Submission to the Economics and Industry Standing Committee

Inquiry into whether the current lease arrangements and management of the Western Australian freight rail network facilitates or hampers state development.

April 2014

EXECUTIVE SUMMARY

Rail freight is one of the key enablers for the efficient operation of the Western Australian grain supply chain. Any restrictions or limitation in track performance creates significant issues for Western Australian grain growers to supply their international markets.

The Western Australian Grain Freight Rail Network (“WAGFRN”) is plagued with a range of issues such as axle weight limits and speed restrictions to the extent that the CBH Group (“CBH”) now has significant concerns that the current approach to management by Brookfield Rail is neither sustainable nor is it best serving the interests of Western Australia’s $3-4 billion grain industry.

These concerns are based on a range of factors:

- The division of the freight carriage and network infrastructure parts of the WAGFRN diverged from the originally intended vertically integrated’ model. Whereas profits from below rail operations (arising from access fees paid by above rail users) were once reinvested into ongoing development of the below rail asset, today are being returned to shareholders as dividends;
- Aside from plans to close the Tier 3 lines, Brookfield Rail has in recent months announced a range of operational restrictions to the Tier 2 Miling line. These have caused considerable concern throughout regional Western Australia and a number of key stakeholders have joined CBH in questioning what other parts of the WAGFRN are to be closed;
- Despite Government committing $164.5 million to fund required track maintenance, there are currently over 750 separate speed and mass restrictions placed on Tier 1 and Tier 2 line sections which hinder effective supply chain operations;
- Brookfield Rail has recently proposed a significant increase in access fees despite plans to close around 800 kilometres of track (which CBH estimates would provide considerable annual maintenance savings to Brookfield Rail);
- WAGFRN performance standards are decreasing while access fees are increasing. Western Australian grain growers are currently paying around 4 times what growers in eastern Australia pay for track access (that have higher speeds/mass);
- Freight rates in Canada and USA are 30-50 per cent lower than Western Australia. Despite this, Brookfield Rail are advocating to further increase access fees; and
- Brookfield’s management of the WAGFRN coupled with confidential Lease arrangements and less than effective oversight has created precisely the monopoly environment that the original regulatory structure was seeking to avoid.

It is unacceptable to the Western Australian grain industry that the operator of the WAGFRN is able to let the below rail asset to deteriorate to a point where it doesn’t serve the economic interests of the State or the commercial requirements of the users.

Given these concerns, this submission makes a range of comments and recommendations for change to the way in which the WAGFRN is managed, how this management would be more appropriately overseen and how key users of the rail asset must have a greater say and influence into ongoing maintenance and performance including:

- To clarify the meaning and intended operation of clauses regarding ‘fit for purpose’ and that rail performance standards should meet the ongoing requirements of above rail users;
- Addressing flawed pricing methodology that sets floor and ceiling price on “gross replacement value” (that could see growers charged $110 million per annum) and that provides a greater provision for a direct correlation between access fees and below rail performance;
- That Government consider ways it may reintroduce the surrender provisions contained in the original Lease that obliged Brookfield Rail to “surrender to Government” those line sections that it no longer chooses to operate (such as Tier 3 Line sections and the Tier 2 Miling Line);
- For third parties to be given the opportunity of operating those line sections that the lease holder (Brookfield Rail) chooses not to operate;

- Developing a collaborative approach to overseeing management of the WAGFRN which incorporates input from key above rail users in planning and prioritising maintenance and line upgrades into the future; and
- Increased transparency such as the terms and conditions of the Lease between Brookfield and the Western Australian State Government to be made public.

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1.0 INTRODUCTION

On 12 March 2014, the Economics and Industry Standing Committee resolved to inquire into and report on whether the current lease arrangements and management of the Western Australian Grain Freight Rail Network ("WAGFRN") comprising Tier 1, Tier 2 and Tier 3 lines facilitate or hamper state development.

In particular the Committee confirmed it would investigate:

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

1.1 CBH's view

For some time now, the CBH Group ("CBH") has been growing increasingly concerned that the current approach to management of the WAGFRN by Brookfield Rail is not sustainable. CBH is therefore strongly supportive of the inquiry initiated by the Economics and Industry Standing Committee.

In recent years, CBH has been persistent in its view that:

- There is a need for increased and effective statutory or regulatory oversight into the performance of Brookfield Rail from the Department of Transport ("DoT") and the Public Transport Authority ("PTA");
- Despite CBH now pursuing an access agreement with Brookfield Rail under the Railways Access Code (2000), considerable change is required to the Code to ensure that it provides a more appropriate regulatory framework governing oversight of the WAGFRN. This would include addressing the current flawed pricing methodology, providing a greater provision for a direct correlation between access fees and below rail performance and ensuring a more suitable definition of the term "fit for purpose";
- Aside from plans to close the Tier 3 lines, Brookfield Rail has in recent months announced a range of operational restrictions including the speed and weight limits on other sections of the WAGFRN such as the Tier 2 Miling line. This has caused considerable concern throughout regional Western Australia and a number of key stakeholders have joined CBH in questioning the manner in which the entire WAGFRN is being operated;
- Despite Government committing $164.5 million to fund required track maintenance, there are currently over 750 separate speed and mass restrictions placed on Tier 1 and Tier 2 line sections which hinder effective supply chain operations;
- There is a need for increased transparency including the terms and conditions of the Lease between Brookfield and the Western Australian State Government being made public;
- As highlighted in the January 2013 report by the State Auditor General, the division of the freight carriage and network infrastructure parts of the WAGFRN diverged from the 'vertically integrated' model chosen by the original Sale and Lease Taskforce. This change meant that the lessee of the rail network no longer received profit from related entities carrying freight over those lines (with those funds no longer available for reinvestment into the below rail asset);[1] and
- There is a pressing need to address the various issues raised in the State Auditor General's 2013 Report regarding deficiencies in the management and lease of the WAGFRN.

1.2 The importance of the WAGFRN

The efficient operation of the WAGFRN including Tier 3 line sections forms a critical component of the grain supply chain helping to ensure Western Australia grain growers remain internationally competitive.

[1] Western Australian Auditor General: Management of the Rail Freight Network Lease: Twelve Years Down the Track January, 2013.

Grain growers are facing increasing competition in the international market place. Regions such as the Black Sea, that operate from a very low cost base (often almost half that of the input costs incurred by Western Australian growers) means that our farmers more than ever need access to the most efficient supply chain possible.

This is not just about growers being a little more profitable, but in many cases ensuring their ongoing viability and survival.

Knowing this, the CBH Group recently made an unprecedented $175 million investment into rolling stock to enhance above rail operations, part of the co-operative's ongoing commitment to create a more efficient in-land supply chain that can meet the shipping demand of Western Australia's international grain customers.

However the current management and operation of the WAGFRN is making the realisation of any efficiency generated in above rail operations problematic.

With access payments to Brookfield constituting in excess of 40 per cent of rail supply chain costs (currently around $40 million annually) and with track performance in perpetual decline, the prospect of Brookfield Rail continuing to exert such ongoing and considerable control is simply not sustainable for the growers of Western Australia or the State's $3-4 billion grain industry.

2.0 BACKGROUND – CBH GROUP

CBH is a unique organisation with a history almost as long as the grain industry it serves. The co-operative's commitment to maintaining a partnership with its Western Australian grain grower members has helped build an industry that has been the backbone of the State's rural economy since the beginning of the bulk handling system in 1933.

This partnership has also been the basis of CBH's strength and success.

CBH has constantly evolved, innovated and grown with operations today extending along the value chain from grain storage, handling and transport to marketing, shipping and processing. Now Australia's biggest co-operative and a leader of the nation's grain industry, CBH is controlled by 4,200 Western Australian grain growers.

The co-operative exists for their benefit and the advancement of the grain industry in Western Australia.

2.1 Current access arrangements to the WAGFRN

CBH has been in extensive, "in good faith" consultations with Brookfield Rail to reach an acceptable commercial arrangement to replace the current rail access agreement which expires in June 2014. Negotiations have focused around CBH achieving satisfactory access to train pathways, to ensure that general performance standards of the track are maintained and that access fees charged by Brookfield Rail are reasonable to the extent that the grain supply chain in Western Australia can remain competitive with other international origins of supply.

Despite four months of consultations, CBH and Brookfield Rail were not able to reach common ground in any of these key areas and it is considered highly unlikely that agreement can be reached by direct commercial negotiation. As an example, Brookfield Rail has proposed a significant increase in access fees despite exhibiting little commitment to addressing the large number of track restrictions it has imposed on the Tier 1 and Tier 2 line sections along with plans to close around 800 kilometres of track (which CBH estimates would provide considerable annual maintenance savings to Brookfield Rail).

CBH therefore took the decision to achieve an access agreement within the Rail Access Code (2000) overseen by the Economic Regulation Authority ("ERA").

In a broader context, it would appear that Brookfield Rail is seeking to operate the WAGFRN only if it can make monopoly profits on behalf of its shareholders while CBH (and the growers of Western Australia) as users of the track are seeking the most efficient and effective network possible (with a reasonable rate of return to the track operator).

It has become increasingly obvious that these two objectives are mutually exclusive.

3.0 THE RECENT STRATEGIC DIRECTIONS AND POLICY DECISIONS RELATING TO THE CURRENT NETWORK LEASE, PARTICULARLY IN RELATION TO THE LOW-TRAFFIC LINES

3.1 The separation of above and below rail

CBH understood that the sale of Westrail in December 2000 to the consortium of Wesfarmers and Genesee and Wyoming (G&W) was to be a “whole of business” transaction with the above rail operation to be sold “freehold” (including all yards, depots and workshops) and the below rail business “leasehold” (on a 49 year lease).

Despite State Government intentions to maintain the business as a single above/below rail entity, in 2006 Wesfarmers Genesee & Wyoming took the decision to sell the Westrail business, splitting the rail assets into two. The above rail operations and rolling stock were sold to Queensland Rail National operating as “ARG” (now known as Aurizon) and the below rail (track lease) business sold to Babcock and Brown, (as WestNet Rail Infrastructure).

It is understood that following the 2008 Global Financial Crisis, Babcock and Brown went into receivership and was acquired by Prime Infrastructure. Prime Infrastructure (operating the below rail asset as WestNet Rail) was in turn acquired by Brookfield Infrastructure; part of the Canadian based Brookfield Asset Management Group. In 2011, WestNet Rail formally became known as Brookfield Rail.

While specific details remain private and confidential, given the considerable deterioration in track performance, it appears WestNet invested very little in maintenance to such an extent that in 2011, and after protracted debate, the State and Federal Governments agreed to fund necessary cyclical resleepering works (it being WestNet’s view that it was not liable to meet the cost of capital maintenance).

At the time of the 2000 sale, 30 million tonnes of freight were being transported across the network annually. In 2006, this figure was estimated to be closer to 56 million tonnes with growth over the next 2 years projected to take annual freight to over 80 million tonnes of freight across the network by 2016.[2]

As highlighted in the January 2013 report by the state Auditor General: Management of the Rail Freight Network Lease: Twelve Years Down the Track, the division of the freight carriage and network infrastructure parts of the rail freight business diverged from the ‘vertically integrated’ model chosen by the original Sale and Lease Taskforce. This change meant that the lessee of the rail network no longer received profit from related entities carrying freight over those lines (with those funds no longer available for reinvestment into the below rail asset).

Similarly, terms of sale and separation of above and below rail operations has created further challenges in removing the potential for flexibility in usage of rail yards and terminals. These key assets which would normally provide critical capacity for rolling stock to be “stabled”, provisioned or reconfigured into larger/smaller consists are in the hands of either Brookfield Rail or Aurizon (who have no interest in assisting each other or competing above rail providers) leaving little to no “common user” rail infrastructure to locate those rail assets not currently in use.[3]

3.2 CBH’s fundamental concerns regarding the sustainability of the WAGFRN

It is CBH’s very strong view that this divergence is one of the major factors in Brookfield’s claims that the Tier 3s are no longer viable and why CBH holds grave concerns for the long-term viability of the entire WAGFRN.[4]

Brookfield Rail has intentions to close the Tier 3 line sections on 30 June, 2014 and has in recent months announced a range of operational restrictions including the speed and weight limits on other sections of the WAGFRN including the Tier 2 Miling line (along with the existing unresolved operational restrictions that Brookfield Rail has in place throughout Tier 1 and Tier 2 line sections). This has caused considerable

[2] Western Australian Auditor General: Management of the Rail Freight Network Lease: Twelve Years Down the Track January, 2013.
[3] Brookfield Rail is endeavouring to place “parking / stabling” charges on CBH if a train has to park up in a load loop/siding.
[4] It is important to make the distinction given Brookfield’s suggestion that the lines are not viable. CBH would contend that operating the Tier 3s is certainly “viable”, just not profitable to the extent of Brookfield’s targeted return on capital.

concern throughout regional Western Australia and brings into question the manner in which the WAGFRN is being operated.

This planned closure of the Tier 3s and the various operational restrictions throughout the rest of the network provides a graphic illustration that the current approach to managing the WAGFRN (the Tier 1s and Tier 2s) is not sustainable; performance standards are decreasing while access fees are increasing. For example:

- Below rail track access constitutes 40 per cent of a growers' freight costs with average access $7-8 per tonne across Western Australia;
- Western Australian grain growers are paying around 4 times what growers in eastern Australia pay for track access (that have higher speeds/mass);
- As an example, the Beacon to Burakin line section, despite being re-sleepered as part of the recent Government funding package still only allows for 30km/h operations for full trains;
- Freight rates in Canada and USA are 30-50 per cent lower than Western Australia; and
- Despite plans to close around 800 kilometres of track, Brookfield Rail has proposed a significant increase in access fees.

Brookfield Rail has indicated that they are willing to continue operating the Tier 3s but only with a substantial injection of capital from the Western Australian State Government of in excess of $90 million. Even with this injection (and further increases in access fees) given recent trends, CBH fears that the result will be deteriorating track conditions and rail performance without any long-term sustainability.

3.3 SGNR and the decision to close Tier 3 line sections

The CBH Group was a willing and active participant in the Strategic Grain Network Committee's (on behalf of the Freight and Logistics Council of Western Australia) December 2009 report into the Strategic Grain Network Review ("SGNR"). At the time, the co-operative articulated "in principle" support for the report's main recommendation that future investment into the network should be undertaken in line with the longer term competitiveness of each particular line section (along with the classification of the plan for three tiers of line section categories).

This was over and above the report's primary recommendation to fund and undertake re-sleepering maintenance on the Tier 1 and 2 line sections (of $164.5 million) and upgrading road infrastructure adjacent to Tier 3 line sections, which would be scheduled for closure (saving an estimated $93.5 million in required rail investment).

When the value of all lines in the grain freight rail network was considered by the SGNR committee, it was noted that "*under no plausible circumstances could Tier 3 line investment be justified*." However these evaluations and statements were all based on the less than optimal input, data and operating models used by ARG (now Aurizon) and WestNet Rail (now Brookfield Rail).

In 2010/11, following CBH's decision to appoint United States based Watco Companies Group to undertake above rail operations on its behalf and to invest $175 million in new rolling stock (locomotives and wagons), it was considered many of the SGNR costings should be reviewed on the basis that CBH's new operating model for above rail operations will have fundamentally changed the original assumptions.

Despite the CBH Group's initial in principle support for the SGNR report, the changes and developments that have taken place in the Western Australian grain industry (arising out of CBH's above rail investment) are of such significance that they contradict some of the SGNR's key findings. Some of these developments since December 2009 include:

Locomotives

- CBH invested in new locomotives which deliver higher horsepower, with more efficient tractive effort than the old ARG grain locomotive fleet (which has an average operational age of over 35 years);
- These new locomotives provide considerable improvements in reliability, fuel savings, higher grain hauling capabilities and modern technologies that can greatly reduce train operating costs (e.g. auto stop/start - reduces idling costs over the old ARG grain fleet especially in the Merredin Feeder Line operations where the oldest and least reliable locomotives have historically been used);

- CBH have purchased three classes of locomotives to operate on the network in Western Australia standard gauge, plus two types of narrow gauge locomotive. The locomotives that will run on all 16 tonne per axle rated line sections, including the Tier 3 lines, will have a maximum axle loading rating of 17.33 tonnes per axle (note that this is the same maximum mass as a current concession that Brookfield has granted ARG to operate the “P” class locomotive across the network today, and has been in place for the last 20 years); and
- Locomotives are built to US Tier 2 emission standards and will reduce the future impact of carbon pricing on CBH growers compared to both ARG’s higher polluting fleet and competing road transport alternatives.[5]

Wagons

- CBH have purchased state of the art wagon technologies including auto-hatch and discharge doors creating a safer and faster discharge unit over the current wagon fleet. The previous ARG Merredin Feeder lines’ wagon fleet utilised old converted coal wagons (XNW class), which only have a wheat payload of 38 tonnes per wagon;
- CBH’s narrow gauge wagons are new aluminium wagons with a wheat payload of 47 tonnes – a 21 per cent payload increase from the old ARG XNW wagons;
- The CBH wagons have a cubic capacity that would allow loading up to 19 tonnes per axle if capacity permitted;
- The CBH wagons are shorter in length allowing for a greater number to be loaded at many of the length restricted sidings; allowing more wagons, each with their greater capacities, resulting in significantly more tonnes per trip and at a reduced cost; and
- Testing of the wagons has shown significantly reduced track wear through improved design, therefore enhancing the rail network and reducing the need and costs for maintenance.

Two years on and with the introduction of such a considerable innovation in above rail operations, it is considered that the conclusions of the SGNR are no longer valid as they are based on out of date assumptions.

3.4 Current opportunity regarding the Tier 3s

CBH has said on a number of occasions that:

- It is simply unacceptable that the below rail operator can “lock away” the Tier 3 rail track on the basis of Government funding not being available and that Brookfield can’t generate a monopoly profit;
- The co-operative’s overwhelming preference is to keep grain on rail and will utilise the Tier 3s if they are presented for use in an appropriate state, and that the access fees charged by Brookfield Rail make the asset competitive to use;
- Closure of the Tier 3s would strand millions of dollars of CBH’s key supply chain infrastructure such as rapid rail loading facilities at Kulin and Quairading; and
- With Tier 3 line sections scheduled for closure on 30 June, 2014, the growers of Western Australia desperately need a lasting and sustainable solution that can ensure their continued operation, not merely a stop-gap proposal by Brookfield Rail’s for extra Government funding every few years.

CBH considers that to operate the Tier 3s into the future, it is critical that they are managed differently and as a function of the proposed freight task. On this basis, CBH has developed an alternative approach that can sustain operation of the Tier 3 assets in a condition that achieves an acceptable and sustainable level of service and safety, while minimising maintenance costs throughout the asset’s useful life.

This approach provides a long-term solution for the continued operations of the Tier 3s as a vertically integrated network with open access to all above rail users.

[5] CBH notes the Federal Government’s intentions to abolish the Carbon Tax.

By contrast, Brookfield's continued management of the Tier 3s will require a frequent "re-injection" of funds from Government as profits generated from track access are returned to shareholders rather than reinvested into track performance.

3.5 Surrender provisions

The opportunity for a lasting and sustainable solution for the continued operation of the Tier 3s has been hampered by an apparent decision to remove the provision contained in the original Lease that obliged Brookfield Rail to "surrender to Government" those line sections that it no longer chooses to operate (such as Tier 3 Line sections and the Tier 2 Miling Line at the end of 2015).[6]

Unfortunately and as outlined by the Auditor General *(Page 9):*

> *"…Limited information is available to Parliament and the public regarding the lease of the network or its condition. The lease and its variations have not been tabled in Parliament, and no regulatory agency reports publicly on the condition of the network or its use."*

CBH would contend that this represents a serious issue in terms of oversight and would urge the Western Australian State Government consider ways to reintroduce the provision that would enable it to "take back" those line sections Brookfield are choosing not to operate.

The Auditor General goes on to stipulate (Page 35):

> *"Placing the lines into care and maintenance while leaving them with the current lessee potentially obstructs prospective new operators from entering the market. This also benefits the lessee by reducing the likelihood of competition while allowing the lessee to retain the right to future economic benefit from disused rail line corridors. The uncertainty over whether the market can provide an alternative viable operator can only be fully resolved by testing the market, which PTA has not formally done. However, it has received unsolicited approaches."*

Given Brookfield's desire to close the Tier 3s, and the benefit operating those line sections could mean for the growers of Western Australia, CBH has sought (on several occasions) to reach an agreement with Brookfield for CBH to take on the operation of the Tier 3s by way of:

- Leasing the Tier 3 line sections direct from Brookfield (with the understanding that a sub-lease arrangement would require the imprimatur from the State Government);
- Leasing the Tier 3s from Government (on the basis of Brookfield surrendering those line sections to the Western Australian State Government); and
- An arrangement whereby CBH would operate the Tier 3 line sections on behalf of Brookfield.

Brookfield Rail has rejected all of these proposals.

4.0 THE REGULATORY ARRANGEMENTS IN PLACE FOR THE NETWORK

CBH would contend that the current lease arrangements hamper state development for a range of reasons as outlined below.

4.1 The terms and conditions of the Lease remain confidential

CBH, like the vast majority of key stakeholders are not, and have never been, privy to the Lease between Brookfield Rail and the Western Australian Government. As such, CBH is obliged to rely upon comments made by the Western Australian Auditor General in its January 2013 report which articulates a range of issues with the Lease and its management by the Public Transport Authority ("PTA").

[6] Note that given that the terms and conditions of the Lease between Brookfield Rail and the Western Australian State Government remain confidential, CBH has no means of confirming that this provision has been removed.

Indeed the Auditor General was pointed in its concern regarding the inherent silence on details of the lease where it stated (page 24):

> *"Parliament has had limited information regarding the condition of the network, partly because PTA is bound by a broad confidentiality clause in the lease, and partly because little information is required to be or has been made public by the other agencies with regulatory responsibilities in this area. Although Parliament has been partially informed about lease terms and conditions through various Ministerial statements, a full copy of the lease and subsequent agreements modifying the lease has never been tabled in Parliament, and only the first five-yearly track condition report in 2005 has been tabled."*

CBH would argue that it is simply unacceptable that the community is not able to access a document that outlines the way in which a key public asset is to be used, maintained and offered to users. It is CBH's view that transparency is required when dealing with public assets, particularly when those public assets are managed by commercial entities. As is the case with other Government contracts (such as Serco's contract to manage the new Fiona Stanley Hospital) these contracts must be fully disclosed to stakeholders.[7]

4.1.1 The Lease is not protecting the ongoing condition of the WAGFRN

Despite intentions that at the conclusion of the lease period, the WAGFRN is handed back to the Western Australian State Government in an appropriate "fit for purpose condition", the State Auditor General suggests (Page 6):

> *"The lease of the rail freight network was set up to do a number of things… It was also intended to ensure that the State's asset is maintained and handed back in a fit for purpose condition, and to allow the State to pursue its policy objectives and protect its interests, particularly where those may diverge from the operator's commercial interests.*

Further comments by the State Auditor General (page 7):

> *"The condition of the narrow gauge lines used primarily for carrying grain has degraded. The 'grain lines' have required substantial government funding to remain in service. Two of the uneconomic 'Tier 3' grain lines have been placed in care and maintenance, and without further government funding, the remaining eight are likely to be taken out of service after 2013."*

CBH would suggest that on present operations, the WAGFRN is certainly not of the same standard as when the lease period commenced in 2000 and that there is a requirement:

- To give further consideration whether the current model for management of the WAGFRN is sustainable and whether change may be required; and
- For Government (and the PTA) to adopt a collaborative approach by consulting with above rail users in order to define a more appropriate, less ambiguous "fit for purpose" standard for each line section.

4.1.2 Managing the lease with the envisioned "light touch" has not worked

As outlined by the Auditor General (page 9):

> *"The lease anticipated a relatively 'light touch' role for government in managing the lease, which is appropriate given the State's original objectives. The State retains a range of risks related to market conditions, the lessee's commercial interests, and the policy of the government of the day. These risks require proactive monitoring and management.*
>
> *Available documentary evidence indicates that an additional $400 million investment commitment was made by the successful bidder during the tender process, but this was not incorporated in the lease. There is no clear record of why.*
>
> *PTA has not had a contract management plan in place for the lease and has not yet completed a structured risk assessment, or formalised its ongoing objectives for the lease. This increases the risk that reactive decisions in response to individual issues may adversely affect the State's interests over the remaining 37 years of the lease."*

[7]- http://www.serco-ap.com.au/media/46101/facilities_management_services_contract.pdf

Given these statements, CBH would suggest that there is a requirement:

- For Government to investigate why this $400 million investment commitment was not included in the amended Lease and provide stakeholders with an appropriate explanation regarding why this occurred;
- To understand why a physical track inspection and audit of the track was undertaken in 2005 but not 2010. Why was this oversight allowed to occur and when will this inspection be undertaken and the report tabled; [8] and
- To consider what changes are required to ongoing oversight of the Lease that would assist the PTA to ensure the WAGFRN does not continue to degrade.

4.1.3 Unclear definition of "fit for purpose"

Similar to those issues raised in section 4.1.1, CBH has concerns that the Lease definition of "fit for purpose" is not satisfactory and that the attendant ambiguity created is jeopardising the state and performance of the WAGFRN.

The State Auditor General raised similar concerns (Page 9):

> *"The lease contains 'fit for purpose' performance standards that are intended to ensure the network remains in the condition required by the State and by users of the network. There are a number of possible interpretations of 'fit for purpose' as used in the lease. Based on internal legal advice, PTA has interpreted the lease so that the only usable standards are the Initial Performance Standards, set at year 2000 levels. This is a substantial reduction of the 'fit for purpose' obligation, as it does not include the requirement to meet the needs of rail users or reflect changes in rail technology. This increases the risk of a gap emerging between the required standards and the needs of rail users, and the risk that at the end of the lease in 2049 the network will be required to be in essentially the same condition it was in 2000."*

Further comments from the State Auditor General (page 10):

> *"The lease anticipates a review of performance standards every five years across the network, seeking to ensure that the standards remain in step with market needs and changing technology. The use of this mechanism is constrained by PTA's interpretation of 'fit for purpose', risking a situation where the five yearly track condition reviews assess the condition of the network against out-dated requirements."*

CBH would suggest that there is a requirement:

- For Government to consider whether it is comfortable that the licensee appears able to let the WAGFRN asset deteriorate to a point where it doesn't serve the State's interests or the commercial requirements of the users;
- To clarify the appropriate accounting method for applying costs to 'uneconomic' lines;
- To clarify the meaning and intended operation of clauses regarding 'fit for purpose' and the related adjustment of rail performance standards that would ensure standards stay up to date. This process should be undertaken with both the operator and above rail users of the WAGFRN; and
- For the PTA as part of the contract management plan, consider and formulate a strategy in relation to end of lease issues.

4.1.4 A lack of transparency in the management of the WAGFRN

CBH has a range of questions and concerns regarding the manner in which Brookfield Rail undertakes management and maintenance on the WAGFRN.

The Auditor General stated that (page 11)

[8] Though not confirmed, CBH understands that a "desk top" audit of the track may have been undertaken in 2010.

"*In the past 10 years, the lessee (Brookfield Rail and its predecessor WestNet Rail) has spent over $2.4 billion on the leased railway infrastructure…,"*

Given such a considerable quantum of expenditure, CBH would seek:

- An audit as to where, when and how this $2.4 billion has been spent;
- Given this expenditure, why are users of the WAGFRN seeing a decline in track performance? As an example in August 2013, Brookfield Rail advised CBH (and its above rail operator Watco) that they are putting in place a range of restrictions for the WAGFRN including:
    - Special Train Notice #256; which took effect immediately, advising that due to deteriorating track condition, double consist trains in both empty and loaded consists on nominated line sections are no longer permitted to operate. The STN refers to not just logistically important Tier 3 line sections but also the Tier 2 Miling to Bolgart line section;
    - Whereas CBH would traditionally operate a 52-54 wagon "dual locomotive" consists on this Tier 2 line section, the STN forced CBH to only run 1 locomotive and a train consist of 26-28 wagons. Watco (and CBH) are now exposed to considerable additional cost and logistical issues to move the same tonnage to port;
    - It is understood resleepering of this line section was undertaken in 2004 with the then track operator utilising a 1 in 2 sleeper replacement methodology similar to that adopted by Brookfield Rail today. That this line section is now subject to such considerable deterioration in track condition that Brookfield Rail have announced the line will be placed into care and maintenance at the end of 2015, reinforces CBH's concerns that the current approach to management of the entire WAGFRN is not sustainable; and
    - This is despite Brookfield Rail's obligations under clause 6.1 of the Operational Track Access Agreement requiring Brookfield Rail to maintain a section of the Network (i.e. the Miling to Bolgart section) at all times to the general standard of that section at the Commencement Date. The issuance of the STN is a clear departure from this standard.

This lack of transparency and oversight regarding the Lease has further issues for Western Australian grain growers.

Brookfield Rail have proven adept at dealing with negative developments regarding the network and the manner in which it is managed to ensure that any blame for increases in cost or diminished levels of performance can be sheeted across to other stakeholders; not Brookfield Rail.

For example, it is suggested that Brookfield Rail, when initially seeking closure of the Tier 3s (in 2009/1010 and around finalisation of the SGNR process) placed increasingly onerous and questionable operational restrictions on above rail operations (such as speed and weight restrictions). Track users were forced to question the ongoing functional viability and use of the Tier 3s, rather than Brookfield having to formally close those line sections.

Consequently a number of key stakeholders suggested incorrectly that it was CBH that chose not to run trains on the Tier 3s, rather than Brookfield Rail seeking to close those line sections. It is suggested Brookfield Rail is seeking to initiate a similar process with the STN for the Tier 2 Miling line.

CBH would:

- Ask how the Western Australian grain industry can operate with any degree of competitiveness when the State's below rail operator can simply and arbitrarily announce a restriction on key line sections causing considerable operational and financial imposition for the Western Australian grain industry;
- Question how is it that Brookfield Rail offers nothing in the way of compensation or operational alternatives when these unilateral track restrictions are imposed;
- Suggest that with this Miling Line STN, Brookfield Rail is seeking once again to place increasingly onerous and questionable operational restrictions on above rail operations forcing track users to question their ongoing functional viability, and so Brookfield can avoid any accusation that they are closing those line sections; and
- Propose that it seems remarkable that similar line sections in South Australia's Eyre Peninsular can operate "triple locomotive" consists on line sections of a standard considerably less than that of the Western Australian Tier 3s (NG light axle lines). For this reason CBH, grain growers and

the Western Australian grain industry find it difficult to understand that operational restrictions are required due to issues with safety and asset preservation (as advised by Brookfield Rail).

4.1.5 A lack of protection against monopoly powers

As outlined by the Auditor General (page 16):

> *"The intended privatisation of the freight rail network by lease was supported by a regulatory structure to prevent the abuse of monopoly positions in the market, to guarantee that all freight carriers could use the network at fair prices, and to ensure the safe operation of the network."*

CBH would contend that:

- Brookfield's management of the WAGFRN coupled with confidential Lease arrangements and less than effective oversight has created precisely the sort of monopoly environment that the original regulatory structure was seeking to avoid. For example, there would appear to be very little provision for a direct correlation between access fees charged by Brookfield Rail and level of performance in the below rail asset;[9]
- Given this original intention has now been compromised, CBH would urge Government to develop more appropriate safe guards to ensure that the standard of the track is brought back to a reasonable standard; and,
- This would include a need for consideration of amendments to the Rail Access Code to ensure an appropriately balanced future for the grain industry (see section 4.2).

4.1.6 A lack of ongoing monitoring of maintenance and performance

The Auditor General outlines (Page 17):

> *"The lease enables PTA to monitor the lessee's compliance with the lease, to ensure the State's asset is maintained in a fit for purpose condition. The lease requires the lessee to provide PTA with five-yearly independent network condition reports, followed by maintenance plans that address issues raised in the condition reports. PTA may also seek evidence from the lessee that planned maintenance has been satisfactorily completed."*

CBH considers that there are a range of issues that must be addressed to ensure that the WAGFRN can be a key component of the Western Australian grain supply chain into the future, in particular:

- Consideration to what additional powers the PTA needs to ensure it can provide more effective oversight;
- For the PTA to adjust its monitoring over time and where appropriate to reflect emerging risks on specific lines, such as those at risk of becoming uneconomic, receiving government funding, or needing major upgrades; and
- For the PTA to collate and update all lease-related documents, variations, maps, plans, and performance standard agreements in a comprehensive lease management volume, to provide a transparent view of the lease and the network.

4.1.7 The need for the immediate surrendering of uneconomic line sections

The Auditor General stated (Page 18):

> *"To avoid the unplanned deterioration of these marginal parts of the network, the lease sought to ensure that the operator of the standard gauge track would have 'a financial or legal interest in the continued maintenance and operation of the narrow gauge track', to the extent that this remained government policy. The lease achieves this through two main means: the inclusion, and ongoing adjustment of performance standards, and the application of a State-controlled process for the surrender or support of marginal lines.*

[9] CBH is reminded regularly by Brookfield Rail when discussing Brookfield Rail's approach to pricing that *"It's not what it costs but what the market will bear that is the key driver."*

> *The 'surrender' option allows the State to use free market competition to find a more efficient operator for marginal lines. "*

This raises a number of very key issues:

- Brookfield Rail's plans to close the Tier 3s and Tier 2 Miling Line section suggest that this original intention to "*avoid unplanned deterioration*" has now been compromised. Consideration is urgently required to consider what safe guards are appropriate to ensure that the standard of the track is brought back to a reasonable condition;
- The correct method for applying costs to assess whether a line is uneconomic and qualifies for State support is unclear. The absence of an agreed method increases the risk that more lines will be regarded as making a loss, increasing the potential requirement for further State Government funding (or line closures);
- What are the Government's intentions regarding the ongoing management of the WAGFRN given the likelihood of further line sections falling into a similar state; and
- Why were the surrender provisions contained in the Lease that obliged Brookfield Rail to "surrender to Government" those line sections that it no longer chooses to operate (such as Tier 3 Line sections and the Tier 2 Miling Line) apparently removed? CBH would contend should this be the case that this represents a serious issue in terms of oversight and would urge the Western Australian State Government to take immediate steps to reintroduce this provision into the Lease.

The issue that the below rail operator having the capacity to choose to not operate a key State asset on the basis of a claim that it is uneconomic to do so represents a considerable strategic matter for the state of Western Australia in that an overseas company now has the capacity to influence the international competitiveness of a substantial Western Australian export industry.

4.1.8 Longer term issues regarding management of the lease

CBH notes comments made by the Auditor General (Page 36) regarding the need to consider the broader issues regarding management and oversight of the lease, in particular:

> *"As the end of the lease approaches, the interests of the lessee and the State are likely to diverge. This is because, without an agreement to renew the lease, the lessee faces a commercial risk that the future benefits from its investments may flow to the State or to a new lessee, and this will affect investment and maintenance decisions by the lessee. This represents a risk to the condition of the network.*
>
> *To manage this risk PTA needs to ensure that the performance standards are regularly updated to reflect the contemporary needs of rail users;*
>
> *there is a potential incentive for the lessee to minimise the actual amount it has to place in escrow and to do this it may reduce spending in the years prior to year 45 to establish a lower baseline of maintenance spending. To manage this risk, PTA should ensure it is effectively monitoring maintenance and repair activity to detect any changes in patterns of activity."*

Given these matters, CBH believes that it is critical that further consideration is given to:

- Whether the lease (and the separation of above and below rail operations within the WAGFRN) has contributed to a failure in meeting the ongoing needs of the market and to facilitate necessary investment;
- The implications for Parliament that it has received such little feedback regarding the fulfilment of the obligations under the lease. It must have further information if it is able to better address the question of fit for purpose and the Lessee's obligations to manage and "hand back the track in an appropriate state;
- Given the previous question regarding "fit for purpose" (section 4.1.3) – whether the track meets the requirements of rail users or their attendant changes in technologies;
- The need for a collaborative approach (incorporating the input from above rail operators) to plan for maintenance and line upgrades over the next decade; and

- The PTA's planned "risk based approach" to ongoing management and oversight of the Lease is welcome. However inherent in a risk based approach is engaging with CBH as the primary consumer of the contracted services. CBH is yet to be contacted by the PTA is this regard.

4.2 Issues with the Railways Access Code (2000)

In essence, CBH considers there is a requirement to make a range of changes to the Railways Access Code (2000) that would have as its core:

- Addressing flawed pricing methodology that sets floor and ceiling price on "gross replacement value" (that could see growers charged $110 million per annum);
- Provides a greater provision for a direct correlation between access fees and below rail performance;
- Ensure a more appropriate definition of the term "fit for purpose";
- Ensure that the PTA has greater powers of oversight regarding the management of the WAGFRN. This would include ensuring the more frequent undertaking of track audits (as prescribed within the RAC);
- Allow track users (such as CBH) to have direct input into track maintenance priorities;
- For the terms and conditions of the lease between Brookfield and the Western Australian State Government to be made public;
- For third parties to be given the opportunity of operating those line sections where the lease holder (Brookfield Rail) chooses not to operate those line sections; and
- For the management and associated terms and conditions of the management of the WAGFRN to be undertaken in line with national guidelines such as that used by the Australian Rail Track Corporation ("ARTC").

5.0 THE MANAGEMENT OF THE NETWORK BY THE PUBLIC TRANSPORT AUTHORITY

It is CBH's view that there is a requirement for the PTA to have increased oversight of the Lessee's management of the WAGFRN.

In line with several of the key themes raised in the 2013 State Auditor General Report (relating to PTA's management of the WAGFRN) CBH considers that management of the WAGFRN by the PTA could be enhanced:

- Clarifying the meaning and intended operation of clauses regarding 'fit for purpose' and the related adjustment of rail performance standards, to ensure standards stay up to date. This process should be undertaken with both the operator and above rail users of the WAGFRN;
- Developing a collaborative approach to overseeing management of the WAGFRN which incorporates input from key above rail operators in planning and prioritising maintenance and line upgrades over the next decade;
- Adjusting its monitoring over time and where appropriate to reflect emerging risks on specific lines, such as those at risk of becoming uneconomic, receiving government funding, or needing major upgrades;
- As part of the contract management plan, consider and formulate a strategy in relation to end of lease issues;
- To collate and update all lease-related documents, variations, maps, plans, and performance standard agreements in a comprehensive lease management volume, to provide a transparent view of the lease and the network;
- Undertaking the planned 2010 physical audit of the track (2005 was undertaken but not 2010) and outlining to stakeholders why this oversight was allowed to occur; and

- Overseeing trials to examine the potential to load heavier axle consists on certain line sections to better meet the needs of rail users. As an example, CBH estimates that increasing current 16 tonnes per axle ("TAL") line sections to 17 TAL would allow an 8.5 per cent increase in cargo carried, creating a significant improvement in rail productivity.

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