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Listed below are the relevant sections of the OIA. Where information has been withheld, a numbered reference to the applicable section of the Act has been made. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

<u>Key</u>	<u>Section and description of ground</u>
[23]	9(2)(a) - to protect the privacy of natural persons
[25]	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
[33]	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
[34]	9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions by or between or to Ministers of the Crown or members of an organisation or officers and employees of any public service agency or organisation in the course of their duty
[35]	9(2)(g)(ii) - to maintain the effective conduct of public affairs through the protection of Ministers, members of government organisations, officers and employees from improper pressure or harassment
[39]	9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Joint Report: KiwiRail – progress on entity form review

Date:	2 March 2022	Report No:	T2021/3153
		File Number:	SE-2-25-2

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree to the recommendations.	16 March 2022
Minister of Transport (Hon Michael Wood)	Agree to the recommendations.	16 March 2022
Minister for State Owned Enterprises (Hon Dr David Clark)	Agree to the recommendations.	16 March 2022

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Michael Moore	Principal Advisor, Commercial Performance, The Treasury	[35]	✓
Rory Sedgley	Principal Advisor, Supply Chain, Ministry of Transport		✓
Maureena van der Lem	Manager, Commercial Performance, The Treasury		
Bryn Gandy	Deputy Chief Executive, Ministry of Transport		

Minister's Office actions

Return the signed report to the Treasury and the Ministry of Transport. If agreed, **send** the report to the Minister for the Public Service.

Enclosure: [Annex 1: Organising commercial and policy functions \(Treasury:4619829v1\)](#)

Annex 1 is publicly available here:
<https://www.publicservice.govt.nz/assets/DirectoryFile/Organising-commercial-and-policy-functions-Feb-20>

Joint Report: KiwiRail – progress on entity form review

Executive summary

The Ministry of Transport and the Treasury are undertaking a review into the entity forms of KiwiRail Holdings Limited (KiwiRail) and the New Zealand Railways Corporation (NZRC). As state-owned enterprises (SOEs), their principal purpose is to operate as a (commercially) successful business, but it is unclear if this is the best entity form for the Government to achieve the mix of commercial and public benefit outcomes that it desires as a result of its multi-billion dollar investments in KiwiRail since Budget 2019.

KiwiRail's entity form was considered as part of the 'Future of Rail' review, and in May 2020 Cabinet noted that it was appropriate for KiwiRail to remain an SOE for the present time, while reforms arising from the Future of Rail review commenced, and that a subsequent entity form review would be undertaken [DEV-20-MIN-0082 refers].

You agreed to a Terms of Reference for the entity form review in September 2021 (T2021/2044 and OC210738 refer). Officials from the Ministry of Transport and the Treasury, working with the Public Service Commission and KiwiRail, have considered analysis produced as part of previous reviews and the rationale for NZRC's role as a passive holder of railway land.

We are now seeking your agreement on the rationale which the Crown owns and invests in KiwiRail (and by extension NZRC). This rationale builds on the Government's vision for rail, outlined in the New Zealand Rail Plan. We advise that these objectives should be to ensure:

- a. the provision of a sufficiently comprehensive, resilient and reliable rail network that supports economic prosperity and improved environmental outcomes;
- b. a competitive alternative to other transport modes is reasonably available to businesses and people, and utilisation of the rail network is maximised to deliver public benefits; and
- c. the most efficient and effective investment in, and operation of, the New Zealand rail system, including the network, rolling stock and associated assets.

The characteristics of KiwiRail successfully addressing these ownership objectives would be that KiwiRail:

- a. runs a commercially sustainable above-rail business, as profitable and efficient as a comparable non-crown business;
- b. invests in the right assets, and maintains those assets – both below- and above- rail – in a cost-effective timely manner;
- c. delivers the public benefits of a national rail network for all New Zealanders including lower transport emissions, reduced congestion and safer roads; and
- d. is an exemplar employer in terms of health and safety and other employment conditions.

In the next phase of the review, we intend to assess different entity form options against the following criteria:

- a. ability to meet public benefit objectives and address Ministers' priorities (as expressed through the ownership objectives outlined above);
- b. ability to engage and support integrated transport system outcomes;
- c. ability to maximise commercial performance, thereby reducing the need for Crown funding over time;
- d. feasibility of change from the status quo; and
- e. ability for operational reporting to be transparent and accountable.

Two 'hurdles' will also be considered when determining if any entity form change is worthwhile:

- a. Any entity form change should be enduring, in that it can be reasonably responsive to the potentially changing needs of government (and different governments) over time; and
- b. The forecast benefits of any change would exceed the expected costs and risks arising from any change.

The four main entity form options that we intend to consider against the criteria are:

- a. Status quo – KiwiRail remains an SOE and existing initiatives such as the separation of above- and below-rail accounts continue unaltered;
- b. Modified status quo – KiwiRail remains an SOE and consideration is given to what new initiatives would be appropriate to help give effect to the Government's objectives for KiwiRail;
- c. Crown entity company – KiwiRail moves 'closer to the Crown' in that whole-of-government directions can be issued to the Crown entity company; and
- d. Crown Agent, possibly with a commercial subsidiary – KiwiRail moves 'closer to the Crown' and provide Ministers with more control in that the Board must give effect to Government policy.

Defining these options more precisely will be important to ensure that they are correctly tested against the criteria. Your feedback will be incorporated into our work plan for the next phase of the review, and we will provide our final advice to you by 30 June 2022.

Recommended action

We recommend that you:

- a **agree** on the ownership rationale and characteristics of a successful KiwiRail (and by extension) New Zealand Railways Corporation, as outlined in paragraphs 25 and 26.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Transport

Agree/disagree.
Minister for State
Owned Enterprises

- b **note** that officials intend to undertake more detailed analysis on the suitability, cost and disruption of four main options (status quo as a State Owned Enterprise, amendments possible while remaining a State Owned Enterprise, a Crown entity company, and a Crown Agent, potentially with a commercial subsidiary), and report back to you with final advice by 30 June 2022.

- c **note** the criteria and 'hurdles' that officials will use to differentiate between these four main options, as outlined in paragraphs 28 and 29.

- d **provide** officials with feedback (if any) on how the review is progressing to date and the intended next steps as outlined in recommendations (b) and (c) above.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Transport

Agree/disagree.
Minister for State
Owned Enterprises

- e **refer** this briefing to the Minister for the Public Service for his information.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Transport

Agree/disagree.
Minister for State
Owned Enterprises

Maureena van der Lem
**Manager, Commercial Performance,
The Treasury**

Bryn Gandy
**Deputy Chief Executive,
Ministry of Transport**

Hon Grant Robertson
Minister of Finance

Hon Michael Wood
Minister of Transport

Hon Dr David Clark
**Minister for State
Owned Enterprises**

Purpose of report

1. This report provides you with an update on progress made in the review of KiwiRail Holdings Limited's (KiwiRail's) and New Zealand Railways Corporation's (NZRC's) entity forms. It outlines our next steps and seeks your feedback, before we undertake detailed analysis and provide you with final advice in June 2022.

Background

The Future of Rail review resulted in a new planning and funding framework

2. In 2017, the Government began a comprehensive review (the 'Future of Rail' review) to define the purpose of rail and, as a result, the outcomes and objectives for rail that the Government seeks. It also set out to determine the appropriate structure, capital requirements and funding mechanisms to reflect that purpose.
3. The review recognised that the existing arrangements with short-term funding decisions were not conducive to building delivery capability and providing value for money over the long-term. It concluded that a structural change to rail network planning and funding, and a substantial programme of remedial investment were required.
4. Rather than ad hoc direct Crown funding, rail network ("below-rail") investment is now channelled through the National Land Transport Fund (NLTF), which is itself funded by revenue from motorists, track users and the Crown. Reforms in 2021 established a Track User Charge (TUC) to be paid by KiwiRail's freight operations into the NLTF to ensure that beneficiaries of the rail network contribute to its upkeep, although this represents a small proportion of total funding required.
5. The new funding model came into effect in July 2021, whereby the Government sets out a strategic direction for rail and its investment priorities in the New Zealand Rail Plan. KiwiRail then uses the Rail Plan and the Government Policy Statement on Land Transport (GPS) to propose a Rail Network Investment Programme (RNIP) for approval by the Minister of Transport (with advice from Waka Kotahi). KiwiRail's shareholding Ministers are consulted as part of this process. Waka Kotahi administers the NLTF and monitors rail network investments made from the NLTF. KiwiRail is projecting that no further Crown funding for above-rail will be required after FY25.
6. The new rail network planning and funding structure is still in its infancy, and monitoring implementation is a priority for the Ministry of Transport, Waka Kotahi and the Treasury. The new structure does not preclude the Crown from providing supplementary investment in rail or, as the owner of KiwiRail, to deliver specific projects (e.g. New Zealand Upgrade Programme) or fund KiwiRail to undertake non-commercial activities through section 7 of the State-Owned Enterprises Act 1986 (the SOE Act), as is occurring through investment in the Hillside facilities.

KiwiRail's entity form remained an outstanding issue following the Future of Rail review

7. While the Future of Rail review addressed the broader planning and funding framework to improve transparency and provide for long-term sustainable investment in rail infrastructure, one aspect that was considered but not resolved was the most appropriate entity form for KiwiRail.

8. It was determined, on balance, that it was appropriate for KiwiRail to remain a state-owned enterprise (SOE) for at least the time being, and that a further review would be undertaken to examine whether this was the most appropriate form to achieve the outcomes the Government is seeking from KiwiRail [DEV-20-MIN-0082 refers]. This deferral provided more time for Future of Rail reforms, such as KiwiRail providing separate above- and below-rail reporting, to be embedded.
9. Given it is also an SOE, officials advised that it would be appropriate to also consider the entity form of NZRC. Unlike other SOEs, NZRC is a statutory corporation and does not have shares. Its sole role is to hold railway land and make it available for KiwiRail to use for a nominal annual fee. NZRC is not expected to derive any return from the land and is not expected to operate as a commercial business. Acknowledging their interdependencies, KiwiRail and NZRC have, by recent convention, the same Chair, appointed by shareholding Ministers.

You agreed to a Terms of Reference and the review has commenced

10. You considered and approved a Terms of Reference in September 2021 (T2021/2044 and OC210738 refer). Officials have subsequently commenced the review, with the Ministry of Transport and the Treasury charged with undertaking the review and delivering advice to Ministers by 30 June 2022. A representative of each department sits on the review's Steering Group, while representatives of each department, the Public Service Commission (PSC) and KiwiRail comprise the review's Working Group.
11. The Working Group has considered analysis produced as part of previous reviews into KiwiRail's entity form, being mindful that while it is prudent to build off of previous work, we are not bound by their findings.
12. The Steering Group met with KiwiRail's Board in November 2020 to discuss the review. This meeting was not a formal consultation on a proposal, but rather gave the Board the opportunity to understand the rationale for the review and sought to ensure that there remains good faith engagement between the Steering Group and KiwiRail's Board as the review progresses.
13. We have undertaken initial analysis on different entity forms that may be suitable in achieving the Government's objectives for KiwiRail and NZRC. Draft criteria have been developed to differentiate between options during the second phase of the review. Our advice on these objectives and the criteria are outlined below. We now seek your confirmation of these objectives, and any other feedback that you wish to provide, to ensure that the analysis in the second phase of the review can be as targeted as possible.

Analysis

14. The assessment of entity form options is driven by what the Crown, as owners, see as KiwiRail's role in achieving its vision for rail. Because of the nature of KiwiRail's multiple objectives, no single entity form is likely to be ideal.

The role of KiwiRail in achieving the Government's vision for rail

15. Through the New Zealand Rail Plan, the Government has set out a long-term vision for New Zealand's rail network. The current vehicle for delivering public investment into the rail network is through a state owned, vertically integrated company – KiwiRail. This is a relatively simple, and internationally common structure for a national rail system. The New Zealand market/private sector would not be able to deliver this vision across a national rail network without substantial public investment. This situation is not unique to New Zealand.

16. A single public organisation integrating train operations and rail infrastructure is recognised as more suitable for small markets where competition (with its associated cost and service benefits) between train operators is unlikely. A single management structure enables coordinated investment and efficient management of trains and track infrastructure. It eliminates the transactional costs and duplication that can occur in a vertically separated industry structure. The Terms of Reference for this review have placed any changes to KiwiRail's currently vertically integrated structure as 'out of scope'.
17. Any change in structure should also be assessed for its relevance and impact on metropolitan rail services. The Ministry of Transport is scheduled to review the Metropolitan Rail Operating Model (MROM), and the interdependencies of this workstream will need to be considered, as noted in the Terms of Reference.

Problem statement

18. KiwiRail has a mix of "above-rail" commercial and "below-rail" public benefit objectives (which are funded through a mix of commercial revenues and Crown funding). There can be tension between maximising commercial performance and achieving the public policy outcomes that the Government seeks through KiwiRail. The current SOE entity form has a strong focus on maximising commercial performance, which could be perceived to put the delivery of public benefit outcomes at risk. Conversely, we note that alternative entity forms could be perceived to put commercial performance at risk given their stronger focus on achieving public benefit outcomes. We will consider whether the current SOE entity form impedes the delivery of public benefit outcomes, such as connections to the regions, in our next advice to you.
19. A key focus for the review is considering the impact of entity form on any trade-off between these two objective categories (commercial and public benefit) over time.
20. KiwiRail has complex funding and reporting arrangements involving a number of agencies (notably the Treasury, the Ministry of Transport, Waka Kotahi, the Ministry of Business, Innovation and Employment and by extension Kānoa) and engages directly with both shareholding (ownership) and policy Ministers. For example, through Budget 2021, there are several different funding initiatives to support KiwiRail's investment programme. These are sourced from a range of policy initiatives with varying policy outcomes being sought and with different oversight arrangements (for example Provincial Growth Fund, Crown Investment Partners/Shovel Ready, the New Zealand Upgrade programme and the Future of Rail). These initiatives may or may not match the priorities that the Board would set for investments.
21. These complexities are currently addressed through:
 - a. the Land Transport (Rail) Amendment Act 2020 bringing the below-rail funding shortfall into the transport planning and funding system, creating a cash neutral below-rail business alongside the expectation of a commercially sustainable and profit-focused above-rail business;
 - b. separate below-rail and above-rail reporting to create transparency around the performance of the public benefit-focused and commercially focused businesses, respectively; and
 - c. directors balancing these objectives in respect of their duties in accordance with the SOE Act, the Companies Act 1993 and other relevant legislation.

22. As noted above, the rail network planning and funding structure is in its infancy. We are of the view that it is not yet clear whether these new initiatives deliver sufficient transparency and accountability. It is possible that further initiatives, including a potential change in entity form, could provide the Government of the day, and future Governments, with a greater ability to achieve the objectives they seek from KiwiRail.

Ownership rationale and characteristics of a successful KiwiRail

23. Clarity on what the Crown is seeking to achieve through its ownership of KiwiRail (and NZRC) is critical in assessing the role of entity form. For example, the extent to which KiwiRail is used as an instrument to implement public policy (potentially at the expense of commercial returns), and the ability to vary that over time, needs to be considered when assessing entity form.

24. The Government's vision for rail was set out in the New Zealand Rail Plan, as follows:

"Our long-term vision is for New Zealand's rail network to provide modern transit systems in our largest cities, and to enable increasing volumes of freight to be moved by rail. Enabling alternative transport options for people and freight is a key part of providing a multi-modal transport system. Increasing the use of lower-emission transport options, including rail, is an important step in the Government's response to the climate emergency. Supporting increased use of rail will be a part of the changes needed for transport to meet the draft emissions budgets proposed by the Climate Change Commission. This will help to achieve the Government's objective of net zero emissions by 2050. By moving more people and freight onto rail, our roads will also be less congested and safer."

25. As the Crown-owned, and only, supplier of below-rail network infrastructure and above-rail freight services, KiwiRail plays a pivotal role in the delivery of this vision. On this basis, we advise that the objectives underpinning the Government's ongoing ownership and investment in KiwiRail should be to ensure:

- a. the provision of a sufficiently comprehensive, resilient and reliable rail network that supports economic prosperity and improved environmental outcomes;
- b. a competitive alternative to other transport modes is reasonably available to businesses and people, and utilisation of the rail network is maximised to deliver public benefits; and
- c. the most efficient and effective investment in, and operation of, the New Zealand rail system, including the network, rolling stock and associated assets.

26. We advise that the characteristics of a successful KiwiRail in addressing these ownership objectives should be that KiwiRail:

- a. runs a commercially sustainable above-rail business, as profitable and efficient as a comparable non-crown business;
- b. invests in the right assets, and maintains those assets – both below- and above-rail – in a cost-effective timely manner;
- c. delivers the public benefits of a national rail network for all New Zealanders including lower transport emissions, reduced congestion and safer roads; and
- d. is an exemplar employer in terms of health and safety and other employment conditions.

27. These are reflected in the proposed criteria against which different entity form options will be analysed.

Criteria to assess different entity form options

28. The Working Group has developed a set of five criteria against which to assess and differentiate between high level entity form options, and develop a recommendation for Ministers in our final advice. These criteria are the:
- a. ability to meet public benefit objectives and address Ministers' priorities (as expressed through the ownership objectives outlined above);
 - b. ability to engage and support integrated transport system outcomes;
 - c. ability to maximise commercial performance, thereby reducing the need for Crown funding over time;
 - d. feasibility of change from the status quo; and
 - e. ability for operational reporting to be transparent and accountable.
29. We have identified two 'hurdles', which any change of entity form should exceed:
- a. Any entity form change should be enduring, in that it can be reasonably responsive to the potentially changing needs of government (and different governments) over time; and
 - b. The forecast benefits of any change would exceed the expected costs and risks arising from any change.
30. Given the challenge in identifying the most appropriate form for an entity with a mix of commercial and public policy objectives, these criteria are intended to help ensure consistent analysis of the relative strengths and weaknesses of each of the options and to ensure that officials can provide objective consideration of alternative entity forms. Ultimately, a judgement from Ministers is likely to be required on the entity form that is appropriate to manage the desired balance between commercial and public policy objectives, noting officials advise that the selected entity form should be enduring and able to accommodate a reasonable flex should successive Governments have different policy preferences and therefore desire a different balance between commercial and public policy objectives.

High-level entity form options

31. There are a wide range of established entity forms, as part of the wider machinery of government framework, that could be considered for KiwiRail. Given its narrower system role, we advise that consideration of NZRC's entity form follow consideration of KiwiRail's entity form (this would be still be incorporated into our final advice to you).
32. The PSC and the Treasury have established a framework for organising mixed commercial and public policy functions (provided as **Annex 1**). This framework assists consideration of the comparative significance of the commercial and public benefit functions within an arms-length entity.
33. Under this framework, commercial functions typically belong in companies, whereas public benefit functions belong in public service agencies, such as departments or Crown entities. In the case of KiwiRail, there are a mix of commercial and public benefit objectives.

34. In line with the proposed ownership objectives (paragraph 25 above), a judgement will need to be taken on whether the focus of KiwiRail should be on making returns for shareholders or simply maintaining a level of commercial discipline. Commercial operations and disciplines can also be used by public service agencies to efficiently deliver their functions. In examining a commercial option, the analysis will need to weigh up the duty of a company director under the Companies Act 1993 to act in good faith and in the best interests of the company, not shareholders, and whether this is likely to be in conflict with the public policy objectives for the rail network from the government of the day.
35. Using this framework, we have identified four main options for KiwiRail that the Working Group intends to analyse against the criteria in the second phase of the review. All four options give KiwiRail operational autonomy, with a Board of directors accountable for performance, and require ongoing Crown investment to deliver the public benefits sought by the Government.
- a. Status quo – KiwiRail remains an SOE, allowing time for the reforms from the ‘Future of Rail’ review to fully bed in, and for the balance of KiwiRail’s rolling stock and fleet renewals to be delivered. The new planning and funding framework, including Waka Kotahi as the monitor of the RNIP, and the separation of above- and below-rail accounts would continue unaltered. This would not preclude the ongoing evaluation of the effectiveness of the new system leading to proposals for further improvement;
 - b. Modified status quo – KiwiRail remains an SOE and consideration is given to what new initiatives would be appropriate to help give effect to the Government’s objectives for KiwiRail – this could include changes to the regulatory system and the governance arrangements the Crown currently has in place for KiwiRail. As noted above, the Ministry of Transport intends to review MROM to ensure that the regulatory regime supports the Government’s aspirations for modern transit systems in Auckland and Wellington. The current separation of shareholding and transport policy Ministerial responsibilities could be examined, or the roles of the public service assessed, to ensure a holistic ‘whole of government’ approach to policy decisions affecting the rail system;
 - c. Crown entity company – this option would bring KiwiRail ‘closer to the Crown’. You may decide this form is preferable if the Crown’s commercial interests do not predominate the Crown’s wider policy interests. KiwiRail would remain a company so certain benefits of change may not necessarily be realised, and this would need to be analysed further before June 2022. Many Crown entity companies have bespoke legislation outlining the purpose and objectives of the company, which provides focus and limits the risk of the company straying from its core purpose. Whole-of-government directions can be issued to the Crown entity company. Three whole-of-government directions are currently in force (applying to ICT, property, and procurement) which are intended to secure economies of scale, improve operational efficiency and improve service delivery, by requiring all entities to apply the Government Rules of Sourcing, for example; and
 - d. Crown Agent, potentially with a commercial subsidiary – this option would bring KiwiRail ‘closer to the Crown’ and provide Ministers with more control in that the Board must give effect to Government policy. We need to further analyse whether Ministers need a formal power of direction given existing levers, such as the GPS on Land Transport, the New Zealand Rail Plan, the RNIP process and Letters of Expectations may mean that KiwiRail is already sufficiently responsive to Government policy. As an arms-length body, a non-executive board appointed by Ministers would still be accountable for the performance of KiwiRail as a Crown Agent. One way to structure these functions might be for a commercial above-rail

subsidiary company to be established within the 'parent' Crown Agent, however this would be a matter for the Board. The Board must be accountable for KiwiRail as a whole, so the objectives of the subsidiary could not conflict with the objectives of KiwiRail as a whole. Alternatively, KiwiRail as a Crown Agent might find that it is more effective to operate without an internal subsidiary.

36. It will be important, as part of the second phase of the review, to define these four options more precisely to ensure that they are being tested correctly.
37. We note that the Government has, over the last three years, reformed the planning and funding regime for the rail network in the context of KiwiRail as an SOE. If this were to change then it is highly likely that the wider transport investment system would also need to change to accommodate that alternative entity form.
38. We also note that the Companies (Directors Duties) Amendment Bill is currently before the House (first reading). This Member's bill, if passed into law, would explicitly allow company directors to take into account matters other than the companies' financial results. This may include matters such as the principles of The Treaty of Waitangi, environmental impacts, good corporate ethics, being a good employer, and the interests of the wider community.
39. This approach would be consistent with section 4 of the SOE Act which states SOEs should be "a good employer", and have "regard to the interests of the community in which it operates".

Costs and benefits will be considered as part of our analysis

40. As we have noted in previous briefings (T2021/2044 and OC210738 refer), machinery of government changes can be disruptive and costly. Organisational change can create on-going uncertainty for KiwiRail's staff and customers. We note that KiwiRail has a multi-billion dollar programme of investment underway, through the RNIP, and the procurement of new ferries, rolling stock and other assets. One of the principles underpinning the criteria is that the forecast benefits of any change would exceed the expected costs and risks arising from any change.
41. Defining the options more clearly will allow the implications, risks and disruptions associated to any change in entity form to be better understood. [25]
42. SOEs can access third-party lending to support commercial activities. KiwiRail has \$350m in lending supporting the renewal of the Interislander ferries, as part of the funding arrangements for Project iReX. KiwiRail accessed this lending from a banking syndicate as an SOE, based on the bank's satisfaction of KiwiRail's commercial performance and ability to service debt. While significant shareholder equity has been required to renew commercial assets, this is intended to support KiwiRail's objective of reaching commercial self-sufficiency¹ from FY25. [25]

43. [25]

¹ We define commercial self-sufficiency as KiwiRail generating sufficient net cash from its operations to be able to fund all of its capital requirements to maintain its assets at a 'resilient and reliable' level in perpetuity, without resorting to any further equity injections from the shareholder.

Comment from the Public Service Commission and KiwiRail

44. The PSC and KiwiRail, in their working group capacity, have been consulted on this report. We have considered their feedback in drafting this report, and their views are summarised below.
45. PSC advises that in the first instance a decision must be made by Ministers on whether KiwiRail is primarily a commercial or a non-commercial entity, which would lead to a subset of likely entity forms. Given the cost of any change, the status quo (SOE) should first be assessed. We will undertake this work in the second phase of the review.
46. KiwiRail advises that any entity form must enable the delivery of both commercial and public benefit objectives. This is because KiwiRail will still be expected to operate in active markets with competitors, as remaining a commercially focused entity provides the greatest ability for the Crown to maximise the financial return from recent Crown funding while providing the best levels of service to its customers. KiwiRail also considers that the delivery of public benefit objectives should also be an enduring principle, as this considers that new funding mechanisms for infrastructure (the RNIP) and for services bought from the company (such as SOE Act section 7 agreements) enable KiwiRail to deliver these outcomes with appropriate resources and accountability. Further, KiwiRail believes that the balance between Ministers' commercial and public benefit expectations are currently clear as a result of the New Zealand Rail Plan, RNIP and Letters of Expectations from shareholding Ministers, and this is strengthened by increased transparency through the new planning and funding framework.
47. If Ministers decided that KiwiRail would become a Crown Agent with a commercial subsidiary option, the subsidiary would report to the Crown Agent Board. The Board should not have conflicting arrangements – tension could arise between the wider Crown Agent which is public benefit focused, and the Board's efforts to optimise a commercially focused subsidiary. As a member of the Working Group, KiwiRail has noted that this option may be unworkable if the public benefit objectives consume the retained earnings of the commercial operation instead of investing in the growth of its operations (meeting projected freight demand and contributing to emissions reduction as a result). KiwiRail's view is that entity form is simply a matter of the best form to enable its business and network functions to be successful together.
48. KiwiRail has also asked that the assessment of any costs and benefits of change explicitly consider the vertically integrated delivery of commercial services and infrastructure management. KiwiRail's view is that any entity form must best enable both objectives to be successful.

Next steps

49. We will incorporate feedback that Ministers provide on this briefing into the work programme for the next phase of the review.
50. We recommend that this briefing be forwarded to the Minister for the Public Service for his information. This is consistent with your decision to forward previous briefings on the entity form review to the Minister for the Public Service.

51. As more detailed options are considered, we will also consider how any changes could impact KiwiRail's ability to service debt and access borrowing facilities. KiwiRail's Board has identified the implications for its current and future lending arrangements as a matter of concern.
52. The Steering Group anticipates having a further meeting with the KiwiRail Board in advance of officials' final advice being provided to Ministers. Consistent with the previous meeting in November 2021, this meeting would not constitute formal consultation on a proposal but would continue good faith engagement between the Steering Group and the Board.
53. We will provide our final advice to you by 30 June 2022.

PROACTIVELY RELEASED BY
TE MANATU WAKA MINISTRY OF TRANSPORT