Management of the Rail Freight Network Lease: Twelve Years Down the Track

Report 1 – January 2013

Background and Objective

The 5 600km Western Australian rail freight network is a strategic infrastructure asset of national importance, carrying around 80 million tonnes of freight in 2012. It remains in State ownership, but has been leased until December 2049 to a private rail network operator. Effective government management of the lease is a complex task requiring a close understanding of the infrastructure and the lease.

The lessee's commercial incentives largely determine the condition of the network, subject to supervision and limited intervention by the State. This combination of private enterprise and public policy is designed to ensure that the network remains 'fit for purpose'.

The audit objective was to assess the management of the 49 year rail freight network lease by PTA and Transport, by determining whether the outcomes to date are in line with original objectives, and whether the agencies are managing the rail freight lease to protect the State's interests into the future.

Audit Conclusion

Many of the original objectives from the lease of the rail freight network have been achieved, including removing government from operating the freight rail network, and its associated costs, and paying down debt. The volume of freight carried on the network has increased and the condition of the standard gauge lines, and the narrow gauge lines used for mineral freight, has improved.

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. Ongoing government funding was anticipated at the time of the lease, but not quantified, so it is not possible to conclude whether actual levels of support are more or less than originally estimated.

To date, PTA has managed the lease without a formal risk-based contract management plan, making it difficult for PTA to demonstrate that it has fully considered the impact of decisions about the lease and network on the State's interests over the life of the lease. PTA is now preparing a plan, which should help better manage risks and to protect the State's interests, while also enabling PTA to maintain the 'light touch' approach envisaged in the lease.

The State faces significant risks over the remaining 37 years of the lease. Specifically these relate to keeping track performance standards up to date, monitoring maintenance on certain lines, the need to adapt or step outside of the lease to meet policy objectives on the grain lines, the application of costs to uneconomic lines, and end of lease issues. A risk-based contract management plan should strengthen PTA's capacity to manage these issues in a considered and proactive way.

Key Findings

- The sale and lease of the rail freight network met many of its original objectives. The State was able to step out of the freight rail business, freeing itself from the costs of running the network, and many of the risks of owning the network. The network was leased for a single up-front payment of $292.5 million.
- The mineral and general freight carrying lines are in better condition now than when they were leased. The overall volume of freight on the network has more than doubled since 2000. The State does not obtain any direct economic benefit from this increase in volume, but benefits indirectly from increases in State-wide economic activity and the lessee's improvements to the network assets.
- Between 2000 and 2011, State funds spent or committed to the network totalled around $102 million, with an additional $258 million from the Commonwealth. The expected level of ongoing public investment was not quantified at the start of the lease.

- Significant sections of the narrow gauge network mainly used for carrying grain have degraded and two lines have been withdrawn from service.
- 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 record of how or why this occurred.
- Limited information is available to Parliament and the public regarding the lease of the network and 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.
- The lease requires proactive and risk-based management by government, but 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 weakens the protection of the State's interests.
- PTA has adapted the lease to reflect changing policy objectives on the 'grain lines'. PTA's explanation of how it reached these decisions is reasonable, but a more structured approach within a contract management plan would enable PTA to better demonstrate the basis for its decisions.
- 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 level of State funding.
- PTA monitors the condition of most of the network against year 2000 standards or lower, based on its interpretation of the lease's 'fit for purpose' performance standards. PTA's interpretation of the lease substantially reduces the 'fit for purpose' obligation, as it excludes changes in rail technology and the requirements of rail users. 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.
- The lease anticipates a review of performance standards every five years across the network, but this has not occurred. This risks the network being assessed against outdated standards.
- PTA comprehensively reviews network condition and maintenance every five years, but more frequent monitoring would better match the risks on some lines.
- As the end of the lease approaches, the interests of the lessee and the State are likely to diverge. End of lease issues are already influencing the commercial relationship, and will require monitoring and proactive management by PTA.

Recommendation in Summary

PTA and Transport should implement a formal contract management plan to guide the management of the 49 year rail freight network lease. This plan should be based on a thorough risk assessment and include consideration of the State's objectives for the near-term and long-term management of the lease and the network.