

OC241052

19 September 2025



Tēnā koe 

I refer to your email dated 17 September 2025, seeking an update on information previously requested and refused under section 18(d) of the Official Information Act (the Act).

On 5 September 2024, the Ministry of Transport (the Ministry) received the following request from you:

“The Ministry of Transport’s assessment of the long-term requirements for a resilient Cook Strait connection:

- 1. The first tranche of advice, that was expected in mid-2024*
- 2. Any briefing paper/s outlining options for further advice on any issues identified.”*

On 30 September 2024, the Ministry provided you a response in which the two briefings in scope of your request were refused under section 18(d) of the Act as *the information is or will soon be publicly available*.

You have since followed up regarding the documents that were soon to be published. I apologise sincerely for this delay.

We have reconsidered our approach and have decided to release both briefings with some information withheld.

The document schedule attached as Annex 1 outlines how these briefings have been treated under the Act. Certain information has been withheld under the following sections the Act:

- | | |
|-------------|--|
| 9(2)(a) | to protect the privacy of natural persons |
| 9(2)(b)(ii) | to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information |
| 9(2)(f)(iv) | to maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials |
| 9(2)(i) | to enable a Minister of the Crown or any public service agency or organisation holding the information to carry out, without prejudice or disadvantage, commercial activities |

With regard to the information that has been withheld under section 9 of the Act, I am satisfied that the reasons for withholding the information at this time are not outweighed by public interest considerations that would make it desirable to make the information available.

You have the right to seek an investigation and review of this response by the Ombudsman, in accordance with section 28(3) of the Act. The relevant details can be found on the Ombudsman's website www.ombudsman.parliament.nz

The Ministry publishes our Official Information Act responses and the information contained in our reply to you may be published on the Ministry's website. Before publishing we will remove any personal or identifiable information.

Nāku noa, nā



Hilary Penman
Manager, Ministerial & Executive Services

Annex 1: Document Schedule

Doc #	Date	Title of Document	Decision on request
1	28/05/2024	OC240407 Cook Strait Resilience Phase One Report	Released with some information withheld under sections 9(2)(a), 9(2)(b)(ii), 9(2)(f)(iv) and 9(2)(i).
2	20/06/2024	OC240547 Cook Strait Resilience Phase Two Report Options Assessment.	Released with some information withheld under sections 9(2)(a), 9(2)(b)(ii) and 9(2)(i).



28 May 2024

OC240407

Hon Simeon Brown
Minister of Transport

Action required by:
Wednesday, 5 June 2024

COOK STRAIT RESILIENCE PHASE ONE REPORT

Purpose

This briefing provides an overview of the freight market across the Cook Strait, and areas for potential Government intervention to increase the likelihood of a market response if KiwiRail withdrew from the market.

We are providing this advice to you now so that you and Shareholding Ministers can consider it alongside two proposals you will soon receive from KiwiRail (single source procurement of new ferries) and a wider testing of the market for new ferries by the Ministerial Advisory Group (MAG).

Key points

- We have identified some constraints to a market response if KiwiRail exits the Cook Strait ferry market, and areas where Government intervention would improve the likelihood of a successful, sustainable market response. However, our investigations suggest that a market response would be possible.
- Our advice is that in the longer term, it would be commercially viable for a new, private entrant to fill the gap left by KiwiRail. 'Lighter touch' interventions could be sufficient to ensure commercially viable services can operate on the Cook Strait, but this is unlikely to be achievable in the time available before the current fleet retires.
- However, while services should be commercially viable, there is no indication that a new operator is 'waiting in the wings' to establish services in the event of KiwiRail's exit.
- It is unlikely that a new operator could establish services in time to avoid a loss of capacity or competition on the route. More direct intervention may be required if Ministers want certainty that sufficient capacity and competition will be available in the immediate period following an exit by KiwiRail.
- More detailed analysis of a broad range of options – from light touch to direct Crown investment and ownership – will be provided to you next month. This advice provides a high-level description of the suite of options to give you an indication of our thinking.

- Our advice has been informed by a period of intensive stakeholder engagement across the ferry and port companies, industry representative bodies, freight forwarding and logistics sector, regulatory agencies, and unions. A full list of stakeholders contacted is provided at **Annex One**.
- We seek confirmation that the outcomes the Government seeks is for commercially viable, competitive, safe, and reliable services across Cook Strait that meet the needs of the wider New Zealand economy. Interventions to achieve these outcomes should also be consistent with the Government's fiscal objectives, and your priorities for the transport system.
- Feedback from you and your colleagues will inform our next piece of advice on the range of alternative interventions to achieve the Government's desired outcomes. Advice on the entities involved, implementation options and more detailed analysis of the benefits and costs will be provided to you and Shareholding Ministers in June 2024. We will continue to work with Treasury and the Ministerial Advisory Group during Phase Two.

We recommend you:

- 1 **discuss** the content of this briefing with officials Yes / No
- 2 **agree** that the outcomes you seek for the Cook Strait in the wider transport system are:
 - a. commercially viable, competitive, safe, and reliable services across Cook Strait that meet the needs of the wider New Zealand economy
 - b. consistent with the Government's fiscal objectives to build a stronger, more productive economy, deliver more efficient, effective, and responsive public services and get the Government's books back in order, and
 - c. consistent with your priorities for the transport system: economic growth and productivity, increased maintenance and resilience, safety, and value for money. Yes / No
- 3 **note** that our initial advice is that if KiwiRail exited the Cook Strait ferry market there are no material barriers which would prevent a market-led response, however, this is unlikely to deliver to the certainty and competitive market you seek for the Cook Strait.
- 4 **note** that additional interventions may be warranted to ensure connectivity and competition on the Cook Strait and that these will be assessed in Phase Two of the Cook Strait Resilience project, due to you by the end of June 2024.
- 5 **note** that Phase Two of the Cook Strait Resilience project will explore the following interventions:
 - a. Minimal intervention – market-based solution
 - b. Low intervention – facilitate and broker market-led solution

- c. Low intervention – incentivise new market entrant
 - d. Moderate intervention – enhanced regulatory regimes, e.g. information disclosure, mandated notice periods
 - e. Moderate intervention – crown tender for services
 - f. High intervention – directly own ferries and contract out services
 - g. High intervention – PPP-like arrangement
 - h. High intervention – mixed-ownership model
 - i. High intervention – directly own and operate
- 6 **note** that our Phase Two advice will offer pathways to preserve optionality should you and Shareholding Ministers want to progress options to purchase new ferries.
- 7 **refer** this briefing to Hon Nicola Willis, Minister of Finance and Hon Paul Goldsmith, Minister of State-Owned Enterprises for discussion with officials. Yes / No



Richard Cross
**Acting Deputy Chief Executive,
 Investment and Monitoring**
 28/05/2024

Hon Simeon Brown
Minister of Transport
 / /

- Minister's office to complete:**
- Approved Declined
 - Seen by Minister Not seen by Minister
 - Overtaken by events

Comments

Contacts

Name	Telephone	First contact
Richard Cross, Acting Deputy Chief Executive	s 9(2)(a)	✓
Bev Driscoll, Manager Rail		
Sarah Carson, Senior Policy Advisor		
Rory Sedgley, Principal Advisor		

COOK STRAIT RESILIENCE PHASE ONE REPORT

Background

- 1 Project iReX would have seen KiwiRail replace its existing fleet of three medium-sized vessels (one of which is rail-enabled), with two large rail-enabled vessels. CentrePort in Wellington and Port of Marlborough at Picton would have undertaken major infrastructure development to support the large rail-enabled vessels, and the projected increase in freight and passenger volume.
- 2 The coalition Government declined to provide further funding for the project in December 2023 and as a result, the KiwiRail board began exit negotiations with the ship builder, Hyundai Mipo Dockyard (HMD). At the time of writing, exit negotiations are still underway and are expected to complete by the end of July.
- 3 Following this decision, three streams of work were commissioned to ensure the continuation of a safe and reliable ferry service:
 - 3.1 KiwiRail is working on options to replace its fleet (either with second-hand ferries, or newbuild vessels from HMD) while continuing to provide a safe, resilient, and reliable service with its existing fleet. Options are expected to be provided to Shareholding Ministers by early June 2024.
 - 3.2 The Minister of Finance and Minister for State-Owned Enterprises established a Ministerial Advisory Group (MAG) to provide independent advice and assurance on the future of KiwiRail's inter-island ferry service. Their advice on the broader market for newbuild ferries is due in early June 2024.
 - 3.3 The Ministry of Transport would lead an assessment of the conditions required for a resilient connection across Cook Strait to connect people and enable freight, supported by the Treasury. This paper is Phase One of that assessment. Phase Two advice will be provided to you in June 2024.
- 4 KiwiRail is also undertaking a strategic review of its business model (aided by McKinsey & Co) which could recommend KiwiRail withdraw from the Cook Strait ferry business, and focus on its core rail infrastructure and freight businesses. Shareholding Ministers have levers to either trigger this outcome, or prevent it, e.g. by not providing KiwiRail with capital funding for new ships.

Context for our advice on barriers to a market-led response and wider work underway

- 5 This briefing provides an overview of the freight transport market and impediments to a market response if KiwiRail decided to exit the Cook Strait ferry market. There is work underway to alleviate some of those impediments, and additional actions could be considered if the Government wanted to minimise capital investment and facilitate a market response in this scenario. A more interventionist approach is also feasible if urgency requires certainty about the continuity of service.

- 6 Ministers will shortly be presented with advice on two proposals. In early June 2024, MAG will report on market options for ferries and Treasury will advise on a process to establish an alternative procurement entity and a procurement strategy. In late July 2024, KiwiRail will present a business case on the feasibility and price of buying new ferries from HMD (reusing elements of Project iRex). The Ministry has identified possible alternative interventions to a direct ferry purchase that could deliver the outcomes the Crown seeks. These should be considered in parallel to any proposal to directly purchase new ferries.¹
- 7 The interventions extend across a range of investment, contractual and regulatory levers. They will each have challenges that we will explore more fully in our Phase Two advice. They are being developed in line with some guiding principles from the Minister of Finance: urgency (providing the public with certainty about the future of Cook Strait ferry services), commercial discipline, and maintaining competition on Cook Strait.
- 8 Phase Two work will involve developing a set of criteria to assess the options. In our view, each of the options will be able to deliver a safe and reliable service. Safety is an operational matter, rather than a feature of a particular market structure. Reliability can also be achieved through a well-run business operation and proactive maintenance. Therefore, safety and reliability will not be its own criterion, but it is critical that any intervention you may progress complies with all the applicable safety standards.
- 9 More detailed advice on the merits, viability and implementation of each option will be developed further in Phase Two.

Conditions for a safe, reliable and resilient Cook Strait connection

Ensuring a safe, reliable, and resilient Cook Strait connection requires capital, operating and regulatory investment.

- 10 The Ministry was tasked with reviewing the conditions that need to be in place ensure a resilient Cook Strait connection and identifying significant impediments to a market response if KiwiRail withdrew from the Cook Strait ferry market.
- 11 We have identified the following conditions, all of which need to be met for a new entrant to enter the market:
- 11.1 Capital and operating expenses must be recoverable, with a reasonable return on investment
 - 11.2 Access to suitable port infrastructure
 - 11.3 Available ship – new or second-hand

¹ The options assume a scenario in which the ferries are RoPax, not rail-enabled. Further information on the benefits, costs, and key differences between rail-enabled and RoPax ferries can be provided if you wish.

11.4 Availability of time slots in a dry dock

11.5 Available labour.

- 12 We have identified some constraints on these conditions being met, but there is nothing to suggest that any of them are at risk of market failure or that the market could not successfully adapt in the long-term. There would undoubtedly be transition risks associated with a market-led response though, and in the short term this could be disruptive to supply chains and the travelling public. These conditions and our advice are explained more below.

The Ministry's assessment of the Cook Strait ferry market

The Cook Strait ferry market is competitive and an acceptable return on investment is possible...

- 13 Ferry services across the Cook Strait have historically been provided by a state-owned entity (KiwiRail and predecessors) with:

13.1 limited competition from 1992 when Bluebridge began carrying freight, and

13.2 fuller competition from 2002 when Bluebridge began carrying passengers as well.

- 14 Over the past 20 years, the market has steadily evolved with Bluebridge now capturing roughly 55% market share with its RoPax (roll-on roll-off passenger) ferries.² s 9(2)(b)(ii)

- 15 The market is now competitive, and whilst we do not have access to detailed financial accounts of either ferry operator, we have been told that Interislander was previously profitable, but has struggled for the past 2-3 years. Interislander still reports a small operating surplus in KiwiRail's annual report. In 2022, Bluebridge's parent company StraitNZ reportedly generated \$45m underlying profit when it was bought by Morgan Stanley Infrastructure Partners for \$500m.

- 16 We have assumed that the hypothetical exit of KiwiRail would not happen overnight. Customers would be given sufficient warning to make alternative plans, and KiwiRail could sell the business as a going concern, rather than winding it up.

- However, several stakeholders have expressed scepticism at the prospect of a successful divestment due to a perception that Interislander's end-of-life-ships, employment arrangements and other legacy obligations represent more

² The market split between the Interislander and Bluebridge for passenger services is approximately 60:40. The focus of our assessment has been on the freight market but it is important to note the value of passengers and tourism to each ferry provider and the wider economy. Officials can provide you with more information on the value of tourism for a resilient Cook Strait Connection if you wish.

liabilities than there are assets in the business. If the business was to be wound up, there could be interest in investing in a start up Cook Strait ferry service among established freight companies, overseas ferry operators, long-term institutional investors, or entrepreneurs. A market adjustment in this way cannot be taken for granted, and there would likely be short-term disruption. There is a significant lead time for the market opportunity to be realised as any new operator would need to source a suitable vessel, negotiate access to port infrastructure, and recruit and train crew.

- 17 The Ministry has not undertaken market soundings to research appetite for investing in or starting up a ferry business. In our view, there is no room in the market (or physical space in the ports) for a third, similar provider in addition to Bluebridge and the Interislander. There is not enough freight demand for a third provider to be commercially viable.
- 18 Bluebridge have been emphatic that in the absence of KiwiRail they would be able to rapidly scale their capacity with additional second-hand ferries to meet the anticipated unmet demand. They are already investigating fleet renewal options as *Strait Feronia* is reported to have 3-4 years useful life remaining.

There are some barriers to entry and leaving it to the market alone creates risk – intervention to secure the Government’s preferred outcomes would be beneficial

- 19 We spoke with stakeholders in the Cook Strait ferry market to test our understanding of the barriers (such as the competitiveness of the freight transport market) and discover what further barriers may exist.
- 20 The barriers can be described as:
- The availability of suitable ships and the trade-offs between high up-front costs for a new ship compared to a cheaper, older ship with refurbishment costs and higher operating costs (e.g. lower fuel efficiency and higher maintenance requirements).
 - High operating and maintenance costs, exacerbated by issues like access to a dry dock and labour issues
- 21 Additionally, several stakeholders identified KiwiRail as the greatest impediment to a market response and competition in the Cook Strait market. As a state-owned enterprise, there is a perception that KiwiRail is not subject to the same commercial discipline as its competitors. KiwiRail also controls significant strategic landholdings in the ports which would constrain the operations of a new competitor and their relationship with ports.³

³ s 9(2)(b)(ii)



The barriers above mean that achieving an acceptable return on investment cannot be taken for granted

- 22 A private investor seeing the potential for unmet travel demand across the Cook Strait would first need to consider if it will be possible to generate an acceptable return on the capital investment required. KiwiRail's annual reports show an operating surplus that has declined from \$51m in 2020 to \$12m in 2023. As a rule of thumb, a prospective private investor might be prepared to put between five and ten times earnings into a business. Shareholding Ministers can expect to receive a business case from KiwiRail in July to support their vessel acquisition proposals which will provide much more detailed advice about the potential for a return on capital.

Access to port infrastructure

- 23 The port companies have told us that with a sufficient lead-in period, landside infrastructure could be made available (wharf access and vehicle marshalling yards etc.). The port operators would require contractual arrangements to secure a commercial return from their investment in infrastructure (e.g. linkspan, vehicle marshalling yard).
- 24 Both Centreport and Port Marlborough have advised that their preference would be for the port company to invest in, own, build and maintain the necessary infrastructure, and that (within limits) they would be able to self-fund that development. The wharves used by KiwiRail in Picton reach end of life in 2029, and the need to replace them with alternative infrastructure remains. CentrePort expect all its wharves to have a useful life of around 20-30 years, but noted its rail linkspan is at its end of life with perhaps two years of life remaining.

Availability of suitable ships

- 25 Access to suitable ships is a contested subject among stakeholders. Bluebridge advised us it has a high-level of confidence in its ability to source a suitable ship on the second hand market to grow its fleet (if there was a commercial opportunity).
- 26 In contrast, KiwiRail has very little confidence that it could source suitable ships on the second-hand market. KiwiRail developed a set of vessel specifications to support its search for second-hand ships on the market. KiwiRail (and the Ministerial Advisory Group) advises there are very few ships in existence that meet these specifications, and none of them are currently for sale.
- 27 KiwiRail and Bluebridge have different specification requirements which inform their different views of the second-hand market. KiwiRail has limited its search to vessels built after 1 July 2010 to ensure the vessels are built to meet 'Safe Return to Port' requirements under the Safety of Life at Sea (SOLAS) regulations developed by the International Maritime Organisation. This means that the ship is built with layers of redundancy in key operational systems so that it can safely return to port if a principal system fails.

- 28 If KiwiRail secured such a ship it may be at a higher upfront cost than an older ship but would likely have lower maintenance costs. Complying with Safe Return to Port requirements reduces likely costs incurred in the event of an incident because it would not need to declare an emergency or be towed.
- 29 If the Government minimised intervention to facilitate a market-led solution, any new operator would develop their own specifications based on their budget, business model, operational requirements, and regulatory compliance considering the whole of life costs.
- 30 On the other hand, Bluebridge has not placed a date limit on its search for second-hand ships (as evidenced by its purchase of the *Connemara* which launched in 2006). The \$109m cost of the *Connemara* is less than a more modern second-hand ship. However, it may need more maintenance – and more costly maintenance as it ages.

Regulatory compliance

- 31 Older ships are not necessarily unsafe, and newer ships may still encounter costly issues at entry into service.⁴ Older ships do require vigilance from the operator and have higher maintenance requirements. There have been issues with sourcing spare parts as systems become obsolete, and there may be more work for the regulator to assure itself that standards of maritime safety have not been compromised. KiwiRail and Bluebridge appear to approach the whole economic life of their fleet differently. Based on our work to date, we conclude that KiwiRail will seek higher upfront capital investment from the Crown with the benefit of lower on-going costs, but Bluebridge prefers lower upfront costs and accepts that this will come with potentially higher maintenance costs.
- 32 Maritime NZ regulates ships based on the safety and environmental standards in place at the time the ship was built (except for some retroactive standards around fire safety, for example). Operation and maintenance of ships in compliance with the applicable safety and environmental standards and continued regulatory oversight, should provide the public with confidence in the safety of Cook Strait ferry services.

International regulations in a domestic context

- 33 New Zealand has supported work through the International Maritime Organisation (the IMO) to adopt measures requiring certain ships (including the Cook Strait ferries) to reduce their carbon emissions intensity – as applicable to their category – by an average of at least 40% by 2030 (relative to the 2019 baseline) as part of rising global impetus to see shipping reduce emissions.
- 34 Some level of emissions reductions are addressed via broader IMO targets and measures, however others are implemented in New Zealand through energy efficiency requirements under Annex VI of the Convention for the Prevention of Pollution from Ships (MARPOL Annex VI, or Annex VI). New Zealand acceded to Annex VI in May 2022.

⁴ For example, *Aratere* suffered high profile technical failures during her entry into service in the late 90s

- 35 Ship operators can comply with the energy efficiency requirements through a range of operational changes (e.g. using biofuels, sailing slower to reduce fuel burn) or through design and fit-out choices. More modern ships are likely to require less costly modification than older ships, so this will be a further consideration for a new entrant to the ferry market to factor into their vessel choice.

Local requirements

- 36 The 2024 Harbourmaster Direction for Tory Channel imposes an upper size limit of 187m in length on vessels operating through Tory Channel. This is a response to recent 'near miss' safety incidents in a narrow channel with strong tidal flows. Larger vessels may be permitted if the Harbourmaster is satisfied that maritime safety will not be compromised. Larger vessels will be required to make a slightly longer voyage (extra 30 minutes in each direction) and use the northern entrance to the Sounds if an exemption from the Harbourmaster cannot be secured.

Limited access to a dry dock will exacerbate maintenance costs

- 37 Access to dry docking is critical to a reliable and resilient Cook Strait service. Currently the ferries are required to travel abroad for docking, either to Sydney, or more frequently, Singapore. International Maritime Organisation rules dictate that passenger vessels must dock twice every five years, with no longer than two years between out of water docking. As context, it takes seven days and \$340,000 in fuel to sail to Sydney and 28 days and \$1.4 million in fuel to Singapore (round trip).
- 38 Progressing a detailed business case for a dry dock at Marsden Point is in the coalition agreement with NZ First. We are aware that work is now underway to progress the dry dock proposal in Northport under the Ministry of Business, Innovation and Employment's (MBIE) Kānoa Regional Economic Development & Investment Unit at the direction of the Minister of Regional Development, Hon Shane Jones. We will work alongside MBIE given our previous work in the area leading the development of a business case in 2023 and our interest in the resilience of the shipping sector.

Issues in recruiting labour increase operating costs

- 39 Attracting and retaining qualified seafarers has been an on-going issue for many years. The sector is seen as unattractive to work in, the qualification and certification system is overly complex for new recruits and the funding model for the maritime schools is seen as not fit for purpose. Competition with Australia is also challenging given the high wages in the Australian oil and gas industry.
- 40 The Cook Strait operators are not immune to these issues. Maritime NZ is working closely with industry association groups on measures to improve the sector's workforce issues. Maritime NZ recently provided the Associate Minister of Transport (Hon Matt Doocey) with an update on work underway to address workforce issues and certification. Maritime NZ has recommended that Minister Doocey shares this advice with you. Work includes options to:

- Shorten and simplify the process for recognition of foreign crew certification
- Streamline the visa application process for foreign crew from specific countries to facilitate the import of skilled seafarers to supplement New Zealand crew shortages
- Develop a programme, in partnership with the private sector, to promote maritime careers within New Zealand to ensure a pipeline of future crew.

The freight transport market is highly competitive and flexible

- 41 Freight shifts between road, rail and coastal shipping based on price, and the characteristics of the freight commodity (e.g. size and density). Competition within the road freight sector is intense. Competition between Bluebridge and the Interislander is also high, as evidenced by s 9(2)(b)(ii)
- 42 If KiwiRail exited the market and capacity across the Strait reduced we expect prices would rise. This would improve the commercial attractiveness of entering the market for a new entrant. It could also encourage price-sensitive, non time-sensitive freight to move to coastal shipping (and we understand the coastal shipping market could absorb the increase). It could also cause system-level changes in supply chains, for instance, encouraging direct imports through South Island ports, rather than concentrating imports and distribution networks in the Upper North Island.
- 43 One key implication we discussed with stakeholders was the impact of the shift from rail-enabled ferries (proposed in Project iReX) to a ferry service of only RoPax ferries (roll-on, roll-off ferries with passenger accommodation). More detail on the difference between rail-enabled ferries and RoPax ferries is provided at **Annex Two** and officials can answer any further questions you may have.
- 44 There is disagreement within the freight sector about the potential future of the inter-island rail freight sector. Some operators are confident that rail freight, road bridged across Cook Strait, will continue to play a role in a multi-modal freight system. Others assert that rail freight volumes will decline, as time-sensitive customers will opt for a door-to-door truck service, and price sensitive customers may be able to move to coastal shipping. s 9(2)(b)(ii)
- The Ministry has modelled some potential mode shift scenarios and can provide more detailed advice if you wish.

The market for passengers and tourists is valuable but highly seasonal

- 45 The market for passenger travel across Cook Strait is actively targeted by both ferry operators, but it is highly seasonal with more than 50% of passenger volume travelling in just four months from December to March. Scaling available capacity to meet the seasonal demand for passenger traffic over the summer is a challenge for the incumbent operators. Any prospective new operator would need to carefully calibrate their capacity to balance between potential under-utilisation of ferries over the winter, and not being able to accommodate the summer peak in demand for travel.

- 46 Of the over 2 million overseas visitors to New Zealand, 60% of these arrive as part of a group tour (tours with a set itinerary of destinations and group passenger transport and a guide). Most of these tours include both islands, but stakeholders in the international tourism sector have reported that some package tour operators are now actively avoiding Cook Strait crossings due to past issues with reliability. This reduces international visitor numbers to the Wellington and Marlborough regions, and works against the New Zealand tourism strategy goal of distributing the benefits of tourism across the country.

A safe, reliable and resilient Cook Strait connection is achievable through a wide range of interventions

- 47 The outcomes the Crown seeks for the Cook Strait in the wider transport system are:
- 47.1 commercially viable, competitive, safe, and reliable services across Cook Strait that meet the needs of the wider New Zealand economy
 - 47.2 consistent with the Government's fiscal objectives to build a stronger, more productive economy, deliver more efficient, effective, and responsive public services and get the Government's books back in order, and
 - 47.3 consistent with your priorities for the transport system: economic growth and productivity, increased maintenance and resilience, safety, and value for money.
- 48 Achieving this outcome would contribute to the needs of the New Zealand supply chain and the Crown's wider economic objectives. The cancellation of Project iReX offers an opportunity for the Crown to consider mechanisms other than direct ownership and operation of ferries, to deliver this outcome.
- 49 There are structural options Ministers could progress if the Government chose not to rely on a market-led solution and wanted certainty over capacity and competition. Some of these options, such as introducing information disclosure requirements, could be progressed if KiwiRail remained in the market. Others, such as incentives to facilitate market entry by a new operator, would only need to be progressed if KiwiRail exited the market.
- 50 Interventions to support Cook Strait connectivity must align with the Government's wider fiscal objectives such as keeping tight control of Government spending and the Government's overarching goals to:
- 50.1 build a stronger, more productive economy
 - 50.2 deliver more efficient, effective, and responsive public services and
 - 50.3 get the Government's books back in order.
- 51 We further recommend that decisions about the future of Cook Strait ferry services align with your wider transport objectives, such as value for money.

Timeframe for advice to Ministers alongside work by KiwiRail, Treasury and the MAG

Workstream	May	June	July
KiwiRail advice on replacement ships		Business case	
KiwiRail explore re-use with HMD	Design (KiwiRail)	Pricing (HMD) 26 July	
MAG advice on new ships	s 9(2)(b)(ii)	7 June advice on market soundings	
MoT Phase Two Report	Evaluate options	Advice expected mid-June	
Treasury advice on alternative procurement entity		7 June advice on establishing new entity and procurement strategy	

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ANNEX 1 STAKEHOLDER LIST

1. We met with representatives from the ferry and port companies, industry representative bodies, freight forwarding and logistics sector, regulatory agencies, and unions.
2. We continue to work closely with Treasury and the Ministerial Advisory Group to ensure alignment across all advice going to Ministers.

Ferry and port companies

- KiwiRail
- StraitNZ
- CentrePort, Wellington
- Greater Wellington Regional Council (as a shareholder in CentrePort)
- Port of Marlborough
- Marlborough District Council (as a shareholder in the Port of Marlborough)

Industry representative bodies

- National Road Carriers Association
- Transporting New Zealand
- New Zealand Shipping Federation
- New Zealand Council of Cargo Owners
- Tourism Industry Association
- Tourism Export Council

Freight forwarding and logistics sector

- Swire Shipping
- Mainfreight
- New Zealand Couriers
- NZPost
- Freightways
- Bascik Transport
- THL (Tourism Holdings Ltd)
- GO Rentals

Agencies and local government

- New Zealand Transport Agency
- Maritime New Zealand
- Ministry of Business, Innovation and Employment – Tourism
- Department of Prime Minister and Cabinet – National Emergency Management Agency
- Marlborough District Council (Harbourmaster)
- Development West Coast
- Destination Marlborough
- WellingtonNZ

Unions

- Maritime Union of New Zealand

Annex Two: Rail-enabled ferries compared to RoPax ferries

The relationship between road, rail and the Cook Strait ferries is dynamic and competitive

- 1 KiwiRail's decision in Project iReX to contract for large, rail-enabled ferries forced several wharf and landside infrastructure requirements to support rail-enabled ferries. These requirements were one of the main drivers of the cost escalation which subsequently saw the project cancelled (see OC231024).⁵
- 2 To support a rail-enabled ferry, the wharf and linkspan must be extremely strong and heavy to keep the ferry very still, even in high winds and swells, while the rail wagons move from the tracks on the ferries to the tracks on the wharf. The fixed, steel wheels allow for very little tolerance.
- 3 In contrast, RoPax (roll on; roll off ferries carrying passengers) ferries have simpler requirements where ramps are lowered onto a linkspan over which rubber wheeled vehicles can drive – offering more tolerance for movement from wind and waves than steel wagon wheels. This is the system Bluebridge uses.
- 4 In Wellington, KiwiRail's ferries use fixed linkspans that move on a hydraulic system to keep the linkspan steady during loading and unloading and offer greater tolerance for movement from wind and waves. Bluebridge uses a simple fixed linkspan with no hydraulics. In Picton, Bluebridge uses a floating linkspan and KiwiRail use fixed linkspans.
- 5 Without rail-enabled ferries, all rail freight will be 'road bridged' across the Cook Strait. This means that rail freight will be transferred on to trailers for the ferry crossing and transferred back onto rail wagons in the port of arrival. KiwiRail already use this method for carrying rail freight on Kaitaki and Kaiārahi.

⁵ For completeness, there were several drivers of the cost escalation in Project iReX. Other drivers include process issues such as a lack of 'single plan', contracting methods, scope increase and variation, and inaccuracies in the original cost estimates.



20 June 2024

OC240547

Hon Simeon Brown
Minister of Transport

Action required by:
Monday, 24 June 2024

COOK STRAIT RESILIENCE PHASE TWO REPORT: OPTIONS ANALYSIS

Purpose

To provide you with advice on the range of possible Crown interventions to ensure a resilient Cook Strait connection.

The Ministry of Transport's (the Ministry) advice has been prepared in parallel with advice from KiwiRail and the Ministerial Advisory Group (MAG) on the operation, maintenance, and replacement of the current KiwiRail fleet.

Key points

- The Ministry was tasked with assessing the requirements for a resilient Cook Strait connection following the cancellation of project iReX. Our Phase One advice (OC240407 refers) identified some constraints to a market-led response if KiwiRail were to cease its Cook Strait ferry services (largely due to the limited supply of vessels and the high cost of entering the market).
- The Ministry did not discover anything to suggest that a market-led response was impossible over the long-term. However, it noted that the Crown would likely need to play a more active role if certainty over capacity and market competition are required.
- As such, the work in Phase Two (the subject of this briefing) focuses on identifying and assessing the range of interventions at Ministers' disposal. These interventions extend across a range of investment, contractual and regulatory levers.
- In assessing the options, we have considered how well each intervention meets the Crown's objectives of maintaining **competition**, ensuring **commercial viability and disciplines**, and ensuring **continuity** of services beyond 2029. We have also considered the extent to which the Crown retains future **optionality** under each intervention.
- This approach has resulted in four shortlisted options for Ministers to consider:
 - Facilitate, broker, and incentivise (low intervention, market-led);
 - Contract out services;

- Mixed-ownership style approach¹; and
 - Directly own and operate (variation on the status quo).
- Except for the first shortlisted option (facilitate, broker and incentivise), the options are variants of a high intervention pathway and require direct Crown capital investment in ferries. These options have high upfront costs but provide greater certainty of service continuity, maintain competition, and provide a high degree of optionality for the Crown.
 - In contrast, the low intervention option (facilitate, broker, incentivise) does not require the Crown to purchase ferries and is therefore lower cost. However, there is a high risk of failure to attract a new entrant, and disrupting the supply chain when the current fleet is retired. There are trade-offs across these four shortlisted options.
 - The mixed ownership style approach appears to be the most appropriate at this stage as it best supports the balance of outcomes sought by the Crown on the Cook Strait. There are implementation risks with this option, notably the complexity associated with establishing new organisational arrangements, managing industrial relations, and transitioning away from KiwiRail in a compressed timeframe. Further analysis would be required to assess the commercial viability of services, attractiveness to potential investors, and port infrastructure requirements.
 - Further detailed planning that could test and support the implementation of the mixed ownership approach is already underway. Treasury will provide advice to Shareholding Ministers on establishing a new Crown owned entity and developing a procurement strategy in week commencing 17 June 2024.

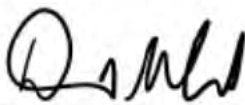
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¹ Mixed ownership model is a legislative term specific to the arrangements for the 51% owned electricity companies. We do not suggest this should apply exactly in this context. However, we are using the mixed ownership label here as it is commonly understood to imply a Crown majority shareholding in partnership with a minority private sector shareholder(s).

Recommendations

We recommend you:

- 1 **discuss** the content of this briefing with officials Yes / No
- 2 **refer** this briefing to Hon Nicola Willis, Minister of Finance and Hon Paul Goldsmith, Minister of State-Owned Enterprises for discussion with officials Yes / No
- 3 **agree** that the mixed ownership style approach best supports the outcomes sought by the Crown on the Cook Strait Yes / No
- 4 **direct** officials to work with the Treasury to prepare further advice on the pathway to implement the mixed ownership style approach Yes / No



David Wood
Deputy Chief Executive, Investment and Monitoring
 .20.. / .6.... / .23...

Hon Simeon Brown
Minister of Transport
 / /

- Minister's office to complete:**
- Approved
 - Declined
 - Seen by Minister
 - Not seen by Minister
 - Overtaken by events

Comments

Contacts

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COOK STRAIT RESILIENCE PHASE TWO REPORT: OPTIONS ANALYSIS

The Ministry's Phase One advice found that there are barriers to entry on the Cook Strait market in the short-term and the speedy entry of a new operator is unlikely

- 1 Following the cancellation of Project iReX, Ministers directed the Ministry of Transport (the Ministry) to assess the long-term requirements for resilient Cook Strait connectivity. This work was divided into two phases:
 - 1.1 Phase One (OC240407) assessed the system-level consequences of a scenario where KiwiRail decides to exit the market, and the barriers to entry for prospective market entrants.
 - 1.2 Phase Two (the subject of this briefing), focuses on understanding the broad spectrum of policy interventions available to Ministers to ensure resilient Cook Strait connectivity is maintained.
- 2 The Ministry's Phase One advice found that there are barriers to entry for a new private operator on the Cook Strait. It is unlikely that there is an operator 'waiting in the wings' to replace KiwiRail due to a shortage of suitable vessels and the costs of establishing new services. If KiwiRail were to exit the Cook Strait market, the Ministry's view is that the most likely market response in the medium-term is a monopolisation of services by Bluebridge and for a loss of capacity on the route.
- 3 Based on the Phase One findings, the Ministry has developed a series of potential interventions which could meet Ministers' objectives for a safe and resilient, competitive Cook Strait connection. These interventions all assume that vessels will be roll-on, roll-off rather than rail enabled (as per Phase One advice).
- 4 We note that the Treasury, KiwiRail and the Ministerial Advisory Group (MAG) will shortly provide a range of advice to you and Shareholding Ministers. We recommend you consider that advice alongside this report. The work programmes include:
 - Advice on vessel procurement (KiwiRail).
 - Assurance of KiwiRail's business case and structural changes required if KiwiRail were to maintain ownership and operation of any new ferries (MAG).
 - Negotiations with HMD (KiwiRail).
 - Market assessment for newbuild ships (MAG).
 - Engagement with ports regarding landside investment (MAG).
 - Engagement with Marlborough harbourmaster regarding approval process for larger vessels using Tory Channel (MAG).
 - Advice on a new vessel procurement process (the Treasury).

- Options for new procurement entity establishment (the Treasury).

We have taken a 'first principles' approach to develop and assess interventions based on Ministers' strategic objectives

- The Minister of Finance provided three 'principles' to guide development and assessment of the options: competition on the Cook Strait, commercial discipline, and urgency.
- In considering the merits and weaknesses of the possible interventions, we have ensured these align with the Minister of Finance's principles and the overarching strategic objectives of the Crown. The objectives are:
 - There is competition in freight and passenger transport across Cook Strait
 - Cook Strait ferry services are commercially viable and follow appropriate commercial disciplines
 - There is continuity of service when current vessels reach end-of-life (end of 2029). The Crown retains future optionality around the provision of Cook Strait ferry services.
- We have explored a broad spectrum of options across the range of contractual, investment and regulatory levers available to Ministers. The options are intended to provide Ministers with an indication of the wide range of interventions that could theoretically be possible and we have also identified areas for further analysis (Table 1). The Treasury and MAG have contributed to the options development and consulted on this paper. KiwiRail has not been involved in this advice.

Table 1: Long list of options considered

Intervention	Description
Option 1. No further Crown role Discounted	KiwiRail ceases Cook Strait ferry services. The Crown plays no role in KiwiRail's divestment of ferry assets / services (outside of its role as Shareholder). Future provision of services is left to either: an expansion of the existing commercial operator (Bluebridge) or a new entrant to the market.
Option 2. Facilitate and broker Discounted	KiwiRail ceases Cook Strait ferry services. The Crown takes steps to facilitate an orderly transition to a new commercial ferry operator including: <ul style="list-style-type: none"> Active oversight of the winddown of KiwiRail's services; Active engagement with potential providers to identify and address barriers to entry; Brokering / interface role with key stakeholders (i.e., KiwiRail, Ports, MNZ, operators).

<p>Option 3. Facilitate, broker, and incentivise</p> <p>Shortlisted</p>	<p>In addition to the facilitation and brokering role of Option 2, the Crown works with potential providers to offer incentives to support new entrants to the market, which could include:</p> <ul style="list-style-type: none"> • Supporting the rationalisation of land ownership around Ports²; • Direct brokering role between the new ferry operator and regulators / ports / KiwiRail customers; and / or • Negotiation of timebound Crown underwrites to support initial operations
<p>Option 4. Enhance regulatory Regimes</p> <p>Discounted</p>	<p>KiwiRail ceases Cook Strait ferry services. The Crown plays no role in securing a new entrant to the market. However, the Crown would adjust current regulatory settings to ensure a transparent, level playing field for commercial operators. This could include:</p> <ul style="list-style-type: none"> • Information disclosure requirements / cost transparency over port fees. • Changes to seafarer qualification requirements. • Licensing requirements (to operate on the Cook Strait).
<p>Option 5. Crown tender for services</p> <p>Discounted</p>	<p>KiwiRail ceases Cook Strait ferry services. The Crown directly procures a new commercial operator to provide an agreed level of service with their own vessels in time to replace KiwiRail's ferry services. The Crown may provide some form of timebound support to the successful operator.</p>
<p>Option 6. Contract out services</p> <p>Shortlisted</p>	<p>The Crown purchases new / used vessels to replace the existing KiwiRail's ferries. The Crown awards a concession to a private provider to operate services for a fixed period (i.e. 10 years) using the Crown's vessels. The provider would then pay a concession to the Crown for use of the vessels. The provider would retain any profits from the operation of the services to incentivise commercial disciplines.</p>
<p>Option 7. PPP-like arrangement</p> <p>Discounted</p>	<p>The Crown enters a PPP-like arrangement with a private sector partner to design, build, finance, and operate services for a fixed period. The Crown would set the service requirements (capacity, frequency etc) and procure a consortium to design, build and fund new vessels. The consortium would operate the vessels on the route for a fixed period (i.e. 30 years). The Crown would make payments over the concession period to repay the upfront capital cost of the vessels, plus a reasonable rate of return.</p>
<p>Option 8. Mixed-ownership style approach</p> <p>Shortlisted</p>	<p>The Crown establishes a new Crown-owned entity to procure and operate vessels across Cook Strait. The Crown-owned entity would be designed to provide future governments with optionality around ownership settings. The Crown would investigate opportunities to sell a partial stake in future (like the Air New Zealand / power company model). Private capital could be introduced prior to or following services commencing.</p>
<p>Option 9. Directly own and operate (modified status quo)</p> <p>Shortlisted</p>	<p>The Crown continues to own and operate Cook Strait ferry services, either through continued KiwiRail operations (following KiwiRail structural reform) or through a new Crown-owned entity. (This is similar to Option 8, however without the flexibility to adjust ownership settings in future).</p>

Rationale for the discounted options

- 8 **Options 1, 2, 4:** The evaluation process discounted these three minimal / low intervention options. These options are 'market-led' and do not require high capital investment from the Crown. However, they were discounted because they did not provide certainty over service continuity, or that there would be continued competition on Cook Strait (due to the low availability of vessels and the high costs of entering the market). Regulatory change or low level 'brokering' are unlikely to be enough to incentivise a new entrant on their own in the short-term.

² As discussed in our Phase One advice (OC240407 refers), KiwiRail's control over significant strategic landholdings in the ports would constrain the operations of a new competitor and their relationship with ports.

- 9 These options also constrained Ministers future optionality. If the Crown relied on a new entrant establishing services but no new operator was forthcoming, it would be too late to avoid a loss of service even if the Crown later pivoted to a higher intervention option.
- 10 **Option 5:** The Crown tendering for services directly would have given certainty over service levels and preserved future optionality. However, work by the MAG and KiwiRail has shown no evidence that there is an operator with appropriate vessels available in the market. The option also fundamentally undermines commercial discipline. One fully commercial operator (Bluebridge) would have been competing against another operator enjoying an ongoing subsidy from the Crown (either from an incentive to enter the market or ongoing underwrite scheme).
- 11 **Option 7:** A PPP-like arrangement was explored but discounted. PPP models have been used to deliver ferry / shipping services in other countries (notably in the UK under Private Finance Initiatives). A PPP-like arrangement is therefore potentially feasible for the Cook Strait. However, the option was discounted from the longlist as:
- 11.1 Time constraints mean that it would be very difficult to procure and complete negotiations with a PPP provider in time to avoid a loss of service on the Cook Strait. PPP arrangements take a whole-of-life view of assets, services, and risks, and so can be complex and costly to negotiate.
- 11.2 The ferries do not have an enduring useful life beyond the likely term of the contract (25-30 years). In New Zealand, PPP-like arrangements have generally been used for durable assets that have a useful life beyond the contract period (i.e. schools where the Crown receives high quality assets after 25 years). In the case of ferries, the Crown would be paying a premium and losing operational revenue in exchange for receiving end-of-life vessels at the end of the concession period. The PPP provider is unlikely to continue operating services on the route at the end of the concession period unless the Crown enters another long-term PPP arrangement.
- 11.3 There are limited opportunities for innovation or operational enhancement. Typically, the higher cost of a PPP is offset by the PPP provider's ability to innovate design, take on risk, and make capital – operating trade-offs (i.e. to pay more upfront to lower operating / maintenance costs long-term). In this case, the vessels would be largely the same if the Crown procured them itself and there are unlikely to be significant opportunities to innovate given regulatory settings and port infrastructure requirements.
- 11.4 PPP arrangements are difficult to exit or adjust during operation. The Crown would need to be comfortable locking itself in to a 25-year arrangement with the PPP operator and losing both control and flexibility in the process.

There are four possible interventions that would support Ministers' objectives

- 12 Four options were shortlisted for a more detailed assessment of their feasibility and implementation requirements (full assessment details in Appendix 1):

Low Intervention (Crown not required to purchase vessels)

- **Facilitate, broker and incentivise:** Alongside facilitating an orderly exit of KiwiRail from the Cook Strait, the Government facilitates and incentivises entry to the market by a new commercial operator. The Crown rationalises land ownership around ports and/or negotiates a timebound underwrite to support initial operations of a new operator. There is still a risk that no new entrant can be found and incentivised to establish services at the time when KiwiRail's fleet retires, but it is the lowest cost option to the Crown.

High Intervention (Crown required to purchase vessels)

- **Contract out services:** The Crown purchases ferries and awards a concession to a private provider to operate services for a fixed period (e.g. 10 years) with Crown vessels. This provider pays a fee for use of the ferries and other associated costs with asset ownership (e.g. maintenance, depreciation). The provider retains any profits from the operation to incentivise commercial disciplines. The Crown recovers some of its capital costs over the life of the contract and can extend the contracting arrangements or return to a Crown operator model as each contract expires.
- **Mixed-ownership style approach (highest ranked):** The Crown establishes a new entity to procure and /or operate vessels. The new entity would allow the Crown to sell a partial stake in future (similar to the Air New Zealand model). The minority shareholder(s) would be expected to bring greater commercial discipline to the entity and help to reduce the level of Crown capital investment required. Private capital could be introduced prior to or following services beginning. There is a distinct possibility of the Crown having to accept a capital write down to ensure participation by private investors is commercially attractive. This option best meets the Crown's objectives, noting the complexity and risk associated with transitioning services from KiwiRail to a new entity.
- **Directly own and operate (status quo):** The Crown continues to own and operate Cook Strait ferry services, either through KiwiRail (post-structural reform³) or through a new Crown-owned entity. This option assumes the Government retains full ownership of the assets and services.

- 13 The lower intervention option, *facilitate, broker and incentivise*, is lower cost but high risk. It relies on a new private operator being available quickly to establish services / procure new vessels. It also requires the Crown to rapidly design and refine an underwrite scheme, secure funding, and complete negotiations with an operator.
- 14 The high intervention options all involve the Crown purchasing vessels but differ in the degree of commercial discipline they enable, e.g. relying solely on the private sector to operate with Crown vessels at one end, versus operating via a Crown owned entity at the other.

³s 9(2)(b)(ii)

The low intervention option is not feasible as there is insufficient time

- 15 It is likely too late to progress the low intervention option without risking a service gap and limiting future options for Ministers. This option has not been discussed with the market, nor have the mechanics of an underwrite scheme been developed in detail. There is no indication that there is an operator 'waiting in the wings' and research commissioned by the MAG and KiwiRail has not revealed any available second-hand ferries. It is unlikely that a timebound support scheme would be enough to incentivise an operator to reallocate existing vessels to the Cook Strait or commit to purchase new vessels at significant cost.
- 16 There is a risk that if Ministers progress only a low intervention option and no new operator is forthcoming, it will be too late to pivot to a higher intervention option. It will take considerable time to design and procure new vessels and secure a slot in congested shipbuilders orderbooks. Given the tight timeframes, operator uncertainty, and the risk of loss of service, we recommend that the low intervention option is not considered further.

The feasibility of the higher intervention options depends on a range of market factors

- 17 There are a range of factors which impact the viability of the higher intervention options.

There are limited new / used vessels available

- 18 The three higher intervention options all require the Crown to procure vessels to replace the aging KiwiRail fleet. Advice from shipbrokers - via KiwiRail and the MAG - is that there are no second-hand vessels which meet the Crown's requirements (including a post-2010 vessel which meets passenger / vehicle capacity, and Safe Return to Port capability requirements). Appropriate vessels are fully utilised by their owners and there is little to no interest in selling them due to the cost of purchasing replacement vessels.
- 19 It is likely that the Crown will need to purchase new vessels from a shipbuilder to meet capability and timing requirements. New vessels are significantly more expensive than second hand vessels. This increases the return the Crown would require to recover its upfront capital costs and meet ongoing maintenance / replacement costs. The Crown may have to accept that it will not be able to fully recover the cost of the new vessels and the associated port infrastructure upgrades.

Two operators should be commercially viable on the Cook Strait

- 20 The Cook Strait freight market is currently highly competitive, with most freight users having a range of options available across the current operators, and coastal shipping (noting some goods are limited in the transport options available to them). Given high competition and substitutable services, there is a limited ability for an operator to increase its prices to cover the costs of expensive, new ferries. Freight users are likely to quickly transition to the most cost-effective option available.

21

s 9(2)(b)(ii)

22

The Ministry considers that two operators should be commercially viable on the Cook Strait through a mix of passenger and freight revenue. Having two comparably sized operators provides sufficient competition to meet Ministerial expectations and ensure users can access directly substitutable services. It will be important that the vessels purchased by the Crown do not represent a step-change in capacity beyond the current KiwiRail fleet. If the Crown supplies too much capacity this could distort the market and negatively impact the viability of both operators.

s 9(2)(i)

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Only the mixed ownership style approach and continuation of the status quo are likely to be feasible given market constraints

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While all three of the high intervention options would meet Ministerial objectives, market constraints mean that only the mixed-ownership style approach and directly own and operate option appear to be feasible at this stage.

27

Contract out services: A concession arrangement is unlikely to be feasible unless the Crown is willing to recover its capital over a longer period, or not recover the full

costs of the new vessels (effectively writing off the value of the vessels from day one). The cost of new vessels means that it is unlikely a private sector operator could provide sufficient return to the Crown to cover capital, maintenance, and depreciation costs, while also generating a reasonable return for its shareholders. This option is not feasible at this stage given the uncertainty regarding the existence of an interested operator, and the challenges recovering the Crown's capital cost.

28 **Mixed-ownership style approach (highest ranked):** A mixed-ownership style approach provides the Crown with the option of reducing its ownership stake to recover its capital costs faster than under the direct ownership option (noting that it is unlikely the Crown would be able to fully recoup its capital costs and may have to accept a write down). The introduction of a private sector minority shareholder can be undertaken at any point in time, and should help to enforce commercial discipline and support the long-term commercial viability of the services.

29 **Directly own and operate (status quo):** Retaining full Crown-ownership of the vessels and services reduces the need to generate significant operating profit. The Crown may be comfortable 'breaking even' after accounting for capital, operating, maintenance, and depreciation costs. ^{s 9(2)(i)}

30 ^{s 9(2)(i)}

31 More detail on the specific implementation requirements and risks for the shortlisted options is included in Appendix 2.

A mixed ownership style approach offers the best balance across the outcomes sought by the Crown

32 Ministers have stressed that there is an urgent need for certainty that there will be service continuity on the Cook Strait. This drives the Ministry's relatively high scores for interventions that involve the Crown purchasing new ferries and continuing to have a high degree of intervention in the market.

33 The mixed ownership style approach offers the best balance across the three high intervention options. The initial Crown investment gives certainty, but unlike the directly own and operate option, there is an opportunity to recoup some of the upfront capital (assuming services are commercially viable and attractive to the potential investors – this would need to be further tested). The Crown is not locked into owning all or some of the services over the long-term.

34 The introduction of a minority private shareholder would also be expected to bring increased commercial discipline to the business. Efficiencies should also be expected from the operation of two new ships, which would be expected to consume less fuel than three old ships and operate with fewer crew.

- 35 KiwiRail and the MAG will shortly provide Ministers with advice on the procurement of new ferries. The Ministry supports the recommendation for direct Crown procurement of new ferries but advises that Ministers make those decision with a view to transitioning to a mixed ownership style arrangement.
- 36 A mixed ownership style arrangement would require the establishment of a new Crown owned entity to run the procurement and initial entry into service. Establishing a new entity offers an opportunity to transition to a mixed ownership arrangement (assuming services are commercially viable and attractive) without the legacy obligations or structural limitations at KiwiRail.
- 37 The mixed ownership style approach still requires further refinement by officials, including:
- 37.1 Confirmation of the type of entity to be established and the implementation pathway required.
 - 37.2 Detailed analysis to understand the commercial opportunity to bring in private capital (including market sounding).
 - 37.3 Analysis of the potential approaches and timing to source private sector capital.
 - 37.4 Confirmation of the port infrastructure requirements and how this will be funded.⁴
- 38 To drive the right behaviours and outcomes, Ministers would need to set clear future ownership expectations with the new entity as part of its establishment.. This includes clear objectives around the intended level of Crown ownership and a specific timetable / milestone for achieving it. It would be comparatively simple to 'walk this back' or increase the share of the entity retained by the Crown should private investment not be feasible or if policy settings change.
- 39 We recommend that if Ministers wish to progress the mixed ownership style arrangement, they direct officials to refine the implementation pathway and other key elements of the approach as set out above.

A transition risk exists for all the options

- 40 Regardless of the intervention choice made by the Crown, there is significant risk associated with KiwiRail's managed withdrawal from the Cook Strait ferry market. Mitigations will need to be put in place to ensure that KiwiRail meets its exit timeframes, works collaboratively with ports, operators and freight users, and does not create any additional barriers to the transition into service of a new entity. Specific implementation risks for each option are provided in more detail in **Appendix 2**.
- 41 If KiwiRail fails to exit the market smoothly, this will have a significant impact on the ports' ability to upgrade infrastructure. Wharves will need to be upgraded for the new

⁴ As discussed in our Phase One report (OC240407 refers) the wharves used by KiwiRail in Picton reach end of life in 2029, and the need to replace them remains. Upgrades are also due at CentrePort, and while both port companies have a preference to self-fund infrastructure development and secure a commercial return from their investment via port fees, there may be a case for Crown funding.

operator while still allowing KiwiRail to continue services in the interim. Similarly, a new entrant will be reliant on customers seamlessly transitioning from KiwiRail to the new entity. There may need to be a role for the Crown in supporting the transfer of customer business to the new entity in the short term, e.g. by continuing to honour some of KiwiRail's customer commitments, before allowing commercial discipline to drive market choices fully.

- 42 There are employment law and employee protection provisions that will require more considered specialist legal advice, as establishing a substantively similar company may trigger expectations of employment transfer of undertakings reflecting current contractual arrangements. Without a true separation of the new ferry procurement entity from KiwiRail though, there is a risk of diluting the benefits of establishing the new entity.
- 43 The Crown could consider splitting out KiwiRail's ferry services (including separate leadership) to enable it to focus entirely on the orderly wind down and transition of services. The MAG is preparing advice for Shareholding Ministers on the oversight and governance arrangements for its ferry operations (Interislander), including potential structural separation. The Treasury is preparing advice on the options and process for establishing a new entity.
- 44 If services remain within KiwiRail during the transition, then we anticipate changes to KiwiRail's operational settings will be required to try and make its services commercially viable in the interim. These settings include employment arrangements and commitments with customers.

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Appendix 1

Shortlist option assessment detail

		Low intervention	High intervention		
Criteria		Facilitate, broker, and incentivise	Contract out services	Mixed-ownership style approach	Directly own and operate
Strategic Objectives	How well the option: <ul style="list-style-type: none"> Meets the agreed objectives (competition, commercial viability / discipline, pace) Aligns with the Government's broader transport priorities 	+1 Supports objectives, but no guarantee new entrant available in time	+3 Brings commercial discipline to operations, certainty over capacity and the required pace	+2 Retains Crown involvement initially, but potential for increased commercial discipline, viability, and optionality over time	+1 Retains full Crown ownership. Potential for non-commercial behaviours through perceived Crown underwrite.
Potential value for money	How well the option: <ul style="list-style-type: none"> Optimises value for money (i.e., the optimal mix of potential benefits, costs and risks). 	+2 Minimises Crown funding requirement and transfers risk to the private sector (noting risk that no operators available)	+1 Requires the Crown to fund and maintain vessels without access to commercial profits from operations. Increasing risk as vessels age.	+2 Ability to recoup initial capital through transition to mixed ownership. Benefits of private sector discipline and risk transfer.	+1 Crown retains all risk and responsibility for funding vessels
Supplier capacity and capability	How well the option: <ul style="list-style-type: none"> Matches the ability of potential suppliers to deliver the required services, and Is likely to result in a sustainable arrangement that optimises value for money over the term of the contract. 	-2 Unclear whether operators are available. Risk that Crown required to step in if no provider available (may be too late to ensure continuity of service)	-1 Unclear whether operators are available. Will become increasingly difficult to retender as vessels age	+2 If the Crown can demonstrate commercial viability, then likely to be interest from investors	+2 Continuation of the status quo. Potential for some market hesitancy if KiwiRail remains in charge of procurement.
Potential affordability	How well the option: <ul style="list-style-type: none"> Matches available funding constraints, and Is likely to be financially sustainable over the long-term. 	+3 Likely to be low cost (timebound underwrite)	+2 Requires upfront capital, but losses profit from operations in exchange for concession	+2 Requires upfront capital, but opportunity to recoup capital and return from viable services	+1 Requires upfront capital, risk of continued investment requirement as under status quo
Potential achievability	How well the option: <ul style="list-style-type: none"> Is likely to be delivered given technical, safety, regulatory, and capability considerations. 	+1 Likely to be deliverable due to low level of Crown involvement (assuming provider can be found)	-1 Complex arrangements, particularly as vessels age and contracts expire	+2 Likely to be achievable, but sourcing capital likely to be complex	+1 Likely to be achievable, noting challenge of establishing new entities / reforming KiwiRail
Total / Summary		+5	+4	+10	+6
Ranking		3	4	1	2

Magnitude	Score
Large positive	+3
Moderate positive	+2
Slight positive	+1
Neutral	0
Slight negative	-1
Moderate negative	-2
Large negative	-3

Appendix 2

Implementation considerations, main risks, and mitigations for the four shortlisted options

Facilitate, broker and incentivise

45 Under this option, there are four key activities which will need to be completed:

- **Identification of new entrant** – to prevent a situation where Bluebridge monopolises the whole market, the Crown will need to actively engage with potential operators to assess interest.
- **Brokering of a new operator** – Once identified, the Crown would act as a facilitator to ensure a smooth entry to market to maintain competition. This would require KiwiRail to work collaboratively with the new operator for a range of matters (e.g. transfer of customer contracts).
- **Financial incentives** – The Crown could offer a financial incentive (e.g. scheme or Crown underwrite) to attract a new entrant to the market given the high barriers to entry. To ensure value for the money and commercial discipline, the financial incentive should be tied to performance. This will require ongoing monitoring and management from a Government agency.
- **Rationalisation of land ownership** – KiwiRail hold significant land holdings at both ports largely for historical reasons and to support its rail-enabled operations. To incentivise a new entrant, the Crown could instruct KiwiRail to sell unrequired land to ports to streamline port infrastructure renewals and management. We believe facilitating this transition would put a new entrant on equal footing with the existing competitor, Bluebridge, which leases all its land and infrastructure directly from the port.

Risks and possible mitigations

46 This option is highly time sensitive. If a new operator is not found quickly (i.e. by December 2024 at the latest), then it may be too late for the Crown to pivot to purchasing vessels, limiting optionality for the higher invention options. Early engagement with the market is required to test the viability of this option.

47 If services are found to not be commercially viable, then the Crown may be required to extend its financial incentive to maintain market capacity. We see this as a low risk as the financial support can be structured to disincentivise the operator from becoming reliant on it, and our own assessment shows that ferry services on the Cook Strait can be commercially viable.

48 If KiwiRail's exit from the market is not managed effectively, then new barriers to entry may be created which jeopardise the viability of a new entrant. To prevent this the Crown will need to have significant oversight of KiwiRail's transition to ensure it meets its timeframes, port infrastructure is available when required, and customers have clarity over their transport options.

Contract out services

49 Under this option, there are four key activities which will need to be completed:

- **Vessel procurement** – The Crown will need to determine the procurement entity of new vessels, which could be a new or existing entity. This will involve confirming vessel design, selecting a shipyard (if new) and negotiating price, management of vessel delivery, and engaging with the ports on required portside infrastructure. A similar process would be had for procuring second-hand ferries.
- **KiwiRail transition** – oversight of KiwiRail transition timeline and winddown to ensure no new barriers to entry are created.
- **Tendering of services and negotiation** – running a procurement process and negotiating a range of key contractual terms, including length of contract, service levels, performance regime, maintenance responsibilities and overall service requirements (e.g. frequency). Ministerial approval would be required to enter this contract.
- **Operations and monitoring** – to ensure value for money and commercial discipline, a government agency will need to monitor overall performance to ensure aforementioned contractual terms are met.

50 We note that some key commercial elements will need to be tested with the market if this option is preferred. For example, it is not clear which party should be responsible for maintenance activities (which impacts which party is at risk during a breakdown or responsible for covering costs during dry dock) or how penalty regimes would work in the event of non-performance (i.e. Crown levers outside of termination or relying on the operator's desire to make a profit to incentivise performance).

Key risks and mitigations

51 If the service contract only lasts for a fixed period (i.e. 10 years), it will become increasingly difficult to retender as vessels age, are more prone to service failure, and require refurbishment. The Crown could find itself financially exposed or unable to secure an operator without some form of incentive. The Crown may need to factor refurbishment into its costs from the outset to ensure it does not struggle to extend or enter new service agreements as vessels age, or increase the contract period.

52 As we have seen, constructing new vessels has increased in price and there appears to be a very limited global supply of second hand ferries. Given the high costs of new vessels, it may not be possible to recoup the costs of the capital through the concession payment without jeopardising commercial viability of the services (i.e. remaining competitive with Bluebridge on price). Early Crown acceptance that the full cost of capital may not be recovered through the concession will be required.

53 There may also be no operators willing to establish services with Crown vessels or accept the terms in a contractual agreement in which case the Crown would need to stand up services itself at pace. Early engagement with the market will be critical to identify the level of interest.

Mixed-ownership style approach

- 54 This option follows the same implementation pathway to the contract our services option with one key difference later in the process:
- **Ownership transition** – this option is open to bringing in private capital predelivery of the vessels or sometime into the future once the services have established themselves. This option offers maximum optionality to the Crown and the amount to be gained would reflect the cost of capital or perceived value of the business based on its commercial success (or not).
- 55 Further work on this option needs to be tested. For example, the Crown would need to confirm the best time and approach to sourcing capital (e.g., after vessels are procured but before operational commencement or following a period of operations to demonstrate commercial viability, direct approach to potential investors (e.g. NZ Super Fund) versus IPO) and the most appropriate operating structure long-term (i.e. Air NZ model versus more direct Crown control).

Key risks and mitigations

- 56 There is a possibility that private capital is uninterested in partnering with the Crown in providing services across the Cook Strait, meaning the Crown's ability to recoup the upfront costs is undermined. However, if services are proven to be viable, it seems that a mixed-ownership arrangement should be feasible.

Directly own and operate (status quo)

- 57 This option is a continuation of the status quo, or can be slightly modified via the creation of a new entity (which the Treasury is leading advice on). This option closely follows the same implementation pathways as the mixed-ownership option but differs in that it does not seek to sell off a stake of the company. This option is by default the most costly but gives the Crown the most control and certainty of continuation of operations.
- 58 The primary implementation pathway for this option is confirming whether the procurement of vessels and operation of services will continue under KiwiRail or a new entity operator. Regardless of whether operations continue with KiwiRail or a new Crown-owned entity, new vessels will need to be purchased, existing vessels transitioned out of service, and portside infrastructure updated to meet new vessel requirements.
- 59 Even in a model where the Crown does not intend to access private capital, the ability to adjust Crown ownership settings in future should be considered when determining the form of the new Crown-owned entity

Key risks and mitigations

- 60 If KiwiRail retains services, it will need to reform to its operations. Without reform, the Crown is likely to find itself incurring costs supporting an unviable business. It is unclear the extent to which meaningful reform could be achieved within KiwiRail. To

minimise ongoing financial support, a high level of Crown oversight to reform activities will be required.

- 61 It is likely that the new entity would be comprised of many former Interislander/KiwiRail employees. Strong governance and oversight will be required to ensure that greater commercial discipline can be achieved.

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