

In Confidence

Office of the Minister for State Owned Enterprises
Office of the Minister of Finance
Office of the Minister of Transport
Office of the Minister for Regional Economic Development

Chair
Cabinet Economic Development Committee

THE FUTURE OF RAIL: KIWIRAIL STRUCTURE AND TRACK USER CHARGES

Proposal

1. We propose that the Cabinet Economic Development Committee (the Committee):
 - 1.1. note that KiwiRail will retain its current entity structure as a vertically integrated State-Owned Enterprise (SOE), with a further review of its SOE status to commence in December 2020
 - 1.2. note that Cabinet has agreed a new planning and funding framework for rail, that will see the rail network funded via the National Land Transport Fund (NLTF), with funding being provided to the NLTF, from the Crown and track users
 - 1.3. note that in order to implement track user charges regulations need to be made to enable track users to pay charges into the NLTF. This will ensure that track users contribution to funding rail network infrastructure is fair and transparent
 - 1.4. agree that track user charges be established and paid into the NLTF from KiwiRail's freight and tourism operations
 - 1.5. note that Auckland Transport (AT) and Greater Wellington Regional Council (GWRC), who are significant users of the rail network for passenger services, currently pay for the use of the Auckland and Wellington networks through contractual arrangements with KiwiRail
 - 1.6. agree that at this stage no changes are made to the existing contractual charges and access arrangements between KiwiRail, AT and GWRC respectively
 - 1.7. note that further consideration will be given to how other existing contractual arrangements between KiwiRail and other rail operators are treated, such as tourism operators and small heritage operators, and the treatment of inter-regional rail services
 - 1.8. 

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- 1.9. note that we will report back to you in July 2020 on final proposals for the level of track user charges, the track users that will be subject to those charges, and the details of how the charges will be administered.

Executive summary

2. The Government is committed to enabling rail to play its role in a multi-modal land transport system. In 2019, Cabinet considered the findings of the Future of Rail review [refer DEV-19-MIN-0123, CAB-19-MIN-0240, DEV-19-MIN-0225, CAB-19-MIN-0439]. Cabinet noted that rail contributes to national and regional economic growth, reduces emissions and congestion, reduces road deaths and injuries, facilitates wider social benefits, and provides resilience and connection between communities.
3. As a result of the Future of Rail review, Cabinet has:
 - 3.1. agreed in principle to an investment scenario to deliver a resilient and reliable rail system to realise the benefits of rail for New Zealand
 - 3.2. agreed to progress legislative amendments to the Land Transport Management Act 2003 (LTMA) to introduce a new long-term integrated planning and funding framework for rail, including funding rail network investments through the NLTF with support from Crown and track user charges
 - 3.3. agreed to Rail Ministers developing and issuing a New Zealand Rail Plan to set the long term direction for rail in New Zealand and guide investment decisions through future Budgets and the Government Policy Statement on land transport (GPS) 2021
 - 3.4. noted that under the new planning and funding framework, the Crown will need to continue to provide substantial and increasing funding for rail activities, including through the NLTF.
4. This is the third substantive policy paper in relation to the Future of Rail review. This paper:
 - 4.1. recommends KiwiRail retains its current organisational status and form as an integrated SOE, with a further review of its SOE status to commence in December 2020
 - 4.2. provides an update on the principles we are applying to guide decisions for funding rail through the NLTF, and the process for establishing track user charges.

KiwiRail structure

5. We have considered whether we should change KiwiRail's structure and form. We acknowledge that KiwiRail comprises a mixture of commercial operations (the rail freight, ferry and tourism business) and other operations, which will be funded for benefits outcomes (largely maintenance and upgrades to the rail network).

6. We agree that vertical integration of KiwiRail's commercial operations of network operations remains appropriate. We do not believe that competition in the rail freight market is likely given the scale of the New Zealand market. There is also efficiency in co-managing track infrastructure along with the trains that use it, aligning network investment with demand, and making the best use of New Zealand's limited pool of rail expertise.
7. We also recognise that KiwiRail's focus should be on delivering its investment into the rail network and its commercial assets. We consider that a form change would add undue pressure to KiwiRail at this time and believe that its focus should be as a commercial enterprise for the foreseeable future.
8. We have therefore determined that the current form of KiwiRail as a SOE should remain in place. While we are recommending that KiwiRail remain an integrated business, we support KiwiRail putting in place separate financial reporting for its commercial and network businesses. This will provide transparency and accountability for the NLTF revenue being allocated to KiwiRail's network costs.
9. We are also conscious of the emerging impacts of COVID-19. We will need to continue to monitor this situation and what this may mean for KiwiRail and the draft New Zealand Rail Plan.

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We need to factor this into our considerations in the future. We do not anticipate any impacts on KiwiRail's form at this time.

10. We have asked officials to initiate a further review of KiwiRail's SOE form in December 2020. This will enable us to consider whether the changes being implemented through the Future of Rail have provided the transparency and accountability outcomes we are seeking through the new planning and funding framework.

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Funding and track user charges

11. Cabinet has previously agreed to a new planning and funding framework for rail, that will see the rail network funded via the NLTF, with funding being provided to the NLTF from the Crown and track users.
12. In order to implement track user charges, regulations need to be made to enable track users to pay charges into the NLTF. This will ensure that track users' contribution to funding rail network infrastructure is fair and transparent. This paper provides an update on the principles we are considering for funding rail through the NLTF, including track user charges.
13. We recognise that track users (those who operate vehicles on the rail network) cannot cover the full costs of the rail network given low utilisation levels relative to the extent of the track network and due to the significant catch-up investment required. We also

acknowledge the broader benefits of using freight and passenger rail for New Zealand. Paying full costs would force up costs for track users and could result in lower utilisation of the network.

14. Cabinet previously noted that under the new planning and funding framework, the Crown will need to continue to provide substantial and increasing funding for rail activities. This includes an ongoing contribution to the NLTF so it can fund the required catch up investment in the rail network and achieve the broader benefits we are seeking from the rail network.
15. KiwiRail's freight and tourism businesses will only be able to pay a small proportion of the track user charges that would be needed to cover the full cost of the national rail infrastructure.

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16. Cabinet has taken decisions through Budget 2020 on the level of Crown funding that will be provided to the NLTF to fund the rail network. Under Budget 2020 \$236.3 million for 2021/22 and \$148.2 million for 2022/23 has been allocated to invest through the NLTF (pending the passage of the Land Transport (Rail) Legislation Amendment Bill). The draft GPS 2021 has also provisionally indicated up to \$120 million per year from existing NLTF revenue sources over the next 10 years. Further consideration will need to be given to this amount as part of finalising the GPS, including considering the overall impacts of COVID-19 on the NLTF and Government priorities. Decisions are not sought on the final funding amount at this time. However, collectively, track user charges, Crown funding and existing NTLF revenue will fund the rail network in future.
17. The Ministry of Transport has work underway with international experts to review and finalise the amount of funding that should be collected through track user charges from KiwiRail's freight and tourism business. We will report back to Cabinet on final proposals for funding amounts and the details of the administrative requirements for track user charges in July 2020. We will also seek approval to begin drafting regulations to enable payment of track user charges into the NLTF at that time.
18. We have also asked officials to consider whether the existing track access charges that KiwiRail has in place with AT and GWRC should be paid into the NLTF to improve transparency. The existing track access arrangements are 85 year agreements and provide contractual and funding mechanisms to ensure that KiwiRail provides the service levels expected on the metropolitan rail networks. KiwiRail charges AT and GWRC for the costs associated with the passenger services they run on the network. The charges are based on an agreed ongoing programme of maintenance and renewal on the network, and include a performance payment for meeting agreed levels of service. AT and GWRC receive partial subsidies for these charges through existing public transport funding, from the NLTF.
19. AT, and its parent body Auckland Council, as well as GWRC have sought to maintain these arrangements as they are now. GWRC and AT have raised concerns about

their ability to hold KiwiRail to account for service performance without these direct contracts. GWRC and AT have noted that existing agreements are well-established and there has been significant work undertaken to put the arrangements in place, including establishing a cost allocation methodology to share costs between KiwiRail as the freight user of the network and themselves for using the network for passenger services.

20. The arrangements provide AT and GWRC long term certainty about the metropolitan rail networks and access arrangements. The arrangements also put in place performance and accountability mechanisms between the parties. Officials also note that paying these charges into the NLTF creates the potential for double counting as these arrangements are already subsidised through the NLTF.
21. Given these issues, at this stage we do not propose that these charges are paid into the NLTF. However, to improve transparency, we propose that these contractual charges be disclosed in the rail network investment programme, alongside any agreed rail activities on the metropolitan rail networks.
22. This is the first time that track user charges will be set to contribute to the NLTF. We expect the overall arrangements will need to be reviewed over time as network investment is made and utilisation of the network increases. We will also need to monitor the impacts of COVID-19 in the coming months, and factor this into our final work.

Background

23. The Government is committed to supporting rail to play its role in a multi-modal land transport system. Cabinet previously considered the findings of the Future of Rail review [refer DEV-19-MIN-0123, CAB-19-MIN-0240, DEV-19-MIN-0225, CAB-19-MIN-0439]. It noted that rail contributes to national and regional economic growth, reduces emissions and congestion, reduces road deaths and injuries, facilitates wider social benefits, and provides resilience and connection between communities.
24. While the Government is committed to rail, the Future of Rail review found that realising these benefits is hampered by:
 - 24.1. the rail network being in a state of managed decline due to long-term under-investment
 - 24.2. the short-term planning and funding arrangements for the rail network which create uncertainty for the rail business
 - 24.3. road and rail investments taking place within different decision-making frameworks, leading to a lack of integration between road and rail network investment.
25. Cabinet agreed in principle to an investment scenario to deliver a resilient and reliable rail system to realise the benefits of rail for New Zealand, subject to agreeing a new planning and funding framework for rail. Cabinet subsequently considered and agreed a new planning and funding framework, which includes the following key components:

- 25.1. Establishing a New Zealand Rail Plan, which will guide investment decisions for Crown funding, NLTF funding and other funding sources over the next 10 years.
- 25.2. The Crown will continue to fund through shareholder equity injections, commercial investment decisions in combination with KiwiRail revenue and other commercial financing (this largely relates to “above rail” assets such as rolling stock and the Interisland ferries).
- 25.3. The costs of the national rail network (“below rail”) will be funded via the NLTF, with contributions from existing NLTF revenue, the Crown and track users.
- 25.4. Rail network activities will be included in the GPS, and KiwiRail will receive funding from the NLTF.
- 25.5. Confirming roles and responsibilities for the Ministry of Transport, Waka Kotahi NZ Transport Agency (Waka Kotahi) and KiwiRail, Ministerial responsibilities, and legislative amendments required to implement the new planning and funding framework for rail.
26. Cabinet also noted that under the new planning and funding framework, the Crown will need to continue to provide substantial and increasing funding for rail activities, including through the NLTF.
27. In December 2019, Joint Rail Ministers issued a draft of the first New Zealand Rail Plan (the Rail Plan). The Rail Plan sets out the Government’s vision for rail over the next ten years, including the changes we are making to implement a new planning and funding framework. It is a non-statutory document that will be used to inform investment signals for rail through the GPS and future Budget funding decisions.
28. In March 2020, the draft GPS 2021 was issued. It allocated funding of up to \$120 million per year for the rail network over the next 10 years, in addition to completing existing metropolitan rail network projects in Auckland and Wellington.
29. Feedback on the Rail Plan and the GPS is currently being sought through the engagement process on GPS 2021. The final Rail Plan is intended to be released alongside the final GPS 2021 later in 2020.
30. This Cabinet paper is the third in the series of three substantive policy papers on the Future of Rail review and its outcomes. This paper:
- 30.1. notes we are not recommending changes to KiwiRail’s current status as a SOE, with a further review to commence in late 2020
- 30.2. provides an update on funding principles and the development of track user charges.

KiwiRail’s structure and status as a SOE

31. KiwiRail is a SOE, which owns New Zealand’s rail infrastructure and operates freight and passenger services. The Crown is a 100 percent shareholder of KiwiRail. The

New Zealand Railways Corporation (NZRC) owns the land associated with the rail network and leases this land to KiwiRail for a nominal annual rental.

32. Rail has undergone significant structural and concurrent market changes in its recent history, from corporatisation and privatisation in the decade to 1993, to reacquisition of the above rail asset by the Crown and the establishment of the combined above and below rail asset as a SOE.
33. Under the State-Owned Enterprises Act 1986 (the SOE Act), a SOE is required to:
 - 33.1. operate as a successful business and be as profitable and efficient as comparable businesses
 - 33.2. be an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage those when able to do so.
34. The SOE Act also allows the Crown to pay SOEs for non-commercial activities.
35. KiwiRail comprises a mixture of commercial operations (the rail freight, ferry and tourism businesses). It also provides the network infrastructure which will, following the anticipated implementation of the Land Transport (Rail) Legislation Amendment Bill (Rail Bill), largely be funded through the NLTF, with revenue from existing revenue sources, the Crown (including the Provincial Growth Fund), and track user charges.
36. As a result of the recommendations of the Future of Rail review to implement a new planning and funding framework, we have now considered whether there should be subsequent changes to KiwiRail's status as a SOE.
37. This is particularly in light of the broader benefits that we recognise we want to achieve from the rail network, and funding the rail freight network activities through the NLTF on a national benefits basis like road (rather than in a commercial decision-making framework).

Separating the above and below rail business would likely cause instability

38. We have considered whether the above and below rail operations should be separated, as they were in the period between 2004-2008. We do not recommend separating the above and below rail businesses.
39. Separation is generally driven by the desire for competitive rail services across a common network to drive efficiency and innovation. New market entrants of a sufficient scale into the commercial rail freight market are unlikely, given the small size of the market. Therefore, we are unlikely to see the benefits of competition.
40. In addition, we are proposing major upgrades to both above and below rail assets. The best way to manage upgrades and operation, to ensure rail continues to deliver commercial benefit and the broader benefits government seeks, is through a fully integrated business. Separating those who work on the network from those who operate the network would be detrimental to the objectives of both.

41. There are also a number of benefits of maintaining vertical integration including:
 - 41.1. efficient co-management of train and track infrastructure
 - 41.2. alignment of network investment with actual market demand
 - 41.3. more efficient pooled use of New Zealand's limited resource of rail expertise.

Statutory form options considered

42. We subsequently considered three alternative statutory forms for KiwiRail – as a SOE, a Crown Entity Company or a Crown Agent.

We propose that KiwiRail retain its integrated SOE status at this time

43. We have considered the three structural options. We consider, given the nature of the railway business and the mix of commercial and benefits being sought from KiwiRail, that none of the statutory form options are a perfect fit.
44. Structural change is a disruptive process. The State Services Commission (SSC) advises that it takes three years on average for an agency to recover from major structural change. We are advised by the SSC that structural change should not be pursued without sufficiently large incentives for change.
45. Officials and KiwiRail advise that structural change could disrupt KiwiRail's primary focus on delivering the resilient and reliable investment programme and the new planning and funding framework. COVID-19 has also caused significant disruption, and it will take time to determine and respond to the effects of this.
46. We recognise that KiwiRail's focus should be on delivering its investment into the rail network and its commercial assets. We consider that a form change would add undue pressure at this time and believe that KiwiRail's focus should continue to be as a profit-oriented commercial enterprise for the foreseeable future. The commercial disciplines and focus of KiwiRail are important to support efficiency in asset management and to drive commercial returns from the provision of freight, property and tourism services to customers.
47. We have, therefore, determined that the current form of KiwiRail as a SOE (with NZRC also as a SOE) should remain in place.
48. We will also be inviting KiwiRail to implement separate above and below rail financial reporting to ensure that there is transparency of the above and below rail revenues and costs. This will be critical to enable the NLTF to fund the rail network under the new planning and funding framework, and ensure that there is appropriate transparency for funding purposes.
49. Accountability arrangements for the different funding sources provided to KiwiRail will also need to be revised. This will include Waka Kotahi taking accountability for monitoring below rail funding through the NLTF, and the outcomes it will achieve.

50.

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We have asked officials to undertake a further review of KiwiRail's structure beginning in December 2020. The review will be reported back to Cabinet by October 2021. The Ministry of Transport and the Treasury will jointly lead this review, with input from KiwiRail and the SSC. [REDACTED]

Funding rail infrastructure under the new planning and funding framework

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Cabinet agreed, in principle, to a reliable and resilient rail system to ensure rail is sufficiently resourced to deliver transport benefits and improved commercial outcomes. This was indicatively estimated at [REDACTED] over a 10-year period (excluding operating and maintenance costs and inflation). Budget 2019 provided \$741 million as the first instalment of funding, and Budget 2020 provided an additional \$1.215 billion.

53.

Significant and increased Crown funding from historical levels, under which rail was in a state of managed decline, will continue to be required. This includes providing ongoing Crown funding to the NLTF to fund the rail network. The funding approved through Budget 2020 includes \$236.3 million in 2021/22 and \$148.2 million in 2022/23 to enable rail network activities to be funded under the NLTF.

54.

Further phases of funding will be required in future Budget rounds to ensure a reliable and resilient rail system.

55.

Funding will be channelled through the NLTF for rail network maintenance and renewal from 2021. Under the new framework, there will be three sources of funding for the rail network:

55.1. the NLTF (revenue into the NLTF is currently paid by road users through fuel excise duty, road user charges and vehicle registration and licensing fees)

55.2. track user charges (revenue from rail operators that use the rail network)

55.3. the Crown account (from general taxation).

56.

Track users are the most direct beneficiaries of the rail network and derive private benefits from the use of the network. However, given the significant funding required to restore the rail network and the current level of utilisation of the network, track users will not be able to fully fund the network. We also acknowledge there are broader benefits from the rail network, such as congestion reduction, environmental and regional economic development benefits. By "track users", we mean the rail operators that operate rail vehicles on the network.

57. Funding will therefore need to come from the Crown and the NLTF, particularly over the next decade while significant investment is required to improve the reliability and resiliency of the rail system.
58. We are using the following principles to guide how funding decisions are made, regarding contributions from track users, NLTF, and the Crown:
- 58.1. Funding needs to be sufficient to enable a reliable and resilient rail system, and acknowledge historic under-investment in the network.
 - 58.2. Infrastructure costs should be borne by those who benefit.
 - 58.3. Funding should be transparent for all parties and the public, and support accountability of all parties.
 - 58.4. Any track user contribution should be affordable for train operators and not reduce the use of rail.
 - 58.5. Funding should be equitable and support inter- and intra-modal competition.
 - 58.6. Funding should support efficient operation of the infrastructure.
 - 58.7. The funding system should not impose unnecessary transaction costs.
59. It will be important to consider the impact of COVID-19 on the principle of affordability for track users. It may mean the level of track user charges set in the short term are different to what might be ideal track user charges in the longer term.
60. The Minister of Transport has provisionally indicated that up to \$120 million could come from the NLTF to support rail in issuing the draft of GPS 2021 that is currently out for public engagement. We recognise that it is appropriate for the NLTF to contribute some of the funding, given the transport benefits associated with the rail network. However, the impacts on the NLTF from COVID-19, and consideration of accelerating infrastructure projects to provide economic stimulus, are also being worked through.
61. The Crown will also need to continue to contribute on an ongoing basis, reflecting the broad benefits (beyond transport) that result from its investment in the rail network. Over the next decade, the Crown contribution also acknowledges the historic under-investment in the rail network and the significant investment required to achieve a reliable and resilient rail network.
62. We are not seeking decisions about the amounts or proportions of Crown or NLTF funding at this time. These decisions, which are critical to support the new planning and funding model, will be taken through GPS 2021 and future Budget processes.

Framework for track user charges

63. Cabinet has agreed in principle, subject to a further report covering the principles for a track user charge, that a track user charge be used to ensure rail operators also contribute towards rail maintenance and renewals in a fair and transparent way

[DEV-19-MIN-0225 refers]. This paper updates you on the framework we are developing for setting track user charges. We will report back to you with detailed policy decisions in July 2020, to support regulations to be made following this.

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- 64.** Introducing track user charges is important for two reasons:
- 64.1. fairness to those contributing to the NLTF** – the beneficiaries of infrastructure from the NLTF should contribute to funding its costs
 - 64.2. transparency** – the basis of any contributions, including the principles on which any rate is set, should be transparent.
- 65.** We have considered two broad options for how track user charges should operate:
- 65.1.** a co-contribution model, whereby Ministers agree the level of contribution from track users every three years when considering the rail activities that are proposed for funding
 - 65.2.** paying track user charges into the NLTF, and establishing the charges through regulations.
- 66.** We intend that track user charges are paid into the NLTF. This option would provide greater transparency, and provides for consistency of treatment with other road user charges.
- 67.** The amendments being made to the LTMA will allow track user charges to be paid into the NLTF and for these charges to be treated as land transport revenue. However, regulations will need to be made under the amending legislation to implement the charges.
- 68.** Paying track user charges into the NLTF will allow the funding coming from track users to be accounted for explicitly as land transport revenue and reported on. However, we recognise the need to improve transparency of the full costs of the rail network and the level of track user charges. We propose that both the costs and funding contributions are noted in the rail network investment programme. This will be prepared by KiwiRail every three years and approved by Ministers for funding from the NLTF.

Who should pay track user charges?

- 69.** The users of the national rail network should all contribute to its funding. At present KiwiRail's freight and tourism business, AT, GWRC and smaller heritage and tourism operators use the national rail infrastructure.
- 70.** Our initial focus for setting the new track user charges' framework is on the contribution that KiwiRail's freight and tourism businesses should make to funding the below rail infrastructure. However, we also need to consider other track users as the work develops.

71. KiwiRail's contribution will be made explicit through setting track user charges externally through regulations and paying the charges into the NLTF. This will improve transparency and fairness with other track users.
72. There are existing contractual track access arrangements and charges in place between KiwiRail, AT and GWRC as well as agreed charges for small heritage operators.
73. In Auckland and Wellington, the maintenance and renewal costs of the infrastructure for the metropolitan area are apportioned between the passenger network and freight network according to the level of use between each user. The charges also include a performance payment that KiwiRail receives if it meets agreed levels of service.
74. The costs of the passenger network are then charged to AT or GWRC as the passenger network operator. AT and GWRC include these costs in their regional land transport public transport costs and receive a proportion of funding for these costs from the NLTF. Heritage operators and other tourism operators also pay access fees to KiwiRail for their use of the track.
75. We have also asked officials to consider whether the existing charges that KiwiRail has in place with AT and GWRC should be paid into the NLTF to improve transparency. The existing arrangements are 85 year agreements and provide contractual and funding mechanisms to ensure that KiwiRail provides the service levels expected on the metropolitan rail networks.
76. AT, and its parent body Auckland Council, as well as GWRC have sought to maintain these arrangements as they are now. GWRC and AT have raised concerns about their ability to hold KiwiRail to account for service performance without these direct contracts. GWRC and AT have noted that existing agreements are well-established and there has been significant work undertaken to put the arrangements in place. The arrangements provide AT and GWRC long term certainty about the metropolitan rail networks and access arrangements. This is important for AT and GWRC in procuring a rail operator to provide passenger services.
77. Waka Kotahi has also raised concerns that paying these charges into the NLTF creates the potential for double counting as these arrangements are already subsidised through the NLTF.
78. Therefore at this stage we do not propose that these arrangements are paid into the NLTF. We recommend that there are no changes to these arrangements at this time. However, for transparency the charges and the revenue they produce are expected to be disclosed as part of the rail network investment programme, against the contractually agreed work on the metropolitan rail networks.
79. Officials will continue to engage with AT, Auckland Council and the GWRC about the proposals, and how the new track user charges for KiwiRail's freight and tourism businesses will interact with their existing arrangements.
80. Further consideration needs to be given to how other existing rail operators' contractual arrangements with KiwiRail will be treated, such as other tourism

operators and small heritage operators, and the treatment of inter-regional passenger rail services provided by KiwiRail (including the Capital Connection and Hamilton to Auckland start-up service).

81. We recognise that the COVID-19 pandemic has had far-reaching consequences, particularly economic disruption. This will in turn impact the economic context underpinning the transport system, the competitiveness and level of use of the rail network, and the affordability of track user charges.

What costs should KiwiRail freight and tourism pay?

82. A key consideration for setting the regulations is that we explicitly acknowledge the full costs of rail activities being provided through the NLTF. Any difference between the full cost and the level of charges on track users should be transparent through the new planning and funding framework.
83. We have begun work to consider what might be an appropriate amount to charge KiwiRail freight and tourism as a track user charge and what level of funding may be required from the NLTF and the Crown.
84. The principles outlined above, in noting that any track user charge should be affordable and not reduce the use of rail, could accommodate the changed economic circumstances, but may need to be reconsidered further as the situation develops.
85. We are conscious of the need to balance several factors and that the funding principles require trade-offs to be made between them. We expect that KiwiRail's freight and tourism businesses will only be able to afford to pay a small proportion of the track user charges that would be needed to cover the full costs of rail infrastructure.

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86. The Ministry of Transport has employed international expertise to help it develop a methodology and approach to establishing track access charges, including estimates of the costs that would be covered. This work will support final recommendations on the level of track user charges. A key input to this will be KiwiRail's future revenue and costs forecasts. This work will need to consider the impacts of the COVID-19 pandemic on KiwiRail and its customers.
87. The final charges will be established through the track user charge regulations and we will report back to you to seek detailed policy decisions on the regulations.
88. Over time, as the New Zealand economy recovers and investment improves performance and utilisation increases, the amount that KiwiRail would contribute to the NLTF through track user charges is expected to increase. This will mean that more funding is captured through track user charges.
89. We expect that we will need to review and adjust the approach to track user charges over time, including considering whether the current contractual charges remain fit for

purpose. We expect track user charges will need to be reviewed every three years in line with the development of the rail network investment programme.

Consultation

Government stakeholders

90. The Ministry of Transport prepared this paper. The Treasury, State Services Commission and Waka Kotahi have been consulted. The Department of Prime Minister and Cabinet has been informed.
91. KiwiRail has been consulted. It considers an integrated profit orientated SOE model as the best model.

External stakeholders

92. In terms of track user charges, AT and GWRC have sought no changes to their current access charges at this time. AT and GWRC have advised that they do not consider their charges should be paid into the NLTF.
93. There has been limited external stakeholder engagement on KiwiRail's structural form, beyond KiwiRail.

Financial Implications

94. There are no financial implications at this time. Funding decisions have been taken through Budget 2020 and further decisions will be taken through the process of finalising GPS 2021 and future Budgets.

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98. The Crown will continue to fund any commercial investment in KiwiRail through shareholder equity injections and retained earnings. As KiwiRail remains a SOE, current "for profit" accounting standards requires it to impair its assets if they do not generate positive cashflows.

Legislative Implications

99. Amendments to the LTMA are already being progressed and it is intended that the legislation will be in force by 1 July 2020.
100. Regulations will be required to set track user charges that come from KiwiRail to enable the charges to be paid into the NLTF. We will report back to the Committee to seek agreement to the detailed policy requirements for these regulations in July 2020, with the intention of regulations being made following those decisions.

Impact Analysis

101. The Treasury agrees that no Regulatory Impact Assessment (RIA) is required for this proposal for track user charges, since it is expected to have only minor impacts on businesses, individuals or not-for-profit entities.
102. Existing RIAs will be updated or a new RIA prepared for the report back to Cabinet following decisions on track user charges in July 2020.
103. There are no regulatory implications of the proposals for KiwiRail to retain its current structure. The regulatory impact analysis obligations do not apply to this proposal.
104. The Ministry for the Environment has been consulted and confirm that the Climate Implications of Policy Assessment requirements do not apply to this proposal as the threshold for significance is not met.

Human rights, gender and disability implications

105. There are no human rights, gender or disability issues or implications associated with this paper.

Publicity

106. There are no proactive communications planned for these decisions at this time. We intend to provide an update on these decisions in the final Rail Plan and GPS 2021.

Proactive Release

107. We propose to proactively release this Cabinet paper consistent with the provisions of the Official Information Act 1982. We propose to withhold components that relate to KiwiRail's structure and any other commercially sensitive information.

Recommendations

108. We recommend that the Committee:

Previous decisions by Cabinet

1. **note** that on 22 May 2019, DEV agreed in principle to a resilient and reliable rail system, subject to a report back on a new planning and funding framework for rail [refer DEV-19-MIN-0123 and CAB-19-MIN-0240 confirmed].
2. **note** that on 28 August 2019, DEV agreed [refer DEV-19-MIN-0225, CAB-19-MIN-0439 confirmed]:
 - 2.1. to implement a new rail planning and funding framework, which will give responsible Ministers decision-making rights on funding rail network investments and channel funding from the National Land Transport Fund to the rail network
 - 2.2. that the National Land Transport Fund and land transport revenue be used to directly fund KiwiRail's rail network activities
 - 2.3. to include rail activities in the Government Policy Statement on land transport
 - 2.4. in principle, subject to this paper, that a track user charge be used to ensure that rail users also contribute towards rail maintenance and renewals in a fair and transparent way.

KiwiRail structure

3. **note** that there will be no changes to KiwiRail's organisational form or structure at this time, and it will continue to operate as a vertically integrated State-Owned Enterprise (SOE).
4. **note** that a further review of KiwiRail's SOE status will be initiated in December 2020, and report back to Ministers in October 2021.

5.

Confidential and
commercially
sensitive

6.

Confidential and
commercially
sensitive

7. **agree** that KiwiRail should implement financial reporting separation of above and below activities within its current structure to improve the transparency of costs, funding and revenues of these business units and support future funding decisions.
8. **note** that Shareholding Ministers will invite KiwiRail to implement separate above and below financial reporting to improve the transparency of costs, funding and revenues of these business units and support future funding decisions.

Funding and track user charges

9. **note** that the Committee has previously been advised that under the new planning and funding framework for rail, the Crown will need to continue to provide substantial funding for rail activities. This amount is likely to increase in future years in comparison to historical levels where rail was in a state of managed decline, including providing funding into the NLTF [refer DEV-19-MIN-0225, CAB-19-MIN-0439 confirmed].
10. **note** that indicatively up to \$120 million per year has been allocated in the draft GPS 2021 from the NLTF to the rail network, and that this will need to be considered as part of finalising the GPS post-engagement.
11. **note** that funding decisions on the level of funding from the NLTF will be taken as part of the process of developing GPS 2021, and that further decisions on Crown funding will need to be taken in future Budgets.
12. **note** that work is underway to understand the impacts of COVID-19 on the NLTF and the final GPS 2021.
13. **note** that the Committee has previously agreed in principle that a track user charge be used to ensure rail users also contribute towards rail maintenance and renewals in a fair and transparent way [refer DEV-19-MIN-0225, CAB-19-MIN-0439 confirmed].
14. **note** that amendments are being progressed through the Land Transport (Rail) Legislation Bill to allow regulations to be made to pay track user charges into the NLTF.
15. **note** that national rail network users include KiwiRail's freight and tourism business, Auckland Transport, GWRC and smaller heritage and tourism operators.
16. **agree** that, subject to legislation being passed, track user charges will be established and paid into the NLTF from KiwiRail's freight and tourism operations.
17. **note** that the full costs of rail network activities will be made transparent, however, estimates prior to the impact of COVID-19 were that KiwiRail's freight and tourism businesses were only likely to be able to pay a small proportion of the track user charges that would be needed to cover the full costs of rail infrastructure.
18. **note** that further consideration will also need to be given to the impacts of COVID-19 on the affordability of track user charges, and that this will be factored in to further work.
19. **note** that the Ministry of Transport has work underway with international experts to review and finalise the amount of funding that is collected through track user charges on KiwiRail's freight and tourism businesses.
20. **note** that the amount of funding collected through track user charges from KiwiRail freight and tourism is expected to increase over time as utilisation of the track improves.

21. **agree** that at this time no changes will be made to the existing contractual metropolitan network access arrangements and charges to Auckland Transport or GWRC, and these charges will not be paid into the NLTF.
22. **note** that existing charges paid by Auckland Transport and GWRC to KiwiRail for access to the network should be noted for transparency in the rail network investment programme, against contractually agreed rail activities on the metropolitan rail networks.
23. **note** that further consideration will be given to how existing contractual arrangements between KiwiRail and other rail operators are treated, such as tourism operators and small heritage operators, including whether such tourism and heritage operators will be required to pay track user charges.
24. **note** that further consideration needs to be given to what track user charges inter-regional passenger rail services provided by KiwiRail should pay.
25. **note** that we will report back to you in July 2020 on final proposals for the level of track user charges, the track users that will be subject to those charges, and the details of how the charges will be administered.

26.

Confidential



27. **note** that track user charges, including existing arrangements, will need to be regularly reviewed alongside the overall costs of the rail network, and development of future GPS's.

Authorised for lodgement

Rt Hon Winston Peters

Hon Grant Robertson

Hon Phil Twyford

Hon Shane Jones

**Minister for State
Owned Enterprises**

Minister of Finance

Minister of Transport

**Minister for Regional
Economic
Development**