greater WELLINGTON
REGIONAL COUNCIL

PUBLIC EXCLUDED

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Contract with Toll New Zealand for the Supply of Wairarapa Passenger Cars

1. Purpose

The purpose of this paper is:

1. to inform and update all Councillors on progress for the provision of 18 railway passenger cars for Wellington to Masterton services.
2. Request the Council, as shareholder of WRC Holdings Ltd, to approve WRC Holdings Group entering into the transaction.

2. Public Excluded

Grounds for exclusion of the public under section 48(1) of the Local Government official Information and Meetings Act 1987 are:

That the public conduct of the whole the or relevant part of the proceedings of the meeting would be likely to result in the disclosure of information for which good reason for withholding exists. (i.e. to enable any local authority holding the information to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations).

3. Significance of the decision

The content of this report proceeds with the proposals set out in the LTCCP amendment and 2005/06 Annual Plan. The LTCCP amendment and 2005/06 Annual Plan are a result of the Council's consultation with the public which took the form of submissions being made on the proposed LTCCP amendment and proposed 2005/06 Annual Plan. The proposed changes to the LTCCP and proposed 2005/06 Annual Plan triggered section 76 (3)(b) of the Local Government Act 2002 and triggered the Council's own policy on significance. Reports 05.150 and 05.151 outline the submission process and analyse the submissions the Council received. The formal submission process undertaken by the Council complied with the decision making and special consultative procedures set out in sections 76 to 79 and 83 to 85 of the Local Government Act 2002.

4. Background

GWRC has been investigating the replacement of the carriages on the Wairarapa- Wellington services. The current carriages are very old and in need of replacement.

A number of discussions have been held with the Government and its agencies regarding the potential funding of these carriages. At the same time negotiations have been conducted with Toll on a new contract for the provision of rail services in the region. During these negotiations it became evident that Toll, while willing to fund capital expenditure, such as rolling stock, would require a return on their investment far in excess of GWRC's own cost of capital.

As a result of this, the Government and GWRC agreed that the Government would assist in funding the purchase of rolling stock on the proviso that ownership resided with the Council. The funding from the Crown would involve a 60% grant from Land Transport New Zealand (LTNZ) and 40% by way of an interest free loan from the Government of $10.6 million. The loan agreement has been approved by GWRC. The loan is repayable in 2007, although the Government's intention is for GWRC to repay it over the life of the carriages.

The current service is well patronised with trains often being full to capacity. As such, the process was based on not only replacing the carriages, but also increasing the capacity.

5. The Contract Process

5.1 Request for Tenders

During December 2004, GWRC issued a Request for Tender (RFT) for the supply of 18 No. railway passenger cars to be supplied in 3 identical train consists (6 carriages each) to operate train services between Wellington and Masterton. A budget of $26.42 million was agreed for the contract. GWRC would procure the new cars and lease them to Tranz Metro Wellington at a 'peppercorn rent' for them to be used solely on Wellington to Masteron Services. As agreed previously with Council, the cars would be owned by a wholly owned subsidiary of GWRC.

The specification required the provision of 324 seats, catering and information facilities and facilities for the disabled. The specification left it to the judgement of the tenderer where to situate the generator for the train's electrical supply.

5.2 Tender Evaluation

On 30 March 2005, GWRC received 3 tenders in response to its RFT from the following organisations.

- Daewoo International Corporation (Daewoo) of Korea
- Hai-Phong Railway Compartment Company (HRCC) of Vietnam
- Toll NZ Consolidated Limited (Toll) of New Zealand

Toll's tender proposed the use of re-built British Rail Mk2 carriages, essentially a development of the S Cars currently operating the Capital Connection service. These would be manufactured in Dunedin at their Hillside facility. However, to ensure they complied with seating capacity and provided an adequate amount of luggage space their base bid (which a price was provided for) was for a 7-car consist, with the 7th car being a dedicated generator (to supply electricity for the other cars) and luggage car. They did submit a technical offer for a 6-car consist (this had the generator in one of the passenger cars as requested in the RFT) but not a price. They also provided an option for fitting new bogies from China as opposed to using refurbished bogies, which was their base design.

Daewoo's bid proposed the use of brand new cars based on their standard export design.

HRCC's bid proposed the use of brand new cars based on an existing Vietnam Railway design.

The tenders were evaluated using an adapted Land Transport New Zealand Methodology, the Price Quality (Simple) Method. GWRC officers evaluated the tenders, under the scrutiny of a probity auditor from Audit New Zealand, with external legal and technical support from Phillips Fox and Lloyds Register. Non-price evaluation attributes were as follows

- Track Record
- Technical Specification and Skills
- Relevant Experience
- Resources
- Management Skills
- Methodology

Daewoo's tender was quickly eliminated due to the proposed cars not being compatible with the New Zealand railway track and loading gauge.

Presentations were made by Toll and HRCC during May and a number of clarification questions were raised by the evaluation team.

Following the presentations and responses to the clarification questions being received, the HRCC bid was also rejected as being unacceptable in the two attributes of Resources and Methodology.

With the elimination of 2 bidders, only Toll were left as an acceptable bidder, but with the issue of only providing a price for a 7-car consist. However, as stated above, Toll had demonstrated that they could offer a compliant 6-car consist. Given this, the evaluation team agreed that the alternative 7-car arrangement was acceptable to open the price envelope since it provided a number of attractive improvements over the 6-car consist.

The price envelope for the Toll 7-car tender was found to be within the agreed budget of $26.42 million. GWRC negotiations were commenced with Toll with the following specific actions:

1. To obtain from Toll the price for the 6-car consist.
2. To identify the advantages and disadvantages of procuring new bogies.

6. Negotiations and Design Clarification

During the past 6 weeks, negotiations with Toll have confirmed the following prices.

18 Cars delivered as 6-Car Consists (Fitted with refurbished bogies) $25.4 million.

21 Cars delivered as 7-Car Consists (Fitted with refurbished bogies) $26.1 million.

18 Cars delivered as 6-Car Consists (Fitted with new bogies) $27.3 million.

In addition to this, the interior layout of the cars has been reviewed to ensure the provision of adequate passenger facilities and an adequate number of seats within the 6-car consist. The present layout provides 332 seats versus a specification requirement of 324.

Whilst new bogies do provide for a reduction in maintenance costs, this would not be achieved until at least year 20 of operation. Election of the new bogie option would also require the Council to allocate and seek additional funding, since the price exceeds the existing budget allocated. Given these facts, and that the new bogie option increases the delivery timescale, admittedly by only 2 months, the option of new bogies is not preferred to the refurbished bogie.

The 6-car consist fitted with refurbished bogies fully meets the requirements of the Council's Specification. The price also allows for the procurement of large capital spares which are estimated to be in the region of $1.0 million. Additional luggage vans and generator vans can be 'spot hired' from Toll as and when required.

7. The China Option

Subsequent to the tenders noted above, Toll recently came with the option of new carriages sourced from China. The current estimate for the new carriages is $25.9 million.

The main advantages of the new carriages are a longer life (35 years for new versus 25 years for refurbished carriages), greater capacity and probably lower maintenance costs.

However, the evaluation for this new option will take another four weeks before a firm recommendation between the two can be put to Directors.

Regardless of the source, the price will be fixed in New Zealand dollars.

Under either option the contracting party will be Toll.

8. Contract Issues and Risks

8.1 Key Contract Issues

Payment for the cars (either option) would be on the following basis:

- Delivery to Wellington Depot – 90% per Car
- Preliminary Acceptance – 7.5% per Car
- Final Acceptance – 2.5% per Car

This payment profile significantly reduces the exposure since it will not be making any payments until virtual full completion of the cars. On other new train contracts it is normal to make significant payments to the train manufacturer far in advance of taking delivery which increases the credit risk to the procuring agency. Delivery of the first consist will be 14 months after contract signing, assuming the refurbished option, with the second and third consist being delivered 17 and 19 months respectively after contract signature. If the new cars are purchased then they will be delivered in 18 months from contract signature.

8.2 Risk – Refurbished Carriages

Design Risk – This is minimised through the vehicle being a development of the Capital Connection cars and the SA/SD cars which operate in Auckland. Whilst not being ‘cutting-edge’ design, they are reliable and design ‘know-how’ has been gained by Toll over the last 10 years. The Council will also employ a consultancy to review the details of the design at an early stage in the project.

Production Risk – Toll would manufacture these vehicles at their Hillside facility. Reference again to other recent projects has demonstrated that they can provide cars to a prerequisite level of quality. The Council will employ a consultant to inspect the vehicles at key points in the production process to ensure that the production standards are met.

Delivery Risk – Always a key risk on a capital programme, this could be affected by the workload at the Hillside Facility. The Council will address this issue by holding regular project management reviews with Toll and ensuring that a risk management process is maintained throughout the contract.

Price Risk – This will be mitigated by the use of a fixed price contract. The present specification is highly comprehensive and any changes would be subject to a thorough investigation and approvals process.

The risk analysis for the new carriage option will be done once the evaluation is completed and prior to any approval by the Directors of WRC Holdings Group.

9. Shareholder Approval

As noted previously, the contract will be in the name of Pringle House Ltd. However, following consultation (as part of the 2006/16 LTCCP) a new subsidiary or Council Controlled Trading Organisation (CCTO) will be set up which will then hold the contract and subsequent ownership of the carriages. It is likely that this new CCTO will be part of the WRC Holdings Group.

Entering into a contract for $26.4 million is a significant transaction (as defined by their respective Constitutions) for both Pringle House Ltd and its shareholder WRC Holdings Ltd. Thus, prior to Pringle House Ltd approving and entering into this contract, shareholders' resolutions will be required by both WRC Holdings Ltd and GWRC (as shareholder of WRC Holdings Ltd).

WRC Holdings Limited is the holder of all of the ordinary shares in Pringle House Limited. Pursuant to clause 4 of the Constitution of Pringle House Limited, the purchase of two carriages and other rolling stock is a "significant transaction" and, pursuant to clause 30 of its Constitution, Pringle House Limited must not enter into a significant transaction unless the transaction is approved by a special resolution of its shareholders or it is contingent on such approval.

The Council is the holder of all of the ordinary shares in WRC Holdings Limited. Pursuant to clause 28.2 of the Constitution of WRC Holdings Limited, the Board of WRC Holdings Limited must first obtain the written consent of the shareholders of WRC Holdings Limited prior to the Board resolving to pass any resolution required to be passed as a special resolution of the shareholders of any subsidiary company. Accordingly, prior to the Board of WRC Holdings Limited resolving to pass the shareholders resolution approving the transactions contemplated in this report, the Council must provide its approval as shareholders.

As noted above, there are two options being considered - refurbished carriages and new carriages. Both are with Toll, both are within the original budget of $26.42 million and both will be fixed price contracts in New Zealand Dollars.

Due to the lateness of the new carriage option and the absence of key staff, the evaluation of this proposal has not been completed. It is intended this will be done in early September. The next opportunity for Council to approve this transaction is not until their meeting on 18 October. This would delay the process for another month.

It is proposed that, if Councillors are satisfied with either option, the Council could approve (as shareholder) WRC Holdings Group entering into the transaction under the following conditions:

a) The Board of WRC Holdings Limited to make the final decision on whether the refurbished or new carriage option is selected.

b) Regardless of which option is chosen, the contract price must be within the budgeted amount of $26.42 million.

The recommendations later in this report reflect the above conditions.

10. Funding

The funding for the carriages will come from two sources:

a) An interest free loan from the Government up to a maximum of $10.6 million. As Councillors will be aware this facility has been approved and signed by both parties..

b) A grant from LTNZ up to $15.85 million. A copy of the letter from LTNZ (formerly Transfund) is attached, refer **Attachment 1**.

The monies will be received by GWRC who, in turn, will increase the number of shares in WRC Holdings Limited to enable them to fund the purchase through a new (yet to be formed) subsidiary.

11. Communication

No communication is required at this stage.

12. Recommendations

That the Committee recommends that Council:

1. ***receive*** *the report.*

2. ***note*** *the content of the report.*

3. ***note*** *that the two options which are currently being considered for the purchase of the carriages and other rolling stock are:*

    a. *Option A: the purchase and refurbishment by Toll Holdings Limited in Dunedin of second-hand/used carriages and rolling stock for an aggregate amount of $25.4 million; or*

    b. *Option B: the purchase of new carriages and rolling stock from a manufacturer in China for an aggregate amount of $25.9 million.*

4. ***consent*** *to the Board of WRC Holdings Limited resolving to pass a special shareholders resolution of Pringle House Limited approving*

either Option A or Option B, as the case may be, on such additional terms and conditions as the Board of WRC Holdings Limited may determine.

5. ***note**, in approving as shareholder this transaction, that this will require the Council to subscribe to additional shares in WRC Holdings Ltd, sufficient to purchase the carriages.*

Report prepared by:	Report approved by:	Report approved by:
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Attachment 1: Letter from LTNZ