

# OIA 20240815

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18 April 2024

Hon Paul Goldsmith, Minister for State Owned Enterprises

WELLINGTON

By email: s9(2)(a)

Dear Minister

**RE: SHAREHOLDING MINISTERS' EXPECTATIONS FOR KIWIRAIL HOLDINGS LIMITED**

Thank you for your 2 April 2024 letter outlining shareholder expectations of the Board of KiwiRail Holdings Limited (KiwiRail) for the 2024/25 financial year and beyond.

KiwiRail moves people and freight by rail and sea and is the steward of the national rail network. Our purpose is Stronger Connections, Better New Zealand. We are contributing to New Zealand:

- Rail provides up to **\$2.1 billion** in economic value to New Zealand.<sup>i</sup> We are in the process of updating the 2021 Value of Rail exercise, together with stakeholders.
- An estimated **288** minor injuries, serious injuries, and deaths on the road are avoided each year through the use of rail.<sup>ii</sup>
- Last year, rail moved **22 million** passengers in Auckland and Wellington.<sup>iii</sup> Metro services are projected to grow, with major upgrades in progress. The Interislander provided **3300** sailings, moving around **600,000** passengers.<sup>iv</sup>
- Rail also served more than **300** freight customers and moved more than **18 million** tonnes of freight over **40,400** mainline freight services – **900** a week.<sup>v</sup> That's **12%** of all New Zealand's freight, **25%** of exports and imports, and **40%** of the largest port's container volumes.<sup>vi</sup>
- It takes about **54** trucks to move a standard freight train.<sup>vii</sup> Rail offers significant savings for road users, such as reduced road maintenance by more than **\$100 million**.<sup>viii</sup> Rail is a very effective pothole prevention fund, as avoiding the need for **1 million** truck trips per year reduces the wear and tear on our roads.<sup>ix</sup>
- Every tonne moved by rail emits **70%** less carbon than by road freight.<sup>x</sup> Increased use of rail presents an immediate opportunity for customers to meet their sustainability obligations, and for New Zealand's emission reduction targets.
- It would take about **357** cars to move the people in a standard three-carriage set on Auckland's network in the morning.<sup>xi</sup> That's **1.6 kilometres** of road lanes freed up for those who have to use the road,<sup>xii</sup> and **1029 kg** CO2 avoided.<sup>xiii</sup>

**Government priorities**

KiwiRail recognises the priorities for the Government this term, in advance of the Enduring Letter of Expectations for Crown entities. These include lifting New Zealand's productivity and economic growth to





increase opportunities and prosper for all New Zealanders and improving the efficiency and effectiveness of the public service and of government-funded services.

We note your reference to the recent findings by the Office of the Auditor General about the borderline issues arising from treating KiwiRail as a profit-making entity and that you are seeking advice on this matter. Our most recent understanding from the Audit Office is that this treatment will continue into the future.

### Specific expectations of KiwiRail

We acknowledge the specific expectations detailed in your letter, reminding us of the need to:

- focus on our core business objectives.
- ensure the efficient allocation of resources (and noting the scarcity of Government funds in doing so).
- maintain a customer-focused outlook with operational improvements taken.
- report consistently and clearly to you to demonstrate how we are achieving value for money.
- disclose executive remuneration in accordance with the NZX Corporate Governance Code.

The first four points are clear and will continue to guide our thinking as strategic decisions are taken. KiwiRail discloses remuneration in accordance with the NZX Corporate Governance Code.

You have also raised further specific matters and our response to these is outlined below.

#### *Delivering within fiscal constraints*

Your letter notes fiscal constraints will restrict the amount of Crown funding available to subsidise KiwiRail's operations. The Board is not seeking any subsidy of KiwiRail's operations. Our costs to serve are lower than the revenue our services gather, and we report an operating surplus.

KiwiRail is seeking funding for the upkeep of the national rail network which, like roads, is a public asset used to transport people and goods. Successive reviews (including the 2014 Commercial Review and the more recent Future of Rail Review) have confirmed that the national rail network requires ongoing Government funding, reflecting the broader benefits it provides for New Zealand. There are legislative processes in place to determine the investment programme and level of funding, and we will continue to work with the Minister of Transport to deliver outcomes from rail infrastructure which support New Zealanders and their businesses.

We understand the fiscal expectations of the new Government as we produce the next Rail Network Investment Programme (RNIP), and we will continue to engage with officials through this process. KiwiRail has proposed s9(2)(f)(iv)

Through this proposal, we have prioritised the renewal and maintenance of existing assets over new projects. We have not yet heard an outcome from Government officials on our proposal.

In line with the draft Government Policy Statement (GPS), s9(2)(f)(iv)

We will present the RNIP to the Minister of Transport in June 2024.







With regard to other major projects, like New Zealand Upgrade Programme, the Board has not sought additional funding for any project and has taken reprioritisation decisions across these projects to maximise the benefits from these investments. s9(2)(i)

#### *Achieving above rail commercial performance goals*

KiwiRail's expectation of commercial self-sustainability of our above-rail business remains a firm objective of the Board and Management. This means our operating and capital costs will be funded from revenue and alternative financing as appropriate. As indicated earlier, we are not seeking Government funding to support the operations of our above rail services business.

Our work with McKinsey & Company is providing a pathway to financial self-sustainability through revenue growth and operational efficiency. This informs our strategic direction and will be a significant customer, commercial, and cultural transformation for our business and we look forward to discussing this with you in the near future. Our financial projections will be revised as a result of this work.

Our existing operating performance is reflecting a deliberate investment in resilience and reliability given the age of our existing Interislander and rolling stock fleet, as customer retention and attraction relies on schedule reliability which in turn relies on asset reliability. This pressure will ease in the coming years as new, modern, fit-for-purpose assets replace aged assets. For instance, late this year a fleet of DM locomotives will replace the DX locomotive fleet – the last of which was built in 1975. This new modern fleet will greatly enhance our safe and reliable service performance for customers, and streamline our asset base.

The letter refers to an operating surplus expectation of **\$235 million** to achieve self-sustainability. This is not correct. This was, in 2022, the high end of the range for FY25 from our 2023-25 Statement of Corporate Intent (SCI) and was revised in 2023 to **\$167 million** in the 2024-26 SCI as a result of forecast economic conditions. Beyond the near-term, our work with McKinsey is helping us to focus our efforts to improve our performance and strengthen our commercial results. And as noted above, KiwiRail is not seeking funding to support the operations of our above rail services business.

#### *Asset management practices that maximise the safety and reliability of services*

There is significant board and management focus on our asset integrity performance, risk, and safety. We are making significant progress. This applies at an enterprise level, as well as a specific focus on the Interislander, with full regulator engagement.

#### *Meeting health and safety targets*

KiwiRail is committed to lifting the health and safety performance of the company to ensure our team arrive home safely every day. This is a central tenet of our high-performance, high-engagement strategy with staff and union partners, and a core component of the commercial strategy for operating a successful business and delivering quality network services to all rail users. We have engaged extensively with all staff and union members to lead and drive comprehensive safety culture improvement.





Our high potential critical risk near miss events, those that could lead to a fatality or serious harm, have reduced by **33%** over the last 12 months. This is an important leading indicator for safety severity. We will continue to focus on the downward trend for our Total Recordable Injury Frequency Rate.

*Working collaboratively in delivering safe and reliable inter-island services*

As noted above, considerable work is occurring to support safe and reliable Interislander services. From December 2023 to February 2024 (the peak period) we operated with **99.6%** asset reliability and **91.5%** on-time performance. February was the best on record with **30,000** private cars and campervans, bouncing back to pre-Covid levels.

We will continue to work collaboratively with Ministers, officials, the Ministerial Advisory Group (MAG), and customers on safe, resilient, and reliable options for servicing the Cook Strait.

We are informing and working with Treasury and the MAG in relation to the existing fleet and future options. Expert maritime advice on the extension of the life of the existing fleet is due around the end of June 2024. In relation to future options for alternative fleets, these are being engaged upon with a view to inform a range of options beginning to be available around May 2024.

*Meeting the needs of metropolitan rail*

KiwiRail is prioritising work as network provider to the metro areas. We are a party to the Metro Rail Operating Model (MROM) review and have requested this review occur for multiple years. We are pleased that your Government has taken this action forward, as 'who pays for what' has been a long-standing issue between the multiple agencies and councils involved in metro rail. We rely on these agencies to fund renewal and maintenance for metro areas at a level that enables their desired level of service, and we will continue to advocate for this.

We are also delivering major catch-up renewal and upgrade programmes in Auckland...:

- Third Main Line to unblock the busiest junction in Auckland is nearly completed (**85%** complete).
- Electrification from Papakura to Pukekohe is nearly completed, with services starting late this year (**82%** complete).
- Rail Network Rebuild (**65%** complete) – Otahuhu-Newmarket and Onehunga completed by March 2023, Eastern Line completed January 2024, with Newmarket-New Lynn and Puhinui-Papakura drainage now underway.
- Rolling Contact Fatigue remediation occurred at pace, fixing an asset degradation risk (**100%** complete).
- Auckland train control centre opened, co-locating train controllers for KiwiRail and Auckland One Rail (**100%** complete).
- Strong partnership with Link Alliance, City Rail Link limited, and Auckland Transport to bring City Rail Link into service.

...and Wellington:

- Overhead power infrastructure in Wellington has been renewed (**100%** complete).







- Trentham-Upper Hutt has been double-tracked, lifting capacity for more train services (**100%** complete).
- Plimmerton Station rebuilt for additional capacity, meaning more trains can operate to increase services (**100%** complete).
- Extensive track upgrades in the Wairarapa will be completed early next year (circa **60%** complete – main tunnel to be done this Christmas).
- All timber bridges replaced (**100%** complete).
- Extensive catch-up renewals underway on Kāpiti and Johnsonville Line tunnels (**100%** complete).
- Wellington train control centre opened, lifting service resilience with space for Greater Wellington to join later (**100%** complete).

As the Minister of Transport is aware, we are reliant on decisions by the Government (Minister and NZTA Board) to complete the existing programmes in Auckland and Wellington which will realise the benefits of investments like the Auckland's City Rail Link and Wellington's additional train units.

We work hard with councils to balance the time needed on the network to deliver the network maintenance and upgrades, which predominantly happens in blocks of line work outside of the weekday peaks. These timetabling decisions are determined in open processes involving the councils.

We have also restructured our organisation to delineate the executive accountabilities for our rail operations from our role as a network provider. The Chief Infrastructure Officer is accountable for delivering network services to councils, who are in turn his largest combined customer. We keenly feel the expectations of commuters for reliable public transport and advocate alongside councils for sufficient funding to achieve their and your aspirations for the network.

*Meaningful, focused and constructive engagement*

We will continue to keep you updated in accordance with your expectations, including expectations outlined in the Treasury's Owners' Expectation document relating to 'no surprises'.

*New Zealand Railways Corporation (NZRC)*

I have conveyed to the NZRC Board the fact that no entity-specific expectations have been raised and that a separate Strategic Issues Letter is not expected or forthcoming.

### **General governance expectations**

*The Treasury's Owner's Expectations document*

KiwiRail will continue to be aligned with governance, reporting, and other expectations as described in this document. We note the intention by the Treasury to update this document, and their intention to consult us on its contents.

We acknowledge the timetable for the 2024/25 business planning process. Given the need to incorporate the results of Budget 2024, the RNIP development and the McKinsey work, we have agreed with Treasury that we will submit the draft Business Plan and SCI by the end of May.





### *Board charter/code of practice*

The Board has existing systems and procedures for registering and managing conflicts of interest and have regard to expectations for non-political behaviours in relation to directors responsibilities at KiwiRail. Directors take care to ensure their personal views are conducted in a manner which is separate from their duties at KiwiRail. New charters for Board Committees, having considered good practise, have been done and a Board Charter is underway.

### *Board evaluations*

KiwiRail conducts independent board evaluations and self-assessments and shares these with the Treasury, contributing to its advice on board composition. The Board engaged Propero to support a Board evaluation, completed in March 2024.

### **Concluding comments**

Despite tough forecast economic climate and tough choices to be made, we look forward to engaging with you on our plans to achieve commercial sustainability and a network which serves its users. We have a plan to transform our business on a customer, commercial, and cultural platform.

Yours sincerely

 David McLean

**Chair**

Copied: Hon Nicola Willis, Minister of Finance

<sup>i</sup> Ernst and Young, "The Value of Rail in New Zealand" (Report for the Ministry of Transport, 2021), 8

<sup>ii</sup> Ernst and Young, "The Value of Rail in New Zealand" (Report for the Ministry of Transport, 2021), 22

<sup>iii</sup> KiwiRail Holdings Limited, "KiwiRail Integrated Report 2023" (Annual Report, 2023), 10

<sup>iv</sup> KiwiRail Holdings Limited, "KiwiRail Integrated Report 2023" (Annual Report, 2023), 10

<sup>v</sup> KiwiRail Holdings Limited, "KiwiRail Integrated Report 2023" (Annual Report, 2023), 10

<sup>vi</sup> KiwiRail sources based on market knowledge, 2024.

<sup>vii</sup> WSP, "Auckland Rail Programme Business Case" (Final Report, 2023), 12

<sup>viii</sup> Ernst and Young, "The Value of Rail in New Zealand" (Report for the Ministry of Transport, 2021), 12

<sup>ix</sup> 2023 KiwiRail annual integrated report

<sup>x</sup> Ministry for the Environment, "Te ine tukunga: He tohutohu pakihi | Measuring emissions: A guide for organisations" (2023 detailed guide, 2023), 83 (rail emissions factor 27.16g CO<sub>2</sub>e/NTK), 89 (long-haul heavy truck emissions factor 105g CO<sub>2</sub>e/NTK).

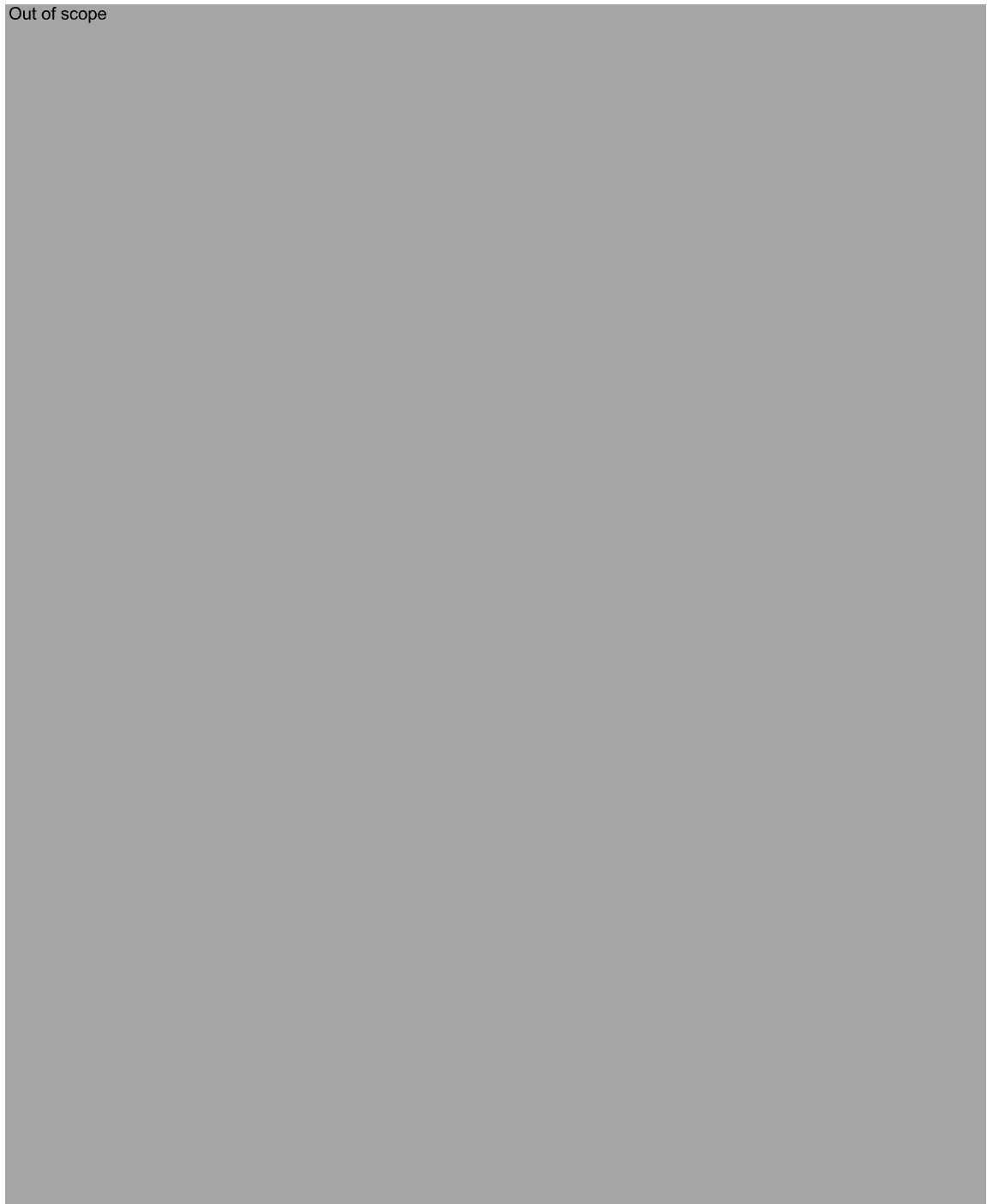
<sup>xi</sup> WSP, "Auckland Rail Programme Business Case" (Final Report, 2023), 9

<sup>xii</sup> WSP, "Auckland Rail Programme Business Case" (Final Report, 2023), 9 [357 cars multiplied by the length of an average car at 4.5 metres generating 1,606.5 metres]

<sup>xiii</sup> WSP, "Auckland Rail Programme Business Case" (Final Report, 2023), 9



Out of scope



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**From:** Angus Hodgson <[Angus.Hodgson@kiwirail.co.nz](mailto:Angus.Hodgson@kiwirail.co.nz)>

**Sent:** Thursday, June 13, 2024 5:20 PM

**To:** Daniel Madley <[Daniel.Madley@parliament.govt.nz](mailto:Daniel.Madley@parliament.govt.nz)>

**Cc:** David mclean <[david@davidmclean.co.nz](mailto:david@davidmclean.co.nz)>; Peter Reidy <[Peter.Reidy@kiwirail.co.nz](mailto:Peter.Reidy@kiwirail.co.nz)>; Ann Webster [TSY] <[Ann.Webster@treasury.govt.nz](mailto:Ann.Webster@treasury.govt.nz)>; Michael Moore <[Michael.Moore@treasury.govt.nz](mailto:Michael.Moore@treasury.govt.nz)>; Albie Murray <[albie.murray@treasury.govt.nz](mailto:albie.murray@treasury.govt.nz)>

**Subject:** RE: Information following last night's meeting

Out of Scope





Out of Scope

- **What exactly is KiwiRail changing?**

- Appreciate this is a difficult question to answer succinctly, and KiwiRail is yet to make certain decisions. Providing a summary of the current initiatives underway would be helpful (as discussed on the phone the intended cost savings between now and September). This also links to question one above – for example, I am not sure if McKinsey has delivered a final report with recommendations to KiwiRail, and if KiwiRail has accepted all of the recommendations, or is in the process of considering some of the recommendations.

Over five years we are aiming to grow through winning customer loyalty. This will be primarily achieved by improving service reliability, customer satisfaction and reviewing our pricing to grow volume and revenue. Cost savings and efficiency gains are required for us to become more competitive.

You asked in particular for information about restructuring resulting in job losses at KiwiRail. Our Transformation Project s9(2)(i) These will come from a range of cost savings initiatives, such as reducing external spend, and lowering our fuel bill. Hiring restrictions, which are already in place for recruitment at some levels of the company, are being applied across all levels, company-wide, in response to difficult trading conditions, weak forecasts and in order to reduce our costs to make ourselves more competitive. The hiring freeze (with some exceptions for critical roles) will not be sufficient to achieve the levels of savings required and there will be a need to disestablish some positions. This will require consultation with our staff and unions, which is expected to start in the coming weeks and will occur in stages, starting in the corporate area.

Out of Scope

Out of Scope



Out of Scope





**Summary of McKinsey transformation support to date**

Time	Phase	Key deliverables	Outcomes
Dec 23 - Apr 24	<b>Full potential assessment</b>	<ul style="list-style-type: none"> <li>Analysis of the historic financial and operational drivers of KiwiRail’s performance (including benchmarking relative to global rail operators) and the momentum case (future trajectory assuming ‘no transformational intervention’)</li> <li>Detailed assessment of full achievable potential across each area of KiwiRail’s portfolio in the next 5 years (considering customer &amp; growth, commercial excellence, operational performance and reliability, capital optimisation) and pathway to achieve financial sustainability for the services business (based on internal and external benchmarks, global rail and functional expert reviews, quantitative analysis, capability assessments, etc.)</li> <li>High level roadmap to deliver the transformation over the next 3-5 years and the near-term interventions required to build the right foundations</li> <li>Assessment on the current capability and the critical gaps required to deliver financial sustainability</li> <li>Assessment of culture, operating model shifts and organisational change required to deliver the transformation</li> <li>Detailed design of the transformation execution governance required, including the metrics / KPIs to be tracked</li> <li>5x full day executive workshops to co-create the full potential assessment with the executive team</li> <li>2x Board briefings on the historic performance and full potential assessment</li> <li>2x workshops with the top 30 senior leaders at KiwiRail</li> <li>Initial union briefing and full day workshop on the outcomes of the assessment</li> <li>Treasury briefing</li> <li>Detailed portfolio review across each of KiwiRail’s businesses (focusing on the freight value chain, Interislander, property, scenic and commuter), including global and local industry trends, KiwiRail’s competitive position and key strategic choices</li> </ul>	<ul style="list-style-type: none"> <li>Full potential plan with detailed levers by business line to achieve financial sustainability and commercial returns for KiwiRail services business by doubling EBITDA over the next 3-5 years, achieving profitability and return on capital in line with comparable global peers</li> <li>Strategic options and preferred business models for each part of the KiwiRail portfolio defined and endorsed (e.g., ILL, Metro, Scenic)</li> <li>Enterprise-wide transformation program designed and stood up (e.g., workstream structure, targets, stock-take and re-prioritisation of current change programs, define valuation approach, program management tracking)</li> </ul>

		<ul style="list-style-type: none"> <li>Financial assessment of different portfolio options and strategic choices and the implications for how to achieve a commercial rate of return</li> <li>1x Board strategy day on the portfolio options</li> <li>Design and launch of the transformation infrastructure (including; workstream structure, targets, stocktake and re-prioritisation of current change programs, define valuation approach, deploy program management tracking)</li> <li>Design and launch of initiatives starting immediately with bottom-up planning (external spend reduction and corporate functions restructure)</li> <li>Initial capability building on transformation essentials deployed for the executive team, top 25 senior leaders and KiwiRail's internal transformation team</li> <li>Onboarding of the Chief Transformation Officer, workstream leads and KiwiRail's internal transformation team</li> <li>Support to develop the immediate cost reduction interventions for FY25</li> </ul>	
<p>May 24- July 24</p>	<p><b>Bottom-Up Planning</b></p>	<ul style="list-style-type: none"> <li>"Bankable Plan" of initiatives that collectively capture the full potential that are co-developed with KiwiRail leaders (9 workstream leads and &gt;100 initiative owners, supported by McKinsey global and local experts, benchmarks and proprietary tools across each business and functional area) and vetted by Finance</li> <li>Detailed sequencing of the initiative plan that considers capability and change readiness while delivering of the financial targets for FY25-27</li> <li>Development of the transformation infrastructure to drive the transformation and build the capability of the KiwiRail transformation team (through coaching and capability</li> </ul>	<ul style="list-style-type: none"> <li>s9(2)(i)</li> <li></li> <li>300+ individual initiatives with 1000+ milestones launched, each with business case and implementation plan, and owned by &gt;100 initiative owners in the business</li> <li>Sequenced implementation plan with a projected impact and investment profile from FY25 to FY27</li> <li>150+ senior KiwiRail leaders upskilled through 20+ core transformation capability building sessions (e.g., communication techniques, KPI design, problem solving, change management)</li> </ul>

		<p>building sessions), including implementation of “WAVE” initiatives and benefits tracking software solution</p> <ul style="list-style-type: none"><li>• Detailed support for the immediate interventions in external spend reduction and corporate functions restructure to delivery short-term financial benefits</li></ul>	<ul style="list-style-type: none"><li>• Business leaders upskilled on core functional skills e.g. contract negotiation approach and tools, pricing, sales planning, product definition</li><li>• Transformation infrastructure established i.e., governance roles, reporting and review cadence and escalation mechanisms</li><li>• SaaS proprietary tool to track and manage the transformation launched and tailored to KiwiRail’s needs (WAVE)</li><li>• Detailed design for select corporate functions completed (e.g., Procurement, People and Communications)</li><li>• External spend taskforce to reduce spend in FY25 set up and operational (focusing on discretionary spend and contract re-negotiations)</li></ul>
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