

Rail Track User Charge *Phase 2* Cost Recovery Impact Statement (CRIS-2)

Agency Disclosure Statement

The Ministry of Transport (the Ministry) prepared this Cost Recovery Impact Statement (CRIS).

The proposals in this paper follow a series of Cabinet decisions made in response to the recommendations of the Future of Rail review. A track user charge (TUC) applying to KiwiRail's freight business will provide funds for rail activities included in the Rail Network Investment Programme (RNIP). The charge will flow into the National Land Transport Fund (NLTF) as land transport revenue.

Over time, the Ministry considers (and KiwiRail agrees in-principle) the charge should at least recover the direct costs of usage of the national rail network imposed by users of that network. For KiwiRail's freight business, this is currently estimated to be \$53 million per annum.

The Ministry recognises that track users are the primary beneficiary of the rail network and should contribute to its costs. We also acknowledge that there are broader public benefits that the Government is seeking from the rail network and that it needs further investment. Transport benefits have been acknowledged already through agreement to set aside up to \$170 million of existing NLTF revenue per annum to partially meet the costs of maintaining and renewing the rail network.

Putting in place a TUC will ensure the contribution from users are transparent and decision makers as well as the public are aware of the level of Crown subsidisation for rail freight services. Implementing financial reporting separation of above and below rail activities within its current structure, as previously agreed by Cabinet, will improve the transparency of KiwiRail's costs, funding and revenue from these activities.

The Ministry accepts that KiwiRail's freight business does not generate sufficient revenue to cover the full direct costs of rail network usage at this time. We also recognise that this is the first time TUC has been set to contribute to the NLTF.

In setting the charge, a pragmatic approach is required which ensures the charge balances the seven funding principles noted by Cabinet (outlined on page 3 of this document). The Ministry expects to undertake a further review of the arrangements for the TUC prior to the development of the next Government Policy Statement on land transport over the next three years.

Affordability has been a key consideration when developing the TUC. Cabinet previously noted that KiwiRail was only likely to be able to pay a small portion of the total costs of rail activities funded through the NLTF. The Ministry is reliant on KiwiRail and the Treasury as the Shareholders representative to advice affordability for KiwiRail. During the process of developing the TUC, the Ministry engaged international consultants Swiss Economics to support the development of the TUC.

Erin Wynne, Director Rail Transformation, Ministry of Transport

29 March 2021

Purpose

This paper provides an assessment of the five options considered by the Ministry of Transport (the Ministry) when determining the amount to recover from KiwiRail's freight business via the track user charge (TUC).

Context

The proposals in this paper follow Cabinet decisions on the recommendations of the Future of Rail review. In particular, the decision Cabinet took to fund the national rail network through the National Land Transport Fund (NLTF), and in-principle decisions to recover a track user charge from KiwiRail's freight and tourism businesses [DEV-20-MIN-0082 refers].

Rail contributes to national and regional economic growth. It provides transport benefits through reducing emissions and congestion on the road network, reduces road deaths and injuries, facilitates wider social benefits, and provides resilience and connection between communities.

The Future of Rail review recommended a package of investment to bring the national rail network up to a resilient and reliable standard. However, it also recognised that remedial investment alone would not be sufficient and that a new planning and funding framework was required for rail under the Land Transport Management Act 2003 (LTMA).

The TUC, payable by KiwiRail's freight business, is required to provide funds for rail network activities included in the Rail Network Investment Programme (RNIP). This charge aims to ensure that KiwiRail contributes in a fair and transparent way to funding those rail network activities. Revenue generated by the charge will flow into the NLTF as land transport revenue.

The Government has already committed to providing investment from the NLTF up to \$170 million per annum through the Government Policy Statement on land transport 2021 (GPS 2021). It has also made initial Crown contributions. These other funding sources recognise the broader public benefits that the Government is seeking from the rail network.

KiwiRail is required to prepare a Rail Network Investment Programme

Under the LTMA¹, KiwiRail must prepare, every three years, a RNIP that includes the rail activities it recommends be funded from the NLTF (with a Crown top up).

The Minister of Transport is responsible for deciding whether to approve the RNIP, after consulting with KiwiRail's shareholding Ministers and considering advice from Waka Kotahi NZ Transport Agency (Waka Kotahi).

The new planning and funding framework for the national rail network will see the network funded from three sources – the NLTF, the Crown and the TUC.

The NLTF collects revenue from fuel excise duty (FED), road user charges (RUC), vehicle and driver registration and licencing, state highway property disposal and leasing, and road

¹ See sections 22A and 22H, which relate to the preparation and approval of the RNIP and approval of funding for rail activities.

tolling. These funds are used to pay for investment in land transport activities under the National Land Transport Programme (NLTP).

Previous policy decisions

The following decisions underpin the analysis in this CRIS:

- Track user charges will be established and paid into the NLTF from KiwiRail's freight business
- KiwiRail will prepare a RNIP which will outline the rail activities to be funded from the NLTF
- GPS 2021 provides a funding range of \$120 million to \$170 million per annum to support funding for rail network activities, which includes investment to enable KiwiRail to deliver a reliable and resilient national rail network
- The full cost of maintaining the national rail network, including maintenance and renewal, to support a resilient and reliable network, is estimated by KiwiRail to be approximately \$420 million per annum over the next decade
- Cabinet noted that under the new planning and funding framework for rail, the Crown will need to continue to provide substantial funding for rail activities, and that this amount is likely to increase in future years in comparison to historical levels where rail was in a state of managed decline, including providing funding into the NLTF
- At this time, no changes will be made to the existing contractual metropolitan network access arrangements and charges to Auckland Transport or Greater Wellington Regional Council, and these charges will not be paid into the NLTF
- Cabinet noted that Shareholding Ministers invited KiwiRail to implement separate above and below financial reporting to improve the transparency of costs, funding and revenues of these business units and to support future funding decisions
- Further consideration will be given to how existing contractual arrangements between KiwiRail and other rail operators are treated, such as tourism operators and small heritage operators, including whether such tourism and heritage operators will be required to pay track user charges [DEV-20-MIN-0082 refers]
- Further consideration needs to be given to what track user charges inter-regional passenger rail services provided by KiwiRail should pay.

Funding principles that guided development of the TUC

Cabinet was previously advised of seven principles to guide funding decisions for the rail network², which include:

- Funding needs to be sufficient to enable a reliable and resilient rail system, and acknowledge historic under-investment in the network
- Infrastructure costs should be borne by those who benefit

² Rail network funding sources include contributions from track users, the NLTF, and the Crown.

- Funding should be transparent for all parties and the public, and support accountability of all parties
- Any track user contribution should be affordable for rail operators and not reduce the use of rail
- Funding should be equitable and support inter- and intra-modal competition
- Funding should support efficient operation of the infrastructure
- The funding system should not impose unnecessary transaction costs.

Application to tourism, heritage and inter-regional rail operations

Given the wide-ranging and severe impacts that the COVID-19 pandemic has had on the tourism sector, we do not recommend that the charge apply to KiwiRail's tourism business at this time. The TUC will only apply to KiwiRail's freight business at this time. We also do not recommend the TUC apply to other tourism and heritage providers that operate on the national rail network or inter-regional rail operations at this time.

Further work is required to consider how the charge may apply to the tourism and heritage sector and KiwiRail's tourism business and inter-regional rail operations. It will also be important to ensure that any charge is equitable across the tourism and heritage sector, including KiwiRail's tourism operation.

Tourist and heritage rail operators that run on the national rail system (NRS) already pay commercially negotiated access charges to KiwiRail, as access provider for the network.

The Ministry of Transport intends to progress work on the charges for tourism and heritage operators and KiwiRail's tourism business ahead of the broader three-year review of the TUC to manage this risk.

Calculation and collection of the charge

Both a fixed and variable charge were considered when developing the TUC. The *Transport regulatory system funding principles, September 2018*³, the Treasury's *Guidelines for Setting Charges in the Public Sector, April 2017*⁴ and the Office of the Auditor-General guidelines for charging fees for public sector goods and services⁵ guided the decision on a fixed versus variable TUC.

Fixed charge vs variable charge

The TUC was developed to ensure that the primary user of the network (i.e. KiwiRail) contributes in a fair and transparent manner to the costs imposed on the network. The costs imposed on the network vary with usage. To support this work, KiwiRail undertook a piece of analysis identifying its costs of maintaining the national rail network and identifying those which vary with usage.

³ Ministry of Transport, September 2018

⁴ The Treasury, April 2017

⁵ Charging fees for public sector goods and services, good practice guide, Office of the Auditor-General, 2008

KiwiRail's analysis concluded that approximately \$53 million per annum of both capital and maintenance investment on the national rail network could be attributed to wear and tear from current usage (i.e. the variable costs of usage).

Applying the TUC based on a flat fee does not take into account the fact that the basis for cost recovery is a variable cost imposed by KiwiRail on the network (i.e. the \$53 million). As activity increases (or decreases), a flat fee would not account for this. The benefits of a variable charge include payments reflecting usage of the asset, which helps to promote efficient usage.

Charging for network usage based on a variable charge ensures this reflects a portion of the estimated costs imposed on the network by that activity. As activity increases (or decreases), the amount payable under the TUC would increase (decrease) proportionally. This is consistent with the methodology used for charging for access to the roading network (i.e. fuel excise duty and road user charges). Both of these are charged based on a proxy for usage and the impact of that usage on the network.

Charging metric/unit

The Ministry considered four charging metrics for the freight TUC. These included lead gross tonne kilometres (GTK), network traffic kilometres, locomotive and/or wagon GTK, and train and/or wagon kilometre differentiated by axle type and weight (similar to RUC). Table 1 on the following page outlines the advantages and disadvantages of each of these metrics.

Freight charging metric

Gross tonne kilometres (GTK) leading (which includes the weight of the locomotive) provides a good approximation of network wear and tear. More sophisticated (and therefore costly to administer) charging metrics were also considered but discarded due to complexity and likely cost to administer/collect the data. These included, among others, charging based on train and/or wagon kilometres differentiated by axle type and weight (similar to RUC).

While this metric may provide improved accuracy over GTK, this additional accuracy is marginal compared to the costs and added complexity of collection. Network traffic kilometres (train kilometres) was discarded as it was considered a less accurate reflection of network wear and tear when compared with tonne kilometres.

The TUC rate will initially apply to KiwiRail's freight business and be calculated based on 1,000 GTK, which includes the weight of the locomotive providing the motive power for the train. GTK provides the most direct metric of mass of the vehicle, which is a major cause of wear and tear on the network.

Table 1: Charging units considered – freight TUC

Freight TUC		
Charging measure - options	Advantages	Disadvantages
1. Gross tonne kilometres (leading)	<ul style="list-style-type: none"> The measurement of tonnes provides best approximation of network wear Data already collected by KiwiRail Is similar to how road use is charged 	<ul style="list-style-type: none"> Data not currently provided to Waka Kotahi New measure needs to be provided for in regulations
2. Network traffic kilometres	<ul style="list-style-type: none"> Reasonable approximation of wear Data already collected by KiwiRail and provided to NZTA for safety fee purposes 	<ul style="list-style-type: none"> Less accurate reflection of network wear compared with tonne kilometres
3. Locomotive or Wagon gross tonnes / vehicle kilometres	<ul style="list-style-type: none"> Marginally improved measure of network wear relative to options 1 and 2 	<ul style="list-style-type: none"> Data not currently collected
4. Train /and or wagon kilometre differentiated by axle type and weight (similar to RUC)	<ul style="list-style-type: none"> Most accurate measure of wear, incentivising lower impact equipment Could be considered further in future if different freight rail operators intend to enter the market and use different train types and loading, which have different impacts on the network 	<ul style="list-style-type: none"> Complex and expensive to develop/administer with marginal gains in accuracy for charging

Waka Kotahi will collect and administer the charge

Waka Kotahi will be responsible for administering and collecting the TUC. This revenue will be credited to the NLTF. This is administratively simple as Waka Kotahi already collects similar charges, including RUC.

Cost recovery options for the TUC

The Ministry considered five options when determining the amount to recover from KiwiRail’s freight business via the TUC, outlined below.

Option 1: Full cost recovery

Set the charge to recover the full costs of maintenance and renewal to support a resilient and reliable rail network (approximately \$420 million per annum).

Option 2: Direct costs plus a mark-up

Set the charge to recover the direct costs of wear and tear of KiwiRail’s freight operations on the network, plus a share to recover fixed costs (\$53 million to \$420 million).

Option 3: Direct costs

Set the charge to recover the direct costs of wear and tear of KiwiRail’s freight operations on the network (currently estimated at \$53 million).

Option 4: Direct costs (with affordable transitional regime)

Set the charge to recover the direct costs of wear and tear of KiwiRail’s freight operations on the network (\$53 million) and implement the charge overtime through a 10-year

transitional regime with regular periodic reviews reassessing direct costs and affordability. This will see the charge set for the first three years and reviewed after three years.

Option 5: No recovery

Do not implement a charge.

Appendix 1 compares the options against the seven funding principles discussed earlier.

Discussion of options considered

Option 1: Full cost recovery

Recovering the full cost of maintaining the national rail network from KiwiRail's freight business would see the charge set at a rate that recovers approximately \$420 million per annum.

This option fully funds the network from KiwiRail's freight business and provides full transparency of costs and accountability as the users of the rail network would cover the full costs of that network.

The Ministry estimates that if KiwiRail passes this cost onto its customers they would be subject to costs equivalent to almost four times more per tonne-kilometre than the equivalent RUC for heavy vehicles.⁶

Setting the charge at this level will result in switching to road freight and reduced usage of the network. This option also does not recognise the broader public benefits the Government is seeking from the rail network.

Option 1 – full cost recovery of rail network maintenance and renewal costs from KiwiRail's freight business – is not a viable option.

Option 2: Direct costs plus a mark-up

This option is based on European approaches whereby track users are charged based on the direct cost of running the train service. In order to contribute to funding the fixed cost of the railway infrastructure, non-discriminatory mark-ups are permitted on top of direct cost. This approach is considered economically efficient, as users are expected to cover at least the direct costs of using the rail network, and, where affordable, mark-ups to a level where customers are willing to switch to alternative modes of transport.

Economic theory suggests that a TUC set to recover the direct cost of wear and tear (short run marginal costs or variable costs are a proxy for this) plus a contribution to the fixed cost of the network (to the extent that mode shift is avoided) is most efficient to maximise network usage. In contrast to the rail passenger services market, few commodities transported via rail freight are charged a mark-up as charges would result in a loss of traffic due to the highly competitive nature of the rail freight market business.

⁶ Calculated based on the H94 licence class, which accounts for about 46 percent of H class travel. H94 is a 9-axle truck and trailer combination with a maximum gross vehicle mass of 50 tonnes, with a RUC of \$435 per 1,000 km GST inclusive as of 1 July 2020 and a Type 951 trailer with a RUC of \$179 per 1,000 km. KiwiRail advises that its total GTK leading were 9.959 billion in the 2018/19 year. Recovering full costs of \$420 million equates to approximately \$42 per 1,000 GTK or \$2,109 for 50 tonnes equivalent.

In the United Kingdom (UK), it is generally differentiated on the carriage of different goods. The main goods that contribute to the fixed costs are those such as nuclear waste, iron ore, power station coal, and biomass as being the only commodities for which the resulting loss of traffic would be negligible as goods are price inelastic. In the case of nuclear waste, it is legally required to use the rail network for safety reasons.

KiwiRail has estimated that its freight operation results in approximately \$53 million in direct wear and tear costs to the national rail network annually.⁷ Recovery of the direct costs of KiwiRail's freight business on the network, plus a mark-up to cover fixed costs partially funds the network from users and provides transparency and accountability, as the beneficiaries of the rail network would cover the costs of that network.

This would see the charge set at a rate that contributes between \$53 million and \$420 million per annum in revenue to the NLTF. Option 3 below provides a discussion of the direct cost calculation. The fixed costs are all the costs that are still incurred by KiwiRail as the network provider, regardless of whether a train is using the rail network.

As discussed in option 3, KiwiRail has advised that it cannot afford the direct costs without leading to customer switching.

Option 2 – recovering direct costs plus a mark-up from KiwiRail's freight business – is not a viable option at this time.

Option 3: Direct costs

The third option considered is to set the charge to recover the direct costs of wear and tear on the network (\$53 million). The Ministry considers (and KiwiRail agrees in principle) that, over time the TUC should at least cover the direct costs of usage of the rail network.

Charging rail operators at least the direct costs of their network usage is important to ensure that rail operators at least cover the costs of using the rail network.

The Ministry accepts that the rail network will require ongoing Crown subsidisation given the broader public benefits the Government is seeking from the network. It is important, however, that these subsidies are transparent.

KiwiRail accepts in principle the payment of the direct costs of usage (i.e. \$53 million). However, it does not generate sufficient revenue to cover this cost at present and passing this full cost on will lead to customers switching to road freight.

While in-principle we consider that charging for the direct costs of using the rail network to rail freight users is appropriate, we recognise a transition period will be required.

Option 3 – recovering the direct costs of usage from KiwiRail's freight business – is not a viable option at present, as it does not meet the affordability principle.

⁷ *KiwiRail: Infrastructure variable costs analysis*, 25 September 2020 (COMMERCIAL IN-CONFIDENCE).

Option 4: Direct costs (with affordable transition regime)

As noted above, while in principle the Ministry and KiwiRail support charging at least the direct costs, KiwiRail has advised that at present charging direct cost would lead to a loss in rail freight volume.

Affordability of the charge to ensure that it does not reduce network usage has been a key consideration when developing the TUC. Prior to the COVID-19 pandemic, Cabinet noted that KiwiRail was only likely to be able to pay a small portion of the total costs of rail activities funded through the NLTF.

KiwiRail has advised that it can afford a charge that recovers \$11.7 million in the first year (2021/22). The first year of the TUC is set to recover this amount. Years 2 and 3 assume a straight-line increase over 10-years to the full direct costs of usage - \$53 million (i.e. fixed increases of \$4.6 million per annum which result in the charge recovering \$53 million in year 10).

The three-yearly review of the charge to test affordability and revenue generated by the charge will help to smooth these impacts. The rate from 2023/24 will continue pending a review. Both KiwiRail and the Ministry accept this proposal.

Table 2 below details how the transition regime will work in practice.

Table 2: Proposed freight TUC rates (2021/22 – 2030/31)

Year	Freight TUC (per 1,000 GTK)	GTK (1,000)	Three yearly review	Total NLTF revenue generated (\$m)
2021/22	1.18	9,959,000	-	11.7
2022/23	1.65	9,959,000	-	16.3
From 2023/24 ongoing	2.11	9,959,000	Review	20.9

The Ministry recognises that this is the first time a TUC has been set to contribute to the NLTF. The Ministry also notes that KiwiRail will receive between \$120 million and \$170 million per annum from the NLTF to contribute towards the \$420 million annual required network investment. It is critical that KiwiRail's freight business, as the main beneficiary of this funding, also contribute to the fund.

The transition period allows for the benefits of Crown investment in both KiwiRail's network and above rail assets to come to fruition. The Ministry will undertake a review of the TUC during development of the next GPS.

Option 4 – direct costs (with affordable transition regime) – is the Ministry's recommended option.

Option 5: No recovery

This option would see no TUC implemented. While this is the best option from an affordability perspective for KiwiRail and noting the Treasury's concerns (as owners) regarding KiwiRail's ability to pay, it would mean rail users are not contributing to the NLTF.

This option does not align with many of the funding principles, including infrastructure costs being borne by those who benefit, and does not support efficient operation of the infrastructure.

Option 4 – no recovery – is not a viable option.

Impact analysis

Potentially impacted parties are listed in Table 7 below.

Table 3: Potentially impacted parties

Category	Affected parties
Rail owners, operators and funders	The Treasury
	Waka Kotahi
	KiwiRail
Rail freight customers	Freight shippers (e.g. Fonterra) and carriers (e.g. Mainfreight) and ports
Contributors to the NLTF	FED, RUC, vehicle and driver registration and licencing and road toll payers

Impact on KiwiRail

KiwiRail has advised that it expects to recover the charge from its customers via a surcharge meaning that the net impact on KiwiRail would therefore be cost neutral if this is successful and it the charge is recovered in arrears rather than paid in advance.

Impact on other contributors to the NLTF – RUC and FED

The impacts on RUC and FED are likely to be relatively minor, given the Government has already agreed to the NLTF activity levels in GPS 2021. As the charge is a rate on the level of lead tonne kilometres, revenue uncertainty exists for the NLTF.

The GPS 2021 allocates between \$120 million and \$170 million per annum. The range of funding available for the rail network is dependent on the level at which the TUC is set to contribute to the NLTF.

Impacts on the Crown as KiwiRail's shareholder

The TUC framework relies on the Crown investing to upgrade KiwiRail's commercial rail freight assets, such as its locomotives and wagons, to improve reliability for customers. Without further Crown investment (i.e. as outlined by KiwiRail in Budget 2021 submissions), it is unlikely that KiwiRail will be able to generate increased revenue to pay a TUC over time.

If the charge is set beyond what KiwiRail considers is affordable to pass on to its freight customers, then it is likely the TUC will need to be funded by the Crown. If this were by cash injection from the Crown as shareholder, this could amount to a circuitous Crown investment into track infrastructure via shareholder funds.

A preferred alternative given the public benefit nature of the infrastructure costs could be for the Crown to fund these NLTF costs directly.

The reasons for continuing to pursue a TUC in these circumstances are for principled reasons already agreed by Cabinet – which include cost transparency and the desire to establish a cost contribution framework for the future and any other potential rail freight users.

Impacts on Waka Kotahi

The impacts on Waka Kotahi relate to the potential administrative burden of their proposed collection of the charges, including IT systems set up and administration costs. Given there is initially only one user (KiwiRail) this is expected to be minimal.

Rail freight customers

Rail freight customers will be affected by any charge to the extent KiwiRail passes the costs of the TUC through. KiwiRail has advised it intends to pass these costs through its commercial contracts.

Consultation

Public consultation on the Land Transport (Rail) Legislation Bill (now the Land Transport (Rail) Legislation Act 2020) included the proposal to implement a TUC. Consultation on the draft New Zealand Rail Plan also included discussion of a TUC.

The majority of submitters supported the concept of a TUC. However, some raised concerns with the level at which it will be set and its relationship with current access arrangements.

The Future of Rail Steering Group (the Steering Group)⁸, comprising sector representatives as well as government, supported the development of a TUC as part of the new planning and funding framework for the rail network.

The Ministry has not consulted other users of the rail network directly as they are not the subject of these proposals. There may be future pressure from other users of the national rail network, such as heritage, other tourism, and metropolitan rail users, to reduce the current access charges they pay to KiwiRail under commercial contracts.

We expect that KiwiRail will engage directly with its commercial customers about the way these charges are passed on.

These access charges to other track users include a level of cost associated with the upkeep of the network. However, we expect to undertake further work on how the TUC and the current commercial access arrangement interact within the next three years. It will be critical that the intention to move to direct costs over time is considered as part of that further work.

⁸ The Future of Rail Steering Group includes senior officials from the Ministry of Transport, the Treasury, Waka Kotahi NZ Transport Agency, and KiwiRail as well as representatives from the Rail and Maritime Transport Union, Auckland Transport, and Greater Wellington Regional Council.

KiwiRail, the Treasury and Waka Kotahi were consulted during the development of the TUC Cabinet paper and CRIS.

KiwiRail has advised that this option is potentially affordable for freight customers.

The Treasury considers that at KiwiRail's projected level of above rail financial performance, any track user charge is unaffordable for KiwiRail for at least the next three years as shareholder support is still required over that period for 'business as usual' (BAU) Capital expenditure.

This differs from KiwiRail's view of affordability, which assumes that it will be able to on-charge the TUC to its customers without loss of volume, and that the Crown will continue to fund the shortfall for BAU capex.

Conclusions

The Ministry concludes that **Option 4**: Direct costs (with affordable transitional regime) achieves the right balance between the seven funding principles discussed earlier.

The Ministry recognises that this is the first time a TUC has been set to contribute to the NLTF. However, the Ministry also notes that KiwiRail will receive between \$120 million and \$170 million per annum from the NLTF to support network investment. It is critical that KiwiRail's freight business, as the main beneficiary of this funding, also contribute to the fund.

The transition period allows for the benefits of Crown investment in both KiwiRail's network and above rail assets to come to fruition. The Ministry will undertake a review of the TUC during development of the next GPS. It will be important that the intention to move to covering at least the direct costs over time is a priority in that review.

Implementation plan, Monitoring and Review

The intention is for the TUC to be implemented by 1 July 2021 in line with the broader implementation of the new planning and funding framework for the rail network, and the next NLTP.

The Ministry of Transport intends to progress work on the charges for tourism and heritage ahead of the broader three-year review of track user charges to manage this risk.

The Ministry is also undertaking a system-level review of the issues that have led to significant rolling contact fatigue on the Auckland rail network. This is likely to include consideration of the level of track access charges for the Auckland network to ensure it is maintained to a resilient and reliable standard.

BUDGET SENSITIVE

Appendix: Assessment of cost model methodology and charging levels options against objectives

		Option 1: Full cost recovery	Option 2: Direct costs plus a mark-up	Option 3: Direct costs	Option 4: Direct costs (with affordable transition regime)	Option 5: No recovery
Objectives / assessment criteria	Description	All expenditure on the national rail network Approximately \$420 million per annum	Direct costs of using the national rail network plus a contribution towards fixed costs, up to the point that mode shift would occur \$53 million to \$420 million per annum	Direct costs of using the national rail network (i.e. wear and tear imposed by use of the network – this includes short-run variable operating costs as well as some short-run capital renewals) \$53 million per annum	A portion of direct costs, with an affordable transition regime < \$53 million per annum	No recovery from network users
Sufficient. Funding needs to be sufficient to enable a reliable and resilient rail system	Fully funds rail network investment to a resilient and reliable state from users. However, we note users are unable to cover the full cost, so in practice will not be sufficient	Contribution to network costs from users – does not fully fund network from users without contribution from other NLTF or Crown revenue	Contribution to network costs from users – does not fully fund network from users without contribution from other NLTF or Crown revenue	Contribution to network costs from users – however, this is lower than options 2 and 3. Does not fully fund network from users without contribution from other NLTF or Crown revenue	No contribution to network costs from users. Relies fully on funding from other NLTF revenue and Crown revenue	
Beneficiary pays: infrastructure costs should be borne by those who use and benefit	A portion of costs delivers public benefits. Full cost recovery from commercial operators does not recognise the broader public benefit of the network	Under this option, users, other NLTF revenue and the Crown will need to fund rail network investment. This recognises the benefits received by users of the network, transport benefits, and broader public benefits	As per option 2, however, the contribution from users may not be as high as the potential benefits received	Primary freight operator beneficiary makes no contribution		
Transparency and accountability	All options provide transparent reporting and accountability					No accountability on rail network users for contributing to the network
Affordable and not detrimental to usage levels	KiwiRail and the Treasury has advised that this is unaffordable. The Ministry also estimates that this is approximately four times the equivalent RUC, therefore would be unaffordable for current rail users and encouraging switching to road freight	KiwiRail has advised that this is unaffordable and if passed onto freight customers would reduce network usage. The Treasury also advises that this is unaffordable for KiwiRail	KiwiRail has advised that this option is potentially affordable for freight customers	Treasury considers that at KiwiRail's projected level of above rail financial performance, any track user charge is unaffordable for KiwiRail for at least the next three years as shareholder support is still required over that period for 'business as usual' (BAU) Capital expenditure. This differs from KiwiRail's view of affordability, which assumes that it will be able to on-charge the TUC to its customers without loss of volume, and that the Crown will continue to fund the shortfall for BAU capex	No cost to rail network user	
Equitable and supportive of competition Funding should be equitable and support inter- and intra-modal competition	In terms of inter-modal competition, any charge that applies equally across all freight operators will support inter-modal competition. In terms of intra-modal competition, anything less than full cost recovery under option 1, could be considered inequitable for road users who pay for full costs imposed on the roading network through RUC					
Efficient operation & usage of the infrastructure	Options 2 is the most theoretically economically efficient charging mechanism as it is set at a level which encourages usage of the rail network up to the point that mode-shift to road will occur. However, in practice, KiwiRail has advised that it only considers that it can pass on the costs under option 4 without customers moving to road. Some level of charge increases incentive for efficient allocation of investment and efficient operations BUT allocation of full costs (option 1) would result in mode shift and less than optimally efficient levels of use of the network					
Avoids unnecessary transaction costs	All options involve charging a single party and a relatively straight forward					No charge
Conclusion	Places unaffordable costs on operator and will not provide sufficient funding	Fairest, most efficient methodology based on preferred EU practice	Fair methodology based on accepted international practice, although still subject to affordability constraints	Methodology supported by KiwiRail for affordability reasons only	Does not meet expectations of a user contribution as condition of access to NLTF & intermodal fairness	