4 November 1997

The Manager
Australian Black Coal Industry Inquiry
Locked Bag 2
Collins Street East PO
MELBOURNE VIC 8003

Dear Sir

Inquiry Submission

The Queensland Mining Council welcomes your inquiry and is pleased with the opportunity to make a submission.

The Council is one half of the Australian Coal Association which will separately made submissions on the international and domestic coal markets. These will show that the prospects for Australian coal producers are a mixture of opportunity and threat and that cost competitiveness will determine whether the industry realises its future growth potential.

The enclosed documents address three crucial issues affecting the competitiveness of the Queensland coal industry:

- **industrial relations**, where the companies now have at their disposal the instruments to affect enterprise-based reforms, but are being frustrated by attitudes developed over decades of inappropriate regulation and intervention in workplace affairs;

  The Industry Commission could assist the industry's cause by highlighting the need for mine-specific solutions and for attitudinal change on the part of management, unions and employees.

- **health and safety**, where the Queensland industry is at a delicate stage in negotiations with the state government and unions on the transition from outdated, highly prescriptive regulation to a duty-of-care approach which is a prerequisite for achieving best practice safety management in the industry;

  The Industry Commission could contribute to improvement in the industry's future safety performance by highlighting the need for a new regulatory approach and lending its support to the reform process underway in Queensland.

- **rail transport**, where the industry is looking to third party access to re-invigorate a reform process which to date has fallen well short of the industry's competitive needs.

  The Industry Commission could contribute to this process by highlighting the need for further coal rail reform in Queensland and for the state government to commit to and actively pursue third party access as a means to deliver change.

Our council does not intend to appear before the commission in the forthcoming public hearings. However, we stand ready to clarify or elaborate on any aspect of our submission. Please refer any enquires to Ben Klaassen in this office.

Otherwise, we look forward to the Commission's draft report in February next year.

Yours faithfully

Michael Pinnock
Chief Executive

CBK:sm

INDUSTRIAL RELATIONS REFORM IN THE QUEENSLAND COAL INDUSTRY

SUMMARY

- Industrial relations reform in the coal industry has been held back by attitudes and practices which developed over decades of inappropriate regulation and intervention by third parties in company affairs.

- The long isolation of coal from the mainstream IR system helped to perpetuate an inward looking approach focussed on industry custom and practice rather than on the needs of individual enterprises operating in a highly competitive environment. Unproductive work practices, a very high strike rate, demarcation restrictions, high absenteeism, overmanning and union control of labour management were common features that persist to varying degrees in mines today.

- The Queensland industry has just completed a five year industrial relations strategy aimed at establishing the means for individual companies to move at their own pace away from centralised, prescriptive industrial relations conditions towards decentralised, enterprise based arrangements. Key objectives were the incorporation of coal into the mainstream IR system; development of a safety net industry award; genuine enterprise agreements; productivity related wage outcomes; and removal of barriers to efficient labour management.

- The abolition of the *Coal Industry Act* and of the Coal Industry Tribunal, and the subsequent introduction of the *Workplace Relations Act*, were milestone achievements in the strategy.

- The *Workplace Relations Act* provides the means for companies to effect genuine enterprise arrangements, although ranged against this is the apparent determination of the coal industry unions to frustrate meaningful change in many areas. Also, decisions of the AIRC will need to be closely monitored to ensure they are in keeping with the intent of the new act.

1. INTRODUCTION

This document does not attempt to comment on the efficacy of different work arrangements in the coal industry. A cornerstone of the industry's industrial relations philosophy is that the work practices which yield best results will vary from mine to mine in accordance with their different needs and circumstances. It is a matter for individual producers to establish the specific ways in which their workplace objectives are being achieved or frustrated in the present industrial relations environment and inform the Commission of these facts.

The purpose of this document is to comment briefly on the evolution of the present coal IR environment and explain the industry's strategic response to the long overdue need for basic change. Queensland coal producers are looking to overturn attitudes and practices which were created and sustained by decades of inappropriate laws and institutions. Principal among these is the notion of the 'coal industry' as a discrete entity, rather than a heterogenous collection of enterprises each with its own operating and commercial imperatives. The industry's future strength lies in its diversity and this must be reflected in the companies' work arrangements.

2. EVOLUTION OF THE PRESENT INDUSTRIAL ENVIRONMENT

The most distinctive feature of the history of coal industrial relations regulation has been its isolation from the rest of the Australian conciliation and arbitration system. From 1946 to 1995, coal IR was governed by the Commonwealth and complementary New South Wales legislation which together established the Coal Industry Tribunal (CIT) to regulate the industry's labour market. As no complementary legislation existed in Queensland, the CIT's powers derived solely from the Commonwealth mainly as promulgated in the *Coal Industry Act 1946* but with some additional powers conferred by reference to the Commonwealth *Industrial Relations Act* of the time.

Initially, the legislation, the CIT and the industry awards established thereunder reflected late 1940s conditions and priorities. At the time the coal industry was almost exclusively domestic; it was strife ridden, labour intensive and under-producing; and its product was an essential raw input to post-war industrial development. The national interest was seen to be best served by raising and sustaining coal production. This was embodied in the synopsis to the Commonwealth act which until 1988 read "An act to provide means for securing and maintaining adequate supplies of coal throughout Australia and for providing for the regulation and improvement of the coal industry in the State of New South Wales and for other purposes".

This contrasts with the synopsis to the Commonwealth *Industrial Relations Act* of the time which read "An act relating to the prevention and settlement of certain industrial disputes and for other purposes"; and with that of the *Workplace Relations Act 1996* which reads "An act relating to workplace relations and for other purposes".
The persistence to 1988 of this emphasis on maintaining supply, over the prevention and settlement of industrial disputes, is itself evidence of the inhibition to change which these unique arrangements helped to induce in the coal industry. The long period of coal's isolation from the mainstream contributed to, among other things:

- a perception that the coal industry was different to other industries and deserving of special treatment;
- a more than usually strong centralised culture focusing on industry custom and practice rather than on individual enterprise needs;
- an unhealthy reliance by managers and employees on arbitration over agreement to determine workplace conditions;
- unusually generous pay and employment conditions largely unrelated to ability and performance;
- unusually strong union power and worker allegiance to the union and 'the industry' rather than to the employer and the enterprise.

Industrial relations reform in the coal industry has generally been slower, more shallow and more costly than reform in most other Australian industries and has lagged well behind the increasing competitive pressures on suppliers of an internationally traded raw material like coal. While the coal industry participated in the general shift towards enterprise bargaining from the late eighties, its institutional and attitudinal baggage constrained outcomes. Many site agreements were more cosmetic than real, having been negotiated under conditions which effectively preserved rigid structures, outdated and inward-looking attitudes and strong union control. The coal industry entered the nineties with many of the worst features of past practice still prevalent and totally inappropriate in a world of globalisation and intense international competition.

Those features included:

- a high proportion of non-productive work time and poor capital utilisation;
- a very high rate of industrial disputation, of which district and national stoppages were a feature;
- a high rate of absenteeism;
- widespread resistance to productive roster arrangements tailored to sites' individual circumstances;
- demarcation restrictions;
- limitations on the use of contractors;
- overmanning; and
- closed shops and a large measure of union control of labour management, including restrictions on overtime and seniority based (rather than merit related) employment practices.

The need for a new, enterprise focussed legal framework for coal industrial relations and for modernisation of the industry's awards was essential for bringing about the labour market reform and cultural change needed for the coal industry to realise its potential in the 21st century.

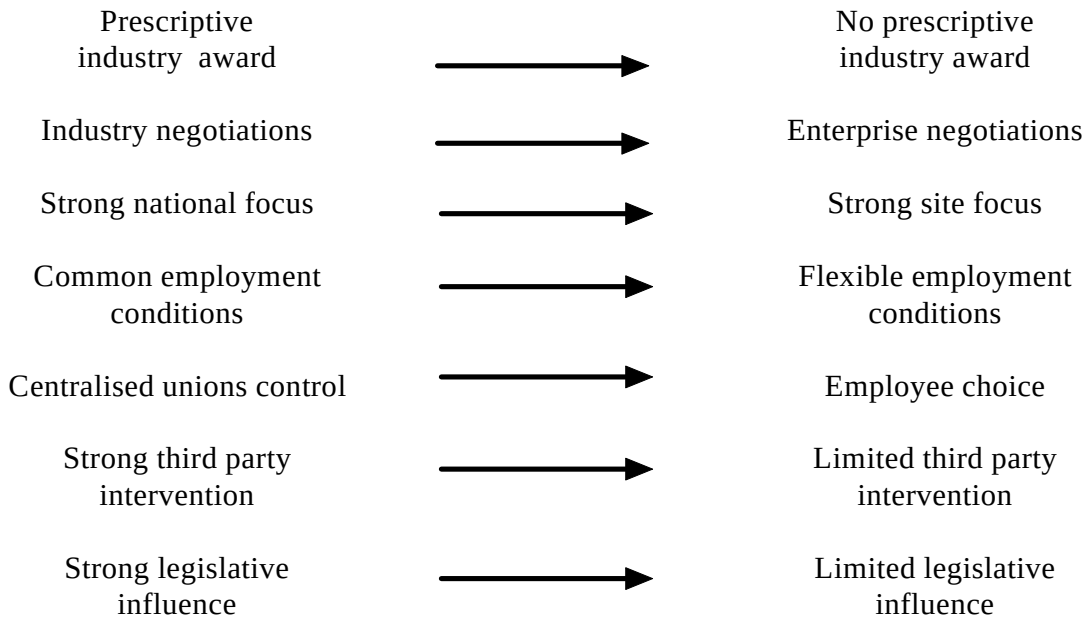
3. INDUSTRY OBJECTIVES

It was against this background that the Queensland coal industry in 1992, under the aegis of the Mining Council, adopted a five year strategy designed to:

> *progress individual companies, within different time frames and with varying degrees of independence, away from the (prevailing) centralised and prescriptive industrial relations model towards a decentralised and site focused industrial relations model.*

Following is a description of the main elements of the change which the strategy sought to effect.

Prevailing	**Objective**



Critical actions arising from the strategy included:

- achieving abolition of the *Coal Industry Act 1946* and of the CIT, and incorporation of the coal industry into the mainstream industrial relations regulation system;
- development of a core (safety net) industry award;
- establishing procedures for the negotiation of genuine enterprise agreements;
- relating wage movements to productivity and reducing the scope for indexation;
- removal of legislative / award based barriers to the employment and deployment of labour; and
- removal of preference conditions and discriminatory employment conditions and practices.

4. STRATEGIC OUTCOMES

Subsequent reviews by the industry of the strategy in 1995 and 1997 yielded the following checklist of achievements consistent with the strategy:

- Coal has been brought into the industrial relations mainstream.

  In April 1994 the federal government announced that the coal industry would be brought into the mainstream, and in November of that year the appropriate legislation was passed abolishing the CIT but continuing awards of the CIT as if they were awards of the AIRC.

The *Industrial Relations Act* was also amended to require the commission to have regard to decisions of the CIT relevant to coal mining matters. The coal industry was allocated to a commission panel, initially headed by the president and with the previous CIT chairman appointed as a deputy president of the commission and also allocated to the coal industry panel.

- Enterprise agreements are more prevalent in the industry and there is generally less frequent resort to third party involvement in workplace arrangements.

- The use of contractors has become more prevalent in the industry and is growing, and there has been a gradual emergence of more innovative work rosters and shift arrangements.

- The introduction of the *Workplace Relations Act 1996:*

  The Queensland coal industry strongly supported the aim of the act to limit uninvited third party intervention in workplace affairs and to place the onus on employers and employees to agree on employment terms and conditions. Key elements are:

  - The act provides for existing federal awards to be pared down to safety net awards covering minimum wages and conditions in twenty 'allowable' areas.

  - It restricts the powers of the AIRC and narrows the union right of intervention in workplace affairs.

  - The act provides for the making of agreements - Certified Agreements and Australian Workplace Agreements - covering matters both within and beyond safety net awards.

  - The act limits the field of industrial action which is legal. Industrial action during the term of an agreement is illegal and the commission has been given stronger powers to enforce strike bans and return to work orders. Protection against secondary boycotts has been restored to the *Trade Practices Act*.

  - Finally, it enshrines freedom of association, outlawing compulsory unionism and prohibiting discriminatory practices like union preference clauses in awards.

  The industry saw in the new act provision for coal mine managers to have greater scope to manage, in particular:

  - to employ and deploy their workers on the basis of abilities and merit rather than seniority or union affiliation;

  - to negotiate work and payment practices which reflect the needs of their individual sites and the true preferences of their employees;

  - to engender in their employees a sense of affiliation with the enterprise - rather than with the 'industry' or the union - which is essential in building trusting and cooperative workplace relations.

- Pursuant to the *Workplace Relations Act* procedures were in place for reviewing the industry award to (i) remove provisions which hinder work performance and productivity, and (ii) strip back the award to the twenty allowable matters listed in S89A of the act.

  These processes are in their early stages and will be progressed on a number of fronts by individual companies and coalitions of companies. A common theme, however, will be the desire to streamline the 'industry' awards applicable to them so that they are in the nature of genuine safety net awards and are positive instruments for change in the industry.

  The effectiveness of the process will depend in large part on the attitude of the AIRC - the commission will arbitrate on the awards if agreements are not achieved by the end of a transition period - and in this respect the coal industry has concerns. Indications to date are that the commission is inclined to interpret allowable matters broadly, permitting conditions to remain enshrined in the award which would be more appropriately dealt with at the workplace or enterprise level. Whether commission decisions are consistent with the intent of the *Workplace Relations Act* will require constant monitoring by the government and the industry.

5. THE ROLE OF THE MINING COUNCIL IN IR MATTERS

The industry's last review of its IR strategy in May 1997 concluded that the strategy had been implemented as far as possible within the present legislative framework. The Mining Council's advisory group which had developed and periodically reviewed the strategy was itself disbanded and the Council's role in industrial issues placed on an 'as needs' footing. The Mining Council will continue to monitor developments and provide advice and assistance to companies when requested, but its involvement in test cases before the AIRC and wage cases will be assessed on a case by case basis.

This winding back of the Mining Council's visible role does not indicate that the industry's industrial reform needs have been met - rather that an important threshold has been achieved in the form of a legislative and institutional framework which, notionally at least, enables the companies to pursue meaningful change at their own pace and in accordance with their different needs. The challenge for the industry, and the test of the new regime, will be whether this potential for change is realised in practice.

6. TRAINING

The subject of training is included in this industrial relations section of Council's submission not because it belongs here, but because it has been the widespread perception of training as a IR related issue that has done much to impede the development of an effective coal industry training agenda.

Queensland coal industry employers have had the opportunity to participate in the national training reform agenda since 1991 when the Queensland Mining Industry Training Council was established as a tripartite training advisory body. However, the QMITC had only marginal support from employers and the early training agenda for the industry developed with little employer input.

The direction of training reform was strongly influenced by third parties including government, training providers, the bureaucracy and other industries, and the only coal

industry participants contributing to the agenda were, by default, the coal unions. As a result the system that was developing was:

- complex, bureaucratic and difficult to understand;
- driven by (national) industrial relations agendas;
- expensive; and
- failing to meet enterprise needs.

In 1995 Queensland employers in both the coal and metalliferous sectors of the mining industry jointly undertook an extensive review of the QMITC. Key objectives were to reposition the QMITC, giving it a business focus and creating much closer linkage with sites. The review was generally successful, with employer support for and participation in the (newly named) Queensland Mining Industry Training Advisory Board continuing at a high level.

The opportunity for employers to further impact on the national Training Reform Agenda arose in 1995 with the establishment of a national mining industry training advisory board (NMITAB) principally to oversee the development and implementation of industry competency standards and subsequently 'training package' arrangements. Notwithstanding general industry support for the development of a competency-based training system, support from the outset for the NMITAB as evidenced by its corporate membership was poor. Very few metalliferous mining companies joined the NMITAB, while coal mining companies became members mainly so that they might effect change from within the organisation.

This poor employer support prompted a review of the NMITAB in 1996/97 with the aim of making the organisation more relevant and responsive to enterprise needs. The review abolished company membership and reconstituted the NMITAB so that it represented the network of state ITABs (and accordingly state ITAB agendas). While Queensland employers had a major influence on this reform process, the potential benefits of the changes are yet to be realised and support for the reformed NMITAB, particularly from employers, remains non-committal.

A major challenge for the NMITAB is the need to reconcile the national training framework with what is an avowedly enterprise focussed industry. This will be the key to attracting and keeping employer support and remains to be achieved. **[end]**

HEALTH & SAFETY REGULATION OF THE QUEENSLAND COAL INDUSTRY

SUMMARY

- The coal industry's unacceptably high incidence of injury and fatality has a large human cost and adversely effects the industry's profitability and competitiveness.

- The industry is committed to achieving substantial and enduring improvement in its safety performance. A necessary pre-condition of this objective is reform of Queensland's regulatory regime for coal mine safety.

- The present highly prescriptive regime is an impediment to improvement. The Queensland *Coal Mining Act 1925* is outdated and inflexible and helps to perpetuate dangerous attitudes to safety on the part of managers (compliance with the act is all that is needed) and employees (safety is a management issue).

- The legislation needs to be changed to:

  - reflect a duty-of-care approach to safety management;

  - be less prescriptive and more enabling of safety management systems and safe operating procedures tailored to mines' individual circumstances;

  - require mines to employ rigorous hazard recognition and risk analysis in developing safety management systems and to thoroughly train mine personnel in safe operating procedures;

  - establish a strong, independent and highly skilled inspectorate to audit and police compliance with safety management systems.

  Such a regulatory framework would place the onus on both mine managers and employees to assess and manage safety risks within the sphere of their control.

- The Mining Council supports the incorporation of coal within mainstream health and safety legislation as a long term goal. In the short to medium term the industry needs to keep its own separate legislation and inspectorate in order to:

  - sensibly stage the process of major change for all participants - regulators, managers and employees;

  - provide for a level of continuing prescription in regard to catastrophic accident risks unique to underground coal mining;

  - build and preserve a skilled coal mining inspectorate.

- The Queensland coal industry is presently engaged in a tripartite process of developing a new Coal Mining Act for introduction in 1998. The proposed act would represent a major step towards the industry's preferred regulatory regime.

1. INTRODUCTION

The Australian coal industry has a poor safety record which cannot be explained by the inherent hazards of underground mining and working with large mobile equipment. The unacceptably high incidence of injury and fatalities has a large human cost in terms of pain and suffering. It also has a large adverse effect on the industry's profitability and international competitiveness.

Mining accidents have the following direct effects on financial performance:-

- lost production time at accident sites;
- lost work performance from those personnel injured;
- necessity to replace the labour of injured personnel with other labour to maintain production;
- lost production time due to industrial arguments arising from some accident events;
- sick leave costs;
- personnel rehabilitation costs;
- accident site rehabilitation costs;
- damaged equipment repair or replacement costs;
- insurance premium increases;
- workers' compensation premium increases.

There are also indirect costs from accidents. The perception of high risk gets factored into pay rates and contributes to the generally poor relations between employees and management in the industry. Safety matters become confused with industrial relations matters causing less effective management of both issues and a consequent constraint on enterprise productivity.

The need for improvement of the industry's OHS performance has been well recognised for a long time. In the pursuit of widespread, enduring improvement, a crucial element is the regulatory framework within which coal mine managers and employees think and act in regard to safety. The present highly prescriptive regulatory regime in Queensland, based on singular accountability, acts as a brake on attitudinal change and needs to be overhauled to reflect the duty-of-care approach which is accepted as the basis of best practice safety management in other Australian industries and worldwide.

2. COAL INDUSTRY SAFETY PERFORMANCE

Appendix 1 is the Minerals Council of Australia's latest report on safety and health in the minerals sector. The salient findings in regard to coal are:

- There has been no discernible improvement in the coal industry's fatal injury frequency rate (FIFR) over the period since 1987/88, highlighting the exposure of underground coal mining to catastrophic accidents. The underground coal sector has an average FIFR about five times higher than the average for all Australian industry. That said, the Australian underground coal fatality rate is similar to that of the USA.

- While the coal industry has demonstrated a substantial long term improvement in its lost time injury frequency rate (LTIFR) the rate remains unacceptably high.

  Again the underground sector of the industry has mainly accounted for the high overall injury rate, although the open cut coal LTIFR has not shown substantial improvement since 1992/93. Australian underground and open cut coal LTIFRs are about double those in the USA and significantly higher than in South Africa.

- Underground and open cut coal display the highest injury duration rates in the Australian mining industry.

Clearly the underground coal industry must manage its catastrophic risk potential more consistently and reliably, and both the underground and open cut sectors of the industry need to substantially improve lost time performance to achieve acceptable national and international standards.

3. THE NEED FOR A NEW REGULATORY APPROACH

3.1 Effect of the Current Legislation

The Queensland coal industry believes the state's *Coal Mining Act 1925* is a major impediment to improving OHS performance in the mines. The act and many of its associated rules are widely recognised as being out of date and in need of major revision. Whilst the act has an underlying intent of improving safety it is clearly failing to achieve the desired result.

The ways in which the act is holding back improvement in OHS performance include:

- It is overly prescriptive and detailed, yet well out of date in regard to some of its requirements on mines.

- It has been cobbled together from earlier acts and amended over the years, often as a 'knee jerk' reaction to significant accidents. The end product lacks vision of the wider issues in safety management and imposes unnecessarily prescriptive requirements on all mines irrespective of their differing working conditions.

- It prescribes a rigid management structure for the mines which is increasingly unsuited to modern operational arrangements.

- It has tended to set minimum standards on safety matters and this has encouraged the erroneous belief that compliance with them automatically equates to the achievement of satisfactory OHS outcomes.

- It places almost all responsibility for accident prevention upon the mine owner and manager rather than encouraging the view that safety is a wider responsibility for the entire workforce.

In summary the act has, in the detail and nature of its prescriptions, fostered wrong attitudes - on the part of mine workers who believe that safety is largely a management issue, and on the part of mine managers who believe that ensuring compliance with the act is all that needs to be done on safety matters.

To change the situation will require a very different legislative setting. Those mines which have embarked on major and successful OHS improvement initiatives have done so because

they realised that the current act could offer no further improvement in OHS performance and an alternative approach was necessary. In some cases they have achieved considerable success in their efforts to improve safety awareness and performance. However, the current act does not necessarily underpin and support their efforts and in some cases may directly impede them. The coal mines inspectorate in Queensland is generally supportive of individual initiatives of this kind even if they are often outside the legislative framework.

Examples of improvement in safety performance in the Queensland coal industry have happened in spite of the *Coal Mining Act*, not because of it. Whilever the act continues to exist in its present form these gains will be constrained in number and in extent regardless of the industry's strength of will to minimise fatalities, injuries and lost time.

3.2 The Required Legislative Framework

Queensland's coal safety legislation needs to be changed in the following ways if it is to underpin further improvements in the industry's OHS performance:

- It needs to be less detailed and prescriptive and more general and enabling of different (mine specific) safety management practices.

- It should enable the wide use of recognised existing standards - including but not necessarily confined to those of the Standards Association of Australia - instead of creating new and different regulations to cover the same issues.

- It should not prescribe managerial structures for mining enterprises, which should be free to develop structures to best ensure favourable OHS and production outcomes.

- It should embody the duty-of-care concept, spreading responsibility for OHS matters to all members of the workforce in proportion to the extent that they can influence OHS outcomes.

- It should require each mine to implement a safety management system by which the safety risk circumstances at that mine can be specifically addressed through the process of hazard recognition and risk analysis using a cross section of the workforce to undertake the task.

- It should require the outcome of safety management systems to be the production of safe operating procedures which reflect the specific conditions of operation at individual mines.

- It should require all personnel at each mine to be thoroughly trained in that mine's safe operating procedures before they undertake the associated activities.

- Because of the unique working environments in coal mines, particularly but not exclusively in underground operations, the legislation will need to retain some prescriptive rules or regulations to govern catastrophic risk areas such as the potential for mine explosions.

- It should establish a strong, independent, well skilled and industry-specific inspectorate charged with the responsibility of auditing the performance of mines against their safety management systems and policing the performance as necessary.

QMC believes that under this legislative framework the onus would be focussed on both the mine management and the mine workforce to accurately assess the operational risks inherent

in the activities at their particular mine rather than enabling them to assume that all risk will be adequately covered by general prescriptive legislative requirements.

Such a change would force all elements of the Queensland coal industry, including regulators, to re-assess their approach to work and safety. Within the mines, the use of cross sections of the workforce to carry out risk assessment and the development of consequent safe operating procedures would result in better general ownership of outcomes.

Underpinned by duty-of-care concepts this would provide the basis for a major improvement in OHS performance in the industry.

3.3 Transition to a New Framework

The Mining Council is aware of the Industry Commission's report on Work, Health and Safety (No. 47. 11/9/1995). In many respects Council's position on the preferred legislative environment for coal OHS parallels the Commission's recommendations in that report. However, there are two areas of notable difference.

The first is in regard to the generality of the legislation. The Commission recommended that there should be only one act to govern all industries in order to simplify the current plethora of legislation. Our Council believes that this would be too great a change for the coal industry to accommodate in the short term. The coal mines have a long tradition of working under a restrictive and prescriptive act targeted specifically at the nature of work in the mines.

Although Council generally supports the view that the coal industry must join the mainstream of OHS legislation it believes this should be achieved through more gradual evolutionary processes than suddenly moving to a single and all embracing health and safety act as envisioned in the Commission's report.

There would need to be considerable adjustment of attitudes within the coal industry to comply with the preferred legislative framework envisaged by the Mining Council. It would represent a very significant change from that to which the industry has become accustomed over more than a century - the 1925 act in Queensland was preceded by other prescriptive legislation dating back to 1881.

Council believes that to achieve the required changes in attitudes to improve OHS outcomes it will be necessary to preserve special legislative coverage for the coal mines in the short term. In particular, we believe that it would be very difficult for a general industry workplace health and safety act to incorporate the necessary minimum requirements to guard against cataclysmic events which arise from the unique difficulties posed in underground coal mine environments.

Incorporating these into general legislation for all industries would unnecessarily complicate that law and partly defeat the simplification the Commission's recommendation was seeking to achieve.

Before coal mines can become regulated by a single general industry act it will be necessary first to demonstrate that OHS performance is improved by the use of duty-of-care concepts, safety management systems and the greater flexibility these instruments provide.

Given the traditional poor OHS record of the coal mines, there is entrenched concern by some parties, particularly in the coal industry unions, about whether the industry is capable of

moving away from a prescriptive regime to a more flexible system while maintaining and improving safety performance.

To accommodate these concerns, both real and perceived, the Mining Council believes the best path to follow is one of 'co-regulation' in which legislation is amended to enable individual mines to develop their own unique operating procedures, while still retaining some prescriptive elements to ensure that controls to cover cataclysmic events are in place at all mines.

The co-regulatory approach will best enable an evolutionary transition from the traditional prescriptive regulatory regime to a full duty-of-care regime over time whilst maintaining safeguards to cover for the main concerns of mine workers and regulators.

In the longer term, provided that the expected improvements are achieved through the use of safety management systems at mines. it then could become practicable to include the cataclysmic event risk controls into individual mine safety management systems and move towards the position proposed in the commission's 1995 report as a later evolutionary step.

The Queensland coal industry is also at pains to avoid the situation arising in which, as is presently the case in NSW, the state's general workplace health and safety law would sit as umbrella legislation above a specific coal safety act. The industry believes this would be a formula for confusion and a loss of focus on OHS priorities.

Our second area of difference with the commission's 1995 report arises from the first and relates to coal mine safety inspection. The Commission's report favoured a single inspectorate to police the proposed single act covering all industries. While Council agrees with the inspectorate's powers as envisaged by the commission, we believe that coal mining merits its own separate inspectorate for as long as the industry is regulated under a separate act.

The working environment of an underground coal mine is unique amongst industries, and to understand that environment it is necessary that the inspectorate be recruited from within the industry. Salaries in the coal industry are high by Australian standards which, in turn, means that attracting suitable members to the coal mining inspectorate requires higher than normal inspectors' salaries. If all inspectors resided in one group it would be extremely difficult to ensure that coal mining inspectors were paid more than their non-coal mining fellow officers, and therefore unlikely that persons of appropriate skill levels and experience could be retained on the coal side.

Given an intention exists to change coal mining legislation in Queensland in the directions preferred by our Council it will become increasingly important that inspectors have higher skill levels than in the past, since one of their future roles will be to audit a wide variety of mine site operating procedures as well as the scope and content of the underlying safety management systems. The days will be gone when a single legislative document was the yardstick by which to determine compliance or lack of it with legislative requirements.

In short, just as it will be important in the short term to maintain a separate act to regulate health and safety in the Queensland coal industry, then so it will be necessary to maintain a separate inspectorate - at least until such time as substantial and sustained improvement in OHS performance is demonstrated by the industry.

3.4 Progress in Creating Legislative Change

The industry is not alone in recognising the need to change the coal mining safety legislation in Queensland. Since 1991 the Mining Council has been active in negotiating the format of a new *Coal Mining Act* embracing the industry's preferred concepts. A legislation review committee comprising representatives of the Council, the mines inspectorate and the coal mining unions was formed to develop the framework of a new act. In addition, several sub-committees of similar tripartite composition were formed to review and develop regulations to supplement the proposed act, using the method of hazard and assessment recognition to determine what regulations, if any, would be necessary.

By mid 1994 the framework of a new act had been formed, although not all elements were agreed by all the parties.

The tragic explosion at Moura No. 2 Colliery in August of that year set back further development of the revised law. All work ceased on legislation review and development pending the outcomes of the inquiry into the accident. When these became known in early 1996 a process of implementation of the Moura inquiry's recommendations was afforded priority over all else.

As the Moura recommendation implementation process drew towards conclusion early in 1997 the legislation review committee and some of the regulatory sub-committees resumed their work.

The current status is that the draft act has undergone several further revisions during 1997 but is nearing its final form. The open cut coal mine regulation review is also nearing completion, while the underground regulation review is lagging but is being given urgent attention. It is proposed that the new act will become law during 1998.

The coal industry disagrees with some aspects of the draft act, principally in respect of its requirement for continuing with a number of defined management positions for which statutory certification will be required. The unions see a necessity for the act to preserve these positions, partly to ensure safety but partly because they believe it will preserve some traditional employment classifications.

Conversely, the Mining Council argues that the requirement to retain certain traditional 'management' positions will limit the scope for mines to determine safety management arrangements which best suit their particular operations and in this way negate some aspects of the new legislative regime.

Nevertheless, the draft act is a significant improvement on the existing legislation and includes most of the elements of the industry's preferred regime described earlier. In particular, it embraces the duty-of-care concept and would require the introduction of safety management systems at all mines.

4. CONCLUDING COMMENTS

The OHS performance of Queensland coal mines must be improved. The best method of enabling this is to replace the straight jacket of the Queensland *Coal Mining Act 1925* with a (coal specific) regime providing greater flexibility for mines to evolve their own safety management procedures in accordance with their individual circumstances. Considerable progress has been made towards this goal during the last six years and given the effort which has been expended to date and which will be required on the part of individual mines in future under the proposed new law, the Mining Council believes that the new act must be trialed before further major changes to legislation are contemplated.

The coal industry believes that under the proposed act, OHS performance will be improved with consequent savings in production costs and improvement in the industry's competitiveness. **[end]**

COAL RAIL REFORM IN QUEENSLAND

SUMMARY

- The coal industry acknowledges and endorses the direction of change in the Queensland Government's approach to coal rail haulage. However, the pace and quantum of change have been insufficient to keep pace with the demands on the industry from increasing global competition.

- The Queensland coal industry needs lowest achievable freight rates as soon as possible.

- Present coal rail reform policy in Queensland has not delivered, and will not deliver, lowest rates. Coal freight rate determination lacks transparency. Coal rail asset values are kept secret but are likely to be overstated because of the valuation method employed. There is no mechanism for assessing rates against best practice. There is indirect evidence of substantial overcharging.

- The Queensland coal industry is looking to third party access to produce lowest rates by allowing competition for contestable rail services and ensuring independent regulation of monopoly services. Prima facie, the only coal rail service which could not be opened up to competition is ownership of the existing infrastructure. All other services - train operation, infrastructure maintenance, train scheduling and control - should be regarded as contestable.

- Where a service is open to competition, the coal industry is content to accept market outcomes, provided that provision of third party access to the track and any other non-contestable services is subject to an effective access regime. An effective regime is one which:

  - › has been developed cooperatively by all stakeholders and has been certified by the NCC/Federal Government;

  - › facilitates entry by third party operators to the network by:

    - ensuring equal opportunity for existing and potential operators to access train paths;

    - enshrining fair and consistent treatment of all operators;

    - enabling new and innovative methods of operation;

    - ensuring competitive neutrality between the government owned incumbent and new entrants;

    - providing clear procedures and documentation covering technical and safety parameters and operating protocols.

  - › embodies transparent, cost reflective access pricing based on efficient service delivery, including:

    - posted access prices by track segment / train path;

    - the allocation of fixed and variable costs on a user-pays basis (same price for same service);

- no discriminatory pricing or cross-subsidisation between mines or between coal and other traffic groups;

- continual benchmarking to ensure below track costs are at or targeting world's best practice;

- historical cost asset valuation and prescribed rates of return determined by CAPM or similar method for equating returns with actual commercial risk.

› is genuinely independent, providing ready access to an independent regulatory / arbitral body whose jurisdiction encompasses all aspects of the regime.

- Queensland's coal rail access arrangements must not carry forward the deficiencies of the present arrangements. If replacement cost asset valuation was preserved much of the expected benefit to users from competition reform would not materialise. There must be transparency of the costs of any service retained as a regulated monopoly. Any differential treatment of traffic types should be done explicitly through CSOs rather than discriminatory charges.

- The access regime also needs to be supported by a competitive rail industry structure. Queensland's present vertically integrated structure is anti-competitive and needs to be comprehensively reviewed - the NSW model being only one of a range of possible options. The recent independent inquiry into the Queensland electricity industry, and subsequent reorganisation of the industry, provides a proven model for addressing rail structure.

- Whether the opportunities arising from the concept of third party access are realised in regard to coal rail will depend on the level of commitment of the Queensland Government to developing an effective access regime and a supporting rail industry structure. The Industry Commission could assist in enhancing the government's appreciation of the need for an effective regime and a competitively configured rail sector.

1. INTRODUCTION

Rail reform has been and will continue to be a critical determinant of coal industry development in Queensland. Rail freight concessions introduced from 1984 provided a crucial measure of relief for the industry when the eighties 'coal boom' failed to materialise. Although freight rates stayed very high, without the concessions that were given many of the mines commissioned in the late seventies and early eighties would have become economically unsustainable.

That said, no new coal mines were then commissioned until after 1989 when significantly lower freight rates were offered to new projects. Investment in Queensland coal assets was simply untenable until rail charges were reduced to something approaching commercial levels.

The present, third phase of reform began in 1994 and is characterised by the corporatisation of Queensland Rail (QR), the application of commercial pricing principles to freight rate determination and a commitment by QR to achieve world's best practice coal rail operations by 2000.

Phase four will be the introduction of third party access to the Queensland coal rail system and will be even more important than the other reform measures introduced to date. Achieving effective access arrangements is the coal industry's main focus in the area of rail reform.

2. INDUSTRY OBJECTIVES

The Queensland coal industry aims to achieve effective rail services at the lowest achievable freight rates that are sustainable and equitable:

- An effective service is efficient, reliable and flexible enough to cater for mines' particular operational needs.
- Sustainable freight rates are sufficient to maintain the rail system and enable efficient haulage operators to stay in business.
- Equitable rates are based on the cost of the service, not on perceived capacity to pay, and do not discriminate among mines or between mines and other categories of rail users.
- Lowest achievable rates are those which are genuinely commercial - embody no monopoly elements - and are based on world's best practice standards of efficiency.

The industry does not have confidence in present arrangements delivering on these objectives. The policy and institutional settings are wrong. QR is a monopolist with a traditional reliance on the coal industry as the mainstay of its business and subsidiser of its unprofitable activities.
Prior to 1993 the state government through the treasury department rigorously promoted this approach and thereby established the coal industry's deep seated mistrust of the rail reform process in Queensland.

Since 1993, this situation has not been adequately addressed by the corporatisation of QR. Rail freight pricing remains opaque; coal rail costs and profits are concealed; the setting of CSOs is obscure, and there is no mechanism in place for achieving best practice freight rates.

And there is evidence that QR's concept of a commercial freight rate is substantially overpriced - by as much as 1.6 cents per net tonne kilometre (ntk) or $3.50 per tonne on average. The difference which potential freight rate reductions of this magnitude would make to the attractiveness of investment in new coal projects is difficult to understate. The industry is strongly motivated to pursue third party access as a means of furthering the process of coal rail reform in Queensland.

3. EVOLUTION OF COAL RAIL FREIGHTPOLICY

3.1 De Facto Royalties

From its inception in the mid 1960s the Queensland export coal industry was subject to excess charges for the rail transport of its product from the mines to the ports. The state government's basic approach was established with the *Thiess Peabody Mitsui Agreement Act 1965* which set the arrangements for the rail line from the Moura mine to Gladstone port, and established the principles which would direct policy for more than twenty

years. The main aspects were (i) funding by the mine of the rail track and rolling stock, but ownership and operation of it by the government, and (ii) use of the facilities to assess royalties on the mines by over pricing the rail services.

The policy was made enforceable by the government's absolute control of the mine to port transport task. Rail is the only practical and economic option available to the mines and Queensland Rail is by law the only provider. Until a few years ago, the mines negotiated freight rates with the Department of Treasury, not with QR, and the freight rates they were 'offered' depended on Treasury's belief about each mine's capacity to pay.

The effects of this approach were mainly three. First, there was no predicability in the system and no relationship between freight rates and the cost related factors like distance, volume and efficiency which would normally determine a rail charge. Planning prospective projects was difficult and negotiations with Treasury were protracted and one-sided.

The government and QR became 'hooked' on the excess revenue from coal rail charges and were very slow to adapt the policy to the chronic deterioration in export coal prices which took hold in the early eighties.
A damaging dynamic developed, with QR's coal division diverting badly needed funds out of the industry and into its loss making passenger and general freight operations. Public sector inefficiency was perpetuated at the expense of coal industry investment, which effectively stalled.

Third, the system was riddled with inequity, elements of which still persist. Different classes of mines were created - (i) sixties/early seventies mines locked into high freight rates, (ii) late seventies/early eighties mines on very high rates, and (iii) newer mines which negotiated much lower rates from the late eighties, by which time the government had belatedly accepted that rail charges had to come down if there was ever to be another coal mine built in Queensland. The majority of Queensland coal tonnages still fall into categories (i) and (ii).

The persistence of these inequities continues to place many mines at a substantial competitive disadvantage.

3.2 Recent Reforms

Policy changes in the last five years have established, at least in principle, several important departures from the coal rail pricing approach described above:

- A review of coal rail and royalty arrangements (concluded 1993) established a programme for phasing out the use of freight rates to collect de facto coal royalties. From 1994, rail agreements for new mines and mine expansions would contain 'commercial' freight rates based on operating costs plus a return on QR funded capital.

  Established mines would go onto commercial freight rates from 2000, or earlier where their existing rail agreements expired before then or were re-negotiated to the mutual advantage of the mine and QR.

  However, for each mine the change to commercial freight rates would be accompanied by an increase in explicit ad valorem royalties to 7% of coal value.

The increase would be either two or three percent of free-on-rail value depending on whether the mine was an open cut or underground operation.

- The corporatisation of QR established the principle that there would no longer be cross subsidisation between different categories of rail users, with QR's loss making activities being funded out of general government revenue.

  QR would enter into contracts with the government for the delivery of community service obligations at 'prices' reflecting efficient operations, and QR would annually report those CSOs by programme and by their capital and operating cost components.

- QR and the government made a commitment to achieving world's best practice coal rail operations. Export coal haulage rates were to be "based on internationally benchmarked commercial freight rates" (1994/95 State Budget Speech).

Important as these policy changes are, they nevertheless fall well short of what is required by the coal industry. Important elements of the package have not been adequately implemented while in other respects the programme has been deficient because it failed to adopt key industry objectives from the start.

4. OUTSTANDING REFORM ISSUES

4.1 Transparency

The most serious deficiency in present rail freight policy is the lack of real transparency. Appendix 1 contains relevant extracts from QR's most recent annual report and a description of QR's commercial pricing principles for coal. These represent the sum total of information available to the coal industry on the determination of freight rates.

The mines have no means of verifying that freight rates are genuinely commercial. They are not entitled to know the value of rail assets attributed to their use, the rate of return applied to those assets or the operating cost component charged to them. Freight rates effectively emerge from a black box, the contents of which are known only to QR.

This lack of transparency extends to QR's public reporting. Operating expenses, asset values and rate of return are reported only on a total QR basis. There is no break down by business groups - that is, coal & minerals versus passenger versus general freight - and returns among those groups might differ significantly. The coal & minerals group might be wholly responsible for the entire 9.8% return on $5,850 billion of QR assets recorded by the railway in 1995/96.

QR's rate of return requirements should not vary markedly from one business group to another if CSOs are properly costed, but there is reason to question whether they are. Contrary to its corporatisation charter, QR is still reporting CSOs only on a business group basis - not by programme, and not by their separate capital and operating cost elements. QR is yet to enter into CSO contracts with the Government and does not anticipate complying with its obligation for detailed CSO disclosure until the release of its 1997/98 annual report.

The coal industry's requests over many years for QR to report costs and returns by business group have been rejected on the grounds that it would compromise QR's 'commercial integrity'. This fragile commercial integrity was ascribed to QR even when

its monopoly position was undisputed. With the prospect of third party access, the argument shifted to protecting QR from potential competition.

Up to 1994/95 QR's operating revenue was reported by business group, but even that practice has been stopped because QR does not want to risk the information being used by a prospective third party competitor.

4.2 Asset Valuation

The coal industry believes that QR has adopted a method of asset valuation which is guaranteed to lead to overpricing of commercial coal rail services.

Appendix 2 contains more detailed comments on the replacement cost approach to asset valuation and its application by Queensland Rail. In summary:

- Replacement cost is not used in the private sector, and its use by north American railroads was explicitly rejected by US regulators in favour of historical cost.

- Replacement cost is said to be (i) preferable to historical cost in accounting for the opportunity costs of capital - which it is not, and (ii) necessary to sustain assets - which it is not. Replacement cost valuation causes an over-recovery of capital costs.

- Replacement cost is irrelevant to assets like track and earthworks which are sustained by maintenance charges in freight rates and effectively have indefinite lives.

- For shorter lived assets, replacement cost valuation is impractical. Given the continual technological change to which locomotives and wagons are subject, the need to adjust values to reflect the relative service capability of potential replacement assets introduces prohibitive complexity. The approach will not be implemented properly.

- QR applies a nominal rate of return to current cost values, resulting in double recovery of the effects of inflation on asset values.

The Queensland coal industry is not alone in believing that the common acceptance of replacement cost valuation is one of the most serious deficiencies inherent in the present pricing of government enterprise services, including rail services. It permits manipulation and enables over charging under the guise of commerciality. If the practice is allowed to be carried over into the arrangements for third party access to those services it will significantly limit the potential benefits meant to accrue to users from competition policy.

The rationale for current cost valuation needs to be debunked and is deserving of special attention by the Commission.

4.3 Evidence of Overcharging

Given the lack of transparency, the industry has had to resort to informed estimates of QR's coal system costs.

Appendix 3 contains a cost analysis by Coopers & Lybrand and RG Read & Associates for the Queensland Mining Council. The study relates to 1993, but its key findings are still very relevant, namely:

- an average commercial coal freight rate is $4.70 per tonne or 1.94 c/ntk (average 240km haulage distance);
- this incorporating operating expenses plus a reasonable rate of return on QR funded capital; and
- recognising and removing from the calculation the value of rail assets contributed by the mines; and
- valuing the rail assets on a written down replacement cost basis to provide conformity with QR's pricing policy; and
- employing a CAPM approach to a derive an average cost of capital reflecting QR's specific risk.

The C&L estimate contrasts with QR's reported average commercial freight rate of 3.6 c/ntk or $9 per tonne (QR Annual Report 1994/95 - coal haulage revenue $764m net of de facto royalties; tonnes carried 85.2m; net tonne kms 21,341m). The estimate indicates overcharging to the extent of 1.6 c/ntk ($4/t) on average, or in excess of $300 million abnormal profit to QR based on present coal tonnages. Note that this surplus is over and above the $270 million in de facto royalty receipts which QR separately identifies and remits to consolidated revenue.

4.4 Best Practice

Neither QR nor the Queensland Government has established a mechanism to deliver the stated objective of 'internationally benchmarked commercial freight rates' for coal haulage. While QR has a benchmarking programme in place for its coal division, the programme relates only to operating costs and gives no indication of QR's performance on freight rates relative to best practice.

The main elements of the programme are:

- The formation of a joint advisory group of the coal industry, the government and QR (the JAG) to examine world's best practice in relation to QR's coal haulage operations.
- A study by consultants Mercer and Travers Morgan which (i) identified the Class 1 North American Railroad, Burlington Northern (BN) as QR's best practice benchmarking partner, (ii) estimated the operating cost difference between QR and BN and the main explanatory factors, and (iii) identified a set of performance indicators for monitoring QR's progress towards best practice.
- The adoption of a CPI – X method of rail freight escalation, with the size of X to reflect in advance the reduction in real operating costs per ntk required by QR to achieve best practice by 2000.

- A programme of two-yearly reviews of QR progress against best practice and adjustment of the X factor accordingly.

The Mercer / Travers Morgan study established that QR was a reasonably efficient operator by world standards. QR's operating costs per ntk were found to be 25% higher than BN's, but once unavoidable structural factors were taken into account, the gap reduced to 17%.

Further discounting of the difference to account for cost savings that were capital dependent left a 10% gap which represented the potential savings from QR operating more efficiently. It is the closing of this 10% gap, plus any unanticipated further reductions in BN's costs, which the JAG's biennial review programme is designed to monitor.

As mentioned, QR's benchmarking programme is confined to operating costs. It does not encompass freight rates and the omission is deliberate. The coal industry's requests for the programme to be expanded to include capital costs - and thereby provide a basis for assessing QR's price performance - was refused.

The Bureau of Industry Economics found that in 1994 QR's commercial freight rates were around 1.0 - 1.5 c/ntk higher than average rates in the USA for coal hauls of comparable length (Rail Freight 1995 - International Benchmarking).

The Mining Council is critical of the BIE analysis. On the one hand it compared QR with a composite of US short haul railroads, not the Class 1 longer haul carriers which represent best practice. On the other, the study's finding that the effect of traffic density on unit rail costs was negligible is counter-intuitive.

QR's coal haulage operations differ in meaningful ways from the US Class 1 railroads. The latter typically have significantly longer haul lengths and higher traffic densities and standard gauge operating envelopes which permit larger capacity rolling stock. And in some cases the coal wagons are owned by the customer rather than the railroad.

However, the QR system also has favourable features which should assist its ability to provide lower freight rates - largely dedicated coal lines to assist train coordination, large mine and port stockpiles to assist railings consistency, favourable terrain, and the fact that a large part of system infrastructure and rolling stock was funded by direct contributions from the mines. And it has been established that QR's operating costs are not more than 25% above those of the best operating coal railway in the world.

In light of these factors it is difficult to reconcile QR's average commercial rate of 3.6 c/ntk with the US Class 1 rates of 1.1 cents to 1.8 c/ntk reported by the BIE (and confirmed by observations of the JAG on a 1995 study tour of north American railroads).

QR's adoption of the best practice objective was an important step and strongly supported by the coal industry. But it does not go to the real issue - which is how QR's concept of a commercial freight rate compares to best practice standards - and therefore its value to the industry is limited. The present offset of rail freight escalation (CPI – 1.3% pa) and any further adjustment arising out the monitoring programme will not deliver world's best practice equivalent rates by 2000.

5. THIRD PARTY ACCESS

The coal industry is looking to competition policy to breathe new life into rail reform in Queensland. Third party access, in particular, is seen as a means of achieving lowest possible freight rates in two main ways:

- by allowing competition for contestable rail services;

  A real threat of entry by third parties, whether realised or not, would compel QR to behave more commercially or risk losing its only profitable business.

- by ensuring independent regulation of monopoly rail services.

  Access provides new avenues for achieving transparency and for subjecting key cost elements (asset values, rates of return) to challenge before independent arbiters.

Whether these opportunities are realised will depend on the effectiveness of the coal rail access regime which is implemented in Queensland. How soon they may be realised - and for the coal industry this cannot be soon enough - will depend on how committed the Queensland Government is to developing an effective regime. The Commission's inquiry could assist greatly in enhancing the government's appreciation of the industry's needs and its level of commitment to the process.

5.1 State of Play

Queensland does not have an effective rail access regime. This is acknowledged by the government and has been confirmed by the National Competition Council's findings in respect of the Carpentaria Transport application for national declaration of QR services.

That said, the facility to develop a state regime now exists. The recently introduced *Queensland Competition Authority Act 1997* establishes the procedures for gaining access to essential infrastructure and an independent body (the authority - QCA) to administer them. The act:

- provides means for infrastructure services to become subject to access - i.e. 'declared' - through government regulation or upon application to the QCA;

- provides for the owner / operators of declared services to negotiate access terms with third parties and reach enforceable agreements;

- to facilitate agreements;

  - provides for the development of infrastructure-specific Access Codes to lay the ground rules for access to particular services;

  - provides for infrastructure owners to develop Access Undertakings laying down the detailed terms and conditions on which they will provide access to their facilities;

- provides for the QCA to:

  - receive declaration requests and recommend whether services be declared;

- arbitrate on disputed terms and conditions between infrastructure providers and third parties;
- provide advice on Access Codes;
- require/develop/approve Access Undertakings;
- conduct investigations and public inquiries into the above matters.

Considerable uncertainty surrounds the translation of this framework into a working coal rail access regime. The Queensland Government has appointed the members and staff of the QCA and, at the time of writing, was preparing to introduce a regulation declaring certain QR lines subject to access. The coal lines will be included in the declaration, but will be subject to a moratorium on access to November 2000 in the same terms as the coal rail moratorium contained in Part III of the *Trade Practices Act*.

However, beyond that the process appears to have lacked definition or clear direction. The purpose and content of the Rail Access Code and QR's Access Undertaking - which together will describe the access arrangements - are unclear. So too is the government's intentions regarding application to the NCC/Federal Treasurer for national certification of a regime. Just what is intended, and when, has proved to be moving feast and the coal industry has yet to be included in the process in a meaningful way.

The industry has two main concerns. First, time is passing - the moratorium on coal rail access expires in November 2000. If coal haulage operations are to be contestable from that time, then a comprehensive and effective rail access regime will need to be in place by the end of 1998. This is to allow sufficient time for negotiations among mines, potential operators and the access provider, and for new entrants to acquire rolling stock and set up the necessary operating systems.

Second, the industry is concerned that it will not be included in the development of an access regime or that its inclusion will be largely token, which has happened before on other rail related issues. The industry does not want a replay in Queensland of the NSW coal rail access experience. The fact that more than twelve months after the introduction of a NSW rail access regime there is no competition on the Hunter Valley line and effectively none in prospect, and that the issue seems destined for the Australian Competition Tribunal, is largely down to the failure of the state government to consult with the coal industry at an early stage.

5.2 Elements of an Effective Coal Rail Access Regime

Prima facie, the ownership of the existing rail infrastructure is the only one of QR's coal services which could not be opened to competition. All of its other services to the coal industry - haulage, infrastructure maintenance, train scheduling and train control - should be regarded as contestable.

Where a service is opened to competition the coal industry will be content to accept market outcomes, provided that provision of third party access to the track and any other non-contestable services was subject to an effective access regime. An effective regime is one which satisfies the following basic criteria:

5.2.1 Non-Discriminatory Access

An effective regime would facilitate third party entry to the network. It would:

- ensure equal opportunity for existing and potential operators to access available train paths;
- enshrine fair and consistent treatment of all operators by the access provider;
- enable new and innovative methods of operation;
- ensure competitive neutrality between government-owned operators and new entrants; and
- lay down clear procedures and documentation covering technical and safety parameters and operating protocols.

Any established government-owned train operator will have a significant competitive advantage from incumbency, and in QR's case this is enhanced by the coal rail access moratorium. The rules and procedures of access must not perpetuate this advantage. For prospective entrants the critical requirements appear to be:

- sufficiently detailed information on train paths, access pricing, and operating procedures and requirements to enable them to identify and evaluate a service;
- certainty as to the train paths and other entitlements they purchase from the access provider;
- confidence that they will be fairly treated by the access provider in relation to one another and the incumbent operator;
- reasonable scope to do things their own way, rather than being locked into the incumbent's mode of operation.

Failure to provide these things will frustrate and discourage prospective operators. This has been demonstrated by the experience with the NSW rail access regime.

5.2.2 User Pays Pricing

An effective rail access regime will embody transparent cost-reflective pricing based on efficient service delivery. It will provide for:

- posted access charges by line segment / train path (segment plus railing time slot);
- allocation of fixed and variable access costs on a user pays basis - that is, same price for same service;
- no discriminatory pricing (eg. Baumol-Willig) or cross-subsidisation between users / operators or between one class of users and another;
- continual benchmarking to ensure access costs are at or targeting world's best practice; and
- historical cost valuation of assets, with prescribed rates of return determined by CAPM or similar methodology for equating returns with actual commercial risk.

An objective of access should be to eliminate the traditional monopolistic abuses of government owned service providers. Transparency should be a basic feature, there being no legitimate reason for an access provider not to disclose all elements of its costs and returns by each different category of traffic.

The ability to exercise price discrimination should be severely proscribed. Access prices should reflect fully distributed costs and should be published in schedule form according to track segment and train path. Keenly contested paths and special entitlements - like automatic right-of-way for passenger trains - should attract a price premium.

Negotiations around the posted price should be limited to variations in the service which have a genuine effect on the costs of delivery, and the access provider's assessment of the users' capacities to pay should play no role in price setting.

The access provider should not be an instrument for wealth redistribution. Governments wishing to support non-commercial activities should do so through CSOs that are fully costed i.e. commercial traffic should not be loaded up with capital costs and overheads that really belong elsewhere. The publication of CSOs by line and traffic type and by capital and operating component is essential.

Last, access charges should not be permitted to embody, and thereby perpetuate, inefficiency. Benchmarking against best practice, allied with CPI–X escalation or similar productivity incentive, should be employed.

5.2.3 Independence

An effective access regime is one which is subject to genuinely independent regulation. There must be ready recourse by third parties to an access regulator established independent of the government and the access provider. The scope for government direction of the regulator should be limited to procedural matters, and all aspects of the regime must be open to challenge and change by the regulator. The government should be not able to insulate an element of the regime from scrutiny - e.g. the access provider's required ROR - by making it an article of government policy.

5.3 Rail Industry Structure

The industry structure within which an access regime operates may be a crucial factor influencing the regime's effectiveness. The standard approach is physical separation of the monopoly and contestable elements of a service in the interests of ensuring non-discriminatory treatment by the access provider of all established and prospective access seekers.
This reflects one of the basic presumptions of competition policy - that vertical integration is inherently anti-competitive and in attempting to establish genuine contestability the burden of proof should rest with those who would retain integrated structures.

The coal industry strongly supports a review of rail industry structure in Queensland. The present configuration - a ring-fenced network access unit within a fully integrated QR - needs to be examined in respect of its implications for effective third party access.

Appendix 4 describes the potential advantages and disadvantages of the three 'conventional models' of rail structure:

- full integration - QR now;
- horizontal separation - in which QR would be segregated along business group lines;
- vertical separation - in which QR would be segregated along functional lines.

This breakdown is purely representative. There are a number a possible variations on the conventional options, all of which would need to be included in a thorough examination of options.

The coal industry acknowledges there are potential cost advantages of retaining QR's integrated structure. However, scale economies can be easily overstated and their significance wrongly held to be self evident. Power generation is a case in point in Queensland. The recent inquiry into the electricity sector found that the cost benefits from having a single state generating authority had been exaggerated - the economies were not significant and were outweighed by the threat to competition from keeping AUSTA Electric intact. The inquiry showed the need to question accepted wisdom.

Further, just because there are potential economies from integration does not mean they will be realised or passed on to consumers. Competition is a spur to greater technical efficiency and responsiveness to customer needs. Monopoly encourages complacency, inattention to costs and resistance to innovation. To the extent that competition is impeded for want of a structure which better facilitates the entry of third parties, then integration is unequivocally bad for overall costs.

This last point goes to the main issue. The coal industry believes that the overriding concern should be the extent to which a particular structure is likely to hinder or help core competition policy objectives like contestability and transparency. On this basis the industry seriously questions the adequacy of QR's ring-fencing arrangements.

Council believes it is counter-intuitive to expect a vertically integrated, wealth maximising entity like QR to not discriminate in its own favour when dealing with third parties with whom it will be in competition.

5.3.1 The Electricity Inquiry Model

The recent, extremely effective review of the Queensland electricity industry provides a model for taking forward the issue of rail structure. The main elements of that process were:

- acceptance of the need for an industry structure and regulatory regime which reflected the competitive objectives of the national electricity market;
- the appointment of an independent expert task force to conduct the inquiry;
- quick adoption by the government of the task force's recommendations;
- the development of a reform plan and establishment of a dedicated unit to implement it.

Prior to the start of the process, Queensland was seriously lagging behind Victoria and NSW in preparing for entry to the national electricity market. Eighteen months later, the

electricity sector has been structurally transformed, new pro-competitive regulatory arrangements are in place and decades of command and control management of the industry is about to give way to a state market commencing in January 1998.

In recent years rail reform in Queensland has exhibited the same 'post-corporatisation' inertia which characterised the electricity industry prior to the review. The electricity example has demonstrated the efficacy of establishing a review process separate from the day to day machinery of government and free of any suggestion of capture by vested interests. It has also showed that an independent, expert inquiry can properly examine public interest and competition policy aspects and deliver a reform programme which is intellectually defendable and, importantly in the context of rail, politically saleable.
[end]

Replacement Cost Valuation of QR Assets Appendix 2

QR's assets are valued in accordance with the deprival approach whereby any asset worth replacing is valued at the cost of acquiring an identical or equivalent asset. Upon corporatisation, QR's start-up asset values were established by the price at which it 'purchased' the assets of its predecessor, Queensland Railways. For commercial assets like those of QR's coal & minerals group the transfer price equated with written down replacement cost (WDRC).

The coal industry believes that these transfer values were artificially derived and that WDRC is an unrealistic approach which inflates asset values and hence commercial freight rates. The industry's objections to replacement cost are both theoretical and practical:

- The worldwide economic factors behind the development of current cost valuation principles in the seventies and eighties no longer apply. Persistent high inflation, escalation of the costs of replacing assets and rising unit costs due to productivity growth lagging behind general price rises prompted a rethink of valuation principles by economists and accounting researchers. These factors are much less relevant today and the perceived theoretical advantages of current cost valuation no longer hold clear sway over its considerable practical difficulties.

- Replacement cost valuation is not used by the private sector - which government corporations are supposed to emulate - or by the Class 1 north American railroads which QR is supposed to emulate in pursuit of world's best practice. The American Railroad Accounting Principles Board (RAPB) and the Interstate Commerce Commission (ICC) explicitly rejected replacement cost valuation for use in the regulation of US railroad pricing (Easton 1996). The replacement cost approach was said to fail tests of validity, accuracy and verification, and was unnecessary even in an inflationary environment for informed decision making or for adequate provision for asset maintenance.

  Instead, the application of the prevailing nominal cost of capital to the net historical cost base was more practical for revenue adequacy and general purpose costing. It also more directly measured the sacrifice necessary to attract capital - that is, 'the costs of debt and equity are measured by the income that is sacrificed from not making the best alternative investment' (RAPB 1987).

- This last point highlights a major misconception about replacement cost valuation - that it most accurately reflects the opportunity costs of holding an asset and therefore, in a government monopoly context, should be the basis for the pricing of use of the asset.

Opportunity cost is an important consideration in pricing, but it does not imply current cost valuation. User pays pricing requires the user to pay for the opportunities that the community had to forego at the time it committed itself to a particular investment. This has little to do with replacement cost (the opportunities which would be forgone if the investment was undertaken today).At any time the opportunity cost of an asset will relate to the depreciated value of the original sacrifice. A nominal rate of return needs to be applied to that residual value - in order to reflect the best alternative use to which the remaining funds embodied in the asset could be applied - but what has happened to the cost of constructing or acquiring the asset in the interim is immaterial.

- Another related misconception is that current cost valuation is needed to ensure adequate provision of funds for asset replacement. The contention is that 'QR needs to maintain the rail system as a going concern [therefore] the relevant capital value is the current worth of the system [and] if the government were to view the rail system solely as a series of discreet cash investments, QR would eventually be starved of funds to maintain and upgrade the system' (QR coal pricing policy, Appendix 1).

  This view derives from a misunderstanding of the role of asset valuation. It is not meant to provide a sinking fund for asset replacement and, provided proper commercial pricing is applied, it is not necessary for assets to be continually revalued on a current cost basis. Companies can and do operate indefinitely by recovering their historical costs of capital. Each new asset is a separate investment decision which should stand or fall on the cash flows it generates into the future, rather than being propped up by over-recovering the cost of the asset which preceded it. The cash flow for replacement should be provided for by an appropriate nominal rate of return on each new asset when it is acquired.

  Further, the argument for replacement valuation to sustain assets contains an implicit assumption of continual asset value inflation. In a sense it pre-determines the outcome of the assessment of 'equivalent service potential' which is supposed to be carried out in any adjustment of values and might result in a decrease in valuation if properly applied.

- There is good reason to believe that replacement cost valuation will not be properly applied given the complexities involved. Australian Accounting Standards impose a number of requirements on the valuation of assets at replacement cost, including (i) adjustment for the relative service potential of the notional 'new' asset compared to the existing asset, and (ii) adjustment for the lower cost operation and maintenance of the replacement asset and consequent greater asset utilisation. This raises numerous practical problems.

  There is the problem of accommodating maintenance costs, particularly in respect of long-lived assets. Genuine maintenance costs - those which merely sustain the depreciated service potential of the asset - need to be distinguished from maintenance which has elements of replacement, refurbishment or enhancement of the asset. This is necessary to avoid double counting - charging users for the cost of replacement / refurbishment as part of maintenance charges, and then requiring them to deliver a return on the consequently higher current value of the asset.

  QR's infrastructure assets - track, signalling and the electric overhead system - are a case in point. Coal freight charges include elements for track relaying and replacement of signalling and electrical componentry to maintain the system in a constant state of renewal. Replacement cost is an irrelevant concept in respect of these assets - they have effectively indefinite lives - and replacement cost valuation results in double recovery of repair and maintenance elements already contained in freight charges.

For shorter lived assets, replacement cost valuation might not be irrelevant, but it is impractical. Rail locomotives and wagons are subject to continual technological change. New materials, re-engineering and new design result in continuous change in rolling stock performance - eg. traction power, wagon capacity, maintenance requirements, down time / in service profile - and in length of service life. Current cost revaluation requires all of these types of adjustments to be made on a regular basis. The process involves the layering of subjective judgements upon subjective judgements with a consequent loss of objectivity and verifiability. As the Centre for Transport Economics (1989) expressed it:

> *In moving from historical cost to reproduction cost we move from the actual transactions undertaken to acquire an actual asset to the hypothetical transactions necessary to acquire the same actual asset now. In adopting the 'equivalent service potential' concept, we move one step further to the estimation of the hypothetical costs of acquiring a hypothetical asset. The increased scope for disputation, and for self-interested manipulation of numbers, is obvious.*

- Finally, the rate of return target applied to QR's assets is a nominal rate rather than a real rate. The effect is a double recovery of the costs of inflation, compensating QR twice for the effects on asset values of general rice rises. **[end]**