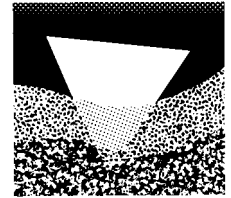


10 November 1998

Ms Helen Owens
Presiding Commissioner
Progress in Rail Reform Inquiry
Productivity Commission
35 Collins Street
Melbourne Vic 8003



QUEENSLAND
MINING COUNCIL

Dear Ms Owens

Queensland Coal Rail Reform

Thank you for meeting with us on 20 August. This letter is meant to provide focus for our appearance before the Commission in public hearing on 12 November. It describes important developments subsequent to our recent submission to the Commission's coal industry inquiry and the House of Representatives rail inquiry, of which you have a copy.

Background

The Commission's 1991 rail inquiry report recommended a number of administrative reforms to rail systems, including their corporatisation, the removal of subsidies and cross-subsidies, and the adoption of best practice operational targets.

Referring specifically to Queensland coal rail, the Commission found that freight rates were inflated by monopoly rent elements which lacked transparency, discouraged efficiency, unfairly advantaged Queensland in the Commonwealth grants process and generally deprived the state and country of economic gains from more efficient coal royalty arrangements. The Commission recommended that, as a first step, the coal royalty elements in the freight rates be identified and paid directly to state treasury.

In the Commission's mind, however, administrative changes like these were secondary to more fundamental structural and regulatory reforms needed to introduce competition to rail systems. Third party access, above/below track separation, accounting separation and prices oversight were all flagged by the Commission prior to being given greater definition by Hilmer and national competition policy.

Our council's submission late last year to the Commission's coal industry inquiry described how Queensland governments have implemented administrative type changes which have gone only part way towards addressing the coal industry's rail freight needs. The submission explained how the industry is looking to third party access to deliver competitive haulage rates and fair infrastructure charges, and described the basic attributes that would need to be reflected in a Queensland rail access regime for it to be effective.

7TH FLOOR
SANTOS HOUSE
60 EDWARD STREET
BRISBANE Q 4000

FAX 07 3229 4564
TEL 07 3221 8722

Queensland
Mining Council
A.C.N. 050 486 952
Email qmcstaff@qmc.com.au
Internet <http://www.qmc.com.au>

Recent Developments

Subsequent to our submission to the coal industry inquiry:

- A state government review of Queensland Rail's structure decided to preserve the railway as a vertically integrated entity, thereby casting doubt on the development and effective delivery of an even handed rail access regime.
- The Commission's draft coal inquiry report in April recommended that the Queensland Government accelerate the development of a comprehensive and effective rail access regime that could be certified by the National Competition Council.
- The Queensland Government has lifted its moratorium on coal rail access (which had replicated the Commonwealth moratorium that itself has been found by the Federal Court not to preclude access by third party operators to the Hunter Railway Line).
- The Queensland Government has submitted its rail access regime to the NCC for certification as an effective state regime.
- Queensland Rail has produced a draft Rail Access Undertaking for consultation with affected parties prior to submitting a final version to the Queensland Competition Authority for public review and approval.
- Queensland Rail has offered a package of limited and short-term freight rate concessions to the coal industry in recognition of the current difficult market circumstances. The concessions include a temporary moratorium on rate escalation and take-or-pay penalties and the addition of a 'rail market review clause' to established haulage agreements.

Our position on these matters is as follows.

QR Structure

Our council recognises that the Queensland Government may be reluctant to change QR's integrated structure in the foreseeable future, but we continue to be seriously concerned about its anti-competitive effects. We believe the inherent conflicts of interest between integration and access will become increasingly manifest and problematic for QR and the state government over time, forcing a re-think of the present policy.

Without above/below track separation, achieving non-discriminatory treatment of incumbent and prospective haulage operators will depend on (i) QR's proposed probity guidelines, which are said to be under development (ii) the nature of internal access agreements between its Network Access Group and QR operated train services, also being developed and, most important (iii) the degree of public disclosure of access agreements, prices and costs. This crucial issue of transparency is discussed further below.

Draft Coal Industry Inquiry Report

Our council agrees with the Commission's draft findings that (i) slow development of state rail access arrangements would hinder the advent of coal freight competition in Queensland, (ii) the state government needed to develop a detailed and transparent rail access regime with accessible appeal mechanisms for rail freight users, and (iii) this needed to include principles and practices which raised confidence in the efficiency and fairness of access pricing.

We believe the draft coal report provides a sound basis for the present inquiry to build on, and correctly highlights pricing approach, transparency and demonstrated fairness as areas for particular attention.

Queensland Coal Rail Moratorium

While the state government's decision to lift the moratorium is welcome, it needs to be kept in perspective. First, the decision was late in coming - by comparison the NSW government decided from the outset that it would not avail itself of the moratorium and has demonstrated throughout a greater overall preparedness to progress rail competition reform than Queensland governments.

Second, the lifting of the moratorium followed Queensland Rail's conclusion of long term rail haulage agreements with most of the coal mines, and the National Competition Council's finding that the moratorium did not prevent access by third party operators to the Hunter Valley line. In other words, from QR's perspective, the moratorium no longer served any purpose in protecting its monopoly position - that position having been underlined with long term contracts.

Finally, the lifting of the moratorium does not establish contestability of coal haulage services. It needs to be supported accompanied by:

- a comprehensive and effective rail access regime. Without knowing the terms and conditions of access, the coal companies have no basis on which to seek bids from alternative train operators for haulage services.
- the 'unbundling' of established coal rail agreements into their separate (regulated) infrastructure and (contestable) haulage components. Without this there will be no significant uncontracted coal tonnages available for third party train operators to compete for, and the competitive challenge to QR will be more notional than real well into the next decade.

QR Freight Concessions

QR's concession package offered to the coal companies from July this year involves:

- a one year moratorium on freight rate escalation;
- a one year moratorium on freight rate penalties for below-agreement railings;
- enhancing corridor incentives for improvements in railings efficiency;
- the inclusion of 'changed circumstances' and 'market review' clauses in existing rail agreements; the latter to allow review of the agreement freight rate if a third party offers a similar service at a lower rate.

While the concessions are welcome, they do not go to the core issues. Freezing freight rates for a year will have no meaningful effect on monopoly rent elements in the rates. Nor will efficiency incentives, although it is recognised that the potential savings need to be fully exploited.

Finally, the market review clause, while a step in the right direction, only provides for reviews in 2001 and 2004. This greatly limits the requirement on QR to respond in a timely way to genuine third party competition and therefore delays the benefits that such competition is intended to provide. In its present form the review clause does not assist the development of genuinely competitive freight rates.

State Rail Regime Certification

In our submission to the NCC we said:

QMC supports the initiatives of the Queensland Government to foster competition reforms in rail freight in the State and, as a first step, supports the lodgement of the rail access regime for certification. However, the council wishes to emphasise that it is crucial that this regime be supported by an effective access undertaking that allows genuine third party rail freight competition.

The rail access undertaking must contain the principles and details needed to enable equal and balanced negotiations between the parties ie. the access provider and access user. It will be these details and the associated implementation processes in the undertaking that will ultimately determine the capacity for effective rail reform within the State.

Going by the NCC's draft recommendations on the NSW rail access regime, it is difficult to see how the council could recommend certification of the Queensland regime in its present form. We expect the NCC to hold off until QR's access undertaking is finalised, or at least until the council is assured that the document will contain certain pro-competitive elements and will be developed in a manner that is independent, consultative and reasonable timely.

While we support the role of the NCC, real understanding of regime design issues can be achieved only at the state level through discussions between the affected parties. It is important that the certification process facilitates and complements those discussions.

Rail Access Undertaking

QR's access undertaking will be the crucial document describing the terms and conditions on which rail access will be provided in Queensland. QR is obliged by the *Queensland Competition Authority Act 1997* to prepare an undertaking and submit it to the authority for public review and approval. To its credit QR has added an intermediate step of consulting with its key stakeholders on a draft document prior to its submission to the QCA.

Our council is presently engaged in intensive consultation with QR on the draft undertaking. Out of these talks we are hoping to reach agreement on amendments and explanations which prescribe the application of the undertaking to the coal lines such that:

- The costs attributed to the coal lines (i) do not import capital or operating expenses from other regions of the network, (ii) are identified at the most disaggregated level possible, and (iii) minimise fixed/overhead elements and maximise variable/line-specific elements.
- There will be no price discrimination exercised among the coal mines on the basis of perceived capacities to pay, as this would contravene QR's legislative obligation to avoid distorting competition between users in the same market. In addition, any proposed price discrimination between coal and other traffic groups on the same corridor would need to be justified on the basis of delivering net benefits to all users on the corridor.
- QR will publish comprehensive reference tariffs for the coal lines which provide users and prospective train operators with an accurate guide to actual negotiated rates. Each tariff would be based on long run average costs, and would relate to a particular line or group of mines and a 'representative train service' (frequency of train trips, duration, availability and train configuration etc). Actual negotiated rates would differ from the reference tariffs only on the basis of service and cost differences.
- Increases in freight tonnage, and other corridor efficiency improvements, would translate into lower reference rates which, in turn, would be available to train operators through review clauses in their access agreements.
- There will be commitment to best practice network service delivery, supported by clear performance indicators and a pricing approach which encourages continuous improvement.
- There will be a high degree of transparency, including disclosure of all access agreements and of individual corridor costs. We are asking QR to acknowledge that, in respect of coal rail access, it is a monopoly without a competitive position to defend and, therefore, without a valid justification for concealment.
- While QR will enter into access agreements only with train operators, coal mines will be entitled to the information they need to seek haulage tenders and to actively participate in negotiations up to the point of executing an agreement.

In summary, the coal companies are seeking (i) fair and equitable third party access terms for below rail services, (ii) genuine contestability of haulage services, and (iii) a 'bottom line' of efficient and competitive coal rail costs, without monopoly rents and cross subsidies.

From the outset the companies have signalled their preparedness for constructive and positive dialogue with QR on the access undertaking. They have been encouraged by the willingness of QR's Network Access Group to engage in discussions on the above issues. It is critical that the concerns raised in these discussions are reflected in the draft undertaking which is submitted to the Queensland Competition Authority.

While all of the elements described above are essential for an effective coal rail access arrangements, they need to be supported by a high degree of transparency so that all the parties have confidence in the integrity of the regime. This transparency should encompass, as well as the reference tariffs already mentioned:

- a published comprehensive cost allocation manual;

- public reporting of costs by rail corridor;
- a public register of all access agreements and, by implication, a ban on commercial-in-confidence clauses in those access contracts.

Unbundling of Existing Long Term Rail Contracts

Mention was made earlier of the need for existing long term rail contracts (most of which were entered into in recent years while QR was protected by the coal rail access moratorium) to be unbundled into their access and haulage components, and for the latter elements to be made contestable. The importance of this point cannot be stressed too heavily - without it the concept of third party access, and therefore of coal rail reform, will be largely academic in Queensland for many years to come.

The decision whether to unbundle the contracts is a policy matter, and will be a threshold test of the Queensland Government's level of commitment to genuinely competitive coal freight rates.

I look forward to expanding on any of the above points at the public hearing.

Yours sincerely

SIGNED

Ben Klaassen
Economist