Submission No 5

REVIEW OF THE CODE OF CONDUCT FOR MEMBERS

Organisation: Independent Commission Against Corruption NSW

Name: The Hon. Megan Latham

Position: Commissioner

Date Received: 1 February 2016

ICAC
INDEPENDENT COMMISSION AGAINST CORRUPTION
NEW SOUTH WALES

D16/02462
(LAC15/059)

The Chair to the Committee
New South Wales Legislative Assembly
Committee on Parliamentary Privilege and Ethics
Parliament House
Macquarie Street
SYDNEY NSW 2000

01 Feb 2016

RE: Request for Submissions to review of the Code of Conduct for Members

Dear Mr Coure,

The submission of the Independent Commission Against Corruption to the Committee's review into the Code of Conduct for Members is attached.

Several of the recommendations made in the Commission's submission were first developed in the Commission's 2013 report *Reducing the opportunities and incentives for corruption in the state's management of coal resources*, and considers it worthwhile to reemphasize these.

The Commission has also attached a copy of recommendations it submitted during the previous review of the Code of Conduct.

If the Commission can be of any further assistance, please do not hesitate to contact me.

Thank you for the opportunity to make a submission.

Yours sincerely

The Hon Megan Latham
Commissioner
/ Feb 2016

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From: Stephen Quain [redacted]
Sent: Monday, 1 February 2016 5:20 PM
To: Ronda Miller
Subject: FW: ICAC submission to review of Code of Conduct for Members
Attachments: ICAC Submission - Review of Code of Conduct for Members - 1 feb 2016.pdf; Previous ICAC Submission - Review of Code of Conduct for Members - 2010.pdf

From: Stephen Quain
Sent: Monday, 1 February 2016 5:17 PM
To: 'ethics@parliament.nsw.gov.au'
Subject: ICAC submission to review of Code of Conduct for Members

Committee on Parliamentary Privilege and Ethics,

RE: Ref: D15/33826

Please find the attached submission from the Independent Commission Against Corruption to the Committee's review of the Code of Conduct for Members. A hard copy has also been sent to the Committee.

Also please find the attached copy of the Commission's previous submission to the committee in relation to the Code of Conduct for Members, and a link to the Commission's report *Reducing the opportunities and incentives for corruption in the state's management of coal resources,* which are provided as background and context for the Commission's recommendations.

Link to report:
http://www.icac.nsw.gov.au/docman/investigations/reports/4209-reducing-the-opportunities-and-incentives-for-corruption-in-the-state-s-management-of-coal-resources-oct-2013/file

Kind regards,

Stephen Quain | Senior Corruption Prevention Officer
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IMPORTANT DISCLAIMER: No liability is assumed by the NSW Independent Commission Against Corruption for expressions of opinion in this communication which are other than the official opinion of the Commission and a communication of other than official opinion is not to be regarded as a communication from the Commission.

INDEPENDENT COMMISSION AGAINST CORRUPTION

REVIEW OF THE CODE OF CONDUCT FOR MEMBERS OF PARLIAMENT

SUBMISSION

TO THE

LEGISLATIVE ASSEMBLY PRIVILEGES AND ETHICS COMMITTEE

1 February 2016

ICAC submission to the NSW Legislative Assembly Privileges and Ethics Committee review of the Code of Conduct for Members

Introduction

1. This submission by the NSW Independent Commission Against Corruption ("the Commission") is made in response to an invitation by the Chair of the Legislative Assembly Committee on Parliamentary Privilege and Ethics ("the Committee") which is conducting a review of the Code of Conduct for Members ("the Code") as required by section 72E (5) of the Independent Commission Against Corruption Act.

2. In addition to recommendations made in previous Commission submissions, this submission asks that the Committee also consider other related matters brought to public attention in recent Commission public inquiries and investigation reports.

Recommendations made in previous submissions to the review of the Code

3. The Commission notes that recommendations made to the Committee as part of the 2010 review of the Code have not yet been implemented.

4. In particular, we refer to the recommendations regarding disclosure by members of other benefits, the strengthening of prohibitions on paid advocacy by Members and the application of sanctions to members who breach the code. Attached is a list of the recommendations made at that time.

Recommendations drawn from recent Commission reports

5. In October 2013, the Commission released its report *Reducing the opportunities and incentives for corruption in the state's management of coal resources.* While this report focused more directly on ministerial conduct, several recommendations are also directed to elected members of parliament.

6. In particular, recommendations regarding the prevention of improper influence of members, and a pecuniary interest register are relevant to the Members Code of Conduct and are worthy of consideration by the Committee.

7. The Code of Conduct for Members does not contain specific provisions concerning members attempting to influence ministerial or bureaucratic decisions that affect their private interest and those of their family and associates, although such conduct seems quite contrary to the

preamble. This ignores the reality that major decisions of considerable value are taken by the executive and by state agencies, and do not come before Parliament.

8. In the Commission 2013 report (page 43), the Commission advised "That the NSW Parliament's Legislative Council Privileges Committee and the Legislative Assembly Privileges and Ethics Committee consider amending the Code of Conduct for Members to deal comprehensively with improper influence by members."

9. Notably, this recommendation was also submitted to the Committee in previous submissions. The Commission recommends that the term "private financial interests" in clause 1(a) be clarified so that it is made clear these include the financial interests of family (including de facto partners), friends or associates whose financial interests may give rise to a conflict of interest for Members by virtue of their relationship.

10. In the report (page 44), the Commission further recommends that the Legislative Assembly Privileges and Ethics Committee consider the establishment of a parliamentary investigator position in consultation with the Legislative Council Privileges Committee.

11. The establishment of a parliamentary ethics investigator to examine minor allegations would provide a number of benefits, including the provision of an impartial and timely mechanism for resolving minor complaints about the conduct of members. Public confidence in the institution of parliament might be enhanced if the standards that apply to members are enforced at all levels. The creation of a parliamentary ethics investigator may also provide for a "graded" approach to non-compliance rather than the "all or nothing" response of the current system.

12. In the report (page 43), the Commission recommended "that the NSW Parliament's Legislative Council Privileges Committee conducts a new inquiry into the mechanism for elected members to disclose the interests of their spouses/partners and dependent children under the provisions of the Constitution (Disclosures by Members) Regulation 1983, with a view to making third party disclosures a requirement." This recommendation has not yet been implemented.

13. The Commission supports expanding the Register of Disclosures to include spouses/partners and dependent children. The benefits of expanding the register include added transparency, minimising perceptions of members avoiding scrutiny, and dealing with the potential for family interests to influence decision making. It should also be noted that many other Australian parliaments require the disclosure of various third-party interests in a register.

INDEPENDENT COMMISSION AGAINST CORRUPTION

REVIEW OF THE CODE OF CONDUCT FOR MEMBERS OF PARLIAMENT

SUBMISSION

TO THE

LEGISLATIVE COUNCIL PRIVILEGES COMMITTEE

AND

LEGISLATIVE ASSEMBLY PRIVILEGES AND ETHICS COMMITTEE

JULY 2010

SUMMARY OF RECOMMENDATIONS

Recommendation 1
The Commission recommends that the term "private financial interests" in clause 1(a) be clarified so that it is made clear these include the financial interests of family (including de facto partners), friends or associates whose financial interests may give rise to a conflict of interest for Members by virtue of their relationship.

Recommendation 2
The Commission recommends that clause 1 of the Code be amended to require Members to take reasonable steps to declare any other material benefit which a Member receives which might reasonably be thought by others to influence his or her actions, speeches, or votes in Parliament, or actions taken in his or her capacity as a Member of Parliament, or which the Member considers might be thought by others to influence his or her actions in a similar manner, even though the Member receives no financial benefit.

Recommendation 3
The Commission recommends that clause 1(b) of the Code be amended to make it clear that disclosure of a conflict of interest when speaking on a matter in the House or a Committee should occur in the House or Committee before the Member speaks on the matter.

Recommendation 4
The Commission recommends the heading of clause 2 be changed to "Paid advocacy" or something similar.

Recommendation 5
The Commission recommends that clause 2 be amended to extend the prohibition on paid advocacy by Members to the promotion of matters to public officials outside the Parliament or its Committees and that the *Constitution (Disclosure by Members) Regulation 1983* be amended to the same purpose.

Recommendation 6
The Commission recommends that the *Constitution (Disclosure by Members) Regulation 1983* be amended so that it is consistent with the clause 2 of the Code of Conduct (as amended in accordance with Recommendations 4 and 5).

Recommendation 7
The Commission recommends widening the scope of clause 5 to include misuse of confidential information generally.

Recommendation 8
The Commission recommends making direct reference in clause 6 to the relevant definitions of what constitutes party activities as set out in the relevant Parliamentary Remuneration Tribunal determinations.

Recommendation 9
The Commission recommends that clause 7 of the Code be amended to require Members to make the disclosures referred to in that clause when voting on a matter as well as when participating in a debate on the matter, unless the disclosure has previously been made in the pecuniary interest register.

Recommendation 10
The Commission recommends that the Code be amended by including a new provision that Members are not to vote on matters where they have a financial conflict of interest.

Recommendation 11
The Commission recommends the Code be amended to provide that the Code has continuing effect unless and until amended or rescinded.

Recommendation 12
The Commission recommends a more comprehensive set of broad ethical principles. Consideration could be given, for example, to incorporating the seven principles of public duty defined by Lord Nolan and which appear in the British House of Commons Code of Conduct for Members (selflessness, integrity, objectivity, accountability, openness, honesty and leadership).

Recommendation 13
The Commission recommends including in the Code what sanctions might apply to a Member who breaches the Code.

Recommendation 14
The Commission recommends that the Code be given a more prominent place on the NSW Parliament website.

INTRODUCTION

1. This submission has been prepared by the Independent Commission Against Corruption ("the Commission") in response to an invitation by the Chairs of the Legislative Council Privileges Committee and the Legislative Assembly Privileges and Ethics Committee which are currently undertaking a review of the Code of Conduct for Members ("the Code").

2. The major role of the Code is to act as a guide for Members' behaviour by setting standards reflecting the community's expectations of the conduct of Members.

3. The Commission's submission concerns clauses 1, 2, 5, 6, and 7 of the Code. The submission also raises a number of other matters for consideration

THE CODE

Clause 1 – the issues

4. The heading of this clause is "Disclosure of conflict of interest". Clause 1(a) of the Code places the emphasis on "private financial interests". The Commission submits that this may be interpreted as excluding two important issues. First, Members may have family (including de facto partners), friends or associates whose financial interests may give rise to a conflict of interest for Members by virtue of their relationship. Secondly, conflicts of interest may not be connected with pecuniary (financial) interests.

5. The Code should make it clear that these issues are included in the requirement to disclose conflicts of interest.

6. The Commission notes that other NSW legislation and other jurisdictions have attempted to address these two issues, for example:

    a) Under section 443(1) of the NSW *Local Government Act 1993*, pecuniary interests also include those of the person's spouse, de facto partner, relative, a partner or employer of the person, or a company or other body of which the person, or a nominee, partner or employer of the person, is a member.

    b) The *Model Code of Conduct for Local Councils in NSW* recognises that there are pecuniary and non-pecuniary conflicts of interest.

    c) The *Guide to the Rules relating to the Conduct of Members* that accompanies the British *House of Commons Code of Conduct for Members of Parliament* requires a Member to include in the Register of Interests any pecuniary interest or other material benefit which a Member receives which might reasonably be thought by others to influence his or her actions, speeches, or votes in Parliament, or actions taken in his or her capacity as a Member of Parliament, or which the Member considers

might be thought by others to influence his or her actions in a similar manner, even though the Member receives no financial benefit.

7. Clause 1(b) of the Code provides that disclosure "may be done through declaring their interests on the Register of Disclosures of the relevant House or through declaring their interest when speaking on the matter in the House or a Committee, or in any other public and appropriate manner".

8. In its September 2003 report: "Regulation of secondary employment for Members of the NSW Legislative Assembly" the Commission recommended that "A Member should be required to disclose a conflict of interest at the start of any proceedings in Parliament which relate to the interests of any employer, association or client who has employed, or is currently employing, the Member. In developing the detail for the operation of a disclosure-before-proceedings rule, consideration should be given to the experience in the British House of Commons, the Scottish Parliament and the Ontario Legislative Assembly" (recommendation 8).

9. The British House of Commons, the Scottish Parliament and the Ontario Legislative Assembly models discussed in the report require Members not only to disclose interests in a register but to disclose interests prior to proceedings in Parliament where the Member is aware that the proceedings may relate to the interests of their secondary employer or, in some cases, any former secondary employer. The purpose of declaration in the House of Commons is explained in the following way:

> *The main purpose of declaration of interests is to ensure that fellow Members of the House and the public are made aware, at the appropriate time when a Member is making a speech in the House or in Committee or participating in any other proceedings of the House, of any past, present, or expected future pecuniary interest which might reasonably be thought to be relevant to those proceedings.*

The Commission supports this approach.

Clause 1 – recommendations

Recommendation 1
The Commission recommends that the term "private financial interests" in clause 1(a) be amended so that it is made clear these include the financial interests of family (including de facto partners), friends or associates whose financial interests may give rise to a conflict of interest for Members by virtue of their relationship.

Recommendation 2
The Commission recommends that clause 1 of the Code be amended to require Members to take reasonable steps to declare any other material benefit which a Member receives which might reasonably be thought by others to influence his or her actions, speeches, or votes in Parliament, or actions taken in his or her capacity as a Member of Parliament, or which the Member considers might be thought by others to

influence his or her actions in a similar manner, even though the Member receives no financial benefit.

Recommendation 3
The Commission recommends that clause 1(b) of the Code be amended to make it clear that disclosure of a conflict of interest when speaking on a matter in the House or a Committee should occur in the House or Committee before the Member speaks on the matter.

Clause 2 – the issues

10. The heading of this clause is "Bribery". It is not clear why this heading is used.

11. In NSW bribery remains a common law offence. Part 4A of the *Crimes Act 1900* also covers the giving and receiving of corrupt rewards. The ambit of both extends beyond what is set out under clause 2.

12. Clause 2 is designed to prohibit Members engaging in both "paid advocacy" and "cash for questions", and to prohibit them casting a vote in return for payment. The clause also prohibits advocacy in return for payment made to family members and other specified persons and entities, rather than directly to a Member.

13. While the use of the heading "Bribery" may have been intended to express disapproval of paid advocacy and cash for questions it potentially introduces confusion. It is possible that a Member might argue that unless a criminal offence of "bribery" is established there is no breach of the clause. It would be appropriate to change the title of clause 2 to reflect more accurately what is prohibited.

14. The general prohibitions on paid advocacy in clause 2 are qualified by the use of the phrase "in the Parliament or its Committees". This suggests that the Code is not intended to prohibit a Member from promoting a matter in return for receiving any remuneration, fee, payment, reward or benefit of a private nature, if the promotion takes place outside Parliament or its Committees. This ignores the reality that Members can, through their advocacy, affect major decisions involving public interest and amenity and of potential considerable value both to the State and those entities that benefit from those decisions.

15. The Commission does not consider that it is appropriate for Members to accept any "remuneration, fee, payment, reward or benefit of a private nature" in return for using their position to advocate the taking of a particular course of action by public officials. There is a strong perception that a Member who is advocating a position in return for reward is primarily motivated by that reward (or the prospect of the reward) rather than the public interest and as such is not using their position "to advance the common good of the people of New South Wales" (as set out in the Preamble to the Code) but rather to advance their own private interest.

16. The prohibition on paid advocacy should not be restricted to the promotion of matters in the Parliament and its Committees but should extend to the promotion of matters to public officials outside the Parliament or its Committees.

17. The Commission notes however that the *Constitution (Disclosure by Members) Regulation 1983* contemplates that Members may derive income from providing a service arising from or relating to their position as Members. Clause 7A of the Regulation defines such a service to include:

    a) the provision of public policy advice,
    b) the development of strategies, or the provision of advice, on the conduct of relations with the Government or Members,
    c) lobbying the Government or other Members on a matter of concern to the person to whom the service is provided.

18. The Commission notes that any provision in the Code banning paid advocacy needs to be accompanied by amendment to the *Constitution (Disclosure by Members) Regulation 1983*.

Clause 2 - recommendations

Recommendation 4
The Commission recommends the heading of clause 2 be changed to "Paid advocacy" or something similar.

Recommendation 5
The Commission recommends that clause 2 be amended to extend the prohibition on paid advocacy by Members to the promotion of matters to public officials outside the Parliament or its Committees and that the *Constitution (Disclosure by Members) Regulation 1983* be amended to the same purpose.

Recommendation 6
The Commission recommends that the *Constitution (Disclosure by Members) Regulation 1983* be amended so that it is consistent with the clause 2 of the Code of Conduct (as amended in accordance with Recommendations 4 and 5).

Clause 5 – the issue

19. This clause deals with improper use of confidential information for the "private benefit" of the Member or others.

20. In its December 1998 report: "Report on investigation into Parliamentary and Electorate travel: Second Report – analysis of administrative systems and recommendations for reform" the Commission recommended that "the Ethics Committees of each House should consider the appropriateness of the term "private benefit" used in clause 5 of the Members Code of Conduct and recommend an appropriate amendment to clarify its meaning" (recommendation 54).

21. The Commission's concern, expressed in its report, was that the test in this clause is whether there is a private benefit for the Member or others. Conceivably, confidential information could be used where it is difficult to substantiate a direct private benefit, such as the leaking of information to discredit a political

opponent's policy proposals, or even an opponent, in an electorate or parliamentary contest. The Code should make it clear that misuse of confidential information in this way would amount to an abuse.

Clause 5 - recommendation

Recommendation 7
The Commission recommends widening the scope of clause 5 to include misuse of confidential information generally.

Clause 6 – the issue

22. In its December 1998 report: "Report on investigation into Parliamentary and Electorate travel: Second Report – analysis of administrative systems and recommendations for reform" the Commission recommended that "the Ethics Committees of each House should consider whether the term "legitimate activities" used in clause 6 of the Members' Code of Conduct should be amended to define these as activities whose principal purpose is for Parliamentary or electorate benefit" (recommendation 57).

23. The Commission notes that the Parliamentary Remuneration Tribunal has since delineated what party activities do or do not fall within the definition of "Parliamentary activities" for the purpose of use of Parliamentary resources and allowances.

Clause 6 - recommendation

Recommendation 8
The Commission recommends making direct reference in clause 6 to the relevant definitions of what constitutes party activities as set out in the relevant Parliamentary Remuneration Tribunal determinations.

Clause 7 – the issue

24. Clause 7 of the Code requires disclosure of secondary employment or other engagements when a Member participates in debates. The Member is specifically exempted from making a disclosure if the Member is "simply" voting on a matter. The Commission does not regard this exemption as being consistent with requisite or desirable standards of transparency.

25. The Commission does not regard as onerous a requirement that Members make the disclosures referred to in clause 7 when voting on a matter as well as participating in a debate on the matter. The Commission notes that under clause 7 it would not be necessary for a Member to make a declaration every time the Member voted if the Member has already disclosed the information in the Member's entry in the pecuniary interest register.

Clause 7 - recommendation

Recommendation 9
The Commission recommends that clause 7 of the Code be amended to require Members to make the disclosures referred to in that clause when voting on a matter as well as participating in a debate on the matter unless the disclosure has previously been made in the pecuniary interest register.

OTHER MATTERS FOR CONSIDERATION

26. In addition to issues relating to specific clauses of the Code, the Commission also raises a number of other matters for consideration.

Disqualification from voting

27. The Standing Orders for both Houses generally disqualify members from voting on matters where they have a financial conflict of interest[1]. It is not clear to the reader of the Code that this is the case and it would be preferable for this to be rectified. It is also preferable that the Code make it clear that a financial conflict of interest includes any situation where the Member has received or anticipates receiving a material benefit.

Recommendation 10
The Commission recommends the Code be amended by including a new provision that Members are not to vote on matters where they have a financial conflict of interest.

Application of the Code

28. Some doubt has previously been expressed as to whether the Code applies to the actions of Members that occur after Parliament has been prorogued and before the Code is adopted by a Sessional Order at the start of a new session. This issue was examined in some detail by the 2002 and 2006 reviews which recommended that the Code be amended to specifically acknowledge that it is intended to apply during prorogation.

Recommendation 11
The Commission recommends the Committees include an amendment to provide that the Code has continuing effect unless and until amended or rescinded.

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[1] See Standing Order 176 of the Legislative Assembly and Standing Order 113(2) of the Legislative Council. See also Standing Order 276 of the Legislative Assembly and Standing Order 210(10) of the Legislative Council which related to Committee Inquiries.

Statement of Principles

29. In its November 1995 submission to the Legislative Assembly Standing Committee on Ethics and its June 2006 submission to the Legislative Council Privileges Committee the Commission stated that "the principles on which expected standards of behaviour are based should be included in the Code so that the rationale for the obligations of Members can be understood".

30. The Preamble to the Code already includes honesty and integrity. Accountability is alluded to in the reference to responsibility in paragraph 2 of the Preamble.

Recommendation 12
The Commission recommends t a more comprehensive set of broad ethical principles. Consideration could be given, for example, to incorporating the seven principles of public duty defined by Lord Nolan and which appear in the British House of Commons Code of Conduct for Members (selflessness, integrity, objectivity, accountability, openness, honesty and leadership).

Breaches of the Code

31. The Code does not set out what sanctions might apply to a Member who breaches the Code. Such a clause could address:
    - the accountabilities of a Member
    - the powers of the Ethics Committee
    - the role of the Commission
    - the relationship of the Code to other accountability mechanisms.

Recommendation 13
The Commission recommends including in the Code what sanctions might apply to a Member who breaches the Code.

Accessibility of the Code

32. In line with the principles of openness and accountability consideration should be given to improving the accessibility of the Code by members of the public. For example it is not immediately apparent from the NSW Parliament website that there is a Code of Conduct for Members.

Recommendation 14
The Commission recommends the Code be given a more prominent place on the NSW Parliament website.

REDUCING THE OPPORTUNITIES AND INCENTIVES FOR CORRUPTION IN THE STATE'S MANAGEMENT OF COAL RESOURCES

ICAC
INDEPENDENT COMMISSION AGAINST CORRUPTION
NEW SOUTH WALES

ICAC REPORT
OCTOBER 2013

ICAC

INDEPENDENT COMMISSION AGAINST CORRUPTION

NEW SOUTH WALES

REDUCING THE OPPORTUNITIES AND INCENTIVES FOR CORRUPTION IN THE STATE'S MANAGEMENT OF COAL RESOURCES

ICAC REPORT

OCTOBER 2013

This publication is available on the Commission's website www.icac.nsw.gov.au and is available in other formats for the vision-impaired upon request. Please advise of format needed, for example large print or as an ASCII file.

ISBN 978 1 921688 49 2

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The Hon Shelley Hancock MLA
Speaker
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Mr President
Madam Speaker

In accordance with s 74 of the *Independent Commission Against Corruption Act 1988* I am pleased to present the Commission's corruption prevention report arising from its investigations into the circumstances surrounding the allocation of certain coal mining licences.

The Commission's recommendations to reduce the opportunities and incentives for corruption in the management of coal resources are contained in the report.

I draw your attention to the recommendation that the report be made public forthwith pursuant to s 78(2) of the *Independent Commission Against Corruption Act 1988*.

Yours sincerely

The Hon David Ipp AO QC
Commissioner

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Chapter 1: Introduction and overview

In July and August 2013, the NSW Independent Commission Against Corruption ("the Commission") furnished to the NSW Parliament its investigation reports on Operation Jasper, titled *Investigation into the conduct of Ian Macdonald, Edward Obeid Senior, Moses Obeid and others*, and Operation Acacia, titled *Investigation into the conduct of Ian Macdonald, John Maitland and others*.

The investigation into Operation Jasper followed an allegation made by a private individual in February 2011 that confidential information regarding the tender process for awarding the Mount Penny coal tenement had been leaked to the Obeid family. As part of that investigation, the Commission examined the circumstances surrounding a decision made in 2008 by the Hon Ian Macdonald MLC, then minister for primary industries and minister for mineral resources, to grant a coal exploration licence (EL) to Cascade Coal Pty Ltd ("Cascade Coal"), the circumstances relating to the tendering process and the way in which the tender bids were assessed.

The Commission found that Mr Macdonald's corrupt conduct was motivated by an agreement with the Hon Edward Obeid MLC ("Edward Obeid Sr") and Moses Obeid to financially benefit the Obeid family. Mr Macdonald, Edward Obeid Sr and Moses Obeid were found to have engaged in corrupt conduct by conspiring to defraud in the creation of the Mount Penny tenement. The Commission also discovered that several co-investors, including Travers Duncan, John McGuigan, John Atkinson, John Kinghorn and Richard Poole, had engaged in corrupt conduct to obtain financial advantage by deception.

The investigation into Operation Acacia followed a referral made to the Commission on 23 November 2011 by both Houses of Parliament, in which the Commission was asked, among other things, to investigate and report on matters surrounding the application for, and allocation to, Doyles Creek Mining Pty Ltd (DCM) of an EL. DCM sought the EL using the pretext of establishing a training mine to benefit the coal mining industry.

The Commission found that Mr Macdonald engaged in corrupt conduct by acting contrary to his duty as a minister of the Crown in granting DCM consent to apply for the EL in respect of Doyles Creek and by granting the EL to DCM; both of which were granted substantially for the purpose of benefiting John Maitland, former leader of the Construction, Forestry, Mining and Energy Union's Mining and Energy Division, who was also a shareholder and chairman of DCM at the time the EL was granted. Corrupt findings were made against Mr Maitland, Craig Ransley, Andrew Poole and Michael Chester for publishing, or agreeing to publish, false or misleading statements to the NSW Department of Primary Industries (DPI).

In the referral from both Houses of Parliament, the Commission was directed to enquire, if deemed necessary, into any related matters with respect to licences or leases under the *Mining Act 1992* ("the Mining Act") and make recommendations for action.

The Commission has identified a number of corruption risks that exist throughout the state's administration system for the coal mining industry. The corrupt behaviour exposed in operations Jasper and Acacia did not occur as the result of a small loophole that was cleverly exploited. Rather, the perverse incentives and opportunities that are embedded in the existing coal allocation system have the capacity to distort the decision-making process on what and when coal deposits should be released, as well as the pathway that an allocation process will follow.

The legislative framework for the coal mining industry in NSW confers broad discretion on the minister and public

officials responsible for mineral resources to determine how coal ELs are released, allocated and renewed. The purpose of the minister for mineral resources[1] granting an EL is to provide exclusive rights to a titleholder so that they may explore and confirm the quality, quantity and physical location of the coal resource (so-called "firming up" activities). Once exploration is complete, a company wishing to establish a mine at the location must obtain a mining licence (ML) from the minister for mineral resources. Before a company can do so, however, it must also obtain development consent under the *Environmental Planning and Assessment Act 1979* ("the EP&A Act"). This provides a key role for the NSW Department of Planning and Infrastructure in assessing a company's application and in considering the wider environmental and social impacts of establishing a mine at that specific location.

In preparing this report, the question facing the Commission was not simply how the state's policy and regulatory framework could allow coal ELs of great value to be corruptly provided to favoured recipients, but how it could have been so easy to do so. It is inconceivable that in any other portfolio area of government such value could be corruptly transferred from the state to favoured individuals with such relative ease.

What, then, is so different about the allocation of rights to state coal assets from the way that the rest of government does business? The corrupt conduct uncovered by the Commission in operations Jasper and Acacia cannot simply be put down to a rogue minister for mineral resources. The state arrangements that relate to coal provided an opportunity not found in other parts of government for individuals to engage in corrupt conduct.

While the corruption exposed in operations Jasper and Acacia related to exploration, these ELs were of high value because they were in parts of the state that are considered "mature areas" for coal. In such mature areas, it is widely understood that coal deposits exist; although the exact quality and quantity still needs to be confirmed. ELs in a mature area may be better viewed as pre-mining approval, rather than a right to undertake true exploration. The real value of having an EL in a mature area is that it represents a pathway to mining operations. If the information obtained from exploration activities indicates a financially-viable mining operation then, by convention, the holder of the EL will apply for development approval to commence mining.

Given the above factors, an ongoing issue for the state has been determining which areas should be released, how the ELs should be allocated to individual mining companies and how often ELs should be renewed. In the absence of an overarching strategy that sets out the preferred approach of government for developing the state's coal mining industry, decisions for the release, allocation and extraction of coal are made in a strategic vacuum and are unable to be judged against any standard. The conflicting roles of government agencies and the time lapse – between decisions made to award ELs and decisions to give development approval to establish a mine in an area – create great risk and uncertainty for the industry over and above that related to typical business risks.

In 2008 and 2009, at the time of the corrupt conduct identified in operations Jasper and Acacia, the Mineral Resources Branch (MRB)[2] sat within what was then the DPI (now the NSW Department of Trade and Investment, Regional Infrastructure and Services). The MRB's role is to focus on decisions regarding the facilitation and regulation of the coal mining industry. Without any broader view on the role of coal in the development of the state, the MRB has largely limited its focus to the release of ELs and the placement of conditions relating to exploration activity. Once allocated an EL, companies invest substantial amounts of money in firming up the case for mining. Only much later does a different arm of government, the Department of Planning and Infrastructure, step in to evaluate the mining proposal of a company against the broader social, economic and environmental matters.

While coal represents the largest export of the state and ELs represent a transfer of assets worth tens or hundreds of millions of dollars from the state to private hands, the arrangements for the release of the resource and allocation of ELs are lacking many basic principles of good governance. There is, for example, an absence of a state plan or policy against which ministerial decisions can be judged, little involvement of the NSW Treasury in asset disposal and limited transparency of decision-making. To outsiders, including mining companies, the process of releasing exploration areas appears ad hoc. Importantly, the current policy and regulatory environment creates a set of incentives that encourage manipulation of the system for substantial personal gain in the choice of areas to be released, the direct transfer of state assets to an individual mining company and the renewal of ELs to maintain control over the deposit. This is not a policy and regulatory environment that would be considered acceptable in any comparable state operation.

The limitations of the state's policy and regulatory environment have had negative effects beyond the specific corruption exposed by the Commission and have restricted

1 The term "minister for mineral resources" is used throughout this report as a default to denote the position title, both past and present, of the person with responsibility for this portfolio. The current position title is "minister for resources and energy".

2 The title of the branch, division or area of government with responsibilities for the administration of ELs has changed over the years. For the purposes of this report, it will be referred to as the Mineral Resources Branch.

the return the state has obtained for its assets during the boom period for coal prices. Perceptions of sovereign risk (in the broadest sense of unpredictable policy changes and shifting discretionary decisions) have been heightened and the reputation of the state as a desirable investment destination has been tarnished. The perception that the state is beholden to mining companies as a result of the additional financial contributions taken from them at the exploration stage has generated community anger about coal mining.

Consultation

The Commission consulted widely with mining professionals and undertook extensive analysis of the current governance and operational arrangements. Government input was obtained through discussions with relevant ministers and their offices as well as past and present directors general of the Department of Trade and Investment, Regional Infrastructure and Services, the Department of Planning and Infrastructure and the NSW Department of Premier and Cabinet. Senior officials from the MRB and the Department of Planning and Infrastructure were also consulted. Generally, there was widespread acknowledgement of the need for change to the current policy and regulatory environment.

Input was also obtained from those with expertise in the coal mining industry, including the Australian Government's Productivity Commission, the Bureau of Resources and Energy Economics, the NSW Treasury (specifically specialists with knowledge of minerals and auction design), and the Australian Securities Exchange, as well as leading academics with expertise in resource industry incentive structures and auction design. A briefing for the Commission on auctions and market design was commissioned by the NSW Treasury and produced by the Centre for Market Design.[3] Industry input was also obtained from the NSW Minerals Council and the Australian Coal Association. The Commission is grateful to those who took the time to participate in interviews.

The Commission's research included the following:

- desktop analyses of the policy and regulatory environments in best practice jurisdictions (with regard to the way that ELs are allocated for coal, oil and gas reserves), including Queensland, Western Australia, the Commonwealth, Norway and British Columbia
- an audit of selected ELs undertaken by auditors working for the Commission
- an examination of MRB policies, process design and structural arrangements
- a statistical analysis of the global relationship between sovereign risk in mining and corruption perceptions as measured by Transparency International
- consideration of the evidence presented in the public inquiries.

Structure of the report

This report examines the policy and regulatory environment in NSW for the allocation of coal ELs in mature areas where the existence of coal deposits is well understood. It analyses both the specific issues that relate to the corruption exposed in operations Jasper and Acacia, and more broadly examines the vulnerability of the EL granting and renewal processes to corrupt behaviour in accordance with s 13(1)(f) of the *Independent Commission Against Corruption Act 1988* ("the ICAC Act"). Section 13(1)(f) of the ICAC Acts states that a principal function of the Commission is:

> *…to advise public authorities or public officials of changes in practices or procedures compatible with the effective exercise of their functions which the Commission thinks necessary to reduce the likelihood of the occurrence of corrupt conduct…*

The report, therefore, makes recommendations for changes to the system that are likely to reduce the incentives and opportunity for corruption while also having regard for the effective functioning of coal EL allocation, EL renewal and mining approvals.

The report is presented in two parts. Part 1 (chapters 2 and 3) examines the policy and regulatory environment at the time of the corrupt conduct in 2008 and 2009. It discusses the role of government and the MRB in facilitating and regulating the coal mining industry in NSW. This includes a discussion of the impact that organisational change and diminishing resources has had on the capacity of the MRB to effectively manage the coal allocation process. Part 1 then examines the flaws in the state arrangements at the time of the corrupt conduct, and the consequences of widespread perverse incentives and opportunities for corruption.

Part 2 of the report (chapters 4, 5 and 6) considers relevant changes made to the state arrangements since the time of the corrupt conduct and outlines the characteristics of a preferred future framework. The preferred framework is based on best practice identified in other jurisdictions and, importantly, other parts of the NSW Government, and extensive consultation. Part 2 also presents the Commission's 26 recommendations for reform. Where possible, the approach has been to recommend changes that

3 Centre for Market Design, August 2013, *Competitive Allocation of Exploration and Mining Permits: An Issues Paper.* This centre is a collaboration between the University of Melbourne, the Commonwealth Treasury, and the Victorian Department of Treasury and Finance.

reduce the incentives and opportunities for corruption by improving the efficiency and effectiveness of the system. An efficient and effective system, almost by definition, would not contain incentives and extensive opportunities to distort the process through improper lobbying, manipulation and corrupt behaviour. As much as possible, the Commission has avoided recommending onerous governance requirements to deal with flaws in the current arrangements.

Finally, Part 2 of the report will consider whether the current requirements concerning the behaviour of members of the NSW Parliament and ministers are adequate. Operations Jasper and Acacia highlighted shortcomings in the accountability framework governing the conduct of members, including the NSW *Code of Conduct for Members* and the current pecuniary interest disclosure system. The report examines the ability of hidden interests of members to impact on executive government decision-making, along with the role of public officials in providing frank and fearless advice as a safeguard against undue influences.

The Commission's recommendations

The Commission's view is that the policy and regulatory environment in NSW for the release and allocation of coal ELs is conducive to corruption. For example, the MRB's decision-making, which is characterised by weak processes, is not framed within government's wider strategic goals. Furthermore, decisions are not transparent, there are incentives for exploration and mining companies to seek resources through direct allocations and there is an implicit pressure generated to approve mining activity when significant additional financial contributions have been made at the exploration stage. Finally, there is only a weak mechanism to prevent licence holders from continually renewing ELs.

The Commission notes that decision-making practices around the release of ELs differ from the prevailing practices in other parts of government. For example, the disposal of state assets or decisions regarding whole-of-government considerations, such as the unsolicited proposals model, are quite different in nature from the arrangements for the management of the disposal of coal. The Commission's recommendations are in many ways the application of well-established approaches utilised in other parts of the NSW Government.

The 26 recommendations fall within five key areas of reform.

First, the state should develop a clear policy statement that conveys how coal mining fits within the broader policy objectives of the state. From that policy statement, a set of factors can be developed that must be considered prior to a decision being made. These would both guide public officials and provide a standard against which decisions can be evaluated in a transparent way.

Secondly, the MRB's decision-making committee, known as the Coal Allocation Committee (CAC), should be replaced with a steering group comprising members with a broader skill set to fully consider the range of issues that link decisions to release and allocate resources to state objectives and priorities and the final approval to mine. Given the relatively unique nature of each EL application, expert judgment provided by the steering group is preferable to rigid prescription. The steering group would comprise senior officials from the Resources and Energy Division of the Department of Trade and Investment, Regional Infrastructure and Services, the Department of Planning and Infrastructure and the NSW Treasury. The Department of Planning and Infrastructure should host and convene the group and co-opt members, as necessary.

The steering group would be assisted by an assessment panel comprising practitioners with relevant expertise from the Department of Planning and Infrastructure, the NSW Treasury and the Resources and Energy Division. The assessment panel would support the formulation of recommendations on areas to be released for exploration and the method by which areas would be allocated for exploration. The recommendations made by the steering group, based on the workings of the assessment panel, would be made to the newly-established Cabinet Standing Committee on Resources and Land Use for final approval.

Thirdly, the auctions method should be the preferred approach to the allocation of the state's coal resources. The NSW Treasury should oversee the design of the auction process. In those cases where direct allocation is necessary, it should be the subject of oversight by the assessment panel.

Fourthly, the current renewal processes for ELs should be replaced by an exponentially escalating lease rent to allow commercial decisions to be made in an environment of certainty and to remove the incentive to repeatedly renew ELs without progressing to mining.

Finally, the Commission makes a series of recommendations to improve the systems that ensure the accountability and scrutiny of members of the NSW Parliament and ministers, including the recommendation that consideration be made for the establishment of a parliamentary investigator position.

The recommendations made in this report are made pursuant to s 13(3)(b) of the ICAC Act and, as required by s 111E of the ICAC Act, will be furnished to the relevant public authorities and the ministers responsible for those authorities.

As required by s 111E(2) of the ICAC Act, the relevant public authorities must inform the Commission in writing within three months (or such longer period as the

Commission may agree to in writing) after receiving the recommendations whether they propose to implement any plan of action in response to the recommendations affecting them and, if so, the plan of action.

In the event a plan of action is prepared, the relevant public authorities are required to provide a written report to the Commission of their progress in implementing the plan 12 months after informing the Commission of the plan. If the plan has not been fully implemented by then, a further written report must be provided 12 months after the first report.

The Commission will publish the responses to its recommendations, any plans of action and progress reports on their implementation on its website, www.icac.nsw.gov.au, for public viewing.

Recommendation that this report be made public

Pursuant to s 78(2) of the ICAC Act, the Commission recommends that this report be made public forthwith. This recommendation allows either Presiding Officer of a House of Parliament to make the report public, whether or not Parliament is in session.

Chapter 2: The policy and regulatory environment for coal exploration and mining in NSW

This chapter will provide a brief overview of the significance of coal mining to the state of NSW and outline the policy and regulatory environment as it operated at the time of the corrupt conduct identified in operations Jasper and Acacia. Chapter 3 will then examine the incentives and opportunities for corrupt conduct created by this policy and regulatory environment.

Introduction to the NSW coal allocation system

Australia is the second largest exporter of coal in the world and coal mining is the largest export industry in NSW, generating employment and raising significant export income. The NSW coal mining industry has experienced a period of substantial growth since 2004–05, due to the growing demand from Asian export markets.

In 2009–10, the value of coal mining production in NSW totalled $13.2 billion, or 80% of the total value of the NSW mining sector. It directly employed 19,000 people and supplied 92% of the state's electricity. The value of coal exports has more than tripled in the past decade. In 2009–10, it accounted for 25% of all export income, making it NSW's single largest export in revenue terms. Coal mining royalties are also a major source of revenue for the state, generating $354 million in 2004–05, which increased to $915 million in 2009–10.[4]

The major coal deposits in NSW range from bituminous coking and thermal coals to sub-bituminous thermal coals. Lower quality coal is used in the local power generation industry, whereas higher quality coal is exported or used in heavy industry. The quality of the coal deposit is a key consideration when mining companies are making investment decisions but it is not the only consideration.

4 Statistics obtained from the Resources and Energy Division's website at http://www.resources.nsw.gov.au, viewed mid-2013.

The mineral resources of NSW belong to the state rather than the owners of the land that contain these resources. It is the responsibility of the NSW Government to facilitate exploration and extraction of those mineral resources for the benefit of the people of NSW in accordance with a policy and regulatory framework set by the state.

The allocation of rights for the exploration and mining of coal is largely regulated by the Mining Act. An EL provides exclusive rights to a titleholder so that they may explore and firm up the quality, quantity and physical location of a particular mineral resource. To obtain an EL for coal, a company must gain the consent of the minister for mineral resources. An EL can be granted by this minister as a direct allocation of the EL to a particular company or the EL can be allocated through a competitive process.

Certain fees are payable on receipt of an EL and, once granted, an EL is subject to conditions. For example, it is a general condition that a titleholder must undertake certain types of exploration within the boundaries of the EL. At the end of a fixed term, a company can relinquish the EL or request a renewal.

Generally, before the minister for mineral resources makes a decision about whether or not to grant an EL, he or she is provided with advice from their department. Principally, the day-to-day functions of the MRB are the identification and allocation of mineral resources to mining companies and the regulation of mining companies in terms of the environment and mine safety. The MRB had in place various operational arrangements to make recommendations about allocation of ELs to the minister for mineral resources (these arrangements will be discussed later in the chapter).

The granting of an EL does not guarantee the eventual opening of a mine. The real value of having an EL is that it represents a pathway that is likely to lead to mining operations. Once an EL is granted, a company conducts exploration activity with a focus on identifying the specific

area within the EL boundaries where mining is most likely to be profitable. A project is more likely to be financially viable if it is in what is considered to be a mature area for coal. There are many regions in NSW where the location, quantity and – to a lesser degree – the quality of coal is well established. Understandably, these mature areas attract greater industry interest, as coal exploration in these areas is considered low risk and regarded by industry investors as more of an activity in firming up of a business case for mining operations rather than true exploration in a frontier area. Many small exploration companies will obtain an EL with a view to carrying out exploration activities and, if a financially-viable resource is identified, might sell that EL to a larger mining company or form a partnership and seek to set up a mine at that location.

Once exploration is complete, a company wishing to establish a mine must obtain an ML from the minister for mineral resources. An ML gives the holder the exclusive right to mine for minerals over a specific area of land. To be granted an ML, applicants must demonstrate that there is an economically-viable mineral deposit within the area of the proposed lease. They must also show that they have the financial and technical resources to carry out mining in a responsible manner.

Before a company can obtain an ML, it must obtain development consent under the EP&A Act. This provides a key role for the Department of Planning and Infrastructure, which is responsible for assessing projects whose size, complexity, importance or potential impacts indicate that they are of state – rather than local or regional – significance.

While an area may be considered a viable location for a coal mine, it may also have competing land uses, a local community in close proximity or significant environmental value. The Department of Planning and Infrastructure considers these types of impacts as part of a merit assessment at the mining development stage. Despite mining being a controversial topic and taking place in populated areas with possible alternate land uses, ELs were awarded at the time of the corrupt conduct identified in operations Jasper and Acacia with inconsistent consideration of the impact that mining could have with regard to economic, environmental and social perspectives (the so-called triple bottom line).

Policy and regulatory environment in NSW

The policy and regulatory environment has a profound impact on the decision-making of companies, their behaviour as they interact with government and, consequently, on the long-term development of the coal mining industry and its contribution to economic growth in the state. Where the environment is opaque, uncertain and discretionary, incentives may be created to lobby and persuade decision-makers to achieve favourable outcomes; the greater the value of the coal resource to be transferred from government to a private entity, the greater the incentive. Similarly, the greater the private investment put at risk by uncertain policy and regulatory decisions, the greater the incentive to improperly lobby and manipulate government decision-making and policy.

A poor perception of the policy and regulatory environment has negative consequences on investment. The Fraser Institute, a widely referenced independent research and educational organisation based in Canada, conducts the *Annual Survey of Mining Companies*. This survey analyses the perceptions of senior managers with regard to the specific public policy factors they believe encourage or discourage mining investment (see figure 1).

The Fraser Institute has identified the type of government policies that encourage investment and classified these as best practice. These best practice policies include "a

world class regulatory environment, highly competitive taxation, no political risk or uncertainty and a fully stable mining regime".[5] Jurisdictions that rank amongst the most attractive investment destinations do not simply give a carte blanche to mining; rather, they all have policy and regulatory environments that reduce uncertainty for the industry.

When considered against the key items identified by the Fraser Institute, the policy and regulatory environment in NSW at the time of the corrupt conduct identified in operations Jasper and Acacia fell well short of ideal. It was characterised by uncertainty, inconsistencies and regulatory overlap, encouraged opaque and highly discretionary decisions, and lacked oversight.

Figure 1: Fraser Institute – *Annual Survey of Mining Companies 2012–13*

Since 1997, the Fraser Institute has conducted an annual survey of mining and exploration companies around the world. The survey now includes 96 jurisdictions from all continents (except Antarctica). Respondents to the 2012–13 survey were asked to indicate how each of the 17 policy factors below influence company decisions to invest in various jurisdictions.

1. uncertainty concerning the administration, interpretation or enforcement of existing regulations
2. uncertainty concerning environmental regulations (stability of regulations, consistency and timeliness of regulatory process, and regulations not based on science)
3. regulatory duplication and inconsistencies (federal/provincial, federal/state, inter-departmental overlap and so forth)
4. legal system (legal processes that are fair, transparent, non-corrupt, timely, efficiently administered and so forth)
5. taxation regime (includes personal, corporate, payroll, capital and other taxes, and complexity of tax compliance)
6. uncertainty concerning disputed land claims
7. uncertainty concerning which areas will be protected as wilderness, parks or archaeological sites and so forth
8. infrastructure (access to roads, power availability and so forth)
9. socio-economic agreements/community development conditions (local purchasing or processing requirements, or supplying social infrastructure such as schools or hospitals and so forth)
10. trade barriers (tariff and non-tariff barriers, restrictions on profit repatriation, currency restrictions and so forth)
11. political stability
12. labour regulations/employment agreements and labour militancy/work disruptions
13. quality of the geological database (quality and scale of maps, ease of access to information and so forth)
14. level of security (physical security due to the threat of attack by terrorists, criminals, guerrilla groups and so forth)
15. availability of labour/skills
16. level of corruption (or honesty)
17. growing (or lessening) uncertainty.

5 Fraser Institute, February 2013, *Annual Survey of Mining Companies 2012–13*, p. 15, viewed mid-2013, http://www.fraserinstitute.org.

Coal mining strategy

In NSW, valuable coal resources are often located in areas with competing land uses, significant local populations and environmental value. Despite this, at the time of the boom, there was no explicit statement laid out in legislation, regulation, plans or guidelines of the NSW Government's goals, priorities and desired outcomes for coal. There was no guidance or standards on how the conflicting demands were to be resolved within the context of larger state-development goals and no decision-making group existed in government with expertise across all relevant areas. There was no consideration of a state plan for coal until 2010; even then, a plan never eventuated. High-level decisions, such as whether, where and when the state's coal resources should be explored, developed and extracted, were never considered at a whole-of-government level prior to the release of ELs. Without an overarching strategy, such decisions were devolved to the department or made at the discretion of the minister for mineral resources.

At the time of the corrupt conduct identified in operations Jasper and Acacia, the Mining Act provided the minister for mineral resources with wide discretion to grant ELs. These arrangements and provisions under the Mining Act remain unchanged. The Mining Act does provide that an application or tender can be refused on the grounds that the applicant or tenderer has contravened the Mining Act or provided false or misleading information in connection with the application or with respect to the tender. Otherwise, it does not specify any criteria or factors that the minister must consider when making a decision and the minister is not required to make the reason for his or her decision public or transparent.

The MRB's 2008 *Guidelines for Allocation of Future Coal Exploration Areas* ("the Coal Allocation Guidelines") set out the circumstances in which ELs would be directly allocated and, conversely, when competitive processes would be adopted. According to the Coal Allocation Guidelines, the criteria for obtaining an EL were framed by the estimated tonnage of the resource and the geographic location. While the normal practice of the department at the time of the corrupt conduct was to advise the minister on the basis of the criteria in the Coal Allocation Guidelines, these guidelines did not impose any formal constraint on the minister's discretion under s 13 of the Mining Act.

The level of discretion afforded the minister for mineral resources in NSW is relatively unfettered in comparison to the discretion afforded to ministers in other state portfolios and in other jurisdictions. Over the years, in the absence of criteria or a strategic plan, the minister for mineral resources and the MRB were afforded great flexibility in decision-making. The exercise of this discretion without oversight resulted in inconsistent outcomes in the release and allocation of ELs that perplexed both the coal mining industry and the community. The decisions made by Mr Macdonald, as identified in operations Jasper and Acacia, did not immediately stand out as unusual to an external observer.

In 2010, a strategic planning initiative was undertaken across various government departments but, due to a change of government in 2011, was not put into practice. At the time that the strategic planning initiative was undertaken, the then Labor government formed a ministerial sub-committee to consider the merits of a single strategy for the coal and emergent coal seam gas industries in NSW. The treasurer and ministers for the portfolios of planning, primary industries, health, and climate change and the environment worked in collaboration to develop a strategy that would efficiently and effectively regulate the industry.

In February 2011, the committee produced a scoping paper titled the *NSW Coal and Gas Strategy*. Its purpose was to provide an overview of the NSW coal and gas industry, its place within the state and regional economies and, given the increasing global demand for energy, its potential growth prospects over a 25-year period. Due to the change of government in 2011, the strategy was not implemented. Nevertheless, this strategic initiative had a solid underlying rationale. Without some form of overarching strategy, high-level decisions about how the state's coal resources should be developed remained at the discretion of the minister for mineral resources and the MRB. Guidance for officials was inadequate and there were few standards against which decisions could be judged.

The absence of clear state objectives is not a reflection on the MRB. The MRB has never had responsibility for strategic thinking with regard to how coal exploration and development should fit within a broader state-development program. Indeed, it has been recognised that such a task is beyond the capability of the MRB and requires input from a number of government agencies (as seen in the attempt at a strategy in 2010).

In the absence of such a focus, the MRB's strategy was to conduct very broad regional resource assessments through a departmental drilling program to identify the resources in that particular area. Thereafter, any further drilling by the department was carried out only when industry indicated an interest in an area and when budgets were available. In these instances, the primary focus for the MRB was on obtaining geo-scientific data without any formal consideration of whether these areas would ever be considered suitable for mining.

The MRB released ELs with a view that exploration is concerned with verifying the quality and quantity

of the resource and that exploration activity has minimal environmental impact. For the coal mining industry and the community, both saw the granting of an EL as a first step towards mining approval being granted, particularly in a mature area. For a mining company, the granting of an EL signaled the start of significant investment and calculations of future earnings, all of which could be put into jeopardy if a social, environmental and economic assessment at the later stage of development approval restricted its planned access to the coal deposit.

As much of the known coal reserves in NSW are located in populated areas that have significant alternative uses, at some point, judgments have to be made that weigh up these multiple issues. Senior management within the MRB has acknowledged that there is little point in allocating an exploration area if the area is unlikely to gain development consent. Yet, despite the role that the Department of Planning and Infrastructure played in giving that development consent and, in the absence of an integrated government approach to coal mining, neither the MRB nor Department of Planning and Infrastructure established a mechanism to determine whether an area would be likely to gain development approval prior to releasing an area for an EL. Instead, these matters were considered informally by the MRB's internal committees.

These issues remain a problem today at the stage when companies move to seek development approval. Generally, ELs start off covering large areas and, then, through a process of elimination, are reduced in scale, so that business plans are developed only for viable areas. As exploration activity is completed, an application for development approval is prepared. This prompts a lengthy process of negotiation between the mining company and the Department of Planning and Infrastructure.

While outright refusal by the Department of Planning and Infrastructure of development approval for a mine is rare, this process of negotiation generally results in development approval being granted for a smaller area and a tonnage that is potentially much lower than that assumed in the mining company's business case. It is at this later stage that competing economic usages and environmental or social concerns are considered; that is, following the millions of dollars invested in developing the business case based on the EL that was issued. The government then begins the assessment of the suitability of the area for mining. The viability of the project is at risk and, along with it, the investment to date and the anticipated future earnings. This risk is exacerbated by the length of time it takes to get development approval in NSW. If there is a market downturn during the period of negotiation and the assumptions on which the company's business case was built change significantly, the company may decide it is more prudent not to invest further in the project.

Without a strategic focus at the government level at the time of the corrupt conduct identified in operations Jasper and Acacia, the MRB had no guidance for the decisions made around whether, where and when the state's coal resources should be explored and developed. Equally, there was no standard against which any decisions made by the MRB could be judged by an external observer. Without an integrated approach to the development of the coal mining industry, each area of government focused solely on its part of the process with little consideration given to the impact of the MRB releasing ELs for broad areas that the Department of Planning and Infrastructure would later restrict.

The consequences of this approach were far reaching, particularly during the years when coal prices were booming and in the lead up to the corrupt conduct exposed by the Commission. First, it created uncertainty in the industry and put investment at risk as a result of inconsistent government actions. As presented in chapter 3 of this report, such a framework created incentives for industry players to lobby government to protect their investments.

Secondly, it created great unease and opposition within the community when ELs were issued for areas of land that had competing land uses, local populations and environmental value. Finally, such an approach led to claims that the MRB, as both regulator and facilitator of the industry, was biased towards the interests of mining companies; an accusation fuelled by the opaque decision-making processes.

The diminished capabilities of the MRB

The rise in coal prices from 2004 onwards led to an increase in exploration and mining activity in NSW and a subsequent increase in workload for the public officials charged with administering the state's MLs. At the same time, however, the MRB was undergoing significant change.

In late 2004, the MRB transferred from Sydney to Maitland in the Hunter Valley, where it was co-located with the industry it regulated. Part of the Industry Coordination Unit, a small subsection of the MRB, remained in Sydney. As is common with any decentralisation, many employees did not transfer to Maitland, leading to a loss of corporate knowledge, a number of vacancies and a deficit of skilled staff. These losses were aggravated further by employment opportunities with mining companies that had arisen during the boom period (encouraging further staff resignations) and a government-wide recruitment freeze that prevented the filling of many job vacancies. Since then, chronic problems with staff retention and recruitment have plagued the

MRB. It has been acknowledged, generally, that workload pressures and staff shortages had left the remaining staff doing "the best they could" with a focus on "keeping their heads above water".

During this time, the stand-alone Department of Mineral Resources was also abolished and transferred to the DPI. The DPI, in turn, had been newly formed following the merger of NSW Agriculture, NSW Fisheries, State Forests of NSW as well as the Department of Mineral Resources. This was just the first of a number of public sector restructures that, between 2004 and 2011, saw the MRB subsumed into larger and larger departments; first, it was merged to form the DPI, which was then amalgamated into the Department of Industry and Investment in 2009, and finally into the Department of Trade and Investment, Regional Infrastructure and Services in 2011.

One rationale for cluster departments is to break down agency silos and encourage creative solutions to issues that cut across previously separate departments. In reality, each area has to compete for resources and the focus of the director general. Despite coal mining representing 25% of state exports and its controversial nature as an industry, it was not always given priority at a cluster level. During the Operation Jasper segment of the public inquiry, Dr Richard Sheldrake told the Commission that when he became director general of the DPI in 2008:

> *…the Department of Primary Industries at that stage comprised 3,500 staff. Mineral Resources were approximately 250. So, and financially in a similar proportion it represented about five to seven percent of the Department of Primary Industries. So I had a range of other priorities and pressures.*

While the MRB retained substantial technical skills after it was subsumed into the DPI, the policy, economic and legal expertise within the MRB was centralised, to a large extent, within the cluster, leaving a deficit of skills in those areas within the MRB itself. An economics unit existed within the DPI but no formal financial or economic analysis was undertaken when it came to decisions about where and when the state's coal resources should be explored. No formal mechanisms were in place within the cluster to ensure the MRB accessed this expertise.

The cluster was just that – a cluster of individual branches – rather than an integrated organisation. It required the MRB to recognise the need for economic, policy or legal input, and request it. In reality, the MRB did not obtain input from these specialist areas, as the perception was that the public servants in those areas did not have enough expertise in minerals to provide the necessary support. As a result, recommendations to release and allocate ELs were formulated solely by the under-resourced MRB without the benefit of the expertise available in the broader department.

These problems that resulted from the establishment of clusters were not unique to the DPI or, later, the Department of Trade and Investment, Regional Infrastructure and Services. In 2012, the NSW Commission of Audit recognised that many clusters "do not have the corporate systems, governance arrangements nor legal authority to operate in a coordinated way".[6]

In its 2011–12 annual report, the Department of Trade and Investment, Regional Infrastructure and Services acknowledges that multiple restructures and mergers since 2004 have led to the department operating with a range of different corporate systems. Given that these more basic integrations have not been successful, it is not surprising that isolated units still exist within the cluster arrangements and that synergies with other areas within the department have not necessarily been achieved.

At the time, as the MRB lost staff, status and capabilities, there were greater opportunities for the minister to pressure or override the branch on behalf of specific miners. As the MRB became isolated, Mr Macdonald and his office generally communicated directly with the MRB rather than through the director general of the cluster. The opportunity for Mr Macdonald to unduly interfere in the work of the MRB was, therefore, established.

Operational arrangements

Process of allocation

The process for obtaining any mineral EL, as described in Part 3 the Mining Act, is uncomplicated. A company applying to the department for an EL must submit an application accompanied by information as specified in s 13 of the Mining Act. Thereafter, using a checklist, the Titles Unit within the MRB considers the information provided. Input is obtained from the various subsections within the MRB and consultation may occur at the discretion of the Titles Unit staff member with other government entities, such as the NSW National Parks and Wildlife Service, Fisheries Division of the DPI or water and energy authorities. The application is then considered at a meeting of the Exploration Titles Committee whose members all work within the MRB (see figure 2). Generally, where an application is recommended for approval, conditions will restrict what activities the titleholder can undertake.

Conditions on an EL divide physical exploration into three categories, with two of these requiring further approvals from the MRB to assess possible and potential impacts on

6 NSW Commission of Audit, January 2012, *Interim Report: Public Sector Management*, p. 28, viewed mid-2013, http://www.treasury.nsw.gov.au.

Figure 2: Committees within the MRB

Coal Allocation Committee

- chair is the executive director, Mineral Resources, MRB
- director, Titles Unit, MRB
- director, Development Coordination, MRB
- director, Coal Advice, MRB

Exploration Titles Committee

- chair is the director, Mineral Operations, MRB
- representative from Environmental Sustainability Unit, MRB
- representative from Geological Survey (reports to executive director, MRB)
- representative from Titles Unit, MRB

the environment. These environmental considerations are not explicit in the Mining Act, but come from statutory responsibilities placed on the MRB under Part 5 of the EP&A Act. It is noteworthy that the environmental consideration under Part 5 of the EP&A Act relates only to the potential impact of exploration activity and not the broader environmental impact of possible mining activity at that location. Once the assessment under Part 5 of the EP&A Act is complete and the conditions of the EL are finalised, a recommendation is made that the minister issue the EL. Delegations in place within the department at the time of the corrupt conduct allowed officers of the MRB to execute an EL on behalf of the minister. When Mr Macdonald was minister for mineral resources, it was very unusual for him to directly execute an EL.

This process for obtaining an EL currently applies to all other mineral resources in NSW and works on a first-come first-served basis (known as a gold rush approach to allocation). Mature areas, however, have always attracted greater industry interest, as coal exploration in these areas is considered low risk and regarded by industry investors as more of an activity in firming up of a business case for mining operations rather than true exploration in a frontier area. The MRB recognised the interest generated in mature areas and sought that coal on lands within the state covered by the Sydney Gunnedah basin and Oakland basin be declared a Mineral Allocation Area. In August 1992, the then governor of NSW made this declaration.

The goal of declaring a Mineral Allocation Area was to control the allocation of ELs in a better way than the first-come first-served gold rush model. Control was not, however, obtained through well-crafted regulations and transparent decisions. Rather, ministerial discretion was enshrined as the sole control of allocation. The process, as established, required that, before an EL application could be lodged and before it could follow the process outlined above, the minister for mineral resources was required to first give written consent for that application to be lodged. It effectively created a situation in which a private company had an incentive to lobby the minister for a transfer of valuable assets from the state to the company.

In response to the boom and an increase in exploration applications, a practice arose whereby companies began submitting applications for ELs in areas just outside the declared Mineral Allocation Area and getting those ELs on a first-come first-served basis. Senior management at the MRB responded to this by recommending that the whole state of NSW be declared a Mineral Allocation Area for coal "in order to ensure the orderly development of coal resources". In December 2006, this declaration was made pursuant to s 366 of the Mining Act.

By Mr Macdonald providing his consent to a company to apply for an EL, it now became the critical point at which he could exert influence and decide whether an EL would be allocated directly, be the subject of a competitive process or be released through a limited expression of interest (EOI). This consent has been described as the "primary policy decision". If that decision was made in favour of a direct allocation, the applicant submitted their EL application following the standard process outlined above. Given the minister had already indicated his support for the project, MRB staff generally viewed the standard EL approval process as a purely administrative one.

Brad Mullard, Executive Director of the MRB, was asked about this practice during the Operation Acacia segment of the public inquiry:

[Counsel Assisting]: *What hurdles remained for a person interested in an Exploration Licence once it had been granted the Minister's consent to apply?*

[Mr Mullard]: *They were largely administrative, effectively all they had to do was actually lodge the appropriate fees, security deposits and demonstrate*

that they had access to appropriate technical and financial, financial ability. It was, it was largely an administrative process it was not, if provided ---

[The Commissioner]: *It's not discretionary?*

[Mr Mullard]: *No, it wasn't. And provided they met the requirements as defined in the Act they would be granted the title.*

When an EL application was considered by the Exploration Titles Committee, it was generally dealt with quickly, as the application already had the support of the minister and there was no instance where an EL was not granted after the minister had given his consent. In effect, it was a fait accompli.

There was also no opportunity for the community to have input prior to the granting of an EL. At the time the events were unfolding in operations Jasper and Acacia, there was a non-statutory requirement on individuals who lodged an EL application to place a public notice in a newspaper. This requirement, however, came after the minister had given his consent to a company to apply for an EL. Similarly, conditions that were placed on some ELs required the titleholder to establish and run a community consultative committee but these committees were established only after an EL was granted.

No information was publicly available about how the minister reached their decision. Without criteria in the Mining Act that set out what the minister must consider before making this decision, the minister had broad discretion to directly allocate ELs.

The role of the Coal Allocation Committee

When companies wrote to Mr Macdonald or the MRB to request that they be given consent to apply for a direct allocation of an EL for coal (see figure 3), those requests were recorded on an Excel spreadsheet known as the Register of Interests. The register listed the name of the relevant company and the area of land over that it had requested an EL. There was no standard information that a company had to provide with its submission; as such, applications varied in length and detail from two-page letters to detailed proposals. Companies that requested a direct allocation were given no indication of how long they would be likely to wait, with time frames varying significantly. The Commission was advised that some parts of the coal mining industry were not aware of the Register of Interests.

The CAC was established to review these applications and make recommendations to the minister as to whether an EL should be directly allocated or be the subject of an EOI. The CAC met, generally, from three to four times a year, although sometimes as few as two meetings occurred. Meetings were arranged when the secretariat was of the view that a sufficient number of applications had been registered to warrant holding a meeting. The person in this role was based in the Industry Coordination Unit in Maitland, while most of the unit was based in the Sydney office.

Like the Exploration Titles Committee, all members of the CAC came from within the MRB (see figure 2). There was no external oversight of the committee and no mechanism for appealing the recommendations it made to the minister.

None of the deliberations or recommendations of the CAC were made publicly available. There was effectively no transparency at all. While the final decision of the minister was known to the applicant, there was no public record of whether or not the minister's decision differed from that recommended by the CAC. This lack of transparency is unlike comparable government activities that can confer great benefit on an individual, such as the issuing of planning approvals. The Department of Planning and Infrastructure has well-defined frameworks for decisions and clear processes by which its recommendations and decisions are made transparent. Assessment reports and recommendations to the minister are made available on the department's website before the minister makes a decision. The minister's response is also made public.

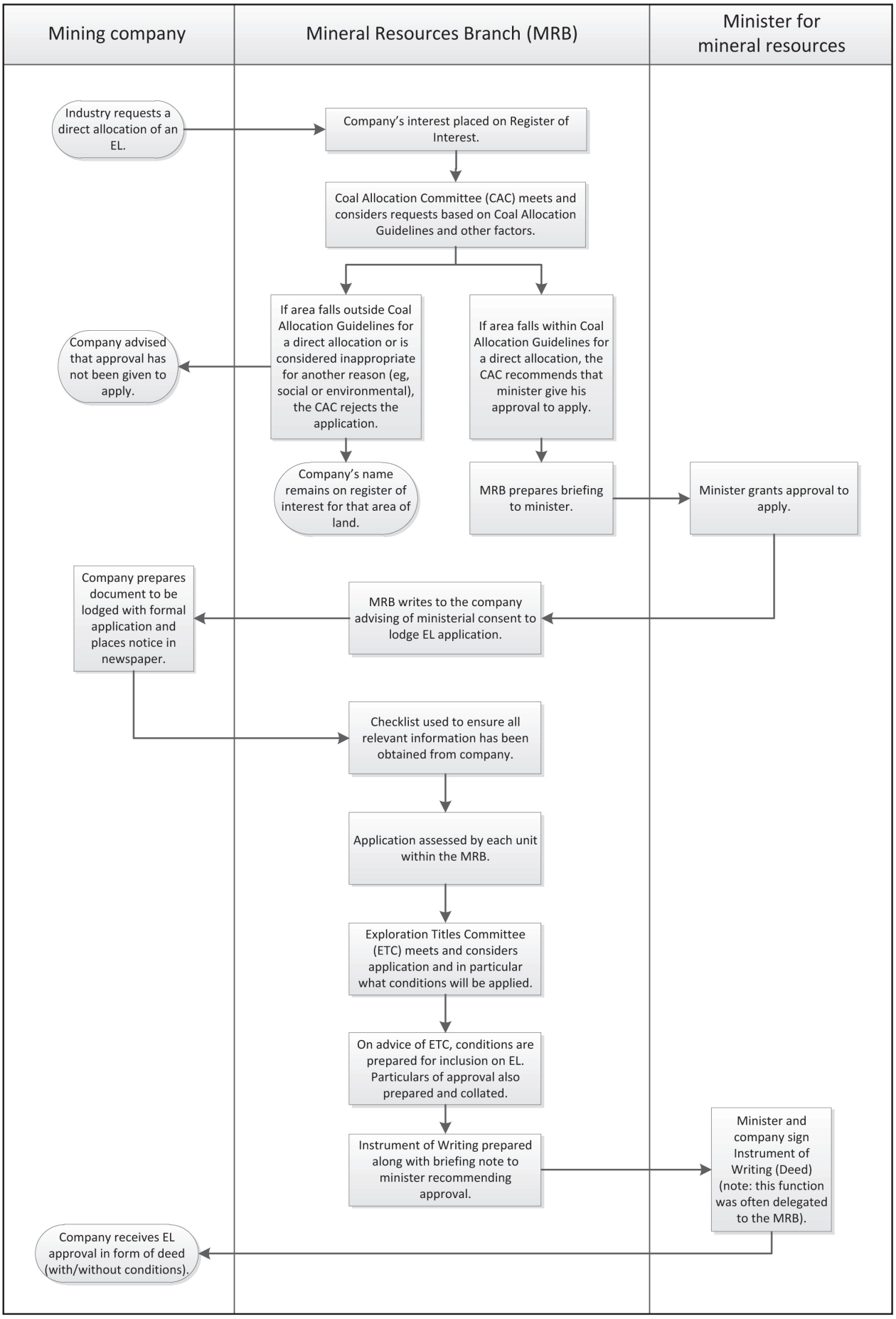
The CAC did not have terms of reference but used the 2008 Coal Allocation Guidelines to guide its decision-making. According to the guidelines, the criteria for obtaining an EL were framed by size and geographic location and fell into the following four categories:

1. Major stand alone areas – these areas contained sufficient coal to develop a large new mine and would be allocated by tender or EOI.

2. Substantial additions to existing mines (20 million tonnes open cut or 50 million tonnes underground saleable coal reserves) – these areas were located adjacent to existing mines and could be mined from a continuation of the existing operations. Such areas may also have had the potential to be major stand alone areas. Unless the area was required to ensure the ongoing short to medium-term future of the mine, competitive tendering or EOI would be used.

3. Minor additions to existing mines (20 million tonnes open cut or 50 million tonnes of underground saleable coal reserves) – these areas were small areas adjacent to existing mines and could be mined by a continuation to the existing mine. These areas were not large enough to develop major stand alone mines.

Figure 3: Process for granting an EL in a Mineral Allocation Area via a direct allocation



These areas could be directly allocated for a number of reasons, including if it would extend the life of the existing mine or the area would not be amenable to the development of a separate small mine.

4. Small areas unrelated to existing mines – these areas were small but may have had the potential to be developed as stand alone mines if located close to infrastructure or markets. Allocation would be by priority of application or by some limited form of EOI.

The CAC was provided with advice from geologists in Coal Advice (a subsection of the MRB) as to the merit of the application, including information on the boundaries, the level of geological knowledge of the area and the estimated tonnage. Some companies were also asked to make a presentation to the CAC on their proposed work program, although this varied from application to application and was not consistent. Once the CAC had all information it considered relevant, the application was then assessed against the Coal Allocation Guidelines and the CAC came to a conclusion as to whether to recommend that the minister give his consent to apply or not.

While the Coal Allocation Guidelines required CAC members to give consideration to the size of the coal deposit, in reality broader considerations (such as environmental and social factors) were brought to bear on applications in an informal way and without input from the Department of Planning and Infrastructure.

In an audit of a sample of ELs granted by direct allocation during the period that Mr Macdonald was minister, the Commission found evidence of inconsistency in approach. In the cases examined by the Commission, there appeared to be a tendency to directly allocate an EL based on an unsupported estimation of the potential resource. In one case, a direct allocation was given to a company of an adjoining resource because it was considered a minor addition to an existing mine under the Coal Allocation Guidelines. No estimate of the potential resource was provided by the company and there was no evidence or documentation to support how the MRB determined that the company met the criteria for a minor addition. The area also adjoined other mining projects but there was no evidence as to why the MRB considered that the direct allocation to one company over another represented the most rational and equitable approach, as required by the Coal Allocation Guidelines.

In another case, an estimated resource of 8 million tonnes was directly allocated to a company and the resource was later found to contain upwards of 89 million tonnes. In that same case, the EL covered part of a dam and was in close proximity to a town, but there was no evidence on file that the potential environmental or social factors were considered.

Neither the Coal Allocation Guidelines nor the CAC had any statutory backing and, so, did not limit the discretion of the minister. Indeed, in Operation Jasper, the decision to release a limited EOI was made at the request of the minister without input from the CAC. Similarly, in Operation Acacia, the application to establish a training mine was considered by MRB staff separate to the CAC process and directly allocated by the minister despite advice to the contrary from the MRB. With little formal guidance, no transparency and a history of seemingly inconsistent decision-making, it was much easier for Mr Macdonald to make the decisions examined in operations Jasper and Acacia.

The EOI process

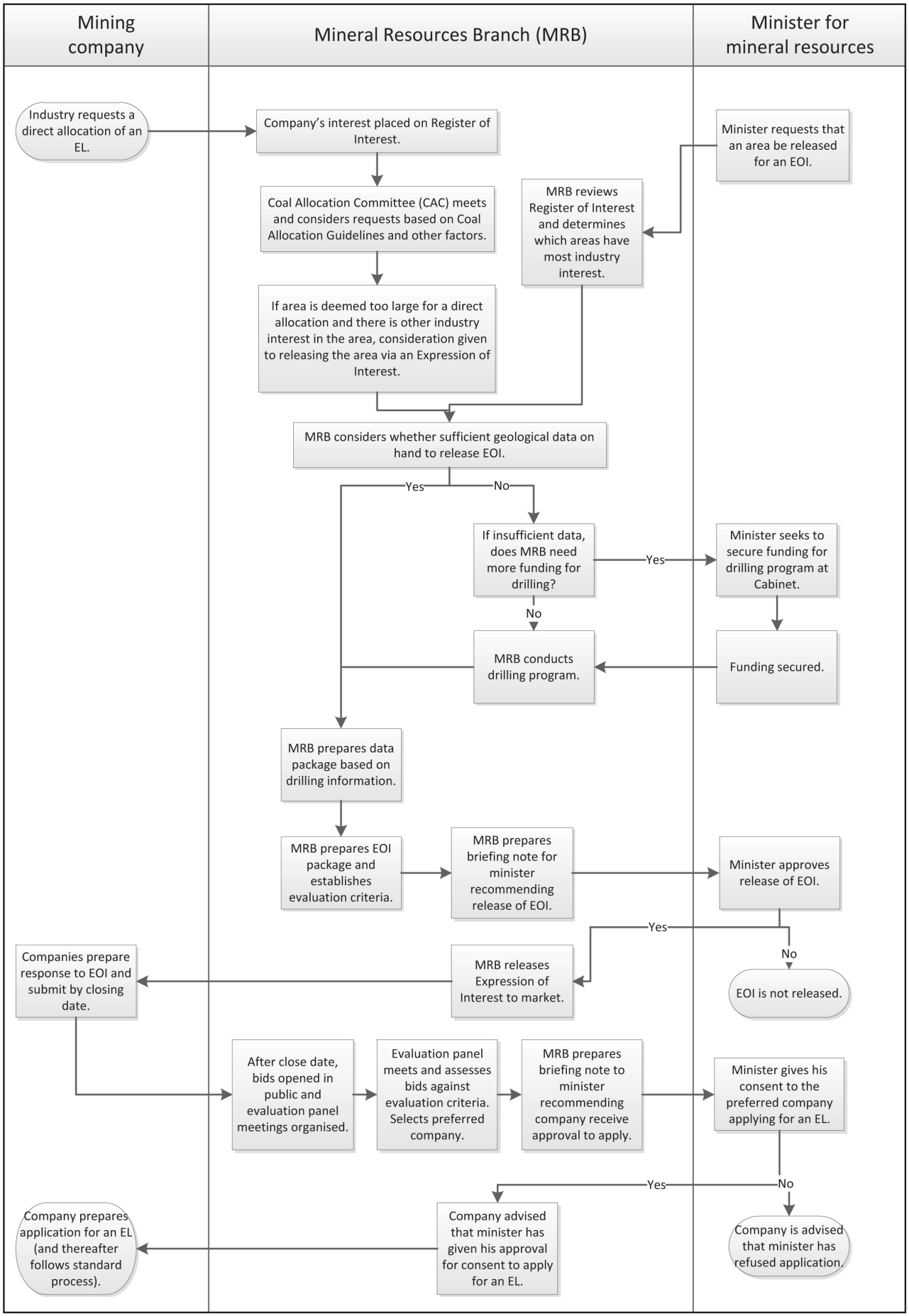
The second consequence of declaring a Mineral Allocation Area was that it gave the government the power to award ELs via a statutory tender under the Mining Act. A company that was refused consent to apply for a direct allocation would remain on the Register of Interests. When multiple applications for one area of land were received, consideration was then given to releasing a call for EOIs (see figure 4). Similarly, when the minister requested that areas of land be released for ELs, the register was consulted to see which areas had significant industry interest. Before the MRB would recommend that the minister release an EOI, the branch would, generally, undertake additional drilling to obtain further geological data. It was argued by the MRB that more detailed geological data would generate greater industry interest.

Tendering provides a vehicle to consider multiple applications for a particular area and to assess which company's work program best satisfies the criteria specified by the MRB. Instead of using the statutory tender provisions available under the Mining Act, however, the MRB used an EOI process with the express purpose of retaining flexibility in the way it managed the process.

Sections 14 and 15 of the Mining Act set out a tender process to allocate coal ELs along with a description of the information to be provided to the MRB by a tenderer, including:

- *Particulars of the financial resources and relevant technical advice available to the tenderer*
- *Particulars of the program of work proposed to be carried out by the tenderer in the proposed exploration area*
- *Particulars of the estimated amount of money that the tenderer proposes to expend on prospecting*
- *Any other information that is specified in the tender invitation*.

Figure 4: Process for granting an EL in a Mineral Allocation Area via an EOI



These statutory tender provisions were not used by the MRB, as there was a view that they did not provide sufficient flexibility for the branch and minister in allocation decisions. It is unclear which elements of the statutory tender processes were considered overly restrictive. Regardless, a decision was made, in the absence of formal legal advice from the department's legal section, not to use the formal tender process but instead opt for an EOI process. Like the placement of ministerial discretion as the cornerstone of allocation, the EOI process was adopted to maximise the discretion afforded to the department and minister in the competitive allocation process.

The EOI process was managed by the MRB's Industry Coordination Unit. Outside of managing the EOI process, the unit worked with companies in advance of their submitting an application for development approval to the Department of Planning and Infrastructure. The unit was established to help those companies cut through red tape. It also carried out various functions, including the preparation of flagship publications on the mining industry in NSW and managing the community consultation process. The unit also maintained the Register of Interests and provided secretariat support to the CAC. When a decision was made to hold an EOI, the unit prepared the selection criteria and worked with the Coal Advice subsection to prepare a data package of geological information to accompany the EOI.

Additional financial contributions

For many years up until 2005, competitive EOI processes were used to enable the MRB to review each company's work program and assess the relevant capabilities and proposals. These proposals were accompanied by fixed fees and a capped additional financial contribution, payable by the successful company. In brief, an EOI package was developed by the Industry Coordination Unit, including a set of evaluation criteria and a data package based on the department's drilling data. An evaluation panel was also established that included an independent panel member from the Department of Premier and Cabinet and a probity adviser. Upon receiving the minister's approval, the EOI was released to the market for a fixed time period. Those companies that had previously requested the minister for mineral resources' approval to apply for an EL in that area were advised of the EOI. The EOI was also marketed more broadly.

At the close of the EOI period, sealed proposals were opened in a public place and then the EOI evaluation panel convened to consider how each company's proposal met the evaluation criteria. The Commission heard evidence that the applications were largely assessed on face value. For example, while one criterion required examination of the financial capacity of the applicant companies, the panel did not interrogate the financial information provided to it or do any independent checks to verify the claims of financial backing. At the conclusion of its deliberations, a recommendation was put forward to the minister and the preferred company was granted the minister's approval to submit a formal application for an EL.

In the parlance of auction theory, the MRB's method of allocation was a "beauty contest". This approach has fallen out of favour in much of the Western world as the sole methodology for allocation of resources. Experience has shown that it can be difficult to specify the criteria and, as a result, makes evaluating proposals challenging. In addition, they can be politically and legally controversial. They create the perception of favouritism and corruption. In mining, the Productivity Commission refers to this approach to allocation as "work program bidding", whereby the allocation decision is based on how well each company's work program meets policy and regulatory objectives. The Productivity Commission notes that such work program bids can be complex to assess.

Not only are the criteria and evaluations discretionary, the system is open to manipulation by mining companies. In NSW, the use of this approach during the boom period allowed companies to offer the promise of future public benefits, such as infrastructure or the development of innovative technology, as part of their application. In reality, the provision of these public benefits is linked to the probability of obtaining an ML, and many companies made these offers knowing that it may be possible to rescind such promises given the right combination of time lapse, changing political climate and pressure on government.

In the years prior to the boom period, when an EOI process for an EL was undertaken, a cap was placed on an additional financial contribution payable by the successful company. In 2005, the then director general of the DPI recognised that, with the increase in coal prices, the value of an EL had increased and that the state could receive an increased additional financial contribution. An added benefit was that, at that time, the DPI was experiencing a budget shortfall and an agreement was made at a political level that revenue generated by the additional financial contribution could offset this deficit. With the agreement of the then minister for mineral resources, Kerry Hickey, the cap on additional financial contributions was removed.

By doing so, a mining company that wished to participate in the EOI was, in effect, asked to consider the value of the coal deposit and then make an offer that it thought appropriate to gain access to the coal resource. The company then submitted that additional financial contribution offer along with its work program and response to each of the EOI criteria.

The uncapped additional financial contribution approach was adopted in EOI allocation processes for the Caroona and Watermark coal exploration areas. In each case, an open competitive process was used, with the EOI process advertised broadly in national newspapers and online. All companies operating a mine within NSW were advised of each EOI. The EOIs were also promoted internationally. This had the effect of stimulating broad market interest.

Coal Mines Australia Limited (a wholly owned subsidiary of BHP Billiton Ltd) offered an additional financial contribution of $91 million, plus further staged payments of $50 million and $65 million for the Caroona coal exploration area (estimated to contain approximately 1 billion tonnes of coal). This was a significant injection to state revenue and was followed up by the release of the Watermark coal exploration area (estimated to contain approximately 1 billion tonnes of coal) in October 2007. China Shenhua Energy Company Limited was the successful company, with an additional financial contribution offered of $276 million, plus an extra $200 million at the granting of an ML.

Clearly, the experience of Caroona and Watermark show the importance of marketing an EOI broadly and the resulting financial benefit to the state. In these cases, by having open and competitive processes, the state received the full value for the EL. Simply lifting the cap on additional financial contributions, however, is not the same as redesigning the system to be auction-based; rather, when the cap was lifted, an auction component was simply added onto the existing process of discretionary assessment. The EOI evaluation panel now no longer focused only on how an applicant met each evaluation criteria and which applicant had the better work program. It now also considered the technical criteria in tandem with the additional financial contribution bid from each company. This mixed model may have raised more revenue but a subjective work program assessment remained.

There are various technical models available for the auctioning of public resources, each with careful design considerations. They do not appear to have been explored when the cap was lifted on the additional financial contribution. By not consulting with the NSW Treasury, which has the relevant expertise and experience, the opportunity was lost to redesign the auction system by using one of these technical models. Had the model been redesigned and overseen by the NSW Treasury, as would be expected for transactions of this size, it would have lessened the opportunity for the minister for mineral resources to influence how an EOI process would take place.

In Operation Jasper, without the NSW Treasury involved and with high levels of discretion built into the process, Mr Macdonald was able to instruct MRB officials to limit the EOI to invited companies only. This significantly narrowed the market, giving an important advantage to the selected companies.

The use and limitations of a probity adviser[7]

While the decision-making processes were not transparent, the MRB did recognise the need to have independent members on the evaluation panel. The MRB was aware that there was a risk in the administration of ELs. As a result, a public official from the Department of Premier and Cabinet sat on the EOI evaluation panel and a probity adviser was also engaged. Kevin Fennell was an independent probity adviser who had assisted with various projects undertaken by the MRB over the 16 years prior to 2008.

Engaging a probity adviser does not guarantee probity in the process. A probity adviser is generally engaged to verify that the processes being followed are consistent with government regulations, policies, guidelines and best practice principles. In Operation Jasper, the minister's office requested that the EOI process be reopened to give additional small- to medium-sized companies an opportunity to apply.

Mr Fennell's initial draft advice on the question of reopening the EOI suggested that the then Department of Commerce (now the Department of Finance and Services), as experts in procurement and contracting, could be called on to provide input. Later, that suggestion was removed and Mr Fennell agreed that the process could be reopened. In explaining his rationale to the Commission, Mr Fennell stated that, "I had to have empathy with the Minister because it seemed to me that, the main reason why he wanted to do this was to, to try and grab in more funds", and that, "if a Minister of the Crown wants to do something he's going to do it anyway and it probably wouldn't have mattered what I said".

It is not the role of a probity adviser to fail to fully consider a matter because of the desires of a minister; even if that request appears on face value to have validity. Probity advisers will often face situations where they need to decide between what they know to be best practice and what they know to be the desire of the agency. It is always open to an agency or minister to give greater weight to financial, technical or political considerations over that of the advice given by the probity adviser; however, a probity adviser should not allow these other considerations to compromise their independence or the quality of their advice.

7 The terms "probity adviser" and "probity auditor" are often used interchangeably within the profession and there is no legal or professional standard in relation to the correct or agreed use of the terms. In practice, it is often the case that the person engaged to perform probity activities for a government project will perform both advice and audit functions. While Mr Fennell was engaged as a probity auditor, the primary function of his role was one of advice. The Commission uses the term "probity adviser" in this report, while acknowledging that many probity advisers provide some audit functions.

While the intention of the MRB was to involve independent expertise and ensure probity in the process, having this involvement solely at the EOI evaluation stage meant the probity adviser had a necessarily narrow viewpoint on the process. The probity adviser had no oversight of the process at the point where the initial recommendation was made about whether a particular area of land was suitable for release or whether a limited EOI approach was appropriate. When a probity adviser cannot oversee the entire process, their value is questionable and a public sector agency may achieve a better outcome by ensuring its own systems, policies and procedures are designed with built-in probity and corruption controls.

Process of renewal

For the tenure of an EL, the resource is linked to a specific mining company. By convention, the EL gives that mining company a right to apply for an ML. The purpose is relatively clear. Some degree of security is provided to a mining company, which may well have spent many millions of dollars firming up the viability of the areas, that it will be able to go on to apply for an ML. The limited tenure provides an incentive to move ahead with the program of exploration or risk loss of, or partial forfeit of, the lease.

The MRB also had responsibility for the EL renewals process but did not have a database that automatically notified MRB staff when ELs were due for renewal. As a result, it was not uncommon for renewal requests to be made immediately before the EL was due to lapse. Once the application was lodged, however, the company was allowed to continue work until the renewal had been processed. Often, the processing of these requests was held in abeyance due to heavy workloads at the MRB.

At the point of renewal, a company was required to forfeit 25% of the EL area to encourage the company to focus on identifying the specific area within the EL boundary where mining was most likely to be profitable.

As part of the renewals process, the Coal Advice subsection undertook an assessment of the company's work program, and whether it had met its conditions and proceeded as planned. A recommendation was then made to the Exploration Titles Committee (made up of representatives from the various subsections of the MRB, as outlined in figure 2) as to whether to support the renewal request. While compliance with the proposed work program and the conditions placed on the EL were key factors in the renewal decision, they were not the sole consideration. It was not uncommon, for example, for other factors put forward by the company seeking a renewal, such as delays resulting from bad weather or problems with obtaining land access agreements, to be considered. Companies were required to show that they were actively trying to progress with their exploration program but these assurances were generally taken on face value rather than requiring those companies to produce any evidence.

The renewal process allowed for some companies to meet with the MRB to explain why they needed a renewal, while others were not invited to do so. In one case examined by the Commission's auditors, multiple companies (as well as the Coal Advice subsection) opposed another company's EL renewal. After the MRB met with the company seeking the renewal, however, the renewal was granted. It is unclear from the file why this decision was made.

There is a real risk of mining companies seeking to hoard resources, which could potentially be accessed by other companies, by repeatedly renewing an EL without intending to progress to a mining project. Despite this risk, there was no formal "use it or lose it" policy in place. Evidence was heard by the Commission during the Operation Jasper segment of the public inquiry that the idea of developing such a policy had been raised by the minister for mineral resources but never progressed. The process remained discretionary and opaque, and inconsistently administered.

Conclusion

The processes within the MRB and the interactions between the minister for mineral resources and the MRB at the time of the corrupt conduct identified in operations Jasper and Acacia were largely hidden from scrutiny. A process that lacks transparency can increase the opportunities for manipulation of release and allocation decisions. This lack of transparency, coupled with a large amount of discretion and a lack of guidance at a state level, led to inconsistencies in the decisions made about EL allocations. The result was a framework that was opaque and created uncertainty for both industry and the community.

The policy and regulatory environment failed to provide industry certainty, ensure quality public policy, capture the value of the assets and reduce opportunities for corruption through transparent decision-making. Rather, such a complex and opaque policy and regulatory environment created an incentive structure that encouraged companies to engage in lobbying and negotiation in order to do business in NSW.

Chapter 3: Doing business in NSW

The behaviour of companies is keenly affected by government policy. A global study released in January 2010 found that, "Government is likelier to affect companies' economic value than any other group of stakeholders except customers".[8] The policy and regulatory environment created by governments is a central influence on the way companies do business and compete against each other. As governments adjust policies and regulations, companies are forced to change the way they operate. Government decisions about infrastructure affect where companies decide to operate, for example, while government regulations restrict what companies are permitted to do. Taxation rules and government programs can also be designed to encourage companies to grow.

This chapter will discuss the incentive structure created by the policy and regulatory environment in NSW in the years preceding the corrupt conduct identified in operations Jasper and Acacia. It will examine the flaws in this structure at the time of the mining boom and the perverse incentives that were imbedded within such a structure. Not all of the flaws discussed below were exploited for corrupt advantage during the period investigated by the Commission for operations Jasper or Acacia. It is the Commission's view, however, that in such a policy and regulatory environment, with so many risks and opportunities for corruption, it was almost inevitable that corruption would occur at some point.

For the coal mining industry in NSW, the policy and regulatory environment, as it operated during the boom period, was far from ideal. As chapter 2 has shown, the majority of decisions to identify, allocate and administer ELs were made by the MRB in the absence of an overarching government strategy. The processes used by the MRB were opaque, so that areas to be released were based on a Register of Interests, the existence of which was unknown to many of the state's industry players. Most EL allocations were made directly to mining companies, guided broadly by the Coal Allocation Guidelines. But these guidelines were applied inconsistently and other factors were also taken into account on an informal basis. For companies, this created uncertainty and an appearance that decisions were made in an ad hoc way.

Many within the coal mining industry in NSW responded to these opaque and complex processes by either engaging lobbyists to try to navigate the process for them or by directly lobbying departments or ministers. In order to establish a mine in NSW, the government had, effectively, created a system that provided for no other way to do business.

There is nothing inherently wrong with lobbying. Appropriate lobbying can enhance the government's decision-making by allowing those with an interest in the decision to contribute in a way that can improve the quality of information to the decision-maker. It is the Commission's experience, however, that a lack of transparency in any process involving government decision-making can be conducive to corruption. That corruption risk is exacerbated when secrecy of the lobbying activity itself is allied with secrecy surrounding the basis on which a decision is made.

The combination of substantial profits available to companies and the opaque, inconsistent and negotiated approach that characterised the policy and regulatory environment in NSW at the time of the corrupt conduct identified in operations Jasper and Acacia made lobbying the logical option for mining companies doing business. It also increased the risk for corruption.

While lobbying might achieve favourable business outcomes in an uncertain environment, it is not how mining companies

8 McKinsey & Company, January 2010, *How business interacts with government: McKinsey Global Survey results*, viewed mid-2013, http://www.mckinsey.com. The online survey was conducted between 17 and 30 November 2009, and responses were received from 1,167 executives from across the globe.

prefer to do business. The Fraser Institute's *Annual Survey of Mining Companies 2012–13* places NSW at 44th place out of a total of 96 jurisdictions in terms of the perceived attractiveness of its policy and regulatory environment.[9]

While the survey focuses on all minerals and not just coal mining, it is reasonable to assume that, as the state's largest export, those involved in the coal mining industry were a sizeable proportion of the respondents to the survey in 2012–13. It is notable that NSW scored much lower than highly-ranked jurisdictions, such as Sweden, Finland and Canada, despite these jurisdictions having large public sectors and stringent environmental and social regulations.

The problem for NSW does not stem from the technical work undertaken by the MRB. The state has invested in the development of geological databases that are ranked second in the world (after those of Finland). Rather, the known problem for mining companies is the opaque and uncertain regulatory and policy environment of the state. Results from the survey reveal that NSW is ranked:

- 44th out of 96 jurisdictions surveyed on uncertainty concerning interpretation and enforcement of existing regulations
- 63rd out of 96 jurisdictions surveyed on uncertainty concerning environmental regulations and 2nd worst among Australian states
- 44th amongst those jurisdictions surveyed on regulatory duplication and inconsistencies.

Together, the survey results indicate that NSW has a relatively significant sovereign risk. Sovereign risk, used in the broadest colloquial way, refers to the risk to a company as a result of inconsistent decisions and shifting rules. It is probable that issues relating to the regulation of coal seam gas influenced the 2012–13 results to some degree, but NSW's low ranking scorecard has remained relatively consistent across many years of the survey.

When it comes to investment destinations, this policy and regulatory environment is not an insignificant component of a company's decision-making. The Fraser Institute survey, which is consistent with other research findings, shows that approximately 40% of an investment decision is driven by a jurisdiction's policy and regulatory environment and 60% by matters related to the quality of the minerals. In NSW, the investment value of taxpayer monies in geological databases has been somewhat negated by the sovereign risk created by the uncertainty in the policy and regulatory environment. The result is a system that is both a deterrent to investment and conducive to corruption.

When operating under such an uncertain policy and regulatory environment, the primary safeguard against corruption then becomes the personal boundaries of individuals; for example, the minister himself or herself, government staff and mining company representatives. Conversely, if any of the personal boundaries of these individuals could be compromised, then corruption is likely to follow.

Consequence waiting to happen – rent seeking and corruption

With the exception of a few boom periods, the growth of the coal mining industry in NSW has been fairly flat and unremarkable. The price of coal was often barely enough to cover costs such as production, royalties and taxes, and to achieve a small profit for the owners.

The flaws in the policy and regulatory structure in NSW became apparent when the price of coal reached a point that significantly exceeded these typical costs. So-called

9 The "perceived attractiveness of the policy and regulatory environment" is the Commission's term for what is called the Policy Potential Index in the Fraser Institute's survey.

super profits suddenly became possible. This phenomenon is also known as economic rents – returns in excess of that required for the continued investment in, and operation of, a mine. In most industries, the presence of economic rents attracts new entrants to the industry and profits tend to normalise as a result of increasing competition. In mining, the scarcity of resource opportunities can sustain economic rents over an extended period.

The effect of economic rents is generally to stimulate "rent seeking" behaviour. In mining, rent seeking aims to secure control of coal resources and the right to mine that resource. Rent seeking is quite different from "profit seeking". Profit seeking is about creating wealth, whereas rent seeking is about expending resources on lobbying – properly or improperly – in order to influence decision-makers and capture the value of a state asset through a transfer of resources and rights. It is typified by attempts to manipulate a given policy and regulatory environment in order to secure a part of the existing wealth.

The best outcome for a mining company wanting to obtain an EL during the aforementioned boom period, and under the policy and regulatory environment that operated at that time, was to do so without any sort of competitive process. The possibility of direct allocation meant a mining company might have been able to acquire the total value of the economic rent at nominal cost to the company.

In Operation Acacia, the board of ResCo Services Pty Ltd (the proponent of the training mine concept before the company changed its name to Doyles Creek Mining Pty Ltd (DCM)), identified the desirability of pursuing a direct allocation and avoiding, if possible, the area being put out through a competitive process. It recognised that such a competitive process might result in large sums of money being offered for the EL and that it could not compete under such circumstances. In preparing its application for a direct allocation, a decision was made by DCM that a "spin" should be put on the application, using the training aspect to "sell as a benefit to the state". Subsequently, Mr Macdonald used his discretion, against the advice of his department, to directly approve and allocate the area to DCM on the basis of its proposal to open an underground training mine.

In most cases, however, the MRB evaluated the proposed work programs of mining companies when they applied for an EL either directly or by way of an EOI. Such evaluations allowed mining companies to offer promises of future public benefits while, paradoxically, providing the incentive to renege on the promises, if required, after the EL had been granted. Such an approach also created a perverse incentive for corrupt-minded individuals to mislead and enhance their company's application if they considered that the MRB was not fully or effectively evaluating their documentation.

Rent seeking can be far more devious than simply pressuring for a release and allocation decision. The practice of directly allocating deposits adjoining existing mines was, at the time, also a strong incentive to have a smaller part of a deposit released as an EL and the rest directly allocated later. If a mining company was able to obtain an EL over such a small release, then it was highly likely that adjacent parts of the deposit would be directly allocated to it at minimal cost.

In Operation Jasper, rent seeking resulted in the Mount Penny area – an area in which the Obeid family owned property and an area that no members of the MRB, who testified at the public inquiry, had ever heard of at the time – being released as part of an EOI. Mr Macdonald directed that the much larger allocation area, known as the North Bylong area, be reduced to the smaller Mount Penny area. The Mount Penny area was then released with another 10 small coal areas as part of the EOI. This decision by Mr Macdonald reduced the potential return to the state, as it left the area then contiguous to Mount Penny open for potential direct allocation to whomever successfully obtained the Mount Penny EL.

At the Operation Jasper segment of the public inquiry, investment banker Gardner Brook gave the following evidence of a conversation he had had with members of the Obeid family:

> *They told me that once you start mining a particular area you have to apply for any contiguous areas, however the likelihood of being granted the contiguous area is very high. So instead of 100 million tonnes they were talking about 700 to a billion tonnes.*

Indeed, a small initial release could be followed by numerous allocations of adjacent parts of the deposit over many years. In a number of cases examined by the Commission, mining companies were able to capture the value of adjacent deposits through repeated direct allocations.

The policy and regulatory environment was strengthened in 2005 when the cap was lifted from the additional financial contribution payable as part of the EOI. The uncapped additional financial contribution was considered by the EOI evaluation panel, along with an administrative assessment of the company's proposed work program. Using this method allowed the state to better capture the full value of the EL and reduce the incentive to use lobbying to obtain an EL allocation.

The introduction of an uncapped additional financial contribution did, however, create an incentive to limit – if possible – to whom an EOI would be released in order to reduce competition (at best) or make collusion easier (at worst) because of the small number of bidders. As

examined in Operation Jasper, Mr Macdonald limited the EOI process to junior miners, thereby closing the market to larger competitors. This advantaged the Obeid family, who took an interest in a junior mining company that was invited to apply under the limited EOI.

Despite the uncapped additional financial contribution approach to EOIs, direct allocations of smaller and adjacent areas remain, to this day, a common method by which coal ELs are allocated to mining companies. Decisions regarding direct allocations of ELs continue to be made by MRB officials assessing the work programs of companies against departmental criteria and, as a result, the risk remains that rent seeking will continue.

In some cases, for a mining company that has obtained an EL, the incentive within this policy and regulatory environment is not necessarily to proceed to mining. Holding an EL can provide a pipeline for future work or an opportunity to keep resources out of a competitor's hands. Repeated EL renewals can be used by companies to tie up the state's resources unproductively for individual gain or for competitive maneuvering. ELs have been held by some companies for a decade or more with little mining progress and, therefore, without any royalty stream coming to the government.

At the time of the corrupt conduct identified in operations Jasper and Acacia, the renewal process was effectively a direct negotiation between the mining company and MRB staff. The MRB reviewed a mining company's progress against its work plan along with EL compliance conditions. A rigid "use it or lose it" policy was not in place at the time and the MRB would take into account other impediments put forward by the mining company as to why it did not complete its work plan by the renewal deadline. This inconsistency and uncertainty in how renewals were processed continues today and remains an incentive for improper behaviour.

For most mining companies, however, an EL with a viable deposit is worth the investment only once it is converted into an operating mine. Any additional financial contribution, lobbying expenses, administrative fees and investment in exploration would not be worthwhile if the development approval to mine is limited to such a small area that future earnings do not generate significant profits.

As exploration activity concludes, the process for obtaining development approval commences. This usually requires companies to enter into lengthy negotiations with the Department of Planning and Infrastructure around the size of the mine and associated tonnage.

The reality for mining companies has always been, and continues to be, that many lose their EL investment unless they persuade the government to approve their mine at a profitable size and without significant conditions. In its submission to the NSW Planning System Review, the NSW Minerals Council identified a delay of 12 months as a tipping point, stating that:

> *…at this point up to a third of planning mining projects would be abandoned, leading to a significant reduction in the number of jobs created by the industry, investment, revenue generated and redistributed and royalties paid to the Government.*[10]

For a mining company, the result of negotiations with the Department of Planning and Infrastructure is often a significant reduction in the amount of coal that can be accessed from a mine. Combined with long delays and conditions placed on mining production, the financial investment already made by the company is eroded as the project becomes less and less viable. Inevitably, this type of uncertainty, delay and risk to projects results in pressure on the government, pressure on officials and, potentially, appeals through court processes.

One of the few protections for the state under an incentive structure that encourages lobbying is some transparency around who or what is lobbying government. Under the current regulatory regime in NSW, only third party lobbyists must place their details on a register and accept a code of conduct before lobbying the NSW Government. This means that most lobbying in NSW is unregulated, including that undertaken by in-house lobbyists, peak bodies or third party professionals. In the Commission's view, this is undesirable.

Community unease and opposition

In addition to its impact on the coal mining industry itself, the lack of a clear government strategy for coal exploration and mining, along with the opaque departmental processes, continues to create a great deal of community unease. Notices posted in newspapers after an approval has been given for an EL do nothing to allay this unease. While geologists may view exploration as, technically, a low-impact activity, that is not as reassuring to the community, which lacks knowledge of what ELs involve and how ELs relate to mining projects.

ELs that appear to be renewed in perpetuity leave local landholders in limbo, causing decisions about the future of their community to be suspended indefinitely. The longer the situation remains unresolved, the greater

10 NSW Minerals Council, June 2013, *NSW Planning System Review – White Paper and Draft Legislation Submission*, p. 3, viewed mid-2013, http://www.nswmining.com.au.

the incentive for landholders to seek certainty. This might result in representations to members of Parliament, public campaigns and protests, and even attempts to manipulate the outcome.

Concerns have been expressed to the Commission that greater transparency would lead to more community opposition to mining. Making unpopular decisions in secret about coal exploration and development, however, does little to reduce concerns of the community. Ironically, the evidence given by landowners during the Commission's public inquiry was that they were prompted to become actively involved in community action groups opposed to exploration and mining in their local areas because they did not understand the link between exploration and drilling or the process used to grant an EL.

The Commission notes that there are parallels with this community reaction and that reported in the *Initial Report on the Independent Review of Coal Seam Gas Activities in NSW* by the NSW Government's Chief Scientist and Engineer. The report found that the rapid growth of the coal seam gas industry, together with complex and opaque legislation and processes, land use conflicts and poor communication with stakeholders, has led to deep community mistrust of both the industry and government, and that:

> *The debate has been primarily fuelled by the failure of industry and government at all levels to adequately address community concerns before proceeding with development.*[11]

As with coal mining, the result has been strong community opposition to coal seam gas exploration and extraction, with the report concluding that, "the government has significant work to do in getting the policy settings right and building the trust of the public".

Conclusion

The current policy and regulatory environment in NSW encourages all those involved in the coal mining industry to engage in negotiations with, and lobbying of, government in order to navigate the state's opaque processes. Not all of the areas of concern outlined above were evident in the corrupt conduct exposed by the Commission in operations Jasper and Acacia. But, with the sums of money at stake in the boom period and the incentives created by the policy and regulatory environment, it was largely inevitable that some individuals would see the opportunities for corruption.

The Commission is of the view that many of the incentives and opportunities for corruption described above are still of concern today. As such, part 2 of this report (chapters 4, 5 and 6) will outline the characteristics of a preferred future framework and present the 26 recommendations made by the Commission.

11 NSW Chief Scientist and Engineer, July 2013, *Initial Report on the Independent Review of Coal Seam Gas Activities in NSW*, p. 24, viewed mid-2013, http://www.chiefscientist.nsw.gov.au.

Chapter 4: Recommendations relating to state decisions affecting the coal mining industry

In formulating its recommendations for reform of the coal release, allocation and renewal system in NSW, the Commission is mindful of the risk of generating excessive regulatory burden. Its goal in formulating these recommendations is to reduce the risk for corruption in a manner that is practical and relatively simple. Rather than attempt to control the lobbying produced by perverse incentives in the current system, for example, it is the Commission's view that it is preferable to redesign certain aspects of the policy and regulatory environment in NSW to remove these incentives.

Part 2 of this report (chapters 4, 5 and 6) presents the Commission's 26 recommendations for reform. This chapter will discuss the benefits of designing a decision-making structure for the release and allocation of coal ELs with imbedded corruption controls and will also consider the role of probity advisers in complex state projects.

Direction for the NSW coal mining industry

The NSW Government has recently taken significant steps towards developing a policy and regulatory environment that takes account of the broader range of considerations and competing interests involved in the decisions to release an area for mining. There remains, however, no specific guidance on the release of ELs for coal in mature areas. As several experts noted during the Commission's investigation, these ELs are more akin to a pre-mining approval to allow a company to firm up a business case for a mine than they are traditional exploration rights. As such, their release often flags the beginning of an application to establish a mine, yet they continue to be released as if they concern only low-impact exploratory activity.

In the past 18 months, the NSW Government has developed several initiatives, some of which are outlined below, to better balance competing land uses and provide greater certainty for the mining industry and local communities.

- The Strategic Regional Land Use Policy (SRLUP) consists of 27 measures to identify, map and protect strategic agricultural land and underground water resources. Under this policy, an "Agricultural Impact Statement" must be prepared at the exploration stage, and there are also provisions for greater community consultation as part of the conditions placed on an EL.
- Under SRLUP, a "gateway panel" provides an independent and scientific assessment of the impacts of mining and coal seam gas proposals on strategic agricultural land before a development application to mine is lodged. Once the development application is lodged, a full merit assessment is conducted by the Department of Planning and Infrastructure and, if deemed necessary, the proposal will be further assessed by the Planning Assessment Commission.
- The Aquifer Interference Policy requires that a water access licence must be held for any exploration activities that will use more than three megalitres of water per year.
- The creation of the position of Land and Water Commissioner to oversee land access agreements between landholders and miners.

In February 2013, further restrictions were announced by the NSW Premier to protect residential areas and land that the government has defined as being used by a critical industry from coal seam gas activities (known as exclusion zones). The administration of coal seam gas was removed from the MRB and an Office of Coal Seam Gas regulation was established to strengthen the

regulation and development of coal seam gas exploration. The NSW Environment Protection Authority has been given a lead regulatory role to assess the potential environmental and health impacts of coal seam gas in NSW.

In July 2013, another proposal was announced to amend the State Environmental Planning Policy for Mining. The amendment, if approved, will require that, when an application is made for development approval to mine, the economic benefits of developing the resource is considered having regard to:

> (a) *the economic benefits, both to the State and the region in which the development is proposed to be carried out, of developing the resource, and*
>
> (b) *any advice by the Director-General of the Department of Trade and Investment, Regional Infrastructure and Services as to the relative significance of the resource in comparison with other resources across the State.*[12]

These initiatives recognise that there are broader economic, social and environmental considerations when an area is being proposed for mining. The involvement of multiple government departments and the use of a gateway mechanism are consistent with the Commission's view on reform. These initiatives, nevertheless, are in a transition phase. The gateway process and proposed exclusion zones, for example, require changes to the state's planning laws, and the full implementation of the SRLUP will not take place until these changes are finalised.

The Commission is also aware of numerous internal reforms to improve the capacity and administrative effectiveness of the MRB. A process is underway, for example, to devise a policy framework and document the current MRB practices, including the role of the CAC and its procedures. An administrative levy has also been introduced to fund staff positions within the MRB and partially fund IT and system administration updates. The levy will also fund the implementation of new service delivery standards for processing EL applications. The MRB is aware that regulatory processing delays are one of the biggest administrative burdens for the coal mining industry. The new delivery standards will provide greater certainty and allow the industry to manage operations and deadlines around the expected waiting times.

The problem remains that the MRB and the Department of Planning and Infrastructure do not jointly consider whether, where and when ELs should be released. Decisions relating to the release of ELs cannot be assessed in terms of consistency with broader public policy goals or whether they meet state objectives and outcomes. The absence of a clear policy and regulatory environment for the coal mining industry in NSW is in stark contrast to many other areas of government activity.

One of the few strategic documents in which minerals are mentioned is the NSW 2021 state plan, which sets ambitious targets for economic growth (such as a 30% increase in mineral production). The contribution of the coal mining industry in meeting those targets is not specified. More importantly, how the target for mineral growth can be met within the competing objectives that make up the state plan is not addressed.

The Commission is less concerned about whether or not the NSW Government should develop a strategic plan than about whether there are clear policy objectives that guide the development of the industry and against which decisions can be evaluated.

Because every situation requires the consideration of a relatively unique set of conditions, the Commission prefers a model based on well-informed decision-making rather than detailed and inflexible prescription. A clear policy statement that lays out how coal mining fits within the broader policy objectives of the state can guide decision-making and, at the same time, provide more certainty for industry and communities.

From that policy statement, a set of factors can be developed to guide decision-making around release, allocation and development of coal resources. These factors, which would need to be explicitly and transparently considered in the decision-making process, might include consideration of agriculture, infrastructure, community concerns, economic needs, and so forth. The predetermined factors that guide this decision-making would replace the current Coal Allocation Guidelines.

Recommendation 1

That the NSW Government sets out the objectives, priorities and outcomes it wants to achieve from the allocation of the state's coal resources. These should demonstrate consistency and alignment with the goals of the NSW 2021 state plan and the "make NSW number one" strategy.

Recommendation 2

That the NSW Government develops a set of predetermined factors to provide guidance in the release, allocation and development of NSW coal resources. These factors must be given consideration

12 Department of Planning and Infrastructure, July 2013, State Environmental Planning Policy (Mining, Petroleum Production and Extractive Industries) Amendment (Resource Significance) 2013, consultation draft, p. 4, viewed mid-2013, http://www.planning.nsw.gov.au.

by all decision-making bodies involved in the process.

Transparent and fully-informed decision-making

The MRB has made it clear to the Commission that it not only recognises the problem of releasing areas for exploration that have difficulty in gaining development consent for mining, but that the branch does not have the capacity to formally assess the release areas against the broader social, environmental and economic goals of the state. In the absence of any other mechanism, ELs continue to be allocated without a formal consideration of the economic, social and environmental objectives of government. A substantial gap remains between the expertise and range of factors considered in the decision to release an EL made by the MRB and the expertise and range of factors considered in the development approval given by the Department of Planning and Infrastructure.

The Commission recommends that the NSW Government replaces the existing CAC with a cross-departmental steering group to oversee the release and allocation of ELs. Given the complexity of the decisions, the broad range of factors that should be considered and the often unique characteristics of specific locations, such a steering group is better placed than the CAC to consider the social, environmental and economic factors within the context of the broad state policy objectives. Such a steering group would also reduce the disconnect between the MRB and the Department of Planning and Infrastructure and minimise the incentive to lobby and pressure government for planning approvals. The use of a steering group to assess proposals that broadly affect the state has precedent in the NSW Government's unsolicited proposals policy.

It is recommended that the steering group have a select core membership of senior officials from the following bodies, each of which brings its own perspective and expertise to the decision-making process:

- Resources and Energy Division of the Department of Trade and Investment, Regional Infrastructure and Services (technical geological knowledge)
- Department of Planning and Infrastructure (broader social and environmental input)
- NSW Treasury (economic specialist skills along with state revenue considerations).

A small membership will reduce the risk of decision-making being stalled or delayed. If and when appropriate, however, additional representatives from other government agencies could be co-opted to assist the steering group in determining the optimal outcome for the government.

Furthermore, the multi-departmental membership of this group is not only better placed to make whole-of-government policy decisions, but also limits the ability of a single minister to exert inappropriate pressure on a public official.

The Commission recommends that the steering group be chaired by a representative of the Department of Planning and Infrastructure, as the department is the lead agency in advising the NSW Government on strategic land use planning and major development and infrastructure projects, and also provides development approval for mines.

Recommendation 3

That recommendations to the NSW Government on the areas to be released and the method by which ELs are allocated be made by a steering group chaired by a representative of the NSW Department of Planning and Infrastructure and made up of three senior officials from the Resources and Energy Division of the NSW Department of Trade and Investment, Regional Infrastructure and Services, the NSW Department of Planning and Infrastructure and the NSW Treasury.

Evidence put to the steering group to inform its deliberations should include a preliminary assessment undertaken by the Department of Planning and Infrastructure of the areas being considered for release in mature areas. This preliminary assessment should consider the social, economic and environmental considerations usually made at the development approval stage, as the ELs released in mature areas are expected to proceed to mining.

The Commission does not suggest that this assessment should duplicate that undertaken at the development approval stage but rather that those elements of the development approval assessment that can be moved to a point earlier in the process are carried out prior to a decision to release an area for an EL. This change would recognise that ELs given in mature areas are not true exploration but rather a form of pre-mining approval. The Department of Planning and Infrastructure has indicated to the Commission that the provision of such advice earlier in the process would assist the development approval process later. It may be possible to model the preliminary assessment on the requirements for mining currently specified by the director general of the Department of Planning and Infrastructure at the development approval stage.

The final recommendations to government from the steering group should be accompanied by the above assessment along with other supporting documentation that would justify the recommendations in terms of the NSW Government's objectives and the predetermined factors that must be considered. The final recommendations to government by the steering group and supporting evidence would also be made available to the public via the Department of Planning and Infrastructure's website; an approach that mirrors the current transparency practices of that department.

The recommendations of the steering group should be made to the Cabinet Standing Committee on Resources and Land Use rather than to a specific minister. This committee will make the final decision to release an area and determine the process by which an allocation of an EL is to be made within the broader context of state goals and competing interests. Such a committee arrangement also removes much of the incentive to lobby and manipulate individual ministers, and makes it difficult for one minister to directly allocate ELs to a favoured individual or for select areas to be released.

Recommendation 4

That recommendations made by the steering group be directed to the NSW Government Cabinet Standing Committee on Resources and Land Use for consideration and final approval.

Recommendation 5

That the steering group obtains from the NSW Department of Planning and Infrastructure a preliminary strategic assessment of areas considered for release in order to provide a view of potential major risks to the future development of mining in the proposed areas.

Recommendation 6

That the steering group's recommendations to the NSW Government on the areas to be released be determined against the objectives and predetermined factors identified in recommendations 1 and 2, and that the steering group's recommendations are made publicly available in the same transparent way as are the NSW Department of Planning and Infrastructure's recommendations to the NSW Government.

Like the CAC, the steering group would be expected to meet approximately quarterly to consider the release and allocation of ELs and other matters. The steering group, therefore, needs to be able to bring together (as required) working groups from across its respective departments to collect data, conduct assessments and provide analyses. Without adequate resourcing, the recommendations of the steering group are unlikely to represent a significant improvement over the current situation.

Recommendation 7

That the steering group is given the resources to establish an assessment panel and working groups, as required, that can provide additional information and analyses to make quality recommendations to the NSW Government.

The role of the assessment panel would be to support the steering group in making its decisions. The assessment panel should comprise appropriately qualified officials with relevant practitioner expertise from the Resources and Energy Division of the Department of Trade and Investment, Regional Infrastructure and Services, the Department of Planning and Infrastructure and the NSW Treasury. If required, additional representatives can be co-opted to support the work of the panel.

Recommendation 8

That the assessment panel provides a triple bottom line assessment of the environmental, social and economic factors of allocating an EL and reports its findings to the steering group.

The role of probity advisers

The Commission does not advocate the routine use of probity advisers and is of the view that probity advisers should be used as the exception rather than the rule. Calls for a greater degree of probity should not result in expenditure on private consultancies, including probity advisers, every time a public sector agency is involved in what is seen to be a complex project. Rather, agencies should seek to develop these skills internally or call on other public sector agencies with the required expertise. While not specifically considering the issue of probity advice, the NSW Commission of Audit's *Interim Report: Public Sector Management* noted that there is substantial technical expertise located in central agencies, such as the NSW Treasury, the Department of Premier and Cabinet and the Department of Finance and Services, and that greater use of this expertise should be fostered.

When engaging a probity adviser, there is the real and perceived risk that he or she may be too close to the agency that has engaged them and that their advice will be skewed to ensure that it is acceptable to the hiring agency, thus guaranteeing their future engagement. It is a fundamental concern that, when a probity adviser relies on an agency

for employment, they may, consciously or not, tailor their advice to what the agency wants to hear. In this situation, it is all the more important that the probity adviser is not the only check on the process to ensure that genuine probity has been achieved.

The Commission is of the view that, in many instances, rather than hiring an external probity adviser, public sector agencies would obtain a better outcome by ensuring their own systems, policies and procedures are designed with built-in probity and corruption controls. If the design of the EOI process previously used by the MRB had, for example, the benefit of expert input from the NSW Treasury, and was overseen by the NSW Treasury, then ministerial interference in that EOI process may not have been possible.

Ministerial memorandum M1998–12 outlines when it is appropriate to use a probity adviser. It includes the statement that probity advisers "should not be used as an 'insurance policy' to avoid accountability for decisions made, or be allowed to become a substitute for good management practices". As the memorandum was issued some time ago and contains outdated references, the Commission recommends it be reviewed and reissued to ensure it remains current, given the emerging prevalence of the probity adviser profession and the limitations associated with reliance on probity advisers highlighted in Operation Jasper.

Recommendation 9

That the NSW Department of Premier and Cabinet reviews and reissues the ministerial memorandum M1998–12 "Use of Probity Auditors by Public Sector Agencies".

Chapter 5: Recommendations for removing the system's financial incentives for corrupt behaviour

As a result of the boom in coal prices in the mid-2000s, the value of coal assets in NSW increased rapidly. Super profits, also known as economic rents, became possible during this time. As chapter 3 of this report has shown, the availability of economic rents encourages rent seeking behaviour (the aim to secure control of coal resources and the right to mine that resource), which is conducive to corruption.

Good public policy means maximising returns to the state for its assets. Generating full value for these assets means, in turn, reducing the likelihood of rent seeking behaviour. While there are several methods for the state to capture full value, such as super profit taxes and super royalties, the Commission is of the view that, from control, transparency and practicality perspectives, the auction method offers the greatest benefits.

Any discretionary process that involves the transfer of value from the state to a private entity can be considered conducive to corrupt conduct. With regard to coal mining in NSW, many of the incentives and opportunities for corrupt behaviour, however, stem from private proponents knowing that it is possible to have exploration rights directly allocated by government without accountability to the public and without the need for a competitive process.

While the Commission is of the view that auction is the preferred method of allocation of ELs, it recognises that, in some situations, direct allocations will continue to be necessary. This chapter includes recommendations for greater oversight of the direct allocation system.

Auctions as the preferred allocation method

Some jurisdictions have attempted to capture the economic rents at the time of extraction or at the time the super profits are generated. In theory, super profit taxes are efficient, as the value of the asset to the state is determined and captured by the state at the time the profit is generated.

This tax allows the state to take back a percentage of any profits that a company generates over the cost of production, plus taxes and royalties and a normal profit. It does not require the government to have a detailed knowledge of the potential deposit and allows for differences in the costs of production across time and project. It also allows for variations in the size of the economic rents that occur as the market fluctuates.

In practice, however, super profit taxes have limitations. For example, companies may minimise their declared profits through a variety of accounting methods to reduce the tax payable, making administration of such a tax difficult.

Auctions are a more practical method of removing economic rents and are widely used for the transfer of state assets to private companies. The transparency of a well-conducted auction allows oversight of the process and, with the right design, can minimise opportunities for collusion. In its paper, *Competitive Allocation of Exploration and Mining Permits*, the Centre for Market Design highlighted the benefits of the auction method:

> *The process of auction design imposes a discipline which encourages clarity of thinking, clarity and transparency in setting objectives, explicit decisions about trade-offs between objectives, and attention to relevant evidence. It also leads to explicit consideration of the scope for collusion and anticompetitive behaviour, and of strategies to minimise these.*

The Commission is of the same view as the Productivity Commission in that the use of auctions, which the latter refers to as "cash bidding" in an extract from a report below, is the most appropriate method of EL allocation in mature areas:

Cash bidding would appear to be most appropriate for highly prospective exploration tenements where the likely rents are known and there is a greater likelihood of multiple potential bidders for the exploration tenement. These situations will usually be in areas where pre-competitive geoscientific evidence indicates that an exploration tenement will be likely to contain sizable mineral or energy resources.[13]

Recommendation 10

That the NSW Government uses the auction method as the default method for allocating ELs, and that any variation from this be justified by the recommendations of the steering group or by a decision of the NSW Government.

Integrity in auctions

At the time of the corrupt conduct identified in operations Jasper and Acacia, the government used an EOI method, requesting that companies submit a proposed work program along with an additional financial contribution. The MRB assessed the work program in terms of the EOI requirements that related to exploration activities but did not consider whether actual mining activities were viable at that location.

This lack of pre-assessment of the potential viability of the exploration area for actual mining increased the risk that, when competing uses and economic, social and environmental issues were assessed much later at the development approval stage, the mining company's proposal would be curtailed to a point where it was no longer viable. The weakness of the connection between the acceptance of the additional financial contribution for ELs and the later approval to mine provided an incentive and legitimate platform for mining companies to apply pressure for development approval to establish a mine.

While the MRB has responsibility for releasing the EOI and accepting the additional financial contribution for the EL, decisions about whether or how to approve mining continue to be made by the Department of Planning and Infrastructure. This puts the government in a difficult position, since it has effectively auctioned a right to firm up a deposit with a view to developing a mining project without having considered whether the Department of Planning and Infrastructure is likely to approve such a project.

Subsequent negotiations are required with the Department of Planning and Infrastructure and there is a risk that most of the benefits of the additional financial contribution or auction would be negated. As the Centre for Market Design states in the aforementioned report:

> *If substantive issues about the rights and obligations of the winner are left unclear, to be resolved by negotiation after the auction, then we are back in the world of the beauty contest. The government is at risk of having the public gains achieved through the competitive auction eroded through subsequent negotiation. All transparency gains of an auction are lost as well … Any lack of clarity in the rights and obligations of the winner will inevitably result in ex post negotiations that will undermine the integrity of the auction.*

It is recommended that, as part of its considerations, the steering group conduct a pre-assessment to establish whether the area being released for an EL is likely to proceed to mining. The effect of this pre-assessment will be to increase the certainty that the EL being released will eventually proceed to mining. This will, in turn, reduce the incentive for companies to lobby and negotiate ahead of, and during, the development

13 Productivity Commission, May 2013, *Mineral and Energy Resource Exploration*, draft report, p. 83, viewed mid-2013, http://www.pc.gov.au.

approval stage. It removes much of the perceived pressure on staff of the Department of Planning and Infrastructure to approve mining as a result of an EL that they do not believe should have been issued.

Recommendation 11

That decisions made by the NSW Government on the release of mature areas for ELs and the auction of those ELs are linked to the likelihood of approval to mine.

The appearance of a moral hazard

Despite the benefits of an EL pre-assessment, not all matters can be foreseen. Cases will still arise in which an EL should not proceed to mining or only proceed with onerous conditions. While reduced in scale and frequency by pre-assessment, the effect will be that the government has auctioned an EL and taken the auction payment in a non-refundable way, but the progression to mining later becomes questionable.

The Commission has identified three broad options, as outlined below, to deal with the perceived moral hazard created by the state taking the proceeds of the auction of ELs prior to providing development approval to mine. All have compelling advantages and significant disadvantages, and all have implications beyond the issue of the integrity of the mining system. For these reasons, the Commission does not make specific recommendations on which of the three options the state should adopt. The final decision requires broader policy considerations by the government.

1. Maintain the status quo

Under this option, the government keeps the auction payment regardless of any decision about the approval to mine. It was put to the Commission that having no possibility of a refund minimises the opportunity for a company to lobby government to have the auction payment returned later in the process. With the EL auction payment lost, without approval to mine being granted, there is a strong incentive for mining companies to pressure the Department of Planning and Infrastructure to grant approval. For the community and public officials, the non-refundable nature of auction payments creates the perception that the government faces a moral hazard, having placed itself in a position where there is an implicit obligation to the mining company.

2. Link the government receipt of the auction payment to the approval to mine

In effect, this would mean that the government would (a) receive the auction payment at the granting of the EL and hold that payment pending development approval for the mine or (b) not take payment until development approval has been granted. This option removes some of the incentive for companies to lobby and manipulate the approval process, reduces the public's perception that the government is beholden to the mining companies and reduces some of the perceptions of sovereign risk.

The primary concern raised with the Commission is that an incentive could be created for mining companies to manipulate the system in order to have a mine proposal rejected and the refund paid if the company's own business situation had altered. The state would bear more of the risk of changing business conditions or problems with the coal deposit. The creation of complex contracts of conditions under which refunds or partial refunds could be made could result in pressure on government and legal action.

3. Provide assurance against sovereign risk but not normal business risks

This option is a combination of the two above. Under this option, the full or partial refund of the auction payment may be possible only if refusal for development approval for a mine is the result of changes in government regulation that occurred after the EL was auctioned. In effect, the state would bear its own risk of inconsistency in decision-making. The benefit is that the revenue from the auction of ELs is retained by the state unless the state changes the rules mid-process. Concerns were raised, however, that, if companies sought to extricate themselves from agreements as business conditions deteriorated, the contractual complexity of this model would inevitably result in legal action and other pressure on government to refund the auction payment.

Ultimately, the decision on the management of auction payment is a matter of policy. It is not for the Commission to make recommendations on the balancing of risk between state and industry, the protection of the investment reputation of the state, and revenue arrangements. For the Commission, the concern is that whatever policy settings are adopted, the related risks need to be recognised and managed.

If the state adopts a policy different from the status quo that allows negotiations relating to partial or complete payments and refunds, then any mining company could be expected to bring to bear all of its efforts in lobbying and pressuring the government in order to reduce payments or recover auction payments. It would not be improper; rather it would be good business. The negotiating environment under such a proposition, however, may be considered to be conducive to corrupt behaviour. Such negotiations should not occur opaquely between one minister or an official of the MRB. It is recommended that, if such negotiations are to be held, they are overseen by the steering group.

Recommendation 12

That, if government policy allows negotiation on any auction payments made at the EL stage, then such negotiations be overseen by the steering group.

The technical nature of auctions

There are many different types of auctions. As stated by the Centre for Market Design, many of the simple auction designs are quite well known and are commonly seen in property auctions, for example. In more complex environments, such as the auction of mineral reserves, auctions can be very sophisticated and technical.

With regard to the type of auction chosen, decisions need to be made as to whether:

- the auction is open and the bids are made public or are closed
- an alternate model, in which bids increase over time, should be used
- ELs should be auctioned as single objects or whether a package of ELs should be auctioned
- ELs should be auctioned simultaneously or sequentially.

Additional safeguards against collusive behaviour in the auction process can include the establishment of a reserve price that is withheld from those involved in conducting the auction and ensuring, through appropriate marketing, that a sufficiently large number of bidders are involved. Collusive behaviour is more difficult when the number of bidders is higher and when the knowledge that there is a reserve price takes away much of the advantage that could be obtained from collusion to lower bids. Should multiple EL areas be released, where different areas are of different value to different mining companies, much more sophisticated auction designs can control collusive behaviour.

Given the technical complexity and sophistication of resource auctions, and the relevant expertise available in the NSW Treasury, the Commission is of the view that the NSW Treasury should have carriage of auctions of ELs.

Recommendation 13

That the NSW Treasury be responsible for the technical design of auctions of ELs and has oversight of the auctioning process.

The addition of a work program assessment in the bidding system is an important tool in some situations but it is also a corruption risk as it introduces considerable discretion into the process. Work program assessments can be valuable for a number of reasons, such as when they are used as a final method of deciding between the top bidders. When assessing the top bids, for example, the final decision may favour miners with advanced technologies that can extract the maximum amount of the resource or whose technologies reduce noise or dust. Similarly, a restriction can be placed on the range of bidders to ensure, for example, that only local miners were eligible and the local industry is sustained.

The vulnerability to corruption of administrative restrictions and assessments as part of an auction was made clear in Operation Jasper, when the EOI was restricted to junior miners. When competition is restricted in this way, the opportunity for collusion increases and the possible auction price is likely to be reduced. Any decision-making that has the effect of reducing competition should record the rationale for such a decision. Both the rationale and final decision should be transparent.

Recommendation 14

That the steering group makes recommendations to the NSW Government Cabinet Standing Committee on Resources and Land Use on the appropriate use of restrictions within the auction process in allocating ELs based on the administrative assessment of bidders.

Direct allocations

In mature coal allocation areas of NSW, tenders or EOI processes for ELs in major stand alone areas are relatively few and far between. The majority of ELs are granted by direct allocation without competition or significant financial return to the state, and many will continue to be granted in this way even if auction becomes the default approach to allocation.

Where a coal deposit adjoins an existing mine, the value of that deposit to the contiguous mining company is high. With equipment, infrastructure and human resources in place, expanding the mine is a marginal cost relative to the cost of establishing a new mine.

Under such a scenario, the state finds itself in a position where the value of an adjoining EL is very high to the mining company in situ but, with no broader market, the state has almost no bargaining power. The incentive to rent seek is heightened for the mining company. The state finds itself releasing an area solely for the benefit of a specific mining company and, then, directly allocating the resource. The result is that a small initial release could be followed by numerous

allocations of adjacent deposits over many years. Repeated direct allocations is a means by which companies can significantly increase the size of the originally approved mine while avoiding auction payments.

The possibility of obtaining repeated direct allocations is an incentive for a mining company to start with a small deposit and expand over time. It is a pattern that was noted by the Commission's auditors and a practice known by those in the industry. It is the Commission's view that such opaque and incremental gain to mining companies should be limited and that, at a certain point, continued expansion should trigger an independent consideration of further direct allocations.

Understandably, mining companies may argue that they are entitled to resources in close proximity to their existing operations, that they are the only company interested in the resource or that they can better serve the wider interests of government by the innovative work programs they are proposing. The Commission is not suggesting that all arguments of mining companies seeking direct allocations are spurious and recognises that there may be other overriding reasons to directly allocate a resource to an adjacent mining company. These matters must each be considered on their merit. What is important, however, is that legitimacy of the argument for direct allocation can be demonstrated.

In order to address the lack of transparency surrounding the process of direct allocation, the Commission recommends that the steering group put in place a "trigger". Such a trigger would be an agreed point at which the decision to directly allocate is moved from the MRB to the assessment panel for wider consideration. The assessment panel would then consider the application on its merits and assess the triple bottom line impact.

The trigger could be one related to the area being applied for in terms of tonnage or a percentage of tonnage in relation to an existing development approval. Alternatively, it could be related to size and acreage relative to the initial development approval. This transfer of decision-making would be triggered either by a single allocation or the cumulative effect of multiple, small allocations by the MRB to an individual mining company.

Recommendation 15

That the transfer of an application for direct allocation of an EL be referred to the assessment panel in circumstances where an application meets a specified threshold determined by the steering group.

Capacities of mining companies

Regardless of whether the method of allocation is by auction or by direct allocation, the decision to grant an EL should not be finalised until due diligence has been undertaken on the mining company.

During the EOI process that was the subject of Operation Jasper, the applications of companies were largely assessed on face value without an interrogation of the proposals to determine whether the applicants had sufficient capacity to undertake the proposed work programs. The following evidence was given by William Hughes, a member of the EOI evaluation panel during the public inquiry:

[The Commissioner]:	*So I take it that you – that in assessing each mining program that was submitted you accepted everything they said at face value without verifying whether they could implement it?*
[Mr Hughes]:	*That's true.*
[Counsel Assisting]:	*And so too the financial material that was put and attached to the various bids, you accepted that at face value, didn't you?*
[A]:	*Yes.*
[Q]:	*You undertook no specific or indeed any due diligence as to whether or not the entities behind it were in fact standing behind it to provide the funding. Isn't that right?*
[A]:	*We accepted it at face value, yes.*

In Operation Jasper, the EOI evaluation panel decided that Monaro Mining NL should be the successful company in respect of six out of the nine ELs in which the company had expressed an interest. Monaro Mining NL was a small exploration company with a particular focus on base metals and uranium and was described in the public inquiry as "financially weak". The company had no experience at all in coal exploration. The EOI evaluation panel took Monaro Mining NL's applications on face value and took no steps to ensure the company had the capacity to undertake the exploration work.

The Commission is of the view that the preferred company must demonstrate it has the technical expertise to

undertake exploration work. Before an EL is issued, the assessment panel must be assured that the company is of reputable standing and has fully complied with previous EL conditions. Similarly, the assessment panel should also be fully satisfied that the preferred company has the financial backing to fund exploration work.

Recommendation 16

That the assessment panel conducts technical analyses of preferred companies to determine if each company has the technical expertise to undertake the exploration activities.

Recommendation 17

That the assessment panel conducts financial analyses of preferred companies to determine if each company has the capacity to fund exploration work.

Incentives to use ELs as intended

At first glance, the current EL renewal arrangements appear quite reasonable. There is an incentive for the mining company to firm up the business case for mining because the EL is time-limited. The additional financial contribution or other fees and auction payment taken by the government, along with the significant cost associated with the firming up process, create a further incentive for the mining company to move through the EL phase as quickly as possible to a point where a return on the investment is being generated. The time limit on the EL also provides an end point for the uncertainty an EL creates for landholders and the community. The convention of allowing the holder of an EL the first right to apply for an ML provides some security for the mining company that its considerable investment in firming up the deposit can be translated into a right to extract the coal.

As described earlier in this report, the effects of these arrangements are distorted when the primary motivation for the holder of the EL is not to proceed as quickly as possible to a mine but to hold on to the EL for an extended period of time. There can be strategic and speculative value in holding on to ELs in this way, such as sustaining a pipeline of future work or locking resources out of competitors' hands.

The ability to negotiate EL renewals with the MRB and put forward various reasons for the lack of progress on a company's work program provides an opportunity to manipulate the system. Under this arrangement, a mining company that has the potential to gain from renewing an EL may – at best – lobby the minister and staff in the MRB and negotiate aggressively. Conversely, the MRB or the minister for mineral resources may – at worst – be misled, manipulated or co-opted into support of the renewal.

The Commission is of the view that the NSW Government should adopt alternative arrangements around the renewal of ELs to better align the incentive structure of the renewal process to the goals of timely progression towards mining. The Commission recommends that ELs be issued with a lengthy tenure, where appropriate, but with an exponentially increasing rent to be paid to the government. During the period that would represent the current three- or five-year period of an EL, the rent would be set at a flat rate. At the point where negotiation for renewal would normally occur, the rent would begin to rise exponentially until the mining company lodges an application for development approval to mine or surrenders the EL.

The incentive for the mining company to move ahead quickly is maintained or enhanced. The mining company can make a commercial decision about the speed with which it undertakes work and the time it wishes to continue to work on the EL before applying for development approval to mine. It can decide to terminate the proceedings at any point. If it does so, the rent ceases to be payable, and the EL, and any data that have been collected, is provided to the state.

At the same time, the escalating EL rent erodes the value of the EL over time. Speculative trading in ELs or locking up resources for strategic reasons becomes less attractive. Buying or holding an EL, for which the clock has already begun ticking, exposes the EL holder to increasingly punitive payments. The declining value of an EL over time, due to rapidly increasing rents and the absence of any point of negotiation with the MRB, removes both the incentive and opportunity to manipulate the system.

The Commission notes that the NSW Treasury has the expertise to create a rent schedule that provides both an incentive for rapid exploration and progression to a mine and an adequate disincentive to hold on to ELs for any other reasons.

Recommendation 18

That the NSW Government replaces the current arrangements of ELs in mature coal allocation areas with a system of EL tenure for which exponentially increasing rents are payable.

The Commission recognises that there are inevitable challenges that face the state in unwinding the current situation in which parts of the mature areas within

the state are covered by ELs that have been able to be renewed without progress toward mining. As ELs come up for renewal, they should move on to the new rent schedule. The NSW Treasury has the necessary expertise to determine a transitional regime and make appropriate recommendations to the NSW Government.

Recommendation 19

That the NSW Treasury develops a transitional regime for moving all existing ELs to a rent-based arrangement and makes recommendations to government.

Assessment leases

There is a third type of resource title available under the Mining Act, known as an assessment lease (AL). An AL is designed to allow retention of exploration rights over an area in which a significant mineral deposit has been identified, if mining the deposit is not commercially viable in the short term but there is a reasonable prospect that it will be in the long term. Not many ALs have ever been granted in NSW and the Commission has not received any complaints about their operation. As such, they are not covered in this report. However, should the use of ALs increase as a result of the changes to the ways in which ELs are released and allocated, the Commission recommends that the granting of ALs be the subject of oversight by the steering group.

Chapter 6: Recommendations concerning the conduct of members and ministers

The corrupt conduct identified by the Commission in operations Jasper and Acacia was only possible because of the policy and regulatory problems of the state. The execution of the grand corruption was ultimately due to improper influences on an unfettered minister, his disdain for departmental advice and secret meetings with proponents. Edward Obeid Sr also did not declare interests in the Mount Penny area, effectively hiding his actions and those of Mr Macdonald from public scrutiny. These behaviours bring into question the adequacy of parliamentary control over the behaviour of its members and the degree to which this contributed to the corrupt conduct that occurred.

The NSW *Code of Conduct for Members* does not provide a broad framework within which acceptable conduct can be measured. Similarly, the principle of frank and fearless advice is not enshrined in the NSW *Code of Conduct for Ministers of the Crown*. The adoption of comprehensive and objective standards to assess the conduct of members and ministers is necessary to establish clear boundaries for acceptable behaviour.

The current Register of Disclosures for members is also limited, in that there is no requirement for members to disclose family interests. Nor is there sufficient transparency around the lobbying of ministers and their staff. This means potential sources of private influence for members and ministers are not subject to public scrutiny.

The conduct of members must also be open to judgment. A comprehensive, timely and independent system for dealing with complaints about the conduct of members is absent in the current system. The NSW Parliament lacks an effective mechanism to manage its own members.

This chapter deals with the above issues and puts forward a number of recommendations for reform.

Supporting the provision of frank and fearless advice

The principle of frank and fearless advice is an important tenet of the Westminster system of government. It requires public officials to give advice that is forthright, non-partisan and does not gloss over possible negative outcomes. It is not simply a matter of public officials expressing their opinion but rather putting forward evidence-based advice on which a decision can be made. Once a minister makes a lawful decision, the public service is obliged to implement that decision, regardless of any previous advice. This was the situation that MRB public officials found themselves in when they recommended against the minister giving his consent to DCM to apply for a direct allocation of the Doyles Creek EL. Once Mr Macdonald gave his consent, MRB staff were obligated to abide by that decision.

Operations Jasper and Acacia highlighted the role of public officials in providing frank and independent advice to a minister, despite pressure to the contrary. Public officials continue to remain vulnerable to potential demands to change recommendations to align with a minister's wishes. Such wishes may be clearly articulated or implicitly understood. An implied threat to the tenure of a public official may also be used to influence the content of advice or recommendations.

The manipulation of departmental recommendations in this way undermines the bureaucracy's role as a source of impartial, expert and accurate information. It also provides a cloak of legitimacy to potential corruption. As decision-making processes are blurred, it is difficult for a third party to identify the source of a particular decision. A false impression is created that a decision-maker is merely acting on departmental advice. Those who wish

to engage in corrupt conduct feel a level of comfort if the extent of their influence and involvement in a decision is hidden.

The NSW *Code of Conduct and Ethics for Public Sector Executives* covers the issue of senior public officials who are concerned about directions or requests received from a minister. For the most part, these provisions are framed in terms of general advice and fall short of providing a protection against undue pressure being placed on public officials.

The Commission is also concerned that the *Code of Conduct for Ministers of the Crown* is silent on this issue, given its implications for the proper functioning of public administration in NSW. Amending the code to capture this issue could help protect public officials who are subject to undue ministerial influence over the content of recommendations. It would also confirm the limits of acceptable behaviour for ministers in this regard.

The Australian Public Service Commission's *Supporting Ministers, Upholding the Values* provides an extensive guide for Australian Public Service (APS) employees on how to engage with ministers and their offices. It acknowledges that briefing materials provided by the public service to ministers' offices may not be sufficiently comprehensive and that a minister's office may need additional information. It is recommended that, in these instances, either a supplementary brief be prepared or that the existing brief be amended. Best practice is that "supplementary briefing and additions to original briefs clarify what advice has been provided at the request of advisers". In instances where APS employees are asked to vary the advice provided, best practice is that:

> *…advice should not be changed or opinions omitted if the agency remains of the belief that particular arguments should be considered by the Minister. Where any changes to advice are involved, the brief should record the nature of the changes and the source of the request for change.*[14]

Currently, the NSW Public Service Commission (PSC) is introducing reforms to the structure of the Senior Executive Service in NSW that could facilitate the provision of frank and fearless advice. The Commission is of the view that the PSC should develop the types of best practice guidance seen in the APS.

Recommendation 20

That the NSW Department of Premier and Cabinet amends the *Code of Conduct for Ministers of the Crown* to prohibit ministers, either directly or via their staff, from demanding that NSW Government agencies change recommendations in instances where the agency remains of the belief that a recommendation ought to be made.

Recommendation 21

That the NSW Public Service Commission develops a best practice guide for public officials who work with the offices of ministers, and that this guide covers the issue of revised briefing materials.

Codes of conduct

Section 8 of the ICAC Act defines the general nature of corrupt conduct. Despite s 8, s 9(1) provides that conduct does not amount to corrupt conduct unless it could constitute or involve:

> *(a) a criminal offence, or*
>
> *(b) a disciplinary offence, or*
>
> *(c) reasonable grounds for dismissing, dispensing with the services of or otherwise terminating the services of a public official, or*
>
> *(d) in the case of conduct of a Minister of the Crown or a member of a House of Parliament – a substantial breach of an applicable code of conduct.*

For the purposes of s 9(3) of the ICAC Act, an applicable code of conduct means in relation to a minister of the Crown, a ministerial code of conduct prescribed or adopted for the purposes of s 9 by the regulations, or in the case of a member of the Legislative Council or of the Legislative Assembly (including a minister of the Crown), a code of conduct adopted for the purposes of the section by resolution of the House concerned. While the *Code of Conduct for Members* has been adopted, the current *Code of Conduct for Ministers of the Crown* has not been adopted for the purposes of s 9.

The *Code of Conduct for Members* does not contain specific provisions concerning members attempting to influence ministerial or bureaucratic decisions that affect their private interests and those of their family and associates, although such conduct seems quite contrary to the preamble. This ignores the reality that major decisions of considerable value are taken by the executive and by state agencies, and do not come before Parliament.

14 Australian Public Service Commission, 2006, *Supporting Ministers, Upholding the Values*, p. 54, viewed mid-2013, http://www.apsc.gov.au.

In contrast to the *Code of Conduct for Members*, the *Code of Conduct for Ministers of the Crown* covers most matters pertaining to the integrity of executive government decision-making. The adoption of recommendation 20 of this report would ensure the *Code of Conduct for Ministers of the Crown* includes a comprehensive consideration of the main obligations of ministerial office.

An amended *Code of Conduct for Ministers of the Crown*, encapsulating recommendation 20 of this report, would provide a useful yardstick against which the conduct of ministers may be judged for the purposes of establishing the boundaries of corrupt conduct. For this reason, it should be an applicable code under s 9 of the ICAC Act.

Recommendation 22

That the NSW Parliament's Legislative Council Privileges Committee and the Legislative Assembly Privileges and Ethics Committee consider amending the *Code of Conduct for Members* to deal comprehensively with improper influence by members.

Recommendation 23

That the NSW Government adopts the *Code of Conduct for Ministers of the Crown* as an applicable code for the purposes of s 9 of the ICAC Act.

Pecuniary interest register

A register should be sufficiently robust in scope to ensure public confidence. Currently, the statutory pecuniary interest disclosure regime in NSW does not require members to disclose the interests of their spouse, domestic partner or other family members.

In 1994, the Commission argued in a submission to the Joint Committee on the ICAC that the interests of close associates are capable of influencing a member's conduct. This suggestion was rejected by the committee at that time.

In 2010, the Legislative Council's Privileges Committee considered the members' pecuniary interest disclosure regime as part of its review of the *Code of Conduct for Members*. The committee recommended that in the next Parliament, the House refer to the Privileges Committee a new inquiry into the best mechanism for members to disclose the interests of their spouses/partners and dependent children under the provisions of the Constitution (Disclosures by Members) Regulation 1983, with a view to implementing third-party disclosures if an appropriate mechanism could be found. This recommendation has not been acted on.

The Commission supports expanding the Register of Disclosures to include spouses/partners and dependent children. The benefits of expanding the register include added transparency, minimising perceptions of members avoiding scrutiny, and dealing with the potential for family interests to influence decision-making. It should also be noted that many other Australian parliaments require the disclosure of various third-party interests in a register.

The general purpose of a disclosure register is to capture private interests that *may* come into conflict with a member's public duty. This concept is distinct from, but connected to, the disclosure of conflicts of interest as they arise. The existence of both a formal disclosure system for private financial interests and transparent mechanisms for the disclosure and management of actual conflicts of interest as they arise is important. Consequently, the Commission believes that the expansion of the Register of Disclosures to capture family interests will complement any revision of the conflict of interest provisions in the *Code of Conduct for Members*. For the sake of completeness, this should specifically include family trusts and companies.

A review of the Register of Disclosures and the *Code of Conduct for Members* would also provide a timely opportunity to reconsider related issues outside the scope of operations Jasper and Acacia. These include the timeliness with which pecuniary interest disclosures are made, the cumbersome nature of the disclosure regime and the transparency of the system.

Recommendation 24

That the NSW Parliament's Legislative Council Privileges Committee conducts a new inquiry into the mechanism for elected members to disclose the interests of their spouses/partners and dependent children under the provisions of the Constitution (Disclosures by Members) Regulation 1983, with a view to making third-party disclosures a requirement.

Parliamentary investigator

The effectiveness of codes of conduct and statutory pecuniary interest regimes is dependent on timely and impartial enforcement mechanisms. No such enforcement mechanism exists in NSW outside of that provided by the Commission's jurisdiction. This is problematic for allegations of minor breaches given the role of the Commission, as far as practicable, to direct its attention to serious and systemic corrupt conduct. Furthermore, the provisions of s 9 of the ICAC Act

require a "substantial" breach of an applicable code of conduct.

The *Constitution Act 1902* provides that either House may declare a member's seat vacant if they wilfully contravene the requirements of the Constitution (Disclosures by Members) Regulation 1983. A member's seat has never been declared vacant under these provisions. In effect, sanction against a member is dependent on party numbers and support for a member. The findings of the 2002 Legislative Council's Privileges Committee inquiry into Edward Obeid Sr's pecuniary interest returns demonstrate the shortcomings associated with relying on parliamentary committees to investigate members.

In recent years, there has been support for the creation of an external third party to deal with complaints concerning members. The background to these proposals is well documented in a paper presented by David Blunt, Clerk of the Parliaments and Clerk of the Legislative Council to the 44th Presiding Officers and Clerks Conference in 2013. Mr Blunt's paper includes a discussion on the Parliamentary Commissioner for Standards model adopted in the UK, and how this model could work in NSW.[15]

The establishment of a parliamentary investigator to examine minor allegations about members would provide a number of benefits. These include the provision of an impartial and timely mechanism for resolving minor complaints about the conduct of members. Public confidence in the institution of parliament might be enhanced if the standards that apply to members are enforced. The creation of a parliamentary investigator may also provide for a "graded" approach to non-compliance rather than the "all or nothing" response of the current system.

The Commission supports further consideration of this idea provided there is no change to its jurisdiction or the definition of corrupt conduct in the ICAC Act as a result of any review.

Recommendation 25

That the NSW Parliament's Legislative Council Privileges Committee considers the establishment of a parliamentary investigator position in consultation with the Legislative Assembly Privileges and Ethics Committee.

Lobbying

As discussed elsewhere in this report, there is a strong motivation for coal mining industry operatives to respond to opaque and complex processes by either engaging lobbyists to try to navigate the process for them or directly lobbying a department or minister. The Commission's recommendations concerning the release, allocation and renewal of ELs seek to reduce both the incentive to lobby and its effectiveness; however, lobbying is unlikely to be completely eliminated.

In 2010, the Commission released its *Investigation into corruption risks involved in lobbying* report. The report recognised that, in general, professional lobbyists act ethically, and that lobbying, when done well, can enhance rather than detract from good decision-making made by public officials. The report also noted that:

> *A lack of transparency in the current lobbying regulatory system in NSW is a major corruption risk, and contributes significantly to public distrust. Those who lobby may be entitled to private communications with the people that they lobby, but they are not entitled to secret communications. The public is entitled to know that lobbying is occurring, to ascertain who is involved, and, in the absence of any overriding public interest against disclosure, to know what occurred during the Lobbying Activity.*[16]

The Commission's report made a number of recommendations regarding the regulation of lobbyists in NSW. The recommendations sought to improve transparency in the system without unduly interfering with access to government. By way of example, it was recommended that a model policy and procedure for ministerial offices concerning the conduct of meetings with lobbyists, the making of records of these meetings, and the making of records of telephone conversations be adopted. While some of these recommendations were adopted, most were not. The Commission's recommendations should be considered in their entirety as representing an integrated control system that allows third parties to determine who or what lobbied, for whom and for what purpose. Consequently, the Commission believes that the government should consider implementing the remaining recommendations.

Recommendation 26

That the NSW Government reviews the recommendations contained in the Commission's 2010 publication, *Investigation into corruption risks involved in lobbying*, and considers adopting the recommendations that apply to the state government's lobbying regulatory regime, which have not been implemented to date.

15 D Blunt, *A Parliamentary Commissioner for Standards for New South Wales, paper* presented at the 44th Presiding Officers and Clerks' Conference, Canberra, 1-4 July 2013, viewed mid-2013, http://parliament.nsw.gov.au.

16 Independent Commission Against Corruption, November 2010, *Investigation into corruption risks involved in lobbying*, p. 7, http://www.icac.nsw.gov.au.

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