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OVERVIEW

FreightCorp was one of many bodies to lodge a submission with the Industry Commission in October 1997 to assist in its initial inquiry into the Black Coal Industry.

In reviewing the draft report which has now been produced, FreightCorp submits several specific comments in relation to points raised as well as a more general commentary in support of its position.

Pricing

The report identifies high rail freight rates as a factor which is disadvantaging the coal industry's performance. In terms of the above rail component of coal freight rates, FreightCorp has implemented reforms which have seen rates reducing quite dramatically, particularly in recent years. FreightCorp's already significant reform program is now being accelerated and more cost reductions are planned. More details can be found in the section titled "FreightCorp Efficiency Reforms".

FreightCorp's pricing policy is based on:

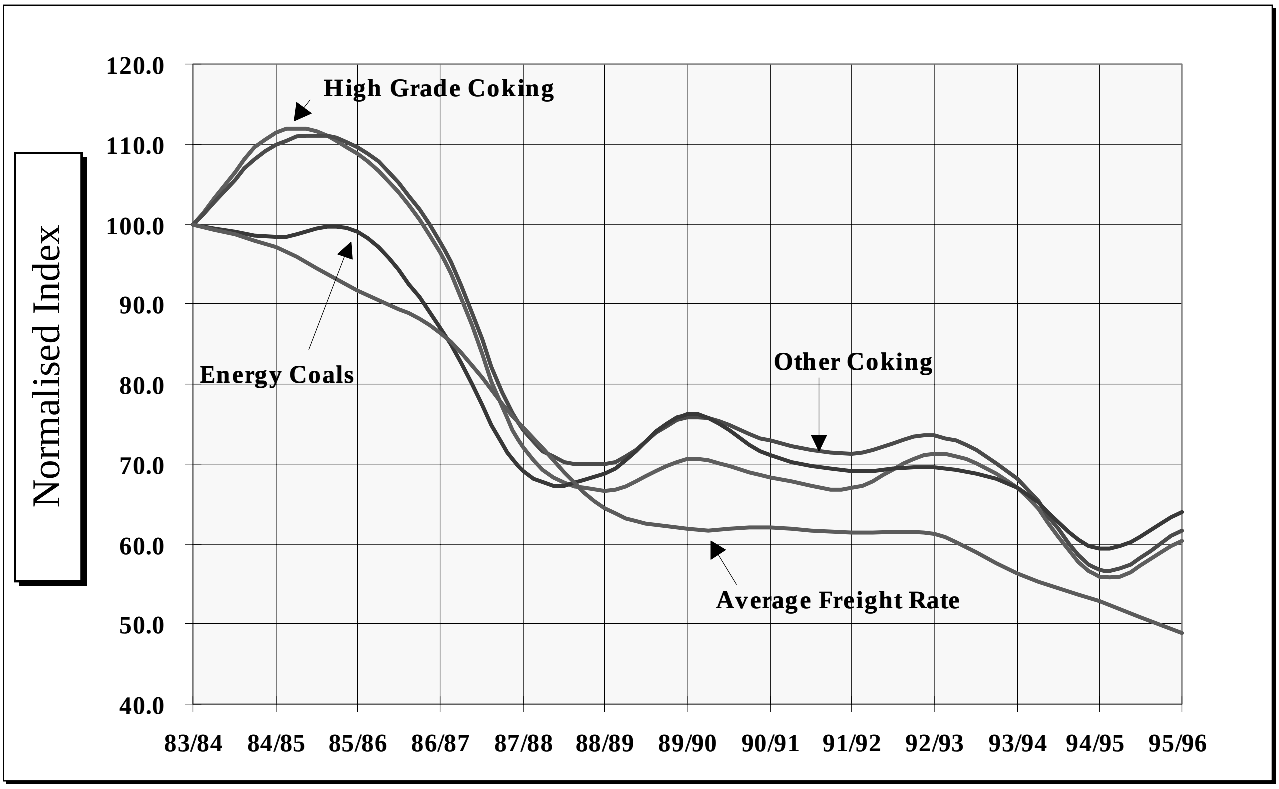
- performance agreements with customers (measuring both FreightCorp and customer performance),
- volume incentives,
- price/service packages which are tailored to customer needs, and
- the sharing of efficiencies as they are achieved.

Reduction in the below rail component of freight rates is a factor which FreightCorp sees as being constrained both by the Rail Access Corporation's (RAC) intention to pursue a significant rate of return on its assets in the Hunter Valley and the absence of urgency in attaining efficient infrastructure maintenance.

As a general comment on pricing, FreightCorp makes the point that the basis of several of the Report's assertions about coal freight rates is data which is up to 4 years old. In NSW during this time, there has been significant structural reform with the separation of above and below rail operations, the introduction of an open access regime and the corporatisation of the government owned rail fright operator. Each of these developments has led to significant reforms in the haulage of coal, the progressive removal of monopoly rents and a significant reduction in coal freight rates. Efficiency gains which FreightCorp has made have also been shared with customers.

The average export coal freight rate in New South Wales has declined in real terms since 1992/93 in excess of the declining trend of average Free on Board (FOB) prices of all coal types.

The figure over the page shows average FOB prices vs average rail freight rates for NSW coal exports.



<u>Sources:</u> *1997 New South Wales Coal Industry Profile (pp 229),*
Australian Bureau of Statistics, Monthly Summary of Statistics,
January 1997 (pp 17)
*[Normalised by CPI (Sydney All Groups)]

FreightCorp's first submission to the Industry Commission also included a comparison of NSW, Queensland, American, Canadian and South African rail freight costs as a percentage of export coal FOB value. These statistics were comparable.

Efficiency Gains

FreightCorp would also like to comment on the claim that the delay of real competition is serving as a barrier to efficiency gains. While FreightCorp acknowledges that a truly competitive market is yet to develop, the emergence of potential competition has yielded similar results. Competitive pressures have provided additional incentive to FreightCorp to realise efficiency gains and share cost savings with its customers. FreightCorp is accelerating its reform program to ensure it continues to deliver such reforms and price reductions. A renewed focus on customer service is also being pursued to ensure FreightCorp delivers its customers' requirements. FreightCorp will offer its customers total logistics solutions based on quality service.

Again, the section titled "FreightCorp Efficiency Reforms" details the efficiency gains made by FreightCorp and the workforce reductions which are planned.

Access Regime

FreightCorp's views on this issue are outlined more fully under the Access Regime section of "Rail Environment" and under Efficiencies in Coal Haulage Operations in "FreightCorp Efficiency Reforms".

Basically, FreightCorp believes that competition has been delayed by the continuing uncertainty over the access environment within NSW and that changes are required in the approach currently taken to the pricing of access to the infrastructure.

In terms of FreightCorp's government ownership, it has neither sought nor received treatment from RAC which is different from other operators. The rationale behind the corporatisation of FreightCorp was the removal of any net competitive advantage (or disadvantage) which it held simply as a result of its public sector ownership. This includes the application of tax equivalent regimes and the imposition of regulations on an equivalent basis to private sector competitors. FreightCorp's position always has been that equity is one of the underlying principles needed in any access arrangements (including pricing).

THE RAIL ENVIRONMENT

Background

Historically, the Australian rail industry has been characterised by railways which were:

- state based,
- publicly owned,
- vertically integrated, and
- operated independently of each other

This system came to be seen as inefficient with monopoly protection and government subsidies minimising the commercial incentives.

New South Wales (NSW) commenced addressing the inefficiency of its rail system in the late 1980s. In 1989 freight operations were established as a separate business group of the New South Wales rail operator, the vertically integrated State Rail Authority (SRA).

From 1989 Freight Rail concentrated on reforming its business to best practice. Significant gains were made during the period from 1988/89 to June 30 1996 through:

- a substantial increase in tonnage, from 50 million in 1988/89 to 63.9 million in 1995/96,
- a reduction in real freight rates of up to 25% in the coal and grain industries,
- an increase in employee productivity of over 150%
- an improvement in on time running from 68% in 1988/89 to 90% in 1995/96,
- a significant reduction in operating costs, and
- the recording of its first cash surplus of $17 million in 1991/92.

FreightCorp was corporatised on 1 July 1996 and the achievements attained since then are set out in the section entitled “FreightCorp Efficiency Reforms”.

Competition

While reforms have been taking place in the Australian rail industry for ten years, the most significant of these have occurred in the past few years with the implementation of National Competition Policy.

This policy was ratified by the Council of Australian Governments (COAG) in April 1995. A key component of this policy is the Competition Principles Agreement. Its aim is to encourage efficient public sector service provision by exposing public business functions to competition.

The agreement provides for third party access to services that are provided by means of significant infrastructure facilities.

Governments across Australia have accepted that rail track and related infrastructure are significant infrastructure facilities and have implemented legislative and structural reforms to this effect.

In response to the requirements of the Competition Principles Agreement, in 1996 the NSW Government separated the then SRA into four separate agencies.

- A new *SRA* - providing long distance and commuter passenger services,
- *Rail Access Corporation* (RAC) - which owns the rail track and related infrastructure and is responsible for facilitating the opening of the NSW rail network to competition,
- *Railway Services Authority* - established to undertake infrastructure and rolling stock maintenance (progressively under tender arrangements), and
- *FreightCorp* - established as a commercial operator of above rail freight operations.

FreightCorp was established as a State Owned Corporation (SOC) to ensure it could compete with private sector companies without any net competitive advantage (or disadvantage) arising from its public ownership.

In addition to the separation of above and below rail operations and the corporatisation of FreightCorp, the conditions necessary for competition are effective access arrangements and a situation of competitive neutrality between road and rail.

While the issue of competitive neutrality is not one which significantly impacts the coal industry given its logistic and environmental propensity for rail transportation, it is an issue on which FreightCorp seeks to influence debate and policy making in terms of the general competitiveness and attractiveness of rail.

The Access Regime

FreightCorp is concerned to ensure the efficient use and development of the New South Wales and Australia wide rail network and to ensure that access pricing is based on efficiency and equity.

A rail access regime which spells out the terms and conditions of access to the rail network was gazetted by the NSW Government in 1996. The NSW regime has been reviewed by the National Competition Council (NCC).

The NCC has issued draft recommendations for revisions to the regime for public consultation. Concurrently, the NSW Minerals Council is continuing with its challenge to the regime.

It would appear that competition on the NSW rail network has been delayed by the uncertainty of the access environment. This uncertainty in the current environment is coupled with future uncertainty due to RAC's reluctance to provide operators with forecast access charges beyond the current year of operation. The difficulties for operators to plan in a capital intensive industry with long asset lives are exacerbated when the supplier of their single largest external cost item is unable to provide any indications of charges beyond a 12 month horizon.

Operators and their customers require a reasonably accurate assessment of future freight charges to input into the development of business and investment plans. FreightCorp offers its customers price certainty with multiple year price/service packages for the haulage component. The below rail component once received from RAC is then added to the haulage component. Uncertainty over long term access charges could serve as a deterrent to new entrants initially faced with making large start-up investments.

When the access issue is considered on a national basis, it is FreightCorp's position that any national track access arrangements should provide for a nationally consistent approach which is efficient for both intra and interstate operators. This has not been the case to date with the result that competitive challenges have been made without regard for NSW state borders while other states do not have adequate reciprocal arrangements in place.

FREIGHTCORP EFFICIENCY REFORMS

Background

Corporatisation has injected the commercial discipline of the competitive market to FreightCorp's operations and has brought about:

- a business operating generally on a level playing field with the private sector,
- a Board fully accountable for FreightCorp performance,
- more clearly defined responsibilities to community, Government and customers, and
- greater pressure for public accountability and bottom line results.

Corporatisation was an important step in the continuing process of rail reform, essential for FreightCorp to be able to meet the challenge of competition and open access to rail infrastructure in NSW.

This has enabled FreightCorp to develop a corporate culture with a commercial and customer service focus.

FreightCorp's achievements in 1996/97, its first year as a corporation include:

- a record tonnage of 72.6 million, an increase of 8.8 million tonnes over 1995/96,
- revenue exceeding $800 million,
- a sound profit and a significant dividend payment to shareholders,
- operations generating 12 billion net tonne kilometres,
- finalisation of its capital structure - giving it the necessary balance sheet strength to look for opportunities in the ever changing transport environment,
- certification of its first Enterprise Agreement which provides the workplace reform essential to deliver lower freight rates and service quality improvements,
- a joint venture agreement to haul the first privately owned coal wagons in the Hunter Valley, (won in a competitive tender process),
- development of performance based contracts with customers and the commencement of a new integrated train management Customer Service Centre at Parramatta,
- the commissioning of the new Enfield Yard, providing state-of-the-art train marshalling facilities in the centre of Sydney,
- the opening of a new locomotive servicing facility at Port Waratah in Newcastle,
- a reduction in staff from 4,000 to 3,500, and
- productivity improvements across all areas of the business:
  - ⇒ loco productivity up by 26%
  - ⇒ wagon productivity up by 21%
  - ⇒ employee productivity up by 31%.

Reform Program

FreightCorp understands the significance of making all of its business decisions in the context of a competitive environment. It recognises the need to continuously improve its operations and pursue efficiency reforms which will be shared with its customers if it is to be the preferred rail freight service provider.

Across its business, pressures on volume arising from mine closures, the Asian economic crisis and seasonality of the business have strengthened FreightCorp's resolve to aggressively pursue a strategy of growth beyond its traditional boundaries, a drive for cost efficiencies and enhanced service quality. FreightCorp's reform program is being accelerated to ensure it can implement these strategies and keep pace with the dynamics of the Australian rail freight industry and the demands of the market.

FreightCorp's reform program includes:

- Head office review
  - review of functions and structures,
  - voluntary redundancy program,
  - job and work redesign, and
  - performance management.

- Enterprise Agreement 1 (1997/98)
  - implementation of job and workredesign,
  - removal of functional overlaps,
  - driver only operation,
  - shunting with radio, and
  - performance management.

- Enterprise Agreement 2 (currently under negotiation)
  - streamlining of classification structures,
  - salary/wage aggregation,
  - FreightCorp specific award structure, and
  - productivity/performance based pay and rewards.

In terms of its workforce, FreightCorp has planned significant reductions as can be seen in the following table.

Staff Projections

July 1996	July 1997	July 1998	July 1999	July 2000
3,959	3,525	3,107	2,438	2,228

FreightCorp currently has 3234 employees, representing an 18% reduction since corporatisation. The continued reductions which are projected are an output of FreightCorp's reform program.

Efficiencies in Coal Haulage Operations

During its history as a rail haulier of coal, FreightCorp has continuously made efficiency gains and implemented initiatives which have seen export coal tonnages within NSW grow at an average annual rate of 8% since 1988/89. Much of this increase has been drawn from the Hunter Valley and exported through the Port Waratah Coal Services (PWCS) terminals in the Port of Newcastle.

In the year ending June 1998, it is projected that rail coal deliveries to PWCS will grow by 20% from 50 to 60 million tonnes. Currently, deliveries are at an annualised rate of over 65 million tonnes.

By November 1998 with the completion of current wagon contracts, FreightCorp will have a Hunter Valley fleet capacity of over 90 million tonnes per annum. Forward investment in fleet capacity will provide the coal industry with the option of shipping coal through Port Kembla Coal Terminal if circumstances exist which make this commercially feasible.

While these capacity issues are critical to the efficient operation and expansion of the coal chain, FreightCorp also recognises the need to continue to focus on reducing costs and improving service quality and reliability. This is particularly important given the recent economic crisis in Asia which has seen a reduction in prices for both contracted and spot-market purchases of steaming and metallurgical coal in an environment of tonnage over-supply.

In addition to the general reform program outlined in the previous section, FreightCorp's specific response within its coal business to the current environment has been:

- an average 10% per annum reduction in the haulage charge,
- the introduction of a rebate arrangement based on a key performance indicator structure which measures operational activity for which FreightCorp and/or customers are responsible such as on time running and loading performance against agreed standards,
- incentives for loading terminal upgrades,
- the setting of haulage charges which reflect current efficient operations and commit FreightCorp to achieving future efficiencies,
- introduction of operational efficiency initiatives,
- a joint approach to improving the interfaces within the coal chain, and
- continued development of modern maintenance facilities.

The acceleration of FreightCorp's reform program and its sharing of cost savings with its customers is ensuring that the haulage component of coal freight rates continues to reduce. However, this is currently the only contestable component of the freight rate. Any similar reduction in the below rail component of the coal freight rate is constrained by two factors:

> (i) The NSW Rail Access Regime currently sets RAC a target of achieving a 14% after tax rate of return. This rate of return is substantially above a return commensurate with the inherent risks within RAC's business and informed analyses from a number of independent sources are in agreement that an appropriate return should be less than 10%. Even a return at this level is contingent upon the sharing of volume risk between operators and RAC. In the absence of such risk sharing, the rate of return should be significantly lower still.

(ii) *Attainment of efficient infrastructure maintenance costs.*

For access prices to be based on efficient costs, they must reflect efficiency both in maintenance practices and in the procurement of network management series. While it is recognised that this may not be achievable immediately, FreightCorp believes that efficiency gains must be obtained and shared with operators and end customers as a matter of urgency.

CONCLUSION

Australian governments have worked to varying degrees to create an environment within the rail industry which encourages competition. The separation of above and below rail operations, the introduction of open access and the changing ownership structure of railways have led to the effective removal of state boundaries and the entrance of new operators.

The attractiveness of the sale of operations such as Australian National and National Rail Corporation to overseas operators as a point of entry to the Australian rail freight market is clear. Within this industry the coal freight business is of particular attractiveness to potential operators.

A truly competitive market and the more efficient operation of rail is being undermined by several factors:

- the uncertainty of both the access environment and the level of future access charges,
- the absence of a level playing field between road and rail, and
- the constraints to a reduction of the below rail component of freight rates.

FreightCorp continues to pursue and achieve its own cost efficiencies and productivity reforms which are shared with customers. As a key component of the coal chain, this will contribute to the competitiveness of the industry and hence the demand for coal. This will in turn generate the volume growth and scale of operations that are critical to the attainment of a viable, efficient, low cost rail industry. FreightCorp recognises that this development will create a truly competitive rail market and is confident of its ability to position itself within this environment as the preferred rail freight service provider.