter of the purchase of Tranz Metro Wellington.

On the other hand, should Tranz Rail refuse to accommodate the Joint Venture partners' request, a number of possibilities arise. Simply put, these are:

- (a) **Tranz Rail may choose to remain in the business of supplying rail passenger transport services in the Wellington region (i.e. Tranz Rail may decide that it is prepared to retain Tranz Metro Wellington at least in the short-medium term).**

If this was to occur, clearly it would be in the interests of both Tranz Rail and the Council to establish a long-term funding agreement – no shorter than ten years – which would ensure that the investments desperately required to maintain and improve services were made on a controlled and planned basis. However, in order for this to happen the Council will be seeking a new non-assignable contract with Tranz Rail (or an alternate provider, should such a provider be in a position to respond to the Council's tender for passenger rail services), including the following key features:

- Requirement for the rail operator to be prepared to invest its own capital into the passenger rail business;
- Requirement for long-term asset management planning beyond the term of the ten-year contract;
- Requirement for tough sanctions in the event of failure to deliver agreed services;
- Requirement for the rate of return on the operator's equity to be capped;
- Requirement for vastly improved transparency and information disclosure.

History would have it that Tranz Rail are not prepared to allow such disclosure, and have repeatedly said so on many occasions. It will also be very interesting to once again test Tranz Rail's appetite for using its own capital, backed of course by appropriate adjustment to the annual contract payments, which is so vital in

ensuring passenger rail has a long-term future. In effect, “this is where we came in”. The Council’s objective has always been to obtain a satisfactory long-term funding arrangement accompanied by full disclosure to provide accountability for public funds and to verify value for money. As Councillors may recall, the option to proceed with a Joint Venture acquisition was only adopted once Tranz Rail had announced its intention to sell the Tranz Metro Wellington operation.

Councillors will need to form their own views on the likelihood of the Council being able to agree a new contract with Tranz Rail that includes the necessary protection for the public purse. However, past history would suggest the chances of agreeing a new contract including the above matters are not high.

- (b) **Tranz Rail may choose to place Tranz Metro Wellington on the open market, with a view to attracting private sector purchasers with an interest in owning and running Wellington’s rail passenger services.**

If this scenario eventuated, the Council, as funder of passenger rail services, would have to take a position on the nature of the rail contract including future subsidies, given a change of ownership. As noted in (a) above any new contract entered into with Tranz Rail should be non-assignable (i.e. should terminate in the event of sale) to ensure that the Council is in a strong position in respect of negotiating with any new operator. Under this scenario there would be no guarantees of future subsidy levels until a new contract with a new operator had been entered into by the Council. Such a contract will need to include the matters noted in (a) above. It may be that under this scenario the Council would wish to go further and advise prospective private buyers that, in the view of the Wellington Regional Council, the current subsidy levels paid to Tranz Rail cannot be justified, and that such uncertainty should be factored into any price they are prepared to bid for Tranz Metro Wellington.

- (c) **If the Council is unable to progress a purchase or negotiate a long-term funding agreement, it will be confronted with a progressively deteriorating rail passenger infrastructure and an inevitable decline in service levels, with no obvious means of resolution.**

Clearly, the Council’s obligations under its legislative mandate make it difficult to contemplate doing nothing. Should either of the above scenarios (a or b) not produce an acceptable outcome, the only alternative for the Council would be to consider what other options for providing passenger services might be available to it.

The major problem with passenger services based on heavy rail, apart from the fact that they are currently controlled by a private monopoly, is that the cost of entry is such that no viable competition can realistically be contemplated. Therefore, it would seem that alternatives to rail provide the only other possible option.

Some time ago preliminary work was undertaken to investigate the feasibility of replacing some or all of the current passenger rail services with comprehensive bus services. There is no doubt that this would be a challenge, but under the circumstances it may be wise for the Council to consider reopening such investigations by asking officers to commence work on so doing. The prospect of

buses replacing the rail service would certainly not be a preferred option, but the Council has to weigh this up with the alternative of being put in an impossible situation of having to sign-off the expenditure of hundreds of millions of public dollars, with little or no assurance of value for money. This clearly would be an intolerable position for the ratepayers, and the Council could reasonably be expected to pursue all other avenues with a view to seeking a viable alternative.

A hybrid solution may be to invite Tranz Rail to indicate the services it is prepared to operate on an unsubsidised basis. For example, the current Johnsonville line Sunday services are not subsidised. Once Tranz Rail has nominated the services the Council could arrange for bus services or, where practical, alternative rail services, to fill the gaps. Since limited public subsidies would then be required for rail services, the information the Council would request from Tranz Rail would be minimal and more related to public transport policy issues.

- (d) **However, investigations into the replacement of the rail services with bus and/or other alternatives may prove that such a prospect is logistically too difficult. There will obviously be a number of factors to consider, including those associated with the economics of service provision, its functionality and, importantly, the preferences of the travelling public. Without pre-empting the investigations, Council should consider what options might remain should an alternative to rail passenger transport prove to be impractical.**

Many of the difficulties associated with ensuring fair and equitable continuity of Wellington's rail passenger transport system can be attributed to the existence of a private monopoly of service provision. The final option open to the Council is to request Central Government to regulate the private monopoly controlling rail passenger services in the Wellington Region. There are clear national, regional and local community benefits to ensuring that passenger rail services continue to exist and grow into the future. Such an outcome is important to the economic and social infrastructure of the Wellington Region and it should not be unilaterally governed by the exercise of private monopoly power. Central Government, its agencies such as Transfund, and the Regional Council, all have an interest in ensuring the regulatory framework provides for the delivery of a successful outcome.

4. CPP Implications

The Council should not lose sight of the fact that it must follow an approved competitive pricing procedure (CCP) when purchasing any bus or rail service. Transfund New Zealand may approve a CPP for the purchase of Wellington urban rail services as early as its December meeting. That CPP could restrict the manner in which the Council seeks to procure rail services (i.e. competitive tender) and could impose conditions on the parties to any contract that might strengthen what officers are currently proposing.

5. Conclusion

This report does not recommend that Councillors make any final decisions on courses of action. Currently, Tranz Rail has a decision to make with regard to continuing negotiations with the Joint Venture partners. This decision will provide for the immediate path forward, but it will not take out of play all the other scenarios noted above.

6. Recommendations

That the Committee recommend to Council that it:

- (1) Receive the report and note its contents;*
- (2) Request officers to update their earlier preliminary investigations on how the current Wellington rail based passenger transport services might be replaced, partially or wholly, with bus services and/or other alternatives.*
- (3) Request officers to seek the view of Government on the desirability of regulating urban passenger rail services, given the monopoly nature of the market.*

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