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Report to the Policy and Finance Committee
from Greg Schollum, Chief Financial Officer

Wellington Urban Rail Services

1. Purpose

To report back on the meeting with the Mayors on 28 September 2001, in accordance with the Council resolutions on 27 September 2001, and to determine the next steps in progressing a solution to the Wellington Rail situation.

2. Background

The Committee will be aware of the history of the Council purchasing rail services via a rail service contract with Tranz Rail, where a quality rail service is seen as vital to the Council achieving its overall transport objectives. Under the current arrangements the Council has been unable to gain sufficient assurance that:

- it is receiving value for money in relation to the significant level of ratepayers' and taxpayers' money invested in rail services each year.
- the rail operator is committed to providing quality passenger services over the long-term. This lack of long-term commitment was borne out when during the second half of 2000 Tranz Rail announced that it intends to exit from all passenger services, including Tranz Metro (Wellington).

Without the long-term commitment of the operator, backed by a long-term funding commitment from Government, the infrastructure supporting passenger rail services is being progressively starved of reinvestment capital. The result of this has been a service which is now operating at near or full capacity, living off "hand to mouth" funding streams via an annual contract and is operating in an environment where there is a stated intention of the operator to sell.

Clearly the current situation is unsustainable and recent reports of Tranz Rail withdrawing rolling stock from use only serve to heighten the concerns about the future of passenger rail services in the Wellington Region. The situation is very fragile.

The current situation is also characterised by Tranz Rail having control over all the key monopoly assets, including the track, meaning the Council has no choice but to contract with the current operator (i.e Tranz Rail determines who can run trains).

The decision by Tranz Rail to exit the passenger business represents an opportunity for the Council to regain control, within the public sector, of the key monopoly assets, and to secure a quality passenger rail service for the next generation.

In recognition of this opportunity on 1 November 2000 the Council's Passenger Transport Committee resolved:

“That the General Manager be authorised to enter into an agreement with Tranz Rail which will allow the option of purchasing Tranz Metro (Wellington) to be pursued, noting that:

In light of Tranz Rail's announcement of its strategic intentions, the current basis of contractual arrangement is neither satisfactory nor sustainable.

Such agreement will not commit the Council to a material course of action without its prior approval.

The current legal mandate of the Council will need to be changed for a purchase to be concluded.

The authority provided be reported to the Council in Public Excluded business at its next scheduled meeting.”

These resolutions were passed after the Committee considered six options on how to proceed, including options 3 and 4 as follows:

- (3) Buy Tranz Rail's Wellington suburban rail operation as a going concern and contract out its operation. (Later in this report this is referred to as “franchising”.)
- (4) Form an alliance with a committed rail operator (other than Tranz Rail) and jointly purchase (50/50) the existing operation as a going concern.

On 7 December 2000 the Council adopted the resolutions of the Passenger Transport Committee which kept open the options of either:

- Purchasing 100% of the Tranz Metro (Wellington) business from Tranz Rail, or
- Purchasing the Tranz Metro (Wellington) business from Tranz Rail with a 50/50 partner.

On 15 February 2001 the Council resolved that it:

Recognises that the joint venture option is the Council's preferred choice.

Authorises officers to commence the selection process to establish the Council's possible future Joint Venture partner.

Notes that the selection process will include the need for the Council to approve the documents described in the report.

Notes that officers will need to seek further authorisations from Council as the process unfolds.

The Council's decision on 15 February 2001 to limit the options to the 50/50 public/private partnership option was essentially one based on effectively managing risk.

Since February 2001 the Council has been regularly briefed about the rail situation and much of the relevant documentation (e.g. options papers) has been provided to Councillors either formally via the Policy and Finance and Passenger Transport Committees or via the Councillors' Bulletin.

Also since February, officers and certain elected members (primarily the Chairman of the Council and Chairman of the Passenger Transport Committee) have been engaged in discussions with representatives of the Territorial Local Authorities of the Region. These discussions have been aimed at explaining the rationale behind the Council's proposed public/private partnership approach for solving the rail situation, when compared with the other available options. Throughout these discussions officers have been at pains to point out that the WRC proposed solution is a pragmatic response to a unique set of circumstances which currently exist in Wellington (i.e. the public sector is looking at how best to reassert control over a business, including key monopoly assets, which are currently under the control of the private sector.) It is not about trying to find the best theoretical model.

Since February a number of options papers have been prepared as follows:

- Passenger Rail options for the Wellington Region, 28 February 2001 (prepared by officers of all Territorial Local Authorities in the Region and the Regional Council).
- Passenger Rail options for the Wellington Region – No 2, 20 April 2001 (prepared by officers of all Territorial Local Authorities in the Region and the Regional Council).
- Passenger Rail options for the Wellington Region – No 3, 18 July 2001 (prepared by officers of the Hutt City Council and Wellington City Council only).

At the same time as officers have been preparing discussion and option papers a number of political meetings have been held at the instigation of Mayor Brash from Porirua City.

Meetings were convened by Mayor Brash on the following dates:

2 March 2001
 20 April 2001
 29 August 2001
 28 September 2001

These meetings have been attended by the Mayors of the Region, the Chairman of the Regional Council, various other elected members and the Chief Executives and other selected officers from all of the Councils represented.

In my opinion, these meetings along with various option papers prepared, have served to progressively bring the parties closer together, as the level of understanding of the WRC proposal has increased and as a full appreciation has been gained of the implications of the current situation whereby Tranz Rail controls all the assets. The issues now seem to have distilled down to what percentage ownership should WRC seek to acquire (50% or 100%) and how long should the initial rail contract be for (3 vs 10 years).

Although the views from around the table at these meetings have varied there has been one major area of concern expressed by the Mayors throughout the process of examining WRC's proposed solution – that of WRC's perceived conflict of interest.

At the 29 August 2001 meeting it was agreed that notwithstanding the work on options that had been completed to date by officers, further work should be completed on reviewing the robustness of the WRC option and assessing what other workable options were available. As a result, a Steering Group of officers was established as follows:

Greg Schollum	(WRC)
Paul Desborough	(WCC)
Stuart Duncan	(HCC)
Griff Page	(SWDC)
Tim Davin	(PCC)

NB: Karen Wallace (WCC) was subsequently added as an alternate to Paul Desborough although both have in effect been involved in the work of the Steering Group.

The Steering Group engaged the services of Booz Allen and Hamilton (“Booz Allen”) to conduct the review and the Office of Auditor-General (“OAG”) to comment specifically on the governance issues arising.

Both Booz Allen and the OAG presented their reports to the meeting convened by Mayor Brash on 28 September 2001.

3. **The Booz Allen Report**

The Booz Allen report is attached as **Attachment 1**. The report has been structured in a logical sequence which initially provides background to the current problem, canvasses options and then draws some conclusions about the way forward.

3.1 **Long-Term Solution**

Booz Allen conclude that in their view the best long-term solution is a franchise arrangement (A franchise is a method of procurement whereby a contract for services is specified, often involving the use of assets, and competitive bids are invited from interested operators.) Probably the most well known franchise arrangement in New Zealand is the Papakura Water franchise. A prerequisite to franchising is that the franchisor (in this case WRC) would first need to have control of all of the assets(i.e. 100%).

Although the WRC proposed approach includes a Rail Service Contract (Funding Agreement) which has a 10 year term and the ability for WRC to seek competitive tenders at the end of the 10 year period, in the view of Booz Allen the fact that WRC would not be “forced to tender” at the end of the contract period makes it an inferior option. (i.e. Booz Allen believe that you must actually go to the market to test the price.)

In the view of officers this is a very theoretical, if not ideological, approach taken by Booz Allen – the key issue is having the “ability” to test the market at the end of the contract, not the actual market testing itself.

It is akin to having the ability or the capacity to exercise control over another entity – the control is there in substance whether it is exercised or not.

Also, in contrasting the WRC’s proposal with the franchising option, Booz Allen acknowledge (on page 57 of their report) that:

“Because Tranz Metro has already been in private ownership, efficiency benefits following franchising are likely to be less in Wellington than experience elsewhere (where typically the railway is moving from public ownership for the first time)”.

This acknowledgement by Booz Allen suggests that the benefits of actually testing the market (franchise) would be low when compared with the ability to test the market (WRC’s Rail Contract). Of course as Booz Allen point out there would be additional costs incurred in the “must go to tender” franchise model.

How these costs and benefits would stack up in the end analysis is difficult to determine at this stage but this is clearly a matter that can be, and should be, assessed closer to the end of the initial contract term.

Notwithstanding the above comments it is important to appreciate that the WRC proposed approach does not preclude franchising in the future, should that be seen as a sensible course of action, long-term.

3.2 Short-Medium Term Solution

In terms of the short to medium term timeframe Booz Allen considered that there were two main options available:

- (1) WRC’s 50/50 public/private partnership approach.
- (2) WRC acquiring 100% of Tranz Metro and then entering into a short-term operator contract (effectively much like we have now with Tranz Rail).

Booz Allen state that in their view the WRC proposed approach would have a number of advantages over the short-term operator contract approach, albeit involving a longer transition period. (Refer to page 55 of the Booz Allen report.)

In Booz Allen’s view the advantages in the short-medium term of the WRC’s 50/50 public/private partnership approach are:

- it would ensure strong operator commitment from the outset through the initial 10 year funding agreement.
- the high degree of transparency which underpins an alliance type arrangement (WRC’s public/private partnership approach) is well suited to contractual situations where, at the outset, information is poor.
- it facilitates an immediate start to service improvements (rather than the danger of a ‘caretaker’ operation for up to three years pending franchise).

Booz Allen go on to say that “the WRC proposal would give greater confidence that the Tranz Metro business would be properly set up as a stand alone business to operate effectively over an extended period”.

However, Booz Allen rightly caution against ‘locking in’ to the JV partner under the WRC’s proposed approach. This is a vital ingredient and the Council must have the ability or capacity to seek an alternative operator. We have already identified the need to add a buy back clause for rolling stock into the Rail Contract (Funding Agreement) as a result of feedback received from interested operators (refer Report PE01.743). The documentation prepared to date will be reviewed to ensure that WRC is not locked in to the rail operator.

Booz Allen make some other very interesting comments on page 57 of their report which serve to reinforce the policy position that the Council has already reached (ie. the 50/50 approach is a safer option in the short-term). Booz Allen state on page 57 of their report that “having a private operator with a 10 year commitment to operate the business involved in the negotiations with Tranz Rail and the establishment of the stand alone railway company must be a significant advantage relative to an operator with a 3 year support agreement”.

They go on to say that “the high degree of transparency and performance obligations required by the WRC purchasing agreement (the Rail Contract) would mitigate any potential additional costs over the extended transition period”. In other words they don’t believe that a longer transition (10 years vs 3 years) would have material effect, financially.

However, it is interesting that despite the advantages noted by Booz Allen of the WRC proposal they have chosen not to come down firmly with a preferred approach in the short-medium term between the WRC’s proposed approach and the short-term operator contract for 3 years (remembering that to pursue the short-term operator contract would require WRC purchasing 100% of Tranz Metro first). Booz Allen have suggested further information about Tranz Metro would assist in making such a decision.

4. **The OAG Report**

The OAG report is attached as **Attachment 2**. The OAG was requested to peer review the Booz Allen report and to provide specific comment on the governance issues arising.

The OAG makes a number of comments across nine different topic areas. The comments made tend to fall into two categories:

- Comments on areas which are seen by the OAG as reasonable.
- Comments on areas which the Council should look at further.

There are no “show stoppers” in the OAG report and the matters raised are useful in providing a further resource for fine-tuning the WRC proposal. However, of much more significance is the OAG view on WRC’s perceived conflict of interest. The OAG has taken the view that conflicts of interest are not uncommon and they just need to be managed appropriately.

In this regard the OAG’s views are entirely consistent with Booz Allen who concluded that “on balance, the joint funder/owner responsibilities of WRC is insufficient cause for ruling out the WRC JV proposal”.

Remembering that, as noted earlier in this report, the issue of conflict of interest has been the major area of concern that the Territorial Local Authorities have expressed about the WRC proposal. This major area of objection has therefore been dealt with and should no longer be an issue going forward.

5. **Results of the Inter-Council Rail Meeting held on 28 September 2001**

The meeting held last Friday (28 September 2001) considered both the Booz Allen and OAG reports. Having considered the contents of the two reports the Territorial Local Authorities (as represented by the Mayors) agreed to unanimously support WRC entering into negotiations with Tranz Rail with a view to finding out more information about the Tranz Metro business.

In providing this support the Mayors reserved their position on the preferred short-medium term option that WRC should pursue (as discussed in section 3) as between the WRC public/private partnership option and a short term contract as a transition to franchising.

The Mayors also agreed that based on the Booz Allen report franchising was the best long-term option.

The WRC Chairman undertook to take that position from the meeting back to the Regional Council for consideration on 5 October 2001.

A further outcome of the meeting was that it was agreed Government should be asked again to clarify its position in relation to rail infrastructure in Wellington.

Therefore the Territorial Local Authorities of the Region, as represented by the Mayors, are united in their views that franchising is the best long-term option but they haven’t yet formed a view as to how WRC should transition to that position ie:

- WRC’s 50/50 public/private partnership (with a 10 year Rail Contract)
- or
- WRC acquiring 100% of Tranz Metro and then entering into a three year operating contract.

(A diagram crystallising this position was presented to the meeting by Roger Blakely, CEO, Porirua City Council.)

The Regional Council, as represented by the Council Chairman, did not support nor oppose the views of the Mayors.

6. **So what does this mean for the WRC?**

WRC is the organisation with the statutory responsibility for purchasing quality rail services (as part of its transport obligations) and it is therefore vital that the Council is comfortable with the remaining options on the table. As referred to earlier in this report it is the view of WRC officers that while franchising might well be seen by others as the preferred long-term solution, it is neither necessary, nor advisable at this point in time to lock into a preferred long-term solution. It is far too premature as the best long-term solution will only become clear after a reasonable period of experience in the post Tranz Rail environment.

However, it is important for the Council to keep its options open (including franchising) should any alternative course of action which is chosen prove to be sub optimal. The fundamental problem with the current arrangements has been that the Council has had only one option - to contract with Tranz Rail. This must change.

Focus therefore needs to go on what is the best way forward in the short-medium term (recognising that franchising needs to be retained as an option in the future).

The suggested way forward, as agreed by the Mayors, is to find out more information about Tranz Metro to enable what they see as a more informed choice to be made between the two short-medium term options.

However, this approach presumes that the WRC accepts that both options are viable options and more importantly that it would, as the body with the statutory responsibility, be prepared to implement either option, and rate the Regional community accordingly. Previous resolutions of Council raise considerable doubts about this.

6.1 **Option 1 – WRC public/private partnership**

The Council already has a policy position that the 50/50 public/private partnership is its preferred solution.

Documentation has been prepared on that basis and “road tested” with interested rail operators (refer report PE01.743).

6.2 **Option 2 – Short-term Operator Contract in preparation for Franchising**

To implement this option the Council would need to be comfortable with acquiring 100% of Tranz Metro. There are a number of issues with this approach but essentially it comes down to management of risk. Many of the following comments are also supported by Booz Allen (refer section 3.2 of this report and the Booz Allen report itself in **Attachment 1**).

The acquisition by WRC of 100% of Tranz Metro would mean:

- ***WRC would be taking all the due diligence price risk***

A key reason for the 50/50 approach taken by WRC to date has been to reduce due diligence price risk; ie. the risk that the Council will pay too much for the Tranz Metro business.

The prospect of conducting due diligence on Tranz Metro without a partner experienced in commuter rail operations who is incurring the same capital risk as the Council is a significant issue that the Council would need to be comfortable with.

- ***The risk of separation issues (e.g. use of shared assets) would be greatly increased without the involvement of the future Rail operator during due diligence***

A key reason for engaging a rail operator prior to the start of due diligence phase is to ensure that all separation issues (e.g. shared assets with Tranz Rail) would be appropriately addressed as part of the due diligence phase. By having such a party working with the Council during due diligence (the party who would be largely responsible for making business work in future), the Council will be able to significantly reduce operational risk.

To the extent that any arrangements with Tranz Rail remain unclear after due diligence the Council, as 100% owner of the Tranz Metro business, would be fully exposed.

- ***WRC would be required to debt fund the full purchase price, not just 50%***

Standard and Poor's, Council's credit rating agency, has already shown an interest in the possibility of Council acquiring a partial interest in Tranz Metro (from the point of view of its potential impact on Council's credit rating).

In their latest report on the Council, Standard and Poor's stated "WRC is considering a number of infrastructure proposals including the future of the Wellington suburban train services Currently there are no firm plans for WRC to fund substantially the capital component of these projects but should plans emerge for a significant input from WRC, Standard and Poor's would review the impact on the rating".

Although we don't yet know the likely purchase price of Tranz Metro we do know that acquiring 100% of the business would be exactly double the size of 50% of the business!

As many of Council's existing borrowing facilities are linked to Council's credit rating there is a significantly higher risk of credit rating downgrade should Council wish to pursue a 100% acquisition of Tranz Metro.

The Council's funding agreements with banks provide that not only will Council's borrowing costs increase if its credit rating reduces but if the rating drops too much the banks are entitled to review the availability of their funding.

Again, the potential for downgrade in Council's credit rating is an issue the Council would need to be comfortable with.

- *The risk that a “caretaker” type phase will occur during the short-term operator contract (3 years)*

The Council would also need to be comfortable with a ‘caretaker’ type phase taking place for the 3 year transition to franchising. The operator will not be likely to want to take any risk during that period and the potential for the rail infrastructure to be further run down in this period would appear to be high.

Any investments by the Council during this period (which would be 100% funded by the Council) would need to rely solely on Council sourced evaluation/analysis without the benefit of the expertise from the Rail operator who had a real stake in the decision. (The operator would largely be in an “all care no responsibility” position). In fact the operator’s interests would be served well by encouraging spending and developing competitive advantage through protecting privileged information.

7. What should happen next?

7.1 Key decisions needed

In my view the Council firstly needs to determine its level of comfort with both the short-medium term options proposed, i.e.:

- WRC’s 50/50 public/private partnership
- WRC acquiring 100% of Tranz Metro then entering into a short term operating contract (3 years).

In other words would the Council be prepared to implement both options? (The Council has previously rejected the option of acquiring 100% of Tranz Metro.)

If the Council is prepared to implement both options the next step is to attempt to re-engage in discussions with Tranz Rail in accordance with the preferred approach of the Mayors. (For the purposes of conducting preliminary due diligence).

Attached as **Attachment 3** is a listing of the sort of information that would be necessary to conduct a full due diligence process. I suggest that if the Council is comfortable to pursue this approach the information requirements be forwarded to Tranz Rail for their comments as to what the company is able and prepared to make available at this time. This will then help to identify the extent of uncertainty and/or complexity around Tranz Metro. Initial discussions already held with Tranz Rail late last year/early this year suggest a high degree of complexity, particularly around the areas of internal charging for shared assets and services.

Alternatively, if the Council is not prepared to implement both options that position needs to be made clear now. If the Council is not prepared to implement both options the decision as to which option is favoured by other parties becomes rather more academic i.e. if the WRC as the organisation that will be funding the acquisition and rating the Regional community accordingly rejects one or both options as impractical, then preamble work is irrelevant.

Obviously it would be preferable to have the agreement of all Territorial Local Authorities to whatever course of action is chosen. In this regard I believe the wishes of the Mayors can be accommodated while still pursuing the WRC's 50/50 public/private partnership. Remembering that all of the options outlined in this report cannot be executed without the Government passing the appropriate law change. This means the Council is not irrevocably committed at any stage prior to the passing of the legislation.

Therefore, the pursuit of the 50/50 public/private partnership not only expedites action at the earliest opportunity, it also allows the "complexity" and "risk" issues to be fully understood before final commitment to any particular model.

In reaching its decision, Council needs to take a view of a range of factors including the prudence of further delaying the implementation of a solution to the rail situation.

An important consideration here is that the new Council will not be fully operational until early December, some two months away. Councillors need to take a view as to whether this issue can wait.

Also of relevance to the decision, is the level of support from Government for WRC's proposed public/private partnership. In his letter, dated 27 August 2001 to the Council Chairman, the Minister of Transport has encouraged the Council to continue work to mature the WRC proposal (refer to **Attachment 4**).

As far as the Council's policy position on the best long-term option for rail the Council should keep its options open, including franchising. In other words, the Council should not lock itself in to any model long-term, as to do so now would be a leap of faith in a vacuum of information about the post Tranz Rail environment.

7.2 **WRC's public/private partnership proposal – the next steps**

If it is agreed that further information is sought from Tranz Rail and a subsequent decision is taken to acquire 100% of Tranz Metro and enter into a short-term operator contract (as a transition to franchising), approval of the future steps in the WRC's public/private partnership proposal will not be required.

However, if the Council chooses to seek more information from Tranz Rail before making a final decision on the preferred short-medium term approach and then WRC's proposed approach is chosen, or if it decides that there is really only one option that it would be prepared to implement (WRC's proposed approach), the Council will need to agree on the process necessary to implement the WRC's proposed approach.

Given the upcoming two month political vacuum, officers felt it was prudent to seek approval of the process at this time, in the event that it may be required. (Refer section 8)

8. WRC's proposed public/private partnership – How would it be implemented?

8.1 Overview

The WRC's proposed public/private partnership includes the following broad steps:

	Step	Completed	Actual/ Estimated Date
(1)	Consultation with TLA's in the Region		November 2000 - ongoing
	⇓		
(2)	Approval of preferred option - WRC public/private partnership	✓	February 2001
	⇓		
(3)	Development of draft documentation for the WRC public/private partnership	✓	July 2001
	⇓		
(4)	"Road Testing" of draft documentation with interested rail operators	✓	August 2001
	⇓		
(5)	Council decision to take the next steps and approval in principle of draft documentation		October 2001
	⇓		
(6)	Review and update of draft documentation as a result of road testing feedback, and feedback from Booz Allen/OAG		October 2001
	⇓		
(7)	Obtain Transfund approval of contestable partner selection process to ensure compliance with competitive pricing procedures (CPP)		October 2001
	⇓		
(8)	Selection of private sector partner to the satisfaction of the independent probity auditor		December 2001
	⇓		
(9)	Signing of Heads of Agreement with preferred private sector partner ("Engagement phase")		December 2001
	⇓		
(10)	Completion of due diligence of Tranz Metro business as a going concern with assistance from Government in relation to track access		March 2002
	⇓		
(11)	Signing of Shareholders' Agreement with private sector partner subject to public consultation results and law change ("Marriage phase")		March 2002
	⇓		
(12)	Establishment of JV company in conjunction with private sector partner		March 2002

(13)	Signing of conditional Sale and Purchase Agreement with Tranz Rail if satisfactory deal can be reached	March 2002
	⇓	
(14)	Signing of conditional Corridor/Infrastructure Access agreements with Tranz Rail or the Government	March 2002
	⇓	
(15)	Consultation with the public based on the conditional Sale and Purchase Agreement signed with Tranz Rail	May 2002
	⇓	
(16)	Government sponsored Law change to enable WRC to take an ownership interest in Tranz Metro (required for both short-medium options on the table)	June 2002
	⇓	
(17)	Long-term funding certainty from Government to enable 10 year contract to be entered into	June 2002
	⇓	
(18)	Finalisation of capital structure for JV company and related borrowing required by each partner	July 2002
	⇓	
(19)	Purchase of Tranz Metro (Wellington) from Tranz Rail	August 2002
	⇓	
(20)	Adoption of Community Charter, Company Constitution, SCI and Business Plan	September 2002
	⇓	
(21)	Signing of Funding Agreement (Rail Contract) between WRC and rail operating company	September 2002

[NB: The above dates are preliminary estimates only and may need to be modified as the process evolves.]

8.2 Partner Selection Process

A fundamental component of the WRC public/private partnership is the selection of the right private sector partner.

Not only is the outcome of this process crucial for the future operation of passenger rail in the Wellington Region, but the process of selection itself is also seen as vital. It must be, and be seen to be, fair and able to withstand challenge. For that reason officers are recommending the appointment of a Probity Auditor whose role will be, inter alia, to:

- Review the proposed partner selection process to ensure it is appropriate (before the process is started).
- Provide real time assurance that the process is being followed.
- Act as the main point of contact for tenderers in relation to probity matters.
- Provide a report on the implementation of the partner selection process.

The partner selection process will be a fully contestable process based on a range of evaluation criteria. In broad terms it will involve:

- A public notification for potential JV partners to register an interest.
- Screening and short listing of interested parties through a request for qualification (RFQ) process.
- Selection of a preferred party through a request for tender (RFT) process.

It will be akin to a two envelope tender process but where the second envelope is not opened for any tenderers. (In a two envelope tender, price is normally the last matter considered once the quality of tenders has been fully evaluated and a decision on the preferred tenderer based on quality has been made.)

Booz Allen's reference to this fully contestable process as a "beauty contest" could be misinterpreted as something significantly less than what is envisaged.

Below is an outline of the partner selection process that would need to be followed:

	Step	Comment
(1)	Appoint Probity Auditor	<p>The partner selection process must be able to withstand scrutiny and be demonstrably fair and equitable.</p> <p>Appointment of a probity auditor will assist in ensuring the process is robust.</p> <p>The probity auditor will have the following responsibilities:</p> <p>At the outset, to review the selection process and provide an opinion that the process accords with good procurement practice. Provide assurance that the steps being undertaken during the process are consistent with the documented process. This will require the probity auditor to undertake checks at various points during the process and, at the end of the process, provide an opinion that the selection process undertaken was in accord with the documented process. Act as the first point of contact for operators in relation to any probity concerns. In addition, the probity auditor will also be required to sign-off any changes to the process on an ongoing basis. That is, if during the process it is found necessary to modify the process, the probity auditor will be asked to sign-off that the modifications will not compromise the overall integrity of the process.</p>
(2)	Obtain sign-off of the partner selection process from the Probity Auditor	As noted above it is important that the probity auditor has input into the process to be followed and that there is a formal sign off before the process commences.

(3)	Obtain sign-off from Transfund NZ on the partner selection process	Ongoing Government funding for rail is vital to the continuation of a quality rail service. Transfund as the funding agency therefore need to be fully comfortable with the partner selection process for CPP purposes.
(4)	Publish notification requesting registrations of interest	In broad terms, the selection process will involve: A public notification for potential JV partners to register an interest. Screening and short-listing of interested parties through a request for qualification (RFQ) process. Selection of a preferred party through a request for tender process (RFT) The starting point is the publication of the notice asking parties to register their interest in receiving documentation on the JV.
(5)	Release RFQ document	Parties registering an interest will be sent an RFQ document. The RFQ will explain the nature of the joint venture (including the documentation already “Road Tested”), provide background on Tranz Metro and request parties to submit their qualifications relevant to becoming a joint venture partner. The information requested from the parties will include, inter alia, financial information, information on their experience in running urban rail services and confirmation that there are no matters which would be of concern to the Commerce Commission.
(6)	Select qualifying parties	Procedures will be developed to evaluate the RFQ documents and select a small number of qualifying parties who will go forward to the tender process proper. The evaluation process will focus on the attributes of the parties and their “fit” with what the Council requires from the joint venture operator. The objective of this part of the process is to screen the interested parties and select a small number of serious operators to go forward to the tender process.
(7)	Release RFT document	A request for tender document will be prepared and sent out to those parties who are short-listed from the RFQ process. The RFT will request the selected parties to provide the Council with a detailed tender to

		<p>act as a joint venture partner.</p> <p>The RFT will request detailed information, including more financial information, information on their expertise, and information on the individuals who might be involved.</p> <p>The RFT will seek financial commitments (including capital funding) from the parties and commitment to the joint venture process and buy-in to the various contractual documents that form part of the joint venture arrangement.</p>
(8)	Evaluate tenders	Formal evaluation of the tenders will include review and evaluation of the written documents submitted, extensive interviews with the tenderers, and reference checking (which may include site visits).
(9)	Select preferred tenders	The tenderers will be ranked and one or two preferred tenderers identified.
(10)	Negotiation with preferred tenderers	<p>Subject to the outcome of the evaluation process, it may be necessary to undertake some negotiations with the preferred tenderer(s) on some of the contractual documentation.</p> <p>The feedback from the “Road Testing” indicated that while the parties are comfortable with the general structure of the joint venture documentation, there will be some issues around the fine details of the documents that they will want to “discuss” with the Council.</p>
(11)	Select preferred party and sign Heads of Agreement	<p>Subject to negotiations, a preferred party will be selected and recommended to the Council.</p> <p>If this recommendation is accepted then a Heads of Agreement will be signed with the selected party.</p>

9. Communications

Regardless of how the Council chooses to proceed as a result of consideration of this report, it is important that the Wellington Regional community is kept fully informed about what is proposed and the opportunities that will arise for community input over the coming months.

As a result of Council’s deliberations on 5 October, officers will prepare suitable material to be released explaining what the Council has decided and what it means.

There will of course be formal public consultation with the Regional community at the appropriate stage.

10. Recommendations

That the Committee recommend to Council that it:

- (1) *Receive the report and note its contents.*
- (2) *Note, the current fragility of passenger rail in the Wellington Region.*
- (3) *Agree, that finalisation of the best long-term option for purchasing rail services in the Wellington Region should be left open pending a reasonable period of experience in the “post Tranz Rail” environment.*
- (4) *Agree, that the option chosen to proceed with in the short-medium term should be structured so as to not preclude the option of franchising in the longer term.*
- (5) *Note, that the Booz Allen report has identified a number of advantages associated with pursuing the WRC’s proposed public/private partnership in the short-medium term.*
- (6) *Note, that the issue of WRC’s perceived conflict of interest in having an ownership interest in rail, while also being a substantial funder is seen as manageable by both Booz Allen and the Office of the Auditor-General.*
- (7) *Note, that the Mayors of the Region, representing the Territorial Local Authorities,*
 - (a) *favour the Council moving to a franchise model in the long-term while reserving their position on the option that the Council should pursue in the short-medium term as between:*
 - *WRC’s 50%/50% public/private partnership with a 10 year Rail Contract.*
 - *WRC acquiring 100% of Tranz Metro (Wellington) and then entering in to a 3 year short operator contract.*
 - (b) *believe that additional information is needed before a final decision on the best short-medium term option should be taken.*
- (8) *Note, that the further pursuit of the WRC’s 50/50 public/private partnership will provide the additional information required by the Mayors without irrevocably committing to any particular ownership model.*
- (9) *Decide, whether, as the organisation with the statutory responsibility for purchasing quality rail services, it is prepared to implement both short-medium term options noted in resolution 7 above.*

- (10) *Agree, that if it is prepared to implement both short-medium term options noted in resolution 7 above, officers should recommence discussions with Tranz Rail Ltd as soon as practicable with a view to ascertaining the additional information required.*
- (11) *Decide, if it is not prepared to implement both short-medium term options, which option it is prepared to implement.*
- (12) *Approve, if it is only prepared to implement WRC's proposed public/private partnership, the broad steps outlined in section 8.1 of this report that would be required (including public consultation), recognising that officers will need to seek further authorisations from Council as the implementation process unfolds.*
- (13) *Approve, if it is only prepared to implement WRC's proposed public/private partnership, the partner selection process outlined in section 8.2 of this report, and request officers to commence this process as soon as practicable.*
- (14) *Instruct officers to report on Wellington Urban Rail Services to an early meeting of the incoming Council.*

Prepared by:

Approved by:

GREG SCHOLLUM
Chief Financial Officer

HOWARD STONE
General Manager

- Attachment 1: Report by Booz Allen and Hamilton**
- Attachment 2: Letter from the Office of the Auditor-General**
- Attachment 3: Draft Due Diligence Checklist**
- Attachment 4: Letter to Stuart Macaskill from the Minister of Transport (dated 27 August 2001)**