

## Proactive Release

This document is proactively released by Te Manatū Waka the Ministry of Transport.

Some information has been withheld on the basis that it would not, if requested under the Official Information Act 1982 (OIA), be released. Where that is the case, the relevant section of the OIA has been noted and no public interest has been identified that would outweigh the reasons for withholding it.

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).

### Notes

- Ministers originally agreed to take a paper to Cabinet (recommendation i) however Ministers subsequently determined that a Cabinet paper was not necessary.
- The wording in paragraph 7 b i, and 7 b iii of this paper is incorrect. Feedback from Ministers on the paper of 2 March 2022 was that these characteristics of a successful KiwiRail should read "runs a commercially sustainable above-rail business with profitability and efficiency as core objectives", and "delivers the public benefits of a national rail network for all New Zealanders including lower transport emissions, reduced congestion, safer roads and regional development and connectivity" respectively. This updated wording was incorporated into officials' subsequent analysis, however, due to an oversight, the original wording was included in the 28 July 2022 paper to Ministers.

Key	Section and description of ground
[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 and New Zealand Railways Corporation –  
Entity Form review

<b>Date:</b>	28 July 2022	<b>Report No:</b>	T2022/633 (The Treasury) OC220553 (Ministry of Transport)
		<b>File Number:</b>	SE-2-25-2

**Action sought**

	Action sought	Deadline
<b>Minister of Finance</b> (Hon Grant Robertson)	<b>Agree</b> to the recommendations. <b>Sign and send</b> the letter, attached as Annex 3, to the Chair of KiwiRail and New Zealand Railways Corporation.	15 August 2022
<b>Minister of Transport</b> (Hon Michael Wood)	<b>Agree</b> to the recommendations.	15 August 2022
<b>Minister for State Owned Enterprises</b> (Hon Dr David Clark)	<b>Agree</b> to the recommendations.	15 August 2022

**Contact for telephone discussion** (if required)

Name	Position	Telephone	1st Contact
Michael Moore	Principal Advisor, Commercial and Institutional Performance, The Treasury	[35]	✓
Richard Manning	Senior Adviser, Supply Chain, Ministry of Transport		
Ann Webster	Manager, Commercial and Institutional Performance, The Treasury	[39]	
Joanna Heard	Policy Delivery Lead, Ministry of Transport	[35]	✓

**Minister's Office actions**

<p>Minister of Finance's office: <b>Return</b> the signed report to the Treasury. If agreed, <b>send</b> the letter attached as Annex 3 to the Chair of KiwiRail and New Zealand Railways Corporation. If agreed, <b>refer</b> this report and the signed letter to the Minister for the Public Service.</p> <p>Minister of Transport's office: <b>Return</b> the signed report to the Ministry of Transport.</p> <p>Minister for State Owned Enterprise's office: <b>Return</b> the signed report to the Treasury.</p>
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**Enclosure:** [Annex 1: Terms of Reference \(Treasury:4664655v1\)](#)  
[Annex 2: Joint report of 2 March 2022 \(Treasury:4664654v1\)](#)  
[Annex 3: Letter to the Chair of KiwiRail and NZRC \(Treasury:4676919v1\)](#)

## Joint report: KiwiRail and New Zealand Railways Corporation – Entity Form review

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### Executive summary

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In May 2020, as part of the Future of Rail review, Cabinet noted that there would be no changes to KiwiRail's organisational form or structure at that time, and that a further review of KiwiRail's state-owned enterprise (SOE) status would be initiated [DEV-20-MIN-0082 refers].

In September 2021, Ministers approved the Terms of Reference for this review into the entity forms of both KiwiRail Holdings Limited (KiwiRail) and the New Zealand Railways Corporation (NZRC). The review's objectives were to:

- review the extent to which the current entity forms of KiwiRail and NZRC as two SOEs support Government objectives;
- determine if any changes to the status quo would better enable KiwiRail and NZRC to achieve outcomes sought by Government, including making changes from the SOE form; and
- advise Ministers on the above two matters and determine next steps following Ministerial consideration.

#### ***KiwiRail is operating in a new environment as a result of Future of Rail decisions***

In preparing our advice, officials have considered recent changes to the environment KiwiRail operates in. Decisions made as part of the Future of Rail review resulted in system level changes to the planning and funding framework in which the rail system operates, and created new Ministerial levers to assist in the delivery of the Government's objectives for KiwiRail, both commercial and for public benefit.

The key changes are:

- the creation of the New Zealand Rail Plan (Rail Plan) to outline the Government's objectives and outcomes for rail and the strategic investment priorities to support a resilient and reliable rail network, through:
  - investing in the national rail network to restore rail freight, and provide a platform for future investments for growth; and
  - investing in the metropolitan rail networks to support growth and productivity in our largest cities.
- changes to the Land Transport Management Act 2003 that, in addition to annual budget investment decisions, enable Ministers to lead investment decision making through the Government Policy Statement on land transport and through approval of the Rail Network Investment Programme;
- integration of the rail network into the national land transport programme to support investment decisions in the network on a public benefit basis and better integrated land transport investment decisions;

- reporting separation of KiwiRail’s commercial above-rail business and public benefit focused below-rail (network) operations; and
- the commitment of over \$5 billion in Crown funding to KiwiRail, with the overarching objective to make the rail network resilient and reliable.

***As an SOE, KiwiRail can deliver both commercial and public benefits objectives***

The decisions outlined above have helped to place KiwiRail in a position to achieve commercial self-sufficiency (with associated fiscal efficiency benefits) and to build and maintain a reliable rail network for public benefit.

We consider that these system-level changes, which came into effect on 1 July 2021, and provide a framework to support the Emissions Reduction Plan, need time to bed-in.

We advise that, on balance, changing KiwiRail’s entity form (to either a Crown entity company or Crown agent) could introduce significant disruption for uncertain benefits, particularly as the Future of Rail decisions are yet to be fully implemented. However, further enhancements need to be made to the way the current SOE form operates in order to fully realise the outcomes the Government is seeking. In particular, the way KiwiRail achieves commercial self-sustainability of the above rail business, does not come at the detriment of enabling more freight and passengers to be moved by rail as set out in the Rail Plan. This needs to be embedded in KiwiRail’s business strategy through better integration of ownership and policy levers.

The review found insufficient evidence that alternative entity forms would deliver greater benefits or provide material improvements in KiwiRail’s ability to deliver on Ministers’ expectations, given the mix of public benefit outcomes and commercial returns sought.

While it is acknowledged that both a Crown entity company and Crown agent form can provide more direct Ministerial levers to drive public benefit outcomes, on balance, officials consider any benefits from these levers are likely to be outweighed by the costs of disruption and of diluting the entity’s commercial focus. In addition, officials consider that performance, and the way Government objectives are given effect, is of greater consequence than entity form itself. That is, it is largely a question of performance, rather than form.

***Existing levers for Ministers (and officials) can be enhanced within the current form***

Officials recommend that there be enhancements made to the way Ministers and officials work with KiwiRail in its SOE form. These enhancements focus on the use of Ministerial levers, particularly with respect to co-ordination between shareholding Ministers and the Minister of Transport with respect to business planning processes, and how the oversight role of officials is given effect. Better integrating the outcomes sought through the Rail Plan into ownership levers will be critical to achieving the public policy outcomes within the SOE form and to ensure that commercial self-sustainability is achieved alongside public policy outcomes. Table 1 on pages 11 and 12 of this report outlines these levers and suggested enhancements.

We recommend that you also communicate specific commercial ‘threshold events’ to KiwiRail. These are leading indicators that will assist in determining if KiwiRail’s transition to above-rail self-sufficiency is on track and will reinforce shareholding Ministers’ expectations.

***We recommend both KiwiRail and NZRC remain state-owned enterprises***

The question of NZRC’s entity form is secondary to that of KiwiRail, as KiwiRail’s contribution to government goals was the driver for this review. While NZRC is an anomaly amongst SOEs, this does not create significant issues, and at the very least provides some

consistency between KiwiRail and NZRC with respect to governance arrangements and oversight.

We therefore recommend that both KiwiRail and NZRC remain as SOEs, and consideration is given to the range of Ministerial policy and ownership levers available to optimise the balance between maximising commercial performance and delivering public benefits.

**Next steps**

We recommend that you send a letter to the Chair of KiwiRail and NZRC communicating your decisions. A draft letter is attached as **Annex 3** for your consideration. Your decisions have machinery of government implications and we recommend you refer this briefing to the Minister for the Public Service for his information. Finally, we recommend you agree to take a paper to Cabinet to inform your Ministerial colleagues of the outcome of the review.

**Recommended action**

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We recommend that you:

**KiwiRail Holdings Limited (KiwiRail)**

a **note** that system arrangements as a result of the Future of Rail review, including new Ministerial levers and increased transparency of KiwiRail's performance, provide stronger incentives for above-rail commercial performance and achieving the Government's public policy objectives

b **agree** that KiwiRail remain a state-owned enterprise

*Agree/disagree*                      *Agree/disagree*                      *Agree/disagree*  
Minister of Finance              Minister of Transport              Minister for State Owned Enterprises

c **agree** to implement changes to strengthen the way existing levers available to Ministers and officials are utilised within the state-owned enterprises form, with a focus on integrated monitoring of ownership and public benefit outcomes, within the current state-owned enterprise form, as outlined in Table 1 of this report

*Agree/disagree*                      *Agree/disagree*                      *Agree/disagree*  
Minister of Finance              Minister of Transport              Minister for State Owned Enterprises

d **direct** the Treasury to provide advice to KiwiRail's shareholding Ministers if any one of the following commercial 'threshold events' occur:

- i. KiwiRail's commercial value, independently reviewed, is either negative or trending in a negative direction;
- ii. KiwiRail requires any further equity contributions, other than for a value-enhancing shareholder approved investment; and
- iii. KiwiRail's forecasts indicate it will be unable to self-fund above-rail asset maintenance and renewal, over the long term, to maintain asset quality at a level that the current investment programme will achieve.

*Agree/disagree*                      *Agree/disagree*                      *Agree/disagree*  
Minister of Finance              Minister of Transport              Minister for State Owned Enterprises

## New Zealand Railways Corporation

e **note** officials consider that any change to the entity form of New Zealand Railways Corporation should be considered secondary to changes to the entity form of KiwiRail

f **agree** that New Zealand Railways Corporation remain a state-owned enterprise

<i>Agree/disagree</i>	<i>Agree/disagree</i>	<i>Agree/disagree</i>
Minister of Finance	Minister of Transport	Minister for State Owned Enterprises

### Next steps

g **agree** for the Minister of Finance to sign and send a letter, attached as Annex 3 to this report, to the Chair of KiwiRail and New Zealand Railways Corporation, communicating the decisions that Ministers have taken on this report

<i>Agree/disagree</i>	<i>Agree/disagree</i>	<i>Agree/disagree</i>
Minister of Finance	Minister of Transport	Minister for State Owned Enterprises

h **agree** to refer this report to the Minister for the Public Service for his information

<i>Agree/disagree</i>	<i>Agree/disagree</i>	<i>Agree/disagree</i>
Minister of Finance	Minister of Transport	Minister for State Owned Enterprises

i **direct** officials to prepare a draft Cabinet paper for your consideration

<i>Yes/no</i>	<i>Yes/no</i>	<i>Yes/no</i>
Minister of Finance	Minister of Transport	Minister for State Owned Enterprises

Ann Webster  
**Manager, Commercial and Institutional  
Performance, The Treasury**

  
Joanna Heard  
**Policy Delivery Lead,  
Ministry of Transport**

Hon Grant Robertson  
**Minister of Finance**

Hon Michael Wood  
**Minister of Transport**

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

## Joint report: KiwiRail and New Zealand Railways Corporation – Entity Form review

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### Purpose

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1. This report provides advice and recommendations following the conclusion of the Entity Form review (the review) into KiwiRail Holdings Limited (KiwiRail) and New Zealand Railways Corporation (NZRC).

### Background

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2. Prior to this review, the entity form of KiwiRail was considered as part of the Future of Rail review. Led by the Ministry of Transport (the Ministry) from 2017 to 2020, the Future of Rail review was a cross-agency project to identify the purpose of rail services, and how it can contribute to New Zealand's transport system.
3. The Future of Rail review also defined the role of rail and outcomes sought from it, considered the challenges it faced, and recommended significant changes so that rail can play its part in the transport system. A key outcome of the Future of Rail review was the development of a new planning and funding framework for rail, to better integrate rail into the land transport system and provide clarity on what the Government is seeking from the rail system. It also defined a series of investments into KiwiRail and the rail system to achieve the Government's outcomes and support KiwiRail's commercial performance. Cabinet agreed to fund KiwiRail in order for the rail network to achieve a resilient and reliable state [DEV-19-MIN-0123 refers].
4. The question of KiwiRail's entity form was also considered as part of the Future of Rail review. It was determined that KiwiRail remain a state-owned enterprise (SOE) for 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 realising the benefits of new commercial assets and providing separate above- and below-rail reporting, to be implemented.
5. The Minister of Finance, the Minister of Transport, and the Minister for State Owned Enterprises (collectively, joint Ministers) agreed in September 2021 to a Terms of Reference for a subsequent review into the entity forms of both KiwiRail and NZRC. These Terms of Reference are attached as **Annex 1**.
6. A Working Group was formed, comprising representatives from the Treasury, the Ministry, Te Kawa Mataaho Public Service Commission (Te Kawa Mataaho) and KiwiRail. The Working Group reported to the review's Steering Group, comprised of a representative from each of the Treasury and the Ministry.
7. The Working Group considered a range of options for entity form change, and the Steering Group provided a briefing (attached as **Annex 2**) to joint Ministers in March 2022 (T2021/3153 refers). This briefing asked joint Ministers to agree the basis on which the second phase of the review would be undertaken, as outlined below:
  - a. The **objectives for the Government's ownership and investment in KiwiRail and NZRC** are:
    - i. the provision of a sufficiently comprehensive, resilient and reliable rail network that supports economic prosperity and improved environmental outcomes;

- ii. 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
- iii. the most efficient and effective investment in, and operation of, the New Zealand rail system, including the network, rolling stock and associated assets.
- b. The **characteristics of a successful KiwiRail** in addressing these ownership objectives would be that KiwiRail:
- i. runs a commercially sustainable above-rail business, as profitable and efficient as a comparable non-Crown business;
- ii. invests in the right assets, and maintains those assets – both below- and above-rail – in a cost-effective timely manner;
- iii. delivers the public benefits of a national rail network for all New Zealanders including lower transport emissions, reduced congestion and safer roads; and
- iv. is an exemplar employer in terms of health and safety and other employment conditions.
- c. The following **criteria** would be used to **assess different entity form options**:
- i. ability to meet public benefit objectives and address Ministers' priorities (as expressed through the ownership objectives outlined above);
- ii. ability to engage and support integrated transport system outcomes;
- iii. ability to maximise commercial performance, thereby reducing the need for Crown funding over time;
- iv. feasibility of change from the status quo; and
- v. ability for operational reporting to be transparent and accountable.
- d. Two '**hurdle**' **criteria** for any entity form change:
- i. 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
- ii. the forecast benefits of any change would exceed the expected costs and risks arising from any change.
- e. **Four entity form options** would be considered against the criteria outlined in paragraph 7c above:
- i. **Status quo** – KiwiRail remains an SOE and existing initiatives such as the separation above- and below-rail reporting continue unaltered;
- ii. **Modified status quo** – KiwiRail remains an SOE and consideration is given to changes the help give better effect to KiwiRail's support of Government's objectives; *[officials' preferred option – see analysis below]*

- iii. **Crown entity company** – KiwiRail moves ‘closer to the Crown’ as a Crown entity company; and
  - iv. **Crown agent**, potentially with a commercial subsidiary, providing Ministers with more control in that the Board must give effect to Government policy.
8. Following the response from joint Ministers, the Working Group undertook further analysis, including assessing the entity form options (paragraph 7e) against the criteria (paragraph 7c) and ‘hurdles’ (paragraph 7d).
  9. Having considered the Working Group’s analysis and recommendations, the review’s Steering Group now presents this report to joint Ministers, consistent with the Steering Group’s overall accountability for the delivery of the review to Ministers.

## Analysis

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10. The Terms of Reference state the objective of the entity form review is to:
  - a. review the extent to which the current entity form of KiwiRail and NZRC as two SOEs support Government objectives – refer paragraphs 15 to 51;
  - b. determine if any changes to the status quo would better enable KiwiRail and NZRC to achieve outcomes sought by Government, including making changes from the SOE form – refer paragraphs 52 to 57; and
  - c. advise Ministers on the above two matters, and determine next steps following Ministerial consideration.
11. The above objectives provide a framework for the analysis that follows. In addition, the Working Group addressed issues raised by Ministers in response to the briefing of March 2022 (T2021/3153 refers).
12. The Terms of Reference outline the scope of the review, and ruled two elements (privatisation and vertical separation) as out of scope of the review. All in-scope elements have been considered in preparing this advice.
13. Our analysis focuses on KiwiRail, rather than NZRC, as KiwiRail is the operational entity by which government objectives are supported. NZRC is subsequently considered in the context of our recommendations for KiwiRail.
14. To address the objectives outlined in paragraph 10 above, the narrative of the ‘Analysis’ section is as follows:
  - a. The challenge set by KiwiRail’s multiple objective environment;
  - b. The effectiveness of current arrangements in supporting government objectives;
  - c. Changes to make the current system arrangements more effective;
  - d. How issues that have been raised by Ministers can be addressed within the SOE form;
  - e. How alternative entity forms compare, relative to current arrangements; and
  - f. Given the above analysis, our conclusion that a modified SOE option is preferred for KiwiRail, and whether any change is recommended for NZRC.

### ***The challenge set by KiwiRail's multiple objective environment***

15. KiwiRail has a mix of above-rail commercial and below-rail public benefit objectives (funded through a mix of commercial revenues and Crown funding). It is widely acknowledged, including by KiwiRail, that KiwiRail is not perfectly suited to the SOE form (nor any other form, given its mixed commercial and public policy objectives).
16. This mix creates a risk (perceived or actual) that commercial performance expectations driven by the SOE Act 1986 can hinder the realisation of public benefits, and conversely that expectations set for delivering public benefits can undermine commercial performance (and fiscal efficiency).
17. These risks are currently mitigated through:
  - a. KiwiRail's directors balancing these objectives in respect of their duties in accordance with the SOE Act 1986, the Companies Act 1993 and other relevant legislation;
  - b. A range of policy and ownership levers available to Ministers to facilitate alignment between KiwiRail's objectives and activities, and government objectives;
  - c. separate reporting to understand performance of, and between, commercial and non-commercial outcomes, in respect of KiwiRail's above-rail and below-rail investments; and
  - d. changes made through the Future of Rail review, including establishing the New Zealand Rail Plan (the Rail Plan), and the Land Transport (Rail) Legislation Act 2020 bringing below-rail investments into the transport planning and funding system.
18. The review considered whether the reforms made through the Future of Rail review, alongside existing mitigations, such as Ministerial levers and directors' duties, are sufficient to address the potential risk of conflict between KiwiRail's commercial and public benefit objectives as an SOE. The review also considered whether changes could improve KiwiRail's ability to support government objectives. As an extension of this, officials considered whether current problems or concerns should be addressed by a change in entity form, or if the root cause was more of a performance or system issue.

### ***The effectiveness of the current arrangements in supporting government objectives***

19. The effectiveness of current ownership arrangements for KiwiRail needs to be considered in the context of the nature of the government objectives. In general, government objectives fall under two categories:
  - a. Efficient and effective employment of Crown assets (the primary consideration for shareholding Ministers), which means KiwiRail should:
    - i. be commercially effective and fiscally efficient; and
    - ii. invest in, and maintain well, the right assets for long-term benefit maximisation (both commercial and non-commercial)
  - b. Be instrumental in the realisation of public policy benefits (the primary consideration of the Minister of Transport), which includes how KiwiRail:

- i. contributes to the outcomes for the rail system outlined in the Rail Plan; and
    - ii. the land transport system outcomes outlined in the Government Policy Statement on Land Transport (GPS).
20. The Minister of Transport asked in March 2022 that the following public policy objectives also be considered:
- i. KiwiRail contributes to the Emissions Reduction Plan (ERP) through supporting mode-shift and the nature of its own operations; and
    - ii. KiwiRail ensures open access to tracks to maximise the public benefits, including for public transport use, of a 'resilient and reliable' rail network.
21. There are potentially trade-offs between the different objectives, and the extent or perception of any trade-off may be considered differently by different parties. The balance of trade-offs may shift over time, as may the objectives themselves. Ownership arrangements, which include the entity form of KiwiRail and NZRC, should be sufficiently enduring to cater for a shift between the two categories to best meet the needs of the day. The 'enduring' nature of any change was one of the two 'hurdle criteria' that we have considered as part of our analysis.

*Major changes to the planning and funding framework mean KiwiRail is now better placed to support government objectives*

22. The changes to the planning and funding framework for rail as a result of the Future of Rail review better enable KiwiRail to support the Government's public benefit and commercial objectives as part of its business transition.
23. The Rail Plan articulates the objectives the Government is seeking from rail and the investments it is considering to support those outcomes. The implementation of the Rail Plan has also been reflected in the ERP. The strategic investment priorities for a resilient and reliable rail network, as set out in the Rail Plan, include:
- Investing in the national rail network to restore rail freight, and provide a platform for future investments for growth
  - Investing in the metropolitan rail networks to support growth and productivity in our largest cities.
24. The Rail Plan alongside the changes to the Land Transport Management Act 2003 (LTMA) has enabled Ministers to make purposeful investment decisions in the rail system to support the Government's outcomes. Ministers can take those investment decisions as part of developing the GPS, approval of the Rail Network Investment Programme (RNIP) and annual budget decisions.
25. Over \$5 billion in Crown funding has been committed since 2018 to KiwiRail to reach a resilient and reliable state. This includes \$2.5 billion for years one to four of the RNIP and \$2.7 billion for the above-rail business, such as the renewal of rolling stock.
26. The Minister of Transport now approves the RNIP for below-rail investment, following consultation with KiwiRail's shareholding Ministers. The RNIP is funded through the National Land Transport Fund (NLTF).
27. We advise that the reporting separation of KiwiRail's commercial above-rail business and public benefit focused below-rail (network) operations, combined with the

significant commitment of Crown support means that KiwiRail is better placed than it has ever been to be both commercially self-sufficient and to build and maintain a reliable rail network for public benefit.

28. However, the new framework has only just been put in place (from 1 July 2021) and the benefits from the investments will not be realised for some time, as most new assets will be operational only from 2025. It will take some time before the effectiveness of the new arrangements can be properly assessed – both in terms of commercial performance and achievement of Rail Plan outcomes.
29. We therefore recommend that consideration is given to the range of policy and ownership levers available (to both Ministers and their officials) and ways to maximise their effectiveness.

**Policy and ownership levers need to be used effectively, and there is room to enhance them**

30. There is already a range of policy and ownership levers available to Ministers with KiwiRail in SOE form. These are outlined in Table 1 below. However, it is critical that these are used effectively, including to gain assurance that:
  - a. The public benefit outcomes being sought through the Rail Plan and ERP (which include the strategic investment priorities for a resilient and reliable rail network) are being appropriately reflected in KiwiRail’s business plans;
  - b. Above- and below-rail segmented reporting is prepared using a robust and consistently applied methodology to ensure against potential incentives to shift items (i.e. expenses, assets, liabilities, revenue and grants) in response to operating environment pressures on KiwiRail at any given time;
  - c. Above-rail assets are being maintained to achieve intended optimum benefits over their useful life and are being replaced on a basis that enables a sustainable level and quality of rail services over time; and
  - d. KiwiRail is enabling the intended public benefits of the Crown’s ongoing investment in both below- and above-rail assets to be realised by supporting the maximum use of the rail network by other users and potential users, on a reasonable and even-handed basis.
31. Table 1 also highlights the enhancement options that takes in to account the above considerations and enables optimal performance of KiwiRail as an SOE.

**Table 1: Levers and enhancement options under the modified status quo option**

Ministerial levers	Enhancement options
<b>Key policy levers</b>	
The Rail Plan is issued by the Minister of Transport, jointly with shareholding Ministers.	Better integration with ownership levers. For example, ensuring the Rail Plan is referenced through the business planning process, including in letters of expectations.  Ongoing outcomes monitoring is in its early stages and needs to be built up between the Ministry, Treasury and Waka Kotahi.
The Minister of Transport issues the GPS, which incorporates rail network funding and investment signals.	As above, this can be reflected through the annual letter of expectations and other business planning tools.

Ministerial levers	Enhancement options
<p>The Minister of Transport approves the Rail Network Investment Programme (RNIP) in consultation with shareholding Ministers. Waka Kotahi provides an additional level of assurance over the performance against the RNIP and reports to the Minister of Transport annually on delivery of the RNIP.</p>	<p>Waka Kotahi's annual report on the RNIP could be copied to shareholding Ministers and officials. Any material concerns on delivery can be monitored by Treasury and the Ministry and consolidated into reporting to Ministers as part of ongoing ownership and policy advice.</p>
<b>Key ownership levers</b>	
<p>Shareholding Ministers appoint, reappoint and dismiss directors of both KiwiRail Holdings Limited and New Zealand Railways Corporation.</p>	<p>To strengthen the appointment processes, which consider commercial, sector and public policy expertise, consultation with the Minister of Transport on proposed board appointments could be brought forward, to occur prior to wider Ministerial consultation.</p>
<p>Shareholding Ministers are involved in KiwiRail's business planning process through:</p> <ul style="list-style-type: none"> <li>• letters of expectations; and</li> <li>• commenting on draft Statements of Corporate Intent (SCIs), which KiwiRail must consider before finalising.</li> </ul>	<p>Consultation with the Minister of Transport (and the Ministry) could be formalised on shareholding Ministers' draft letters of expectations and comment on draft SCIs. This ensures integration of public policy expectations, as articulated in the Rail Plan and ERP, into the overall suite of expectations.</p>
<p>The Crown can fund non-commercial activities (section 7 of the State-Owned Enterprises Act 1986 (SOE Act)).</p>	<p>Potential to use this lever more, within reason, for transparency and to maintain commercial performance expectations. A key lever when the Crown is seeking a non-commercial service or objective from KiwiRail (outside of network investments funded through the RNIP).</p>
<p>Shareholding Ministers can direct KiwiRail to make certain changes to its Statement of Corporate Intent, or to pay a dividend (section 13 of the SOE Act).</p>	<p>This lever should only very rarely be considered, as directions risk undermining the responsibility of the Board. For context, only seven directions have been issued under the SOE Act and the last direction was issued in 2000. No directions have been issued to KiwiRail.</p>
<p>Shareholding Ministers can invest in value-enhancing initiatives. Equity injections require the approval of shareholding Ministers.</p>	<p>KiwiRail's equity drawdowns for above-rail activity will continue to be applied on a strict commercial basis.</p>
<p>Shareholding Ministers have powers to request information from KiwiRail (section 18 of the SOE Act).</p> <p>Separately, there is the ability to undertake independent reviews at any time.</p>	<p>More use could be made of these levers if necessary, for example to provide assurance around</p> <ul style="list-style-type: none"> <li>• the integrity of reporting separation (as this is critical in ensuring the right performance incentives exist above and below rail)</li> <li>• the quality of KiwiRail's forward projections and their impact on commercial viability</li> <li>• the above rail asset management programme to give comfort around commercial sustainability</li> <li>• the manner in which track access is administered for maximum public benefit.</li> </ul>
<p>Regular engagement between Ministers and the Board.</p>	<p>The relationship between Ministers and the board is critical. These continue to be the primary basis for ensuring that government objectives and priorities are well understood.</p>

Ministerial levers	Enhancement options
	To enhance this, shareholding Ministers and the Minister of Transport could jointly meet with the Board on an annual basis to review performance and identify priorities.

32. Officials will also continue to develop their oversight of, and engagement with, KiwiRail, to complement the use of Ministerial levers. These include:
- a. continued engagement with Waka Kotahi as part of their new role in assessing and advising the Minister of Transport on the RNIP's consistency with the purpose of the LTMA and the transport directions set out in the GPS;
  - b. continued assessment of KiwiRail's equity drawdowns for above-rail activity on a strict commercial basis; and
  - c. integrating outcomes monitoring for the Rail Plan and KiwiRail's contribution to those outcomes into ongoing monitoring processes.
33. As part of the development of the next GPS, Ministers will also need to consider whether they wish to refresh the Rail Plan and purchase anything from KiwiRail beyond the 'resilient and reliable' scenario currently committed to (which still requires funding for years 5 to 10). Achieving a resilient and reliable network provides a platform for future growth, which requires adequate access windows to allow the work to be performed. The ERP currently supports the implementation of the Rail Plan and its strategic investment priorities (investing to restore rail freight and investing in the metropolitan rail networks to support growth in our largest cities).

*The Treasury and the Ministry of Transport need to continue to work together to assess KiwiRail's performance and the performance of the overall rail system*

34. The Government has outlined some ambitious outcomes for the rail system and made significant investments in KiwiRail to help achieve those outcomes. Alongside those system outcomes, shareholding Ministers expect KiwiRail to transition its above-rail business to be commercially self-sustaining. Collectively, these changes will require significant business transformation from KiwiRail.
35. The system shifts and investments required to implement the resilient and reliable scenario will likely to take a decade to complete. KiwiRail is forecasting that its transition to above-rail self-sufficiency will take several years. As with any forecast, this is underpinned by a range of assumptions and can be affected by KiwiRail's operating environment – for example, the supply chain and labour market constraints that KiwiRail (and other businesses) is facing.
36. The Treasury and the Ministry will need to work together, along with Waka Kotahi, to monitor KiwiRail's business transformation and determine, over a sufficient length of time, whether it is contributing to the wider transport outcomes outlined in the Rail Plan.

*'Threshold events' can be put in place to help reinforce shareholding Ministers' expectations*

37. As performance monitors, the Treasury notes the strong focus of KiwiRail's board to transition to commercial self-sustainability. The appointment of a new Chair with a commercial background (David McLean) and the institutional knowledge of the incoming Chief Executive (Peter Reidy, who was previously KiwiRail Chief Executive from 2014 to 2018) is likely to assist KiwiRail in making this transition.

38. Retaining KiwiRail's status as an SOE will, in the view of officials, maximise its ability to deliver a commercial return on the Crown's investment. To assist in maintaining focus on the transition to above-rail self-sufficiency, the Treasury recommends that 'threshold events' be established. These have been drafted to align with the commercial characteristics of a successful KiwiRail (paragraph 7b) that were considered by joint Ministers in March 2022.
39. The Treasury will monitor these 'threshold events' as part of ongoing oversight. If a threshold is breached, it will trigger the delivery of advice from the Treasury to shareholding Ministers as to why the threshold has been breached, an assessment as to whether the viability of KiwiRail's above-rail self-sufficiency is in question, and our recommended next steps. As a result, the 'threshold events' provide the KiwiRail Board with a clear 'line in the sand' with respect to shareholding Ministers' expectations.
40. We recommend that the breaches for 'threshold events' be established and communicated to KiwiRail as follows:
- KiwiRail's commercial value, independently reviewed, is either negative or trending in a negative direction;
  - KiwiRail requires any further equity contributions, other than for a value-enhancing shareholder approved investment; and
  - KiwiRail's forecasts indicate it will be unable to self-fund above-rail asset maintenance and renewal, over the long-term, to maintain asset quality at a level that the current investment programme will achieve.
41. We advise that the establishment of these 'threshold events' provide an appropriate balance between KiwiRail receiving further time to demonstrate that its above-rail business can perform in the manner expected of a SOE, and joint Ministers' desire for this transition to occur in a timely and focused way that achieves the realisation of both commercial and public benefit outcomes.

***Issues raised by Ministers can be addressed within the current SOE framework***

***Emissions Reduction Plan***

42. The Minister of Transport asked in March 2022 whether the ERP should be referenced in the objectives and rationale under which the Crown owns and invests in KiwiRail.
43. At present the ERP supports the implementation of the Rail Plan and the strategic investment priorities contained within it. There is currently good alignment in terms of supporting the public policy objectives of the ERP through Rail Plan investments.
44. As noted in Table 1 above, ownership levers can be better utilised to support the delivery of the ERP and the Rail Plan, including through references in letters of expectation and KiwiRail's business planning documents. In addition to this, the ERP can be reinforced through Ministers' ability to engage with the KiwiRail Board directly and frequently.

***Network access and innovation***

45. [34]
- There were concerns that this may preclude some useful supplementary services and the potential for innovation from other players. It was requested that this review should have sufficient space to consider these issues, or at least set up further work to consider them, noting that this does not need to lead to structural separation as there could be lower-level actions that could assist.

46. Officials have considered whether a change of entity form would have an impact on network access. We recognise that providing network access may not always align with the commercial objectives of an SOE. However, the Crown's ownership of KiwiRail does provides some influence over KiwiRail's approach to network access.
47. We are aware that while KiwiRail provides access to the network, there are still claims from some stakeholders of preferential behaviour and challenges around access. KiwiRail has provided the following context regarding network access:
- a. It currently provides access to the network on common access terms;
  - b. It has processes in place to separate access decisions from its rail operations (which are subject to those access processes);
  - c. All applications for new and existing users to access the network in the last two years have been approved and no applications have been escalated for resolution; and
  - d. That access decisions occur through open forums involving all rail users with an interest in the line being discussed. Existing rail users currently discuss and prioritise access through governance arrangements and timetable committees.
48. We acknowledge that there is significant requirement for KiwiRail to access the metropolitan rail networks to deliver the maintenance and upgrade programmes required by the Government and local authorities, which impacts on access for passenger rail operations (and also KiwiRail's freight and tourism operations). Work is ongoing in Auckland and Wellington to modernise maintenance practices and ensure optimal use of access windows on the network.
49. More consideration would need to be given to what the real or perceived challenges may be to access to the network. We are mindful that there needs to be a balance between users and the need to provide sufficient access for maintenance and delivery of the agreed investment programme and ensure alignment with the investment priorities established in the Rail Plan. We also need to be mindful of the significant investment programme to improve the state of the network over the next decade.
50. We do not currently have a strong evidence base to determine whether there are problems with network access. However, officials consider that if there are significant issues with rail access other levers besides entity form might best address these issues.
51. [33]

Officials will also work with KiwiRail to consider how access provision can be more transparent through the enhanced monitoring arrangements outlined in this paper. KiwiRail has notified the Ministry in respect of two current applications with regard to building the City Rail Link, which are currently in the approval process.

#### ***Alternative entity forms were considered***

52. Our March 2022 progress report (**Annex 2**) identified five performance criteria and two 'hurdle' criteria by which to assess potential entity forms (as outlined in paragraph 7). The entity forms identified as alternatives to the SOE form were Crown entity company and Crown agent (ie, core Crown entity).
53. Based on the Working Group's combined experience of working with Crown entities and SOEs, the following table summarises the Working Group's assessment of these different options against the agreed criteria.

**Table 2: Summary assessment of entity form options against criteria**

<b>Objective-based criteria</b>	<b>Summary comment</b>
<b>Public benefit objectives</b>	Collectively, benefits available through alternative entity forms are either marginal or can be achieved by giving better effect to levers available in the SOE model. The disruption and legislative costs of change are potentially significant.
<b>Integrated transport system outcomes</b>	It is important to distinguish between what might be seen as a form issue relative to a performance issue as issues faced are largely independent of entity form.  Where tensions may appear, there should be ways of dealing with them, such as access agreements and/or regulatory controls, that are not related to entity form. KiwiRail is one entity within the wider rail and transport system, and wider co-ordination with the Ministry and Waka Kotahi is critical to enabling transport outcomes.
<b>Maximise commercial performance</b>	The SOE form provides the strongest incentive framework for commercial performance, provided the business can operate at a commercially sustainable level (an SOE that requires constant top-ups from its shareholder has a much diluted incentive framework).
<b>Feasibility of change</b>	Crown agent would be heavily disruptive and take time to give effect. Crown entity company change is more straightforward (relatively simple legislative amendments). However, the least complex approach would also bring very little difference in the operating model and would introduce uncertainty and disruption for KiwiRail to operationalise the changes.
<b>Transparent and accountable</b>	Crown agent option has the potential for higher levels of transparency, although this is at the risk of commercial asset efficiency and effectiveness. Under the current SOE model, there is potential to improve transparency and build clearer accountabilities across the sector.
<b>Hurdle criteria</b>	
<b>Enduring</b>	Depends upon the way in which each option is given effect. There are some risks that an arrangement 'closer to core Crown' will be more susceptible to changes in Government. Conversely, a form further from the core heightens the needs for effective use of ownership levers.
<b>Benefits outweigh costs</b>	Fundamental challenge for uncertain benefits of change to outweigh the more certain disruption and costs associated with change of entity form. In summary, the evidence of benefits for change was not compelling, particularly if there was an opportunity to make greater use of levers within the current entity form.

54. Through the options analysis the following key findings emerged:

- a. There are no alternative entity forms which deliver significantly compelling benefits or provide material improvement in the entities' ability to deliver on Ministers' expectations, given the mix of public benefit outcomes and commercial returns;
- b. Changing KiwiRail's entity form (to either a Crown entity company or Crown agent) could introduce significant disruption for uncertain benefits;
- c. Ministerial levers provided for under the SOE model could be better utilised to manage potential tensions between commercial and non-commercial objectives, alongside strengthened monitoring arrangements between the Treasury and the Ministry;

- d. System level arrangements established through the Future of Rail review need to bed-in – for example delivery of the strategic investments and outcomes in the Rail Plan to achieve the ERP outcomes; and
  - e. While both a Crown entity company and Crown agent would provide some additional Ministerial levers to drive public benefit outcomes, on balance, this is unlikely to outweigh the costs of disruption and of the risks of diluting commercial focus.
55. In summary, when assessed against the criteria neither a Crown entity company or Crown agent form would necessarily improve the realisation of the full suite of government objectives. A change in entity form, in itself, does not address the potential tensions between commercial and non-commercial objectives. Rather, more important is the way in which the arrangements are given effect under any entity form, as well as the nature of investment decisions to support these objectives.
56. Officials consider that Ministerial levers available within the SOE form, with the enhancements outlined above, are sufficient to ensure that KiwiRail supports government objectives. Alternatives to the SOE form did not clearly surpass the hurdle of benefits exceeding costs.
57. Consequently, having considered the extent to which current entity form can support government objectives and the alternative options available, officials recommend the 'modified status quo' option for KiwiRail.

#### ***New Zealand Railways Corporation***

58. NZRC is an anomaly as an SOE. It is a statutory corporation and neither a company nor does it generate material revenue. It holds the railway land for lease to KiwiRail for a nominal amount. It has no employees as it undertakes its activities through a management contract with KiwiRail. Property-based commercial activities all sit within KiwiRail.
59. Nevertheless, its status as an SOE provides a governance and oversight framework consistent with KiwiRail, through the Statement of Corporate Intent and Annual Report processes.
60. Its entity form has not, to date, presented any material issue with KiwiRail, NZRC or government objectives. We advise that NZRC's entity form is, of itself, not a priority. Work has been done on NZRC's form in the past, including between 2013 and 2015. This work was not completed as it was not considered a priority and NZRC's continued operation as an SOE was not causing any material problems. We advise that any change of NZRC's form should follow that of decisions made with respect to KiwiRail's form.
61. On the basis that no change of entity form is recommended for KiwiRail, as outlined above, removing NZRC from the SOE schedule is also not recommended.

#### **Risks**

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62. Deciding to retain KiwiRail's status as an SOE, and by extension NZRC's status as an SOE, has risk.
63. The key risk is that the modified status quo option will not deliver the benefits sought. That is, KiwiRail's transition will not occur in the timeframe or manner that has been forecast (therefore undermining the delivery of the government's commercial

objectives) and that KiwiRail may underperform in its ability to contribute to the realisation of the government's public benefit objectives.

64. This risk can be mitigated in a number of ways, most specifically by the application of enhanced levers for Ministers and officials as discussed above, and the clear communication of Ministers' expectations, including through the establishment of explicit commercial 'threshold events' that the Treasury will monitor and advise shareholding Ministers on. The monitoring of transport outcomes by the Ministry will also be critical.
65. Changing KiwiRail's entity form also presents risks, which are difficult to assess with any precision. Our assessment is that, on balance, the uncertainty and disruption posed by a change away from the SOE form is a risk (and cost) that is less preferable to the more known risks of KiwiRail remaining an SOE, particularly as we advise that these risks can be actively mitigated. In this way, Ministers are also avoiding the introduction of unknown risks by not making a change to KiwiRail's SOE form.
66. We note that certain members of the public, rail industry groups and commentators can have strong views with regards to KiwiRail's role in the transport system and how it contributes to the realisation of wider objectives. These views may be based on the assumption that there would be greater investment in passenger rail if KiwiRail were not an SOE. However, decisions to invest in passenger rail for public benefit are matters for the Government to consider (through the strategic investment priorities set out in the Rail Plan and GPS), irrespective of entity form. The Ministry will continue to advise Ministers on how best to balance public ambition for rail within the strategic investment priorities established in the Rail Plan.
67. This review did not include consultation with the public. While the Terms of Reference stated that external input could be considered, the Working Group, when reviewing documentation prepared as part of previous reviews, assessed that further external input was not warranted. We note that the Rail Plan and the Land Transport (Rail) Legislation Act 2020 were both subject to public consultation. As a result, the findings of the review may be criticised to a greater extent than if public consultation had been undertaken. It is therefore important that the rationale for retaining KiwiRail and NZRC as SOEs is clearly communicated as supporting the Government's objectives for rail to be achieved.

## Consultation

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68. As noted above, no public consultation was undertaken as part of the review.
69. Te Kawa Mataaho and KiwiRail were involved in the review as Working Group members. They contributed to the Working Group's work programme, and the final Working Group report and its recommendations, which the Steering Group considered when preparing this report.
70. The Steering Group met with the KiwiRail Board in November 2021 and May 2022 to discuss the review. These discussions were on the basis of good-faith engagement as opposed to formal consultation with the Board, or the Steering Group seeking the Board's endorsement of a particular approach.
71. The Steering Group provided a draft of this report to Te Kawa Mataaho and KiwiRail, as non-Steering Group members, to assist the organisations in providing a comment in the report at their discretion. Te Kawa Mataaho decided to not include a comment.

## **Comment from KiwiRail**

72. KiwiRail supports the conclusion of the Steering Group that it remains an SOE for the foreseeable future. KiwiRail's directors believe this is the most appropriate form for KiwiRail to deliver its commercial strategy alongside the public benefits purchased by the Government. In our view, a change in entity form would be a significant potential disruption and risk our ability to deliver the work programme and associated benefits. We do not consider there is any better model which would justify such a change.
73. Any review of entity form, particularly considering delivery of transport outcomes and commercial performance, needs to have a long-term focus (i.e. be enduring). The proposal to establish 'threshold events', which trigger advice to shareholding Ministers from the Treasury, is fair and reasonable. These align with KiwiRail's strategy to become financially self-sustaining for our above-rail business. However, the next three years will be challenging, with continued pandemic related uncertainty in the economy and for labour markets, supply challenges and our freight and tourism markets. In addition, most of our new assets do not start to arrive until 2025. The 'threshold events' appear to have a post-2025 KiwiRail in mind. Therefore, we consider that the thresholds should apply after financial year 2025/26. This will enable KiwiRail to demonstrate our ability to perform with new assets in place.
74. With respect to the section on network access, the majority of discussions around the provision of access are for appropriate levels of network maintenance, which is critical to the delivery of the resilient and reliable network investment programme (RNIP). We determine blocks of line to maintain the network through programmes agreed with the authorities responsible for metropolitan rail operation.
75. Access arrangements are designed as a collaborative forum involving all rail users on a line. In the event of a new rail user wishing to access the network, KiwiRail stands up an access and networks control group to advise the chief executive on any new access agreement. The group recommends the agreement be entered so long as the applicant obtains a rail safety license from Waka Kotahi, agrees to common access terms accepted by all rail users, and agrees to access fees and charges reflecting wear-out and levels of service requirements. We support further discussions on network capacity and access from an evidence-based perspective and aligned with the strategic priorities established in the NZ Rail Plan.
76. We wish to acknowledge the Future of Rail Review, which provided greater clarity and transparency over the commercial and public benefit objectives for rail and the different ways these are planned and funded. We see merit in the Ministry communicating these arrangements more clearly with the public, including the respective roles of planning and funding agencies for passenger rail and the process for any new service. KiwiRail continues to be a willing operator of passenger rail services and we are supportive of the Government's objectives for passenger rail as outlined in the NZ Rail Plan. We want to see more passengers on rail, and investing in a resilient and reliable network is a critical building block.
77. Finally, while not a matter of entity form, we continue to advocate for a review of aspects of the Metro Rail Operating Model (MROM) by the Ministry of Transport. This should include assessing whether the funding assistance rates between central and local government are reasonable. KiwiRail is concerned to ensure appropriate funding is in place for the level of investment required to maintain the metropolitan networks in a resilient and reliable state. We consider that this policy programme should be commenced as soon as possible.

## Next steps

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78. If you agree with our advice, we recommend the Minister of Finance sign and send a letter to David McLean, the Chair of both KiwiRail and NZRC, communicating the decisions you have taken. A draft letter, consistent with the recommendations of this report, is provided as **Annex 3** for this purpose.
79. Your decisions have machinery of government implications. As such, we recommend that, once you have collectively made decisions, this report is forwarded to the Minister for the Public Service for his information.
80. We recommend that you take a paper to Cabinet informing your Ministerial colleagues of the decisions you have taken and the outcome of the review. A Cabinet Minute would also be helpful to supplement the previous Future of Rail Cabinet Minutes, where it was noted that this review would be undertaken. If you agree with our recommendation, officials will provide you with a draft Cabinet paper for your consideration.
81. The review is public knowledge and has been subject to media commentary. The Terms of Reference were released in December 2021 in response to an Official Information Act request, where it was stated officials would report back to Ministers in mid-2022.
82. We expect Ministers to receive queries regarding the outcome of the review. You may wish to reply with the following:
  - We are considering advice from officials and Ministers have not yet made any decisions. We will make an announcement in due course.
  - [If you decide to take an item to Cabinet] We will be discussing this matter with our Cabinet colleagues and will make an announcement following the conclusion of this process.
83. Given the public interest in the review, we advise that proactively releasing key documents relating to the review will be in the public interest. This release would occur following any update you may wish to take to Cabinet. We will prepare these documents and provide them to you separately for your consideration.