

ARCO Coal Australia Inc.

A.R.R.N. 009 738 407

Asset Management
AMP PLACE
10 Eagle Street
Box 51, GPO
Brisbane, Qld.
Australia

4001

Telephone (07) 3867 8100
Telex AA42420
Facsimile (07) 3867 8283

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Industry Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Attention: Mr Vince Manion
Dear Mr Manion

Thank you for taking the time to brief Barry Golding on the Industry Commission Submission on the coal industry. Our efforts are currently focused on the industrial issues confronting our Company and we are unable to make a full submission at this time. Suffice to say that ARCO is making every endeavour to ensure that the productivity from its Australian mines will be at Worlds Best Practice.

We are pleased however to make the attached submission on coal rail haulage which, after minesite productivity is the most significant factor impacting our international competitiveness.

Should you have any questions on this submission, please contact Barry Golding.

Yours sincerely

Bill Wagener
President

INDUSTRY COMMISSION SUBMISSION
Background Information

Strip coal mining with large draglines commenced in Queensland in the 1960's. From the beginning, the Queensland Government realised the potential to extract de-facto royalty payments from coal producers through rail freight rates. Rail contracts were negotiated by Queensland Treasury and the rail freight rates were acknowledged to contain a considerable de-facto royalty component. By the 1980's the Queensland Government was making more profit on each tonne of coal railed than most coal producers. The Government therefore had considerable incentive to ensure that every tonne of coal produced was railed as soon as possible. Queensland Railways acting as the service provider ensured that infrastructure and rolling stock was sufficient to cover all possibilities.

In 1990 the Queensland Government belatedly acknowledged that high rail freights were impeding the development of new coal mines in Queensland and the 1993 Royalty Review represented a distinct philosophical turnaround. The Government agreed to remove the defacto royalty in rail freight rates by the Year 2000 and increased the advalorem royalty to 7%. The Queensland Government still maximises its income from coal by maximising coal shipments from Queensland, however, contrary to the situation that applied prior to 1993 the Government has no interest in inflated rail freight rates. The Government's objective is the same as that of the coal mining industry, that is minimum sustainable rail freight rates to encourage the maximum volume of coal exports. Fortunately for the coal mining industry, the Queensland Government's objective and the coal industry's objectives are now aligned. It only remains for the Government and the coal industry to ensure that the path we follow will deliver the lowest possible rail freight rates.

Initiatives to Date

Corporatisation of Queensland Rail and benchmarking against Worlds Best Practice have been the two major initiatives to date. The mining industry in its support of the Government's efficiency initiatives sought to ensure that:

transparency was achieved by having the Queensland Rail divisions(especially Coal and Minerals) produce separate financial reports, so that non-performing sections were identified and publicly acknowledged;

CSO's were reported explicitly for each particular activity;

- the emphasis was on the efficient use of assets rather than rate of return on assets, and that efficiency gains were passed on to the users;

the process of appointing board members ensured the selection of members with excellent technical and financial knowledge of Queensland Rail, who would not be compromised politically, who would act independently and be held accountable

- there was proper recognition of industry funded assets

- there was a commitment to Worlds Best Practice and a program to achieve this and that,

- any benchmarking must include freight rates not just technical and operating cost benchmarks.

Unfortunately apart from the commitment to Worlds Best Practice, none of these objectives have been met and the industry is disillusioned with the progress on freight rate reform.

At the micro economic level progress has certainly been made and there is a strong working co-operative relationship between the coal industry and Queensland Railways Coal and Minerals Division. From the coal industry's perspective however the Coal and Minerals Division seems to be hamstrung by the current integrated Queensland Railways structure as well as unrealistic financial objectives placed on Coal and Minerals Division from Government

Future Progress

The mining industry has continually supported the competition reform and where true competition can possibly be introduced the industry sees this to be the most efficient way of delivering services. The dilemma for the coal industry is how to achieve lowest sustainable rail freight rates. Because of the degree of natural monopoly in a rail system, it is questionable whether competition can deliver the lowest possible rail freight rates in Queensland. However it appears that the present deliberate obfuscation of financial data and lack of transparency within QR can only be overcome through the introduction of competition.

With rail haulage being open to competition in the Year 2000 it is imperative that we establish the operating rules for new entrants by the middle of 1998 so that coal producers can effectively call tenders for provision of rail services in late 1998. Although the Queensland Railways Access Unit has offered to work with the industry in developing these operating rules there is little support from the Queensland Government.

Immediate Needs

To make Queensland's coal industry as competitive as possible there remain two key objectives. Firstly, to ensure minesite productivity is at Worlds Best Practice and secondly, to ensure coal rail haulage rates are at Worlds Best Practice. In Queensland the latter can only be achieved if the Government as well as Queensland Railways commit to putting in place detailed and practical operating principles for third party access providers and to ensuring that where competition is not possible there is transparent pricing based on the cost of provision of the service. The Queensland Electricity Reform Unit has been very effective in moving Queensland into a competitive market in electricity. We would suggest that a similar approach should be

taken for Queensland Rail. However before any restructuring is contemplated, the operating rules for third party operators must be agreed, just as was done in the electricity industry.