

Draft decision

Aurizon Network: Tariff variation to recover 2017 cyclone Debbie costs

April 2018

We wish to acknowledge the contribution of the following staff to this report:

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SUBMISSIONS

Closing date for submissions: 3 May 2018

Public involvement is an important element of the decision-making processes of the Queensland Competition Authority (QCA). Therefore submissions are invited from interested parties concerning its assessment of Aurizon Network's 2017 review event application for costs arising from tropical cyclone Debbie.

Submissions, comments or inquiries regarding this paper should be directed to:

Queensland Competition Authority
GPO Box 2257
Brisbane Q 4001

Tel (07) 3222 0555

www.qca.org.au/submissions

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The assessment of confidentiality claims will be made by the QCA in accordance with the *Queensland Competition Authority Act 1997*, including an assessment of whether disclosure of the information would damage the person's commercial activities and considerations of the public interest.

Claims for confidentiality should be clearly noted on the front page of the submission. The relevant sections of the submission should also be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two versions of the submission (i.e. a complete version and another excising confidential information) could be provided.

A confidentiality claim template is available on request. We encourage stakeholders to use this template when making confidentiality claims. The confidentiality claim template provides guidance on the type of information that would assist our assessment of claims for confidentiality.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office, or on the website at www.qca.org.au. If you experience any difficulty gaining access to documents please contact us on (07) 3222 0555.

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EXECUTIVE SUMMARY

The QCA has made a draft decision to approve the review event application submitted by Aurizon Network on 22 September 2017, as amended on 21 March 2018. Aurizon Network has proposed to recover \$16.90 million (pre-escalation) in costs for restoring rail infrastructure that was damaged by tropical cyclone Debbie.

Cyclone Debbie crossed Central Queensland on 28 March 2017, causing widespread flooding across Aurizon Network's Newlands, Goonyella, Blackwater and Moura systems in Central Queensland.

The QCA's preliminary position is to accept the expert advice from engineering consultant AECOM that the activities included in Aurizon Network's revised proposal are efficient additional incremental costs associated with the 2017 flood event, that have not previously been recovered through reference tariffs.

AECOM's review of Aurizon Network's original claim identified a number of misallocations of labour and material costs. Aurizon Network wrote to the QCA on 21 March 2018, to amend its claim to address AECOM's findings. This reduced the claim to \$16.90 million, from a recovery claim of \$16.93 million in the original proposal lodged in September 2017.

Aurizon Network also said it would recover \$244,382 of electric infrastructure costs on the Goonyella system through the AT5 tariff. This was a response to a concern raised by stakeholders that the electric costs should not be recovered through the non-electric AT3 and AT4 tariffs.

Given Aurizon Network has sought to address concerns raised by AECOM and stakeholders, the QCA has made a draft decision to approve the revised proposal to recover cyclone Debbie costs, including the approach to adjusting the relevant tariffs, under Schedule F, clauses 5.3 and 5.5 of the 2016 access undertaking.

This executive summary should not be taken as a substitute for the detail contained in this draft decision.

Stakeholders are invited to comment on this draft decision, and AECOM's report, by 3 May 2018.

THE ROLE OF THE QCA—TASK, TIMING AND CONTACTS

The Queensland Competition Authority (QCA) is an independent statutory body which promotes competition as the basis for enhancing efficiency and growth in the Queensland economy.

The QCA's primary role is to ensure that monopoly businesses operating in Queensland, particularly in the provision of key infrastructure, do not abuse their market power through unfair pricing or restrictive access arrangements.

Contacts

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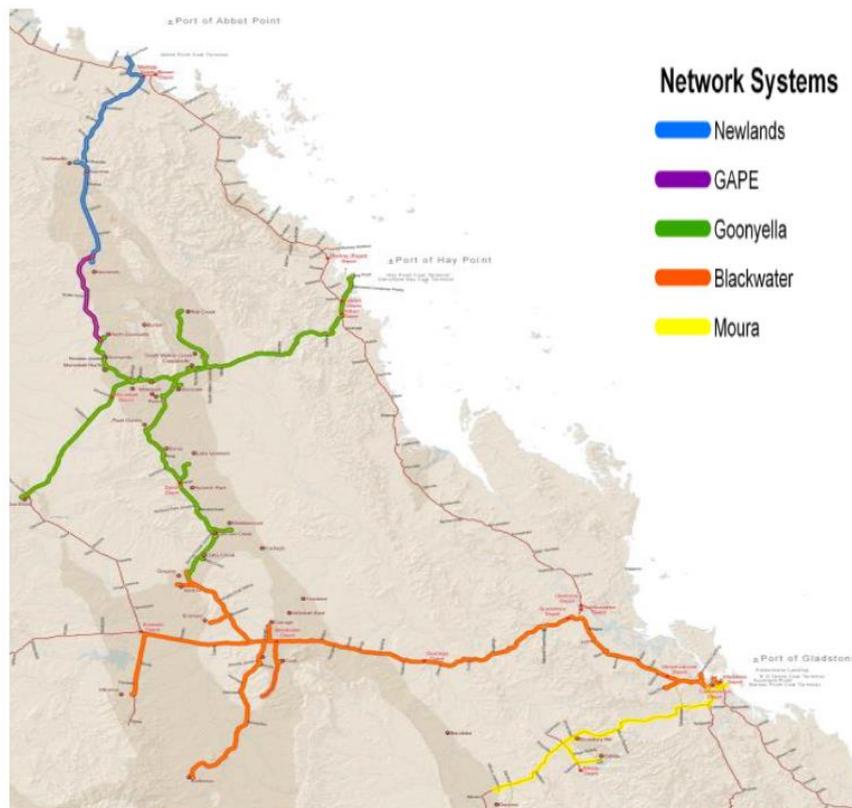
www.qca.org.au/Contact-us

1 BACKGROUND

1.1 2017 flood

Cyclone Debbie brought heavy rainfall, high winds and widespread flooding to northern and central Queensland in late March to early April 2017, damaging Aurizon Network's rail infrastructure across each of the Newlands, Goonyella, Blackwater and Moura systems.

Figure 1 Central Queensland coal network



Source: Aurizon Network 2017 review event submission.

Cyclone Debbie was a severe category 4 system when it crossed the Queensland coastline south of Bowen on 28 March 2017. The system continued inland, progressively weakening and developing into severe thunderstorms which produced torrential rainfall in eastern Queensland. Flooding occurred in some coastal catchments and extended to inland districts. The damage was widespread, leading Aurizon Network to declare force majeure across all of the central Queensland coal network (CQCN). Aurizon Network provided a map of the cyclone's track in its submission.¹

1.2 Regulatory process

Aurizon Network's 2016 access undertaking (2016 AU) requires it to apply to the QCA to vary reference tariffs within 60 days of a review event, including a force majeure event.

¹ Aurizon Network, Submission to the QCA, *Review event: 2017 tropical cyclone Debbie*, September 2017, p. 5.

On 10 May 2017, Aurizon Network wrote to the QCA saying the flood repair work would not be completed within 60 days, and seeking to extend the time to lodge its 2017 flood review event submission by eight months to 31 January 2018. On 24 May 2017, the QCA approved Aurizon Network's request.

On 22 September 2017, Aurizon Network submitted its review event claim, seeking to recover incremental maintenance costs of \$16.93 million (pre-escalation). Aurizon Network proposed to vary the AT3 and AT4 tariff components for each of the Blackwater, Goonyella, Moura, Newlands and Goonyella to Abbot Point systems to recover these costs.

On 7 November 2017, Aurizon Network provided a letter including supplementary information that it said would clarify aspects of the 2017 flood review event submission.

After releasing Aurizon Network's application for comment, we received submissions from Queensland Resources Council and Anglo American.

On 21 March 2018, Aurizon Network wrote to the QCA to amend its claim by reallocating some maintenance costs from other systems to the Goonyella system, and by seeking to recover electric infrastructure repair costs in the Goonyella system through the AT5 tariff. It also reallocated \$26,519 of costs as capital expenditure, which reduced Aurizon Network's proposed recovery of maintenance costs to \$16.90 million (pre-escalation).

This draft decision addresses stakeholders' comments, and Aurizon Network's amended proposal, having regard to the expert advice provided by engineering consultant AECOM.

We invite stakeholders to comment on this draft decision by 3 May 2018.

Extension DAAU

On 9 November 2017, the QCA approved Aurizon Network's draft amending access undertaking to extend the terminating date of the 2016 access undertaking (the September 2017 Extension DAAU).

In addition to extending the terminating date of the 2016 undertaking, and establishing transitional reference tariffs for the remainder of 2017–18, the DAAU included the proposed incremental flood costs relating to cyclone Debbie (although they were still subject to approval by the QCA under the review event application that is being considered in this draft decision).

The outcome of the QCA's decision on the review event, along with all transitional elements proposed, will also be subject to a 'true-up' process after the final decision on the next Aurizon Network access undertaking (the 2017 draft access undertaking, or UT5). This means that the amount ultimately recovered for costs arising from cyclone Debbie review event will be that approved under the review event provisions in the 2016 undertaking.

1.3 Assessment criteria

The QCA has assessed Aurizon Network's 2017 flood claim under the 2016 undertaking. The undertaking requires Aurizon Network to submit a reference tariff variation following a *review event* (Schedule F, cl. 5.1).

A review event is defined as the occurrence of a force majeure event such as a flood that causes *additional incremental costs* greater than \$1 million that have not previously resulted in a variation of the relevant reference tariff (Schedule F, cl. 5.3).

The 2016 undertaking sets out four key criteria for approving a proposed *reference tariff variation*, when the proposal is made under the review event provisions (Schedule F, cls. 5.5(c)(ii) and (iii)). The QCA must be satisfied that:

- a review event has occurred
- the tariff variation is consistent with the change in cost resulting from the review event
- the tariff variation reflects the impact of the review event on the financial position of AN (including the impact of incremental maintenance and incremental capital costs)
- the tariff variation has been calculated as if all other reference tariffs were also being recalculated due to the review event.

The rest of the report is structured as follows:

- Chapter 2: Review event
- Chapter 3: Additional incremental costs
- Chapter 4: Variation of the reference tariff

2 REVIEW EVENT

2.1 Regulatory framework

In assessing a reference tariff variation, the QCA must be satisfied that a review event has occurred (Schedule F, cls. 5.3 and 5.5(c)(ii)(A)). A review event is defined to include an event that:

- is a force majeure event—that is, beyond the reasonable control of Aurizon Network. It includes a fire, flood, cyclone, severe weather conditions or other catastrophe
- has affected Aurizon Network to the extent that it has incurred or will incur additional incremental costs of greater than \$1 million, and
- has not previously resulted in a variation of the relevant reference tariff.

The relevant clauses in the 2016 undertaking are summarised at greater length in Appendix A.

2.2 Aurizon Network's submission

Aurizon Network considered the March 2017 flood event satisfied the definition of a review event, as:

- it met the definition of a force majeure event under the 2016 AU
- it resulted in additional incremental costs that exceeded the \$1 million materiality threshold
- the additional incremental costs had not previously resulted in a variation of the relevant reference tariff.²

2.3 Stakeholders' comments

No stakeholders commented on this issue.

2.4 QCA assessment

The QCA accepts that the March 2017 cyclone Debbie flood event meets the definition of a force majeure review event.

² Aurizon Network, Submission to the QCA, *Review event: 2017 tropical cyclone Debbie*, September 2017, p. 7. (Aurizon Network's 2017 review event submission)

3 ADDITIONAL INCREMENTAL COSTS

3.1 Regulatory framework

Aurizon Network can apply to recover the costs of restoring its network after a flood review event if it 'has incurred or will incur additional *Incremental Costs* [emphasis added] of greater than \$1 million that have not previously resulted in a variation of the relevant Reference Tariff' (Schedule F, cl. 5.3).

Incremental costs are defined as 'those costs of providing Access, including capital (renewal and expansion) costs, that would not be incurred (including the costs of bringing expenditure forward in time) if the particular Train Service or combination of Train Services (as appropriate) did not operate, where those costs are assessed as the *Efficient Costs* [emphasis added] and based on the assets reasonably required for the provision of Access' (cl. 12.1).

Efficient cost is defined as reflecting 'the cost that would be reasonably expected to be incurred by a Railway Manager adopting efficient work practices in the provision of the Rail Infrastructure to the required service standards, having regard to any matter particular to the environment in which Aurizon Network operates' (cl. 12.1).

The focus of this assessment is therefore whether the costs are:

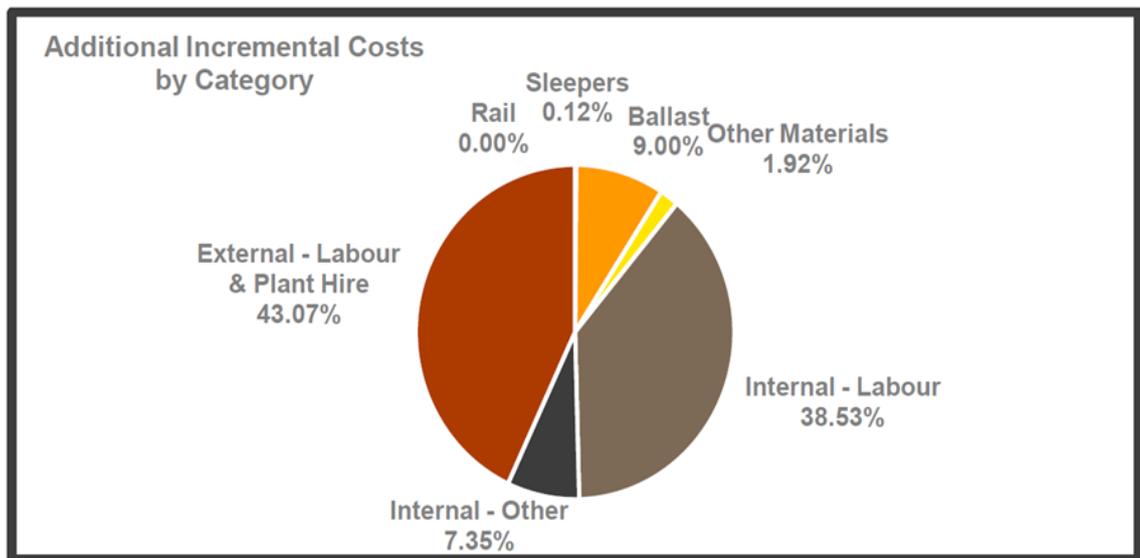
- incremental (i.e. the costs of providing access)
- additional (i.e. would not have been incurred if the flood event did not occur)
- efficient (i.e. are those that would be reasonably expected to be incurred by a Railway Manager adopting efficient work practices)
- not previously recovered through reference tariffs.

Our assessment of additional incremental costs is divided into the following sections:

- Section 3.2: Aurizon Network's proposal
- Section 3.3: Efficiently incurred additional incremental costs
- Section 3.4: Insurance and self-insurance
- Section 3.5: Transparency of costs

3.2 Aurizon Network's proposal

Aurizon Network said its response to cyclone Debbie required \$16.93 million (pre-escalation) of incremental maintenance costs over the 2016–17 and 2017–18 financial years. It subsequently amended the claim to \$16.90 million. The two largest cost categories were 'External—Labour & Plant Hire' (43% of the claim), and 'Internal—Labour' (38%) (see Figure 2). Aurizon Network's claim is set out in more detail in its September 2017 submission, and March 2018 amendment letter, which are published on the QCA website.

Figure 2 Aurizon Network's flood costs breakdown

Source: Aurizon Network 2017 review event submission.

Aurizon Network said the costs incurred, and to be incurred, in rectification works associated with tropical cyclone Debbie were appropriate, given the environment in which the CQCN operated.³ Aurizon Network said it applied its recovery planning procedures after the flood to prioritise civil construction work.⁴

Aurizon Network said its cost capture process ensured costs attributed to the review event were additional to the approved maintenance allowance under UT4, and were only additional incremental costs that resulted from the review event. It said this was done by distinguishing between general maintenance work, and work specific to a site damaged as a result of the review event.⁵

Aurizon Network said that for separating capital expenditure and operating expenditure, it had followed the same general assessment criteria that were applied for other review events. These defined capital projects as ones where:⁶

- the total materials cost (incurred or to be incurred) was greater than \$40,000
- for linear assets, the physical distance over which the infrastructure was renewed was greater than 75 metres
- the work was not ballast undercutting.

Aurizon Network said those costs categorised as capital expenditure had not been included in the review event submission, but would be included in Aurizon Network's 2016–17 capital expenditure proposal.

³ Aurizon Network's 2017 review event submission, p. 28.

⁴ Aurizon Network's 2017 review event submission, p. 28.

⁵ Aurizon Network's 2017 review event submission, p. 24.

⁶ Aurizon Network's 2017 review event submission, p. 26.

Aurizon Network's accounting report

Aurizon Network retained accountancy firm RSM to review the tropical cyclone Debbie flood claim for accuracy. This paper was published on the QCA website in October 2017.

RSM had previously been retained by the QCA to check past capital expenditure claims for errors and omissions such as double-counting and re-claiming of previous costs.⁷ Aurizon Network said it opted to engage RSM directly, to provide assurance about its claim in a timely manner. The review included providing a 'limited assurance conclusion' on whether:

- the operating expenditure costs included in Aurizon Network's 2017 flood claim contained duplication
- the operating expenditure costs and capital expenditure costs specific to the tropical cyclone Debbie recovery reconciled to Aurizon Network's accounting system (SAP)
- a consistent methodology was applied to define capital expenditure and operating expenditure
- the operating expenditure costs within the 2017 flood claim were additional to the approved scope of the FY17 maintenance allowance under UT4.⁸

RSM identified one matter it considered a medium risk and two that were low-risk:

- *Operating expenditure and capital expenditure classification* (medium risk)—RSM said two operating expenditure transactions included within the 2017 flood claim should have been classified as capital expenditure. Aurizon Network adjusted the claim by removing the transactions valued at \$1,416,300 in order to avoid overstating operating costs.
- *Application of operating expenditure methodology* (low risk)—RSM said some large invoices were split equally between operating expenditure site codes included in the 2017 flood claim and capital expenditure site codes excluded from the claim. Aurizon Network added an additional criterion to the capital expenditure methodology and reclassified two site codes resulting in a net reduction of the 2017 flood claim by \$25,311.
- *Incorrect application of labour rates* (low risk)—RSM identified that incorrect labour rates were applied for nine engineering team members, which resulted in an undercharge of \$18,828. Aurizon Network said it did not adjust the claim, as it represented 1 per cent of the total labour costs and would result in an increase to the 2017 flood claim.⁹

RSM did not assess the amendments Aurizon Network made to its proposal on 21 March 2018.

3.3 Efficiently incurred additional incremental costs

AECOM's engineering report

The QCA retained engineering consultancy firm AECOM to provide expert technical advice on the costs included in Aurizon Network's review event proposal. The AECOM report has been published on the QCA website along with this draft decision.

AECOM advised on whether the costs Aurizon Network sought to recover were additional incremental and efficient costs, based on a detailed review of the scope, standard and costs of a

⁷ See, for example, RSM, *Cost Review of Aurizon Network's 2015–16 Capital Expenditure Claim*, May 2017.

⁸ RSM, *Aurizon Network: Cost Review of 2017 Flood Claim—Tropical Cyclone Debbie*, October 2017, p. 1.

⁹ RSM, *Aurizon Network: Cost Review of 2017 Flood Claim—Tropical Cyclone Debbie*, October 2017, p. 2.

sample of projects. AECOM used benchmarking and other measures to assess 18 out of 833 submitted projects, with a total cost of \$10.4 million, representing 60 per cent of the amount claimed.¹⁰ The sampled items represented a cross-section of projects, covering all the systems on the CQCN, and a range of disciplines and values (Table 1). AECOM's review has primarily been a desktop review, with several rounds of requests for additional documents to clarify issues.

AECOM's review also assessed and reported on the quality and range of documentation (categorised as 'high', 'medium' or 'low') made available by Aurizon Network for each project under review (Table 1).

Table 1 AECOM's assessment of Aurizon Network's review event claim

Project	Flood Assessment				Project Cost (\$ million)		
	Increm.	Increm. Addit.	Cost Efficient	Doc. Quality	Claim	Adjust.	Prelim. Accept
Goonyella System					\$4.3		\$4.3
GA-001 – Ballast Washout	✓	✓	✓	Medium	\$0.15		\$0.15
GA-004 – Slip (Track Debris Flow)	✓	✓	✓	High	\$0.83		\$0.83
GA-008 – Slip Multiple (Track Debris Flow)	✓	✓	✓	High	\$0.80		\$0.80
GA-052 – Yukon SER to Hatfield SER – Fibre Break	✓	✓	✓	Medium	\$0.30		\$0.30
GA-053 – Blocked Drain Debris Clean-up	✓	✓	✓	High	\$1.29		\$1.29
GA-071 - Slip Multiple (Track Debris Flow) SER Hut & BM Crossovers	✓	✓	✓	High	\$0.37		\$0.37
GA-103 – Overhead Repairs Black Mountain	✓	✓	✓	Medium	\$0.34		\$0.34
GA-364 – Black Mountain Control System Repairs	✓	✓	✓	Medium	\$0.24		\$0.24
Blackwater System					\$0.29		\$0.29
BW-003 – Scouring on Side of Track	✓	✓	✓	Medium	\$0.29		\$0.29
Moura System					\$0.22		\$0.22
MA-023A – Scour/Washout	✓	✓	✓	High	\$0.22		\$0.22
Newlands System					\$0.35		\$0.35
NL-111 – Exposed Tape, Back Fill Hole in Access Road	✓	✓	✓	Medium	\$0.17		\$0.17
NL-226 – Pipes Silted Again	✓	✓	✓	Medium	\$0.18		\$0.18
North Coast Line					\$0.09		\$0.09
NCL-001 – Damage to Access road on UP Track	✓	✓	✓	Medium	\$0.07		\$0.07
NCL-002 – Slip on Access Road on UP Track	✓	✓	✓	Medium	\$0.02		\$0.02
General Projects					\$4.97		\$4.97
General Goonyella Operating Expenditure	✓	✓	✓	Medium	\$2.81		\$2.81
General Blackwater Operating Expenditure	✓	✓	✓	Medium	\$1.16		\$1.16
General Moura Operating Expenditure	✓	✓	✓	Medium	\$0.40		\$0.40
General Newlands Operating Expenditure	✓	✓	✓	Medium	\$0.59		\$0.59
All Projects Reviewed					\$10.24		\$10.24

% of projects in Claim reviewed by Number

2%

% of projects in Claim reviewed by Value

60%

Source: AECOM, *Review of Aurizon Network Review Event 2017 Submission—Tropical Cyclone Debbie*, 2018.

AECOM found that almost all of the costs submitted by Aurizon Network in its proposal of 22 September 2017 were additional incremental costs required to restore access to the CQCN in response to damage caused by tropical cyclone Debbie. AECOM advised that, in general, the program of work was managed effectively and efficiently, with the network restored to service within a month of the event.

¹⁰ AECOM, *Review of Aurizon Network Review Event 2017 Submission—Tropical Cyclone Debbie*, March 2018, p. 10. It is noted that the general projects assessed account for approximately 30 per cent of the claim and include general operating expenditure for the Goonyella, Blackwater, Newlands and Moura systems.

AECOM identified a small number of misallocations of labour and material costs in the September 2017 submission, including:¹¹

- Aurizon Network proposed a large number of labour hours, and therefore costs, for repairing a slip on an access road on the North Coast Line (Project NCL-002). AECOM found that most of the labour costs Aurizon Network had submitted for work on the slip road by a particular contractor should actually have been allocated across a number of other projects instead.
- Aurizon Network claimed approximately \$174,000 for materials and ballast through general project codes.¹² AECOM advised that these costs should have been transferred to site codes that applied to the specific projects where the materials and ballast were used.

Aurizon Network's amendments of 21 March 2018 sought to address these issues.¹³ The changes to the cost claim were:

- (a) transferring \$42,022 of costs from the Blackwater, Moura and Newlands systems to the Goonyella system; and
- (b) recategorising \$26,519 of costs as capital expenditure (which had the effect of reducing the overall claim to \$16.90 million).¹⁴

After reviewing Aurizon Network's changes to its proposal, AECOM found that Aurizon Network's flood claim of \$16,904,434 (pre-escalation), as amended on 21 March 2018, represented efficient additional incremental costs.¹⁵

Stakeholders' comments

The Queensland Resources Council (QRC) said given that it did not have access to the detailed information that supported Aurizon Network's submission, it was relying on the QCA to ensure that the costs claimed met the requirements under Schedule F, clause 5.3 of the undertaking.¹⁶

QCA analysis

Consistent with our previous flood decisions, we considered Aurizon Network's proposal, stakeholders' comments and our engineering consultant's assessment.

Our draft decision is to accept AECOM's conclusions about Aurizon Network's proposal, as amended on 21 March 2018. Our preliminary position is therefore that Aurizon Network has demonstrated that its proposed recovery of \$16.90 million¹⁷ represents additional incremental costs resulting from the cyclone Debbie force majeure review event, and that these costs are efficient and not already being recovered through approved tariffs.¹⁸

¹¹ Aurizon Network, Review event: 2017 tropical cyclone Debbie, letter to the QCA, 21 March 2018.

¹² AECOM, Review of Aurizon Network Review Event 2017 Submission—Tropical Cyclone Debbie, March 2018, p. iv.

¹³ Aurizon Network, Review event: 2017 tropical cyclone Debbie, letter to the QCA, 21 March 2018.

¹⁴ Aurizon Network also proposed to transfer \$244,382 of Goonyella costs to the AT5 electric infrastructure tariff, from the AT3 and AT4 non-electric tariff. This is discussed in Section 4.4 of this draft decision.

¹⁵ AECOM, Review of Aurizon Network Review Event 2017 Submission—Tropical Cyclone Debbie, March 2018, p. 8.

¹⁶ Queensland Resources Council, Submission to the QCA, Aurizon Network's review event—2017 tropical cyclone Debbie, November 2017, p. 1.

¹⁷ Aurizon Network, Review event: 2017 tropical cyclone Debbie, letter to the QCA, 21 March 2018.

¹⁸ The QCA notes that, while the approved tariffs at the time of the flood did not recover the cyclone Debbie repair costs, the tariffs were amended in the September 2017 extension DAAU to reflect an estimate of those costs (subject to a true-up after UT5 is approved—see Section 1.2 of this draft decision).

3.4 Insurance and self-insurance

Aurizon Network said none of the flood costs were recoverable under its insurance policy, or covered by its self-insurance arrangements. Aurizon Network said its external insurance did not cover assets damaged as a result of this review event and its self-insurance was not the appropriate mechanism for covering losses associated with extreme and sporadic risks such as the cyclone Debbie flooding.

Anglo American said it was concerned about the treatment of insurance and self-insurance for flood events.¹⁹

In our final decision on Aurizon Network's 2014 DAU, we accepted Aurizon Network's methodology for self-insurance and accepted that costs associated with major weather events or force majeure events exceeding \$1 million would be subject to a pass-through provision in the access undertaking.²⁰ On this basis, we accept the 2016 undertaking allows Aurizon Network to claim weather-related pass-throughs (Schedule F, cl. 5.3). Consistent with the QCA's decision on the 2014 DAU, Aurizon Network's claim for flood damage exceeding \$1 million is appropriate, given it is not part of the 2016 undertaking self-insurance allowance.

3.5 Transparency of costs

Aurizon Network's proposal

Aurizon Network submitted a public report on its flood cost recovery proposal, which the QCA published in September 2017, as well as the RSM accounting report that we published in October 2017. It also submitted to the QCA, on a confidential basis, a variety of internal papers and reports through which it sought to substantiate its cost recovery proposal. In addition, it provided further documents to the QCA and its consultant AECOM in response to information requests.

Stakeholders' comments

Anglo American said the documentation lodged by Aurizon Network was inadequate and did not provide any reliable information to enable a robust process. In particular, the claims were lodged with no information or granularity in the build-up of costs or the split between coal systems. Anglo American said it did not accept that RSM was independent, and said the QCA should 'appoint its own independent engineering and auditing experts'.²¹

QCA analysis

The QCA recognises that the public report from Aurizon Network does not include all the information and supporting documentation that has been provided to the QCA. We consider it is the role of the QCA, assisted by appropriate technical advisers, to assess the information Aurizon Network has provided on a confidential basis for this review.

In regard to Anglo American's suggestion that the QCA seek advice from an independent engineering consultancy we note that, consistent with its practice in previous flood reviews, the

¹⁹ Anglo American, Submission to the QCA, *Review event: 2017 tropical cyclone Debbie*, November 2017, p. 5.

²⁰ Queensland Competition Authority, *Aurizon Network's 2014 DAU*, final decision, Volume IV—MAR, April 2016, p. 83.

²¹ Anglo American, Submission to the QCA, *Review event: 2017 tropical cyclone Debbie*, November 2017, p. 4.

QCA has done so, retaining AECOM to prepare a comprehensive report assessing Aurizon Network's proposal (see section 3.3 and AECOM's report).

We note Anglo American's concerns about the status of the RSM report, given the accounting firm was retained directly by Aurizon Network. The QCA has observed that there have been some improvements in Aurizon Network's record-keeping for flood cost information compared to previous years. We accepted that it was useful for Aurizon Network to engage RSM to review its submission before it was lodged, in order to improve the quality of the data. On balance, we consider that we can rely on RSM's professional integrity, and the transparency it provided about the matters it identified during its review.

The QCA and AECOM have also checked for errors in the course of assessing the claim. While it is still possible that there are remaining undetected issues with the data submitted by Aurizon Network, of the sort identified by accounting experts in this and previous submissions, the QCA considers the review has been appropriate.

4 VARIATION OF THE REFERENCE TARIFF

4.1 Regulatory framework

The undertaking specifies that the QCA may approve the review event if it is satisfied that the variation of the reference tariff:

- (a) 'is consistent with the change in the cost resulting or that will result from the Review Event' (cl. 5.5(c)(ii)(B(1)))
- (b) 'reflects the impact of the relevant Review Event on the financial position of Aurizon Network (including the impact of incremental maintenance and incremental capital costs)' (cl. 5.5(c)(ii)(B(2)))
- (c) 'has been calculated as if all other Reference Tariffs were also being recalculated due to the Review Event' (cl. 5.5(c)(iii)).

This chapter divides the analysis of the tariff calculation into:

- Section 4.2: Timing of recovery
- Section 4.3: Escalation of the tariff
- Section 4.4: Calculation of the variation

4.2 Timing of recovery

Aurizon Network's proposal

Aurizon Network has proposed to recover the 2017 cyclone Debbie flood costs by varying reference tariffs for the six-month period between 1 January 2018 and 30 June 2018. This has already been approved on a provisional basis through the September 2017 Extension DAAU (see section 1.2). Aurizon Network said the proposed recovery period was appropriate because it:²²

- avoided the need to revise the Extension DAAU
- avoided the need for a lump sum payment of revised reference tariffs from July 2017
- provided transparent recovery during the 2018 financial year and reduced the risk of increasing the adjustment charge once the replacement undertaking (UT5) was approved
- provided for any under- or over-recoveries between the transitional tariffs and the final approved UT5 tariffs to be reconciled as part of the UT5 adjustment charge process.²³

Stakeholders' comments

No stakeholders commented on this issue.

²² Aurizon Network, Submission to the QCA, *Review event: 2017 tropical cyclone Debbie*, September 2017, p. 29.

²³ Aurizon Network, Submission to the QCA, *Review event: 2017 tropical cyclone Debbie*, September 2017, p. 29.

QCA analysis

We consider that maintenance costs that are appropriate to approve under the review event provisions in the 2016 undertaking should be recovered by Aurizon Network as soon as possible. This will enable costs to be recovered within a reasonable period of time, particularly given the risk of further flood events resulting in a 'cascading effect' on tariffs.

The QCA's Extension DAAU decision in November 2017 addressed transitional tariffs, and considered Aurizon Network's proposed recovery between 1 January 2018 and 30 June 2018 to be appropriate.²⁴ However, the QCA said the final outcome would be subject to the QCA assessment of the review event claim and a true-up once UT5 was approved.²⁵ We confirm the extension DAAU approach to timing of cost recovery in this draft decision.

4.3 Escalation

Aurizon Network's proposal

Aurizon Network proposed that flood costs incurred and recovered in the same year be escalated at the consumer price index (CPI) so they could be expressed in nominal terms. Where recovery of costs was deferred to a subsequent year, costs would be escalated at the weighted average cost of capital (WACC) to account for deferred cost recovery.

In line with this approach, Aurizon Network proposed that costs incurred from April 2017 were escalated by WACC for two months to the end of the 2017 financial year to account for deferred revenue recovery. Aurizon Network said it escalated the 2017 flood costs to 2017–18 financial year dollars by CPI using a treatment consistent with QCA's final decision on the 2016 undertaking (UT4).²⁶

The relevant inputs to these calculations, which were applied in the transitional tariffs in the Extension DAAUs for the 2016 undertaking, were:

- 7.17 per cent WACC
- 2.5 per cent estimated CPI
- 2017 financial year tonnage assumptions, which have been applied on a six-month pro rata basis to account for the six-month recovery period.²⁷

Stakeholders' comments

Anglo American said using WACC as an escalator effectively rewarded Aurizon Network for incurring review event costs, when other escalation methods for operating expenditure were more appropriate in that they did not calculate a return on a non-capital item. The QRC said the costs claimed were incurred when the UT4 WACC applied. However, 'for escalation relating to the period from 1 July 2017, the UT5 WACC (when this is determined) should apply, with any differences dealt with through adjustment charges'.²⁸

²⁴ Queensland Competition Authority, *September 2017 Extension DAAU*, final decision, November 2017, p. 2.

²⁵ Queensland Competition Authority, *September 2017 Extension DAAU*, final decision, November 2017, p. 2.

²⁶ Aurizon Network, Submission to the QCA, Review event: 2017 tropical cyclone Debbie, September 2017, p. 29.

²⁷ Aurizon Network, Submission to the QCA, Review event: 2017 tropical cyclone Debbie, September 2017, p. 29.

²⁸ Queensland Resources Council, Submission to the QCA, *Review event: 2017 Tropical Cyclone Debbie*, November 2017, p. 2.

QCA analysis

We consider Aurizon's Network's approach to escalating flood-related costs to be consistent with the 2016 access undertaking. As discussed in our previous flood decisions, we do not consider escalation provides double recovery, or escalates payments already made. Escalation does not reflect a return on the repair costs but rather compensation for the fact that recovery of the pass-through costs is delayed during the application and approval processes. On this basis, we accept Aurizon's Network's escalation methodology.

4.4 Reference tariff variation

Aurizon Network's proposal

Aurizon Network proposed in its September 2017 submission that the AT3 and AT4 tariff components be varied to recover this flood claim, for each of the Blackwater, Goonyella, Moura, Newlands and Goonyella to Abbot point (GAPE) Systems (see Table 2).

Aurizon Network separately identified costs associated with GAPE (the Northern Missing Link), to be recovered from GAPE system users. Aurizon Network proposed to allocate the balance of flood recovery costs as 'common costs' between GAPE and Newlands as they related to restoring shared infrastructure on the Newlands System.

Aurizon Network said in its September 2017 submission it had not adjusted the AT5 tariff to recover costs associated with damage to electric infrastructure on the basis that:

- the quantum of costs attributable to electrical works was a very small portion of the overall costs attributable to the relevant systems (with the expected impact on the transitional AT5 reference tariff less than \$0.01 per'000 eGTK), and
- if necessary, a reconciliation between electric and non-electric reference tariffs could take place after the QCA's decision on the review event.

Table 2 Reference tariff changes by system

Cost Recovery	Blackwater	Goonyella	Newlands	GAPE	Moura
Recovery incl escal (\$)	2,513,870	12,167,134	503,973	1,215,241	1,047,415
Tonnes ('000)	33,905	57,812	4,506	8,500	6,256
\$ per NT	0.07	0.21	0.11	0.14	0.17
Tariff increase					
AT3	0.10	0.51	0.37	0.20	0.53
AT4	0.04	0.11	0.06	0.07	0.08

Source: Aurizon Network 2017 review event submission.

On 21 March 2018, Aurizon Network wrote to the QCA saying it would reclassify \$26,519 of its proposed flood maintenance costs as capital expenditure, reducing the claim to \$16,904,434 (pre-escalation—see Table 3). It also transferred \$42,022 of costs to Goonyella from Blackwater, Moura and Newlands.

Aurizon Network further said it was seeking to recover \$244,382 costs for restoring electrical infrastructure on the Goonyella system through the AT5 tariff, rather than its previous proposal to recover them through the AT3 and AT4 non-electric tariffs.

Table 3 Aurizon Network original and revised 2017 flood claim by system

CQCN Systems	Cost (pre-escalation)			Affected Tariffs and direction of change		
	Original submission:	Amended claim:	Change	AT3	AT4	AT5
	22/09/2017	21/03/2018				
Goonyella:	\$ 11,806,827	#				
Non-electric costs ²⁹		\$11,604,467	+\$42,022	↑	↑	
Electric Costs		\$244,382				↑
Blackwater	\$ 2,439,426	\$2,438,620	-\$806	↑	↑	
Newlands	\$ 1,668,303	\$1,601,072	-\$67,231	↑	↑	
Moura	\$ 1,016,397	\$1,015,893	-\$504	↑	↑	
Total	\$ 16,930,953	\$ 16,904,434	-\$26,519			

Notes: #—The total amended Goonyella claim amount of \$11,848,849 includes electric infrastructure costs of \$244,382.

Source: Review Event: 2017 tropical cyclone Debbie, letter to the QCA, 21 March 2018.

Stakeholders' comments

The QRC considered that the costs that related to electrical infrastructure should be allocated to AT5.³⁰

QCA analysis

Aurizon Network's proposal to recover almost all of its Cyclone Debbie flood repair costs by varying the AT3 and AT4 reference tariffs is consistent with the principles set out in our previous flood review decisions. This approach is appropriate because it provides for all customers that use the system to contribute to the cost of repairs from which they benefit.

We note that Aurizon Network has amended its claim, so that it is now proposing to recover Goonyella electric infrastructure repair costs from users of the electric infrastructure by varying the AT5 tariff, as suggested by stakeholders. The QCA considers this change is appropriate to approve.

As discussed in Section 1.2 of this draft decision, any difference between the approved revenue and tariff adjustments arising from this flood review event, and those included in the transitional tariffs that are already being collected, will be adjusted through a true-up once the replacement undertaking (UT5) is approved.

In any event, the effect on the tariffs already collected will be minimal. The largest change to the original, September 2017 proposal, is the transfer of \$244,382 to Goonyella AT5 costs. This

²⁹ The amended Goonyella non-electric costs reflect \$42,022 of costs transferred from the Blackwater, Moura and Newlands systems. Aurizon Network has recategorised a further \$26,519 of costs from those three systems as capital expenditure.

³⁰ Queensland Resources Council, Submission to the QCA, *Review event: 2017 Tropical Cyclone Debbie*, November 2017, p. 2.

represents 0.3% of the 2017–18 Goonyella AT5 revenue requirement, and 0.1% of the Goonyella AT3/AT4 revenue requirement.

5 QCA DRAFT DECISION

For the reasons outlined in this decision document, we have made a draft decision to approve Aurizon Network's 2017 flood claim of \$16.90 million (pre-escalation), as amended on 21 March 2018.

In forming this preliminary review, we have considered Aurizon Network's submissions, stakeholders' comments, and expert advice from AECOM.

Stakeholders are invited to comment on this draft decision and AECOM's report by 3 May 2018.

APPENDIX A: EXCERPTS FROM THE 2016 ACCESS UNDERTAKING

Review event approval criteria

Clause 5.1 of Schedule F of the 2016 access undertaking states that Aurizon Network will submit a reference tariff variation to the QCA if a review event has occurred.

A reference tariff variation as a result of a review event must be submitted in accordance with clause 5.4 of Schedule F, whereby Aurizon Network must:

- nominate the Reference Tariff to be varied;
- include details of the methodology, data and assumptions used to vary the Reference Tariff;
- provide evidence that the Review Event has occur or will occur.

The QCA may approve the proposed variation, with respect to a review event, if it is satisfied that:

- the review event has occurred or will occur and
- the variation of the relevant reference tariff:
 - is consistent with the change in the cost resulting from or that will result from the review event
 - reflects the impact of the relevant review event on the financial position of Aurizon Network
 - (including the impact of incremental maintenance and incremental capital costs), and
 - has been calculated as if all other reference tariffs were also being recalculated due to the review event.

Force majeure review event

In the 2016 access undertaking, a review event is defined as:

- the occurrence of a force majeure event, of the type set out in paragraph (e), (l) or (m) of the definition of that term
- affecting Aurizon Network to the extent that it has incurred or will incur additional incremental costs of greater than \$1 million, and
- have not previously resulted in a variation of the relevant reference tariff.

This definition limits its application to three types of force majeure events, namely:

- act of God
- fire, flood, storm surge, cyclone, tornado, earthquake, washaway, landslide, explosion severe weather conditions or other catastrophe or natural calamity, and
- epidemic or quarantine restriction.

REFERENCES

AECOM, *Review of Aurizon Network Review Event 2017 Submission—Tropical Cyclone Debbie*, March 2018.

Anglo American, Submission to the QCA, *Aurizon Network's review event—2017 tropical cyclone Debbie*, November 2017.

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Queensland Competition Authority, *Aurizon Network's 2014 DAU*, final decision, Volume IV—MAR, April 2016.

Queensland Competition Authority, *September 2017 Extension DAAU*, final decision, November 2017.

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RSM, *Aurizon Network: Cost Review of 2017 Flood Claim—Tropical Cyclone Debbie*, prepared for Aurizon Network, October 2017.