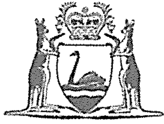

Government of **Western Australia**
Public Transport Authority

Your ref : ....
Our ref : qA124976 ....
Enquiries : 9326 2858....................

16 April 2014

Dr Loraine Abernethie
Principal Research Officer
Economics and Industry Standing Committee
Level 1
11 Harvest Terrace
WEST PERTH WA 6005

Dear Ms Abernethie

PARLIAMENTRY INQUIRY INTO THE MANAGEMENT OF WESTERN AUSTRALIA'S FREIGHT RAIL NETWORK

Please find attached a joint submission from the Public Transport Authority and Department of Transport to the Economics and Industry Standing Committee's Parliamentary Inquiry into the Management of Western Australia's Freight Rail Network.

Yours sincerely

Reece Waldock
CHIEF EXECUTIVE OFFICER

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The Committee has now commenced an inquiry into the whether the current lease arrangements and management of the Western Australian freight rail network comprising Tier 1, Tier 2 and Tier 3 lines facilitate or hamper state development.

In particular, the Committee will investigate:

- *The recent strategic directions and policy decisions relating to the current network lease, particularly in relation to the flow-traffic lines;*
- *The regulatory arrangements in place for the network; and*
- *The management of the network by the Public Transport Authority.*

Submission

The grain rail freight network was developed during a time when in the vast majority of cases there was no practical or viable alternative to the transportation of grain by rail. This changed in the latter part of the twentieth century when large, efficient trucks and an expanded road network became available.

When the State sold the rail freight business (rollingstock and above rail assets) and leased the railway infrastructure to WestNet Rail in 2000, it was recognised that certain lines may not be economically viable and as such a clause was inserted into the Lease that allowed the lessee to surrender certain lines at any time after 17 December 2006 providing specified conditions were met.

It should be noted that had the Lease required the Lessee to resleeper 'Uneconomic' lines then the price the State received for the Lease would have been substantially lower, resulting in less funds available to pay off State debt, which was one of the original objectives of the lease of the rail freight network.

In accordance with clause 16 of the Lease the conditions for the surrender of lines were:

1. there has been a "Significant Reduction in Use" in respect of the Line during a Financial Year other than as a result of Force Majeure or WestNet's breach of the Lease Agreement; <u>and</u>
2. the continued maintenance of all or the relevant part of that Line in accordance with the maintenance obligations in clause 15 of the Lease Agreement would, for the following three years or more, be "Uneconomic"; <u>and</u>
3. WestNet is otherwise capable of performing its obligations under the Lease Agreement even if that Line were no longer used by WestNet.

To demonstrate a "Significant Reduction in Use", WestNet must show the traffic over the Line in the previous financial year as:

a. below 200 000 Net Tonnes, or

b. traffic is less than 50% of the average traffic for that Line during each of the previous three Financial Years.

To demonstrate that future maintenance of a line would be "Uneconomic", WestNet must show that future maintenance costs for that line over a three year period, including capital expenditure such as re-sleepering, would exceed the revenue expected to be derived by WestNet and any related entity (i.e. Australian Railroad Group) from that line.

When Babcock and Brown Infrastructure purchased Australian Railroad Group (ARG) from Wesfarmers Ltd and Genesee & Wyoming Inc and on-sold the above rail freight business to Queensland Rail in 2006, revenue from the above rail operations which was now no longer a related entity of WestNet, was not included in the test for "Uneconomic" maintenance. This made it easier for WesNet to meet the "Uneconomic" component of the surrender tests, should they have elected to do so.

As reflected in the *Report prepared for the Freight and Logistics Council of WA on behalf of the Strategic Grain Network Committee*, the declining use of the grain network and its deteriorating state has been due to market forces shifting the grain freight task from rail to road, and not due to delayed maintenance of the network.

Many farmers have found it cheaper to transport grain by road than by rail. Trucks carrying grain by road do not meet the full costs of the construction and maintenance of the roads. A proportion of these costs are subsidised indirectly by the public through general government spending on the road network, and these costs are not fully recovered from truck freight operators. In comparison, freight carried by rail must meet the full cost of the maintenance and construction of the rail for the rail line to remain profitable.

The transition from the 'single desk' Australian Wheat Board market structure to a deregulated wheat market in 2008 also adversely affected the grain lines. As a result of the newly deregulated environment, in 2009–2010 Cooperative Bulk Handling (CBH) began withdrawing the 'cross-subsidisation' of the storage and transport of grain in marginal areas. CBH had previously charged the same handling/transport price per tonne of wheat for all locations, regardless of the distance the wheat was carried. This change increased the cost of transporting grain by rail from more remote agricultural districts, creating pressure for the grain freight task to move from rail to road in these areas.

In PTA's view, the movement of grain freight from rail to road was inevitable without government intervention, and very difficult to reverse once established. This view has been confirmed by extensive Government led reviews of the grain freight network; the Grain Infrastructure Group (GIG) of 2008 and Strategic Grain Network Committee (SGNC) of 2010 both of which heavily involved industry in arriving at the conclusion that a significant number of grain lines should close.

When WestNet Rail approached Government in 2009 seeking $238million in funding for the resleepering of the grain lines which they stated were uneconomic in accordance with the provisions of the Lease, the Minster for Transport established the SGNC made up of industry representatives and chaired by leading transport expert, Professor Fred Affleck to take a leading role in examining and providing advice and findings on the future of the State's grain rail network and the Government's possible investment in it.

The SGNC consisted of members from the following organisations:

- Strategic design+Development.
- Pastoralists and Graziers Association.
- WA Farmers Federation.
- WA Local Government Association.
- CBH Limited.
- WestNet Rail.
- Australian Railroad Group.

- Public Transport Authority.
- Department of Transport, WA.
- Department of Agriculture, WA – Grains Industries.
- Dept of Infrastructure, Transport, Regional & Local Government, Commonwealth (DITRLG).
- WA Treasury and Finance.
- Main Roads WA.
- Industry Association.
- Office for the Minister of Transport.

In December 2009 the *Report prepared for the Freight and Logistics Council of WA on behalf of the Strategic Grain Network Committee* (SGNC Report) was finalised. The executive summary of that reports states:

1. *The grain sector produces an average 11 million tonnes per annum, with 90% of production destined for export markets. Rail transports around 60% by volume and 80% by net-tonne-kilometres, but its share is falling, as road transport is being increasingly used in some areas.*
2. *Deregulation of export grain marketing arrangements has allowed CBH to manage the entire export supply chain on behalf of traders using its facilities. CBH uses road and rail services to move grain to port at lowest possible cost. New entrants into logistics markets will be similarly motivated. Network based pricing has been abolished in favour of bin-pricing which will accelerate change.*
3. *Resleepering needs to be done every 10-15 years on all lines. Much of the rail network serving the grain industry is due for re-sleepering over the next three years and the WA Government will need to fund the capital works, at a potential cost of $258 million for all current lines.*
4. *However, in some areas, notably the Kwinana South zone, rail services are unsustainable as they are uncompetitive with road transport, and under all plausible scenarios this will continue. Therefore the low quality track on which they operate does not warrant resleepering investment. This would save costs for resleepering of $94 million. The SGNR has found that cessation of rail services is likely to occur on several lines in this area (Quairading, Kulin, Kondinin, Corrigin and Yealering). This will also create a need for targeted investments for road upgrading to handle many new truck movement.*
5. *To keep the Kwinana South zone grain on rail via loading at Brookton and other key sites, some public investment will be needed at these CBH sites to improve rail efficiency (for longer sidings and fast train loading - estimated cost $15m).*
6. *Some short term operating support (estimated $16m over 7 years) will be needed to ensure rail services are commercially competitive with road. The most appropriate vehicle for this support is to enable reduction in WestNet Rail access charges. Without this support, there will be no incentive for exporters to choose rail over trucking to Kwinana for up to 1 million tonnes per year. This operating support is offset by up to $4million per annum savings in real externality costs.*
7. *Rail transport operations are commercially viable in the Albany and Kwinana North zones, but a $164m contribution will be needed for resleepering . In the Geraldton zone, grain freight shares network costs with other freight (e.g. iron ore), and no public contribution will be needed. No other line closures are recommended at this stage.*
8. *Rail can be viable going forward if Government meets resleepering costs, and its competitiveness will increase as diesel fuel and carbon costs increase in future.*
9. *Investment in road corridor upgrades worth up to $320m would complement the long term rail network including roads not fit for purpose for use by heavy grain haulage trucks, most notably the*

Chester Pass Rd into Albany. Some of these roads will be impacted by cessation of uncompetitive rail services on lines which will consequently be redundant and should be formally closed.

10. *The heavy vehicle permit system should be fully reassessed so that large combination vehicles hauling grain from bin to bin and bin to port are permitted on a limited number of routes, concentrated in areas not served by rail. This will have an immediate effect in reducing road maintenance costs. CBH and WALGA should be engaged as active partners in this process*

In relation to the Tier 3 lines the report stated: '*There is no sound business case for upgrading the Tier 3 lines, as transport of grain will be cheaper by road regardless of rail upgrading; these will soon cease to operate*'.

It should be noted that the findings of the SGNC Report was generally in line with the findings of the earlier 2008 GIG Report, a four year investigative process which included industry and whose recommendations were not enacted. The findings of the GIG Report were:

- *in the past, the grain rail freight business has been a marginally viable operation providing below average commercial returns. If the current supply chain arrangements continue, there will be little incentive for the below rail operator to invest in long term track infrastructure;*
- *changes in the grain market have resulted in further weakening of the rail freight system as an increased share of freight is being diverted to the road sector. This has been facilitated by the "un-level playing field" that exists in road and rail pricing whereby the marginal cost of road use is substantially lower than the price paid by the user;*
- *a sustainable rail system will require one or more of the following:*
  - *some rail network rationalisation and branch line re-sleepering;*
  - *road network investment;*
  - *upgrading of rail and grain receival and rail loading infrastructure; and*
  - *subsidisation of some current rail services;*
- *regardless of which rail closure scenario is adopted, $400m is required over the next five years for investment in transport infrastructure (rail, road and rail loading) with $200m for rail re-sleepering required in the next three to five years; and*
- *a $400m investment to upgrade local and State roads is also required, bringing the total farm gate to port supply chain package to $800m over the next 10 years.*

The SGNC Report was also generally in line with the 2004 ARG/CBH Grain Network Review (GNR), which recommended the closure of 1000km of rail line including all of the Tier 3 lines as well as some more heavily trafficked lines.

On the basis of the SGNC Report and a subsequent Business Case, the State and Commonwealth Governments approved $187.9million for the resleepering of the Tier 1 and 2 grain lines, which has been substantially completed (all resleepering works completed with full completion including clean up and defect liability period scheduled for May 2014) some $26million under budget, notwithstanding the Brookton and Kellerberrin siding upgrades were not undertaken.

Had WestNet Rail been required to fund the resleepering of these lines they would have had to increase rail access fees to recover the cost of those works. This would have resulted in a significant proportion of the volumes of grain that are carried on those lines transferring to road together with a loss of the

benefits (externalities) that rail transport provides. This would then have resulted in a 'Significant Reduction in Use'.

Had the Government relied on the strict interpretation of the Lease and waited until both the 'Significant Reduction in Use' and 'Uneconomic' requirements of the Lease were met, then the large volumes of grain that are carried on those lines would have transferred to road well before a decision could have been made by Government whether to terminate the Lease in respect of those lines, or propose the payment of moneys to WestNet Rail so that maintenance of those lines was not Uneconomic.

Had the Government terminated the Lease in respect of those lines, then given the Tier 1 and 2 lines are critical transport infrastructure, not only would the Government have then been required to resleeper those lines, but they would also have had to operate those lines or find another lessee to do so.

Similarly, in 2004 the Government took the view that the Lessee's request to defer the completion date for the Grain Line Strengthening Plan as required by the Lease should be approved.

The 2004 deferral followed an in depth analysis of the matter by PTA personnel together with an audit of the condition of those lines by an independent expert and extensive consultation with all relevant stakeholders including the Rail Access Regulator, grain industry and the Rail Safety Regulator prior to approval by the Minister and Cabinet.

This deferral resulted in the $16.5 million that was to be spent on unsustainable and uneconomic lines that have or are shortly due to be withdrawn from service, being spent on Tier 1 and 2 lines instead; this is a much better outcome than would have been achieved had the Government implemented the requirements of the Lease without question.

The Government also took a pragmatic approach to the ongoing responsibility and management of Tier 3 lines that go into 'Care and maintenance'.

Given the grain industry through the SGNC Report had determined that '*There is no sound business case for upgrading the Tier 3 lines, as transport of grain will be cheaper by road regardless of rail upgrading; these will soon cease to operate*' and there was a potential ongoing cost to the State of approximately $2million per year to keep the Tier 3 lines in 'Care and maintenance' together with the associated liability, the Government determined that it was better for the Tier 3 lines and all associated costs and liabilities to remain with the Lessee for the duration of the Lease rather than transfer to the State.

As to the ongoing management of the leased railway infrastructure by the PTA, in addition to the day to the scheduled and day activities related to the management of the Lease, the PTA holds quarterly meetings with executives from Brookfield Rail and the Department of Transport to ensure that the requirements of the Lease and the strategic requirements of the State in relation to the leased rail freight infrastructure are being met.

Additionally, where the State funds a project on the leased rail freight infrastructure, such as the resleepering of the Eastern Goldfields Railway in 2007 and the recent Grain Line Resleepering Project, a Project Control Group is formed and monthly meetings are held with the Lessee to go through a detailed monthly report on the status of the project and feedback from monthly inspections of the works by the PTA, to ensure the best outcome for the State.

Summary

The viability of the grain freight lines has been the subject of several studies and reports over the years with the most recent being the SGNC Report. Earlier reports provided clear recommendations/views that some lines should close and others required investment; generally Governments have not acted on the recommendations of these earlier reports.

The SGNC Report was the result of a comprehensive review into the grain freight network by all major stakeholders in the grain industry, who agreed (at the time) to the recommendations of the report which have now been largely implemented.

In relation to the Tier 3 lines, the grain industry itself, through the SGNC Report had determined: *'There is no sound business case for upgrading the Tier 3 lines, as transport of grain will be cheaper by road regardless of rail upgrading; these will soon cease to operate'*.

While there have been changes in the grain industry in WA since the SGNC Report was finalised, such as CBH purchasing its own rollingstock, as per the Minister for Transport's media release of July 2011: *There has not been a compelling case for the retention of the Tier 3 lines and therefore the Government is not prepared to change an investment of more than $100million from roads to re-sleepering of the Tier 3 lines.*

The closure of the Tier 3 lines is not only the result of market forces and the commercial realities of the grain rail freight business but it is in line with the findings of several reports into the grain freight network since 2004. Indeed there is still nothing preventing CBH and Brookfield Rail from negotiating an outcome to keep these lines open.

Importantly, at the time the freight network was leased in 2000, it was expected that certain lines may not be economically viable and as such a specific clause was inserted into the Lease to provide for that eventuality.

Whether the current lease arrangements of the Western Australian freight rail network comprising Tier 1, Tier 2 and Tier 3 lines facilitate or hamper state development should be considered in the context that any changes to the Lease would in all likelihood come at a substantial cost to the State.

The management of the Western Australian freight rail network by the PTA is best judged by the current status of the rail freight network today that in all respects, except the Tier 3 lines which have succumbed to market forces and commercial realities, is in a far better state that when it was leased in 2000.

All strategic directions and policy decisions relating to the current network lease have been the result of extensive research, analysis and consultation prior to approval by either the Minister of the day or Cabinet to ensure the best outcome for the State.