



**Decision**

**QR Network's Review Event  
Submission – Central Queensland  
Flooding**

**October 2012**

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## **1. SUMMARY OF QR NETWORK'S APPLICATION AND THE AUTHORITY'S ASSESSMENT**

### **1.1 Background**

Central Queensland suffered some of the most severe and destructive flooding in recorded history in the period between December 2010 and January 2011. Uncharacteristically persistent monsoonal rainfall during this period brought wide-spread flooding across the central Queensland coal region (CQCR), starting on the Rolleston branch-line on Christmas Day, then spreading across the Blackwater and Moura systems, the North Coast Line and into Rockhampton City on 4 January 2011. The impact of this flooding on QR Network's rail infrastructure in the CQCR was significant.

In light of the scale of this natural disaster and consequential major recovery effort, and in accordance with clause 2.2.3 of Schedule F of its 2010 access undertaking, QR Network submitted a cost pass-through application in relation to the necessary repair and restoration costs of affected infrastructure.

The total value originally claimed was \$5.9 million, represented by \$5.0 million damage on the Blackwater system and \$0.9 million on the Moura system. While some damage was also incurred on the Goonyella and Newlands systems, QR Network said that the associated repair costs were not material and so excluded them from the claim.

QR Network's original claim was published on the Authority's website in March 2012 and three submissions in response were received from stakeholders, namely the Queensland Resources Council (QRC), Sojitz Coal Mining (Sojitz) and Stanwell Corporation Limited (Stanwell).

Subsequently, in response to issues raised in submissions, QR Network provided an addendum to the original claim. This was published on the Authority's website in August 2012, and one further submission was received in response (from Xstrata).

### **1.2 QR Network's Proposal and Methodology**

QR Network's original application sought to recover the costs associated with this review event through a variation to the 2011-12 Moura and Blackwater reference tariffs, as a retrospective charge. Stakeholders were concerned with this approach, in particular the notice period for that decision and the consequential impact on billing calculations and take-or-pay obligations. As a result, QR Network amended its claim and has now sought to recover the proposed costs of the review event through a variation of the Moura and Blackwater reference tariffs with effect from 1 September 2012.

QR Network proposed a cost pass-through approach where only incremental costs associated with QR Network's flood event response were claimed, not costs that were otherwise provided for in allowances included in the build-up of reference tariffs. QR Network indicated that this was achieved by ensuring that its claim:

- (a) excluded all asset renewal and replacement costs;
- (b) applied a 5.75% margin on direct labour costs associated with the flood event and included it in this claim to be consistent with the Authority's position on approved undertaking maintenance cost allowances;

- (c) captured flood-related costs at the work order level, which were linked to QR Network's finance system based on the location of the works completed, and which reflected QR Network's approved costing manual;
- (d) included only costs that were booked against cost codes established specifically to capture costs directly associated with the repair works performed because of the flood event;
- (e) did not include costs associated with tasks performed by QR Network but paid for by customers or other entities, so that all costs relate only to the remediation and repair of below-rail assets in the CQCR; and

The largest proportion of costs associated with QR Network's claim related to external contractor hire, direct labour costs and construction services, which accounted for 42%, 19%, and 19% of total costs claimed respectively. The significant expenditure incurred on contractor hire and direct labour costs was primarily due to the labour intensive nature of the repair work and the time critical nature of QR Network's emergency response to the flooding event in central Queensland.

QR Network also drew heavily upon the labour and non-labour resources of QR National Limited's Construction Services Group, given the priority of quickly restoring the track to recommence coal carrying train services. QR Network said that these costs were recorded in accordance with QR Network's internal charging policy and do not form any part of the Authority's approved maintenance cost allowance under-pinning the existing reference tariffs.

The amounts claimed by QR Network for the Blackwater and Moura systems, as well as the escalation values of these amounts when translated to 2012-13 values (and including additional expense for the Rolleston branch-line), are contained in Table 1 below.

**Table 1: QR Network's Total Costs Claim (\$'m)**

<i>Total Flood Claim</i>	<i>2010-11 without escalation</i>	<i>2012-13 (with cost escalation and additional Rolleston branch-line)</i>
Blackwater	5.05	6.97
Moura	0.86	0.97
Total	5.91	7.95

Repairs to the Rolleston Branch line were subject to a separate contractual arrangement between QR National and Xstrata and were not included in the original claim. However, QR Network's amended August 2012 claim included an additional amount (around \$1.1 million) that related to repairs on the Kinrola Junction to Rolleston Mine line section. QR Network provided the Authority with an independent audit report confirming that this amount had not been otherwise recovered, and proposed that it be recovered via the system premium for the Rolleston mine.

### 1.3 Stakeholder Comments

While stakeholders expressed general support for QR Network's proposed method for recovering costs associated with the claim, several issues regarding the original claim and the addendum were raised by stakeholders, and these are discussed below.

## Timing of recovery of costs

Stanwell argued that QR Network's original proposal to recover costs via adjustment of 2011-12 reference tariffs would result in a significant lump sum back charge to customers, which would be inconvenient for customers in terms of the impact on annual operating budgets.

## Additional Incremental Costs and Self-Insurance

QRC said that it was important to ensure that QR Network's claim does not include any potential for costs already accounted for in the build-up of existing reference tariffs to be double-counted.

Firstly, QRC argued that any costs that are recovered through a flood review event application must be incremental costs directly attributable to the event – i.e. labour and contractor costs should be additional to costs already covered in the maintenance cost allowances used to calculate reference tariffs.

Secondly, QRC argued that QR Network's claim should not include any costs that it already self-insures for, in accordance with the self-insurance arrangements endorsed as part of the Authority's approval of the 2010 access undertaking. This position was reiterated by Xstrata.

## Efficiency of costs and cost allocation methodology

The QRC said that, as QR Network's claim only provided general public information as to the nature of the repair costs sought to be recovered, it was important that the Authority appropriately satisfy itself that only efficiently incurred and prudent costs would be recovered as part of the claim, and that any costs of a capital nature were allocated appropriately and would not be passed through as an expense item.

The QRC also questioned the allocation of costs between coal and non-coal traffic – specifically, that QR Network proposed to allocate none of the flood repair costs to non-coal traffic which might constitute inappropriate cross-subsidisation of non-coal traffic by coal traffic. This position was reiterated by Sojitz.

## Aggregation of events

Stakeholders raised two specific concerns with regard to the way in which QR Network has sought to 'aggregate events' as part of its flood review event claim.

Firstly, Xstrata argued that the total cost being claimed has been artificially elevated by grouping together a number of discrete force majeure events, some of which, when analysed individually, could potentially fall under the review event trigger of \$1 million and thus should be excluded from the claim.

Secondly, QRC argued that the definition of review event in the access undertaking, as it relates to force majeure events, requires that additional incremental costs of \$1 million or greater from an event be recoverable if they have not previously resulted in a variation of the relevant reference tariff. This raises the question of whether the \$0.9 million sought to be recovered via adjustment to the Moura system reference tariff has met the relevant trigger.

## Rolleston line

The Rolleston line (which is an Xstrata customer-specific branch-line) suffered very significant damage as part of the 2010-11 central Queensland flooding events. QR Network

was engaged by Xstrata to perform reinstatement works, with Xstrata committing to pay for a detailed set of works (as listed in Xstrata's submission).

QR Network's flood review event claim seeks to recover an additional \$1.1 million via the system premium for the Rolleston branch-line. QR Network said that this was the cost of necessary works that were additional to the works already committed to by Xstrata. Xstrata wanted to be assured that there was no double-counting between these different sets of work.

## 1.4 The Authority's Assessment

QR Network's 2010 access undertaking provides for QR Network to seek approval from the Authority to vary reference tariffs in response to a review event, which can include a force majeure event caused by, amongst other things, a flood, and with an impact of greater than \$1 million. The mechanism for then varying reference tariffs is detailed in Part B of Schedule F of the undertaking.

As part of its consideration of QR Network's proposal, the Authority has taken account of the matters raised by stakeholders in submissions. These matters are discussed in the following sections.

### Incremental costs

The Authority shares the view of QRC that it is important that any costs recovered via a review event attributed to flooding must be clearly identified as being incremental costs directly caused by the event – i.e. not costs that are otherwise included in allowances already incorporated into reference tariffs.

Following submission of its original application in March 2012, QR Network commissioned an external audit by PricewaterhouseCoopers (PwC) to assess whether costs claimed were actually incurred and were not recoverable under other mechanisms, including existing reference tariffs. The final report of the external auditor has been provided to the Authority.

The Authority has assessed the auditor's report and is satisfied that the report indicates that the costs claimed by QR Network were actually incurred and were not otherwise recoverable through allowances incorporated into existing reference tariffs. Specifically, the auditor's factual findings included that the:

- (a) total schedule of costs identified, by work order and corridor, match the listing of costs claimed by QR Network;
- (b) randomly selected sample of work orders relate to sections of the network that suffered flood damage (with supporting evidence sighted by the auditor);
- (c) randomly selected sample of costs in the listing were supported by documentation sighted by the auditor, including invoices, loading requests, material issuance cards and timesheets for internal labour costs; and
- (d) work orders contained in the listing did not include any work conducted to repair facilities in the Callemondah yard (an above-rail facility).

Thus, the Authority has accepted QR Network's claim that the costs sought to be recovered by its flood review event application do not include double-counting of allowances already incorporated into existing reference tariffs.

## Self Insurance

With regard to the issue of potential double-counting of damage costs claimed by QR Network and coverage of self-insurance arrangements, the Authority shares the views of QRC and Xstrata that it is important that such double-counting does not occur, but also acknowledges the arguments made by QR Network in its addendum to the original claim relating to the uncertainty of coverage of the self-insurance arrangements and lack of relevant historical data for determining appropriate management of self-insurance risks.

As noted by QRC, the Authority's 2009 draft decision on QR Network's 2009 draft access undertaking provided for approval of QR Network's proposed allowances for self-insurance on the basis of self-insuring for weather related damage up to a value of \$8 million. However, as noted by QR Network, its proposal did include reference to this figure being based on limited actuarial analysis and that further analysis would be conducted with the intention of developing a more robust estimate of potential losses.

Such further analysis was not conducted prior to the approval of QR Network's 2010 access undertaking. However, QR Network has now had further work done by its insurance consultant (Finity). This work is summarised in QR Network's addendum to its claim and the detail has been separately provided to the Authority.

Finity's analysis indicates that assessment of weather losses over the current undertaking period has been significantly greater than in previous periods, even without consideration of the December 2010 / January 2011 severe flooding event. This reflects the end of the 10 year drought in central Queensland in 2008 and movement into a seemingly wetter period subsequent to that. In that context, Finity concluded that the most recent historical data suggests that a self-insurance premium to cover all weather related events would be significantly greater than the allowance provided for in the Authority's 2009 draft decision (and, in turn, the October 2010 final decision).

The Authority also notes that the definition of review event contained in the 2010 access undertaking includes a force majeure event (including fire, flood, earthquake, washaway, landslide, explosion or other catastrophe, epidemic and quarantine restriction) affecting QR Network to the extent that QR Network has incurred or will incur additional incremental costs of greater than \$1 million that have not previously resulted in a variation of the relevant reference tariff.

As a consequence, while holding some concerns regarding QR Network's approach to demonstrating the adequacy or otherwise of its self-insurance arrangements (especially the late provision of additional analysis by Finity), the Authority accepts that the flood review event damage costs are not covered by the existing self-insurance arrangements and thus are eligible to be recovered via adjustments to reference tariffs.

However, the Authority is concerned that significant uncertainty regarding the coverage and nature of the self-insurance arrangements continues to exist. In that regard, the Authority notes that the definition of review event in the undertaking specifically provided for QR Network to recover the costs of developing and implementing a self-insurance function, provided that function was in place by no later than 31 December 2010 and included:

- (a) a resolution by the QR Network Board resolving which events are being self-insured and acknowledging that it is considered that QR Network will have sufficient financial capability to assume such self-insured risks;

- (b) operation of an appropriate claims management system and implementation of other procedures to ensure that full and accurate costs of any self-insured losses are identified and claimed by QR Network;
- (c) varying accounting systems to establish a self-insurance fund and separate expense items for self-insurance;
- (d) expanding the current claims management team to provide sufficient capacity to assess and manage additional claims against self-insured risks including the pursuit of recovery against third parties (including QR parties) where appropriate;
- (e) establishing any other appropriate policies, processes and procedures to manage claims against self-insured risks; and
- (f) either demonstrating to the Authority that self-insured losses would not be otherwise recovered through revenue recovery provided for by the undertaking, or submitting a draft amending undertaking to remove the potential for any recovery.

Despite the opportunity to recover the costs of implementing a self-insurance function via a review event being explicitly included in the undertaking, QR Network has not to date availed itself of this opportunity. The Authority considers that this has meant that the level of certainty that could have been provided around the self-insurance arrangements has been, and continues to be, lacking. The Authority strongly encourages QR Network to provide that greater certainty by following steps (a) to (f) above as soon as possible. The Authority will be keen to ensure that uncertainty regarding the self-insurance arrangements does not continue beyond commencement of operation of QR Network's next access undertaking.

### **Efficiency of costs**

As noted above, the QRC said that QR Network needed to effectively demonstrate that the costs incurred in repairing flood damaged infrastructure were prudently incurred and that the costs did not include any capital expenditure.

In this regard, the Authority notes that:

- (a) the scale of the flooding that occurred in central Queensland in December 2010 / January 2011 was very significant compared to other events in the region in the recent past;
- (b) the claim is not unreasonable as the total claim submitted by QR Network (\$5.9 million repair costs, plus the additional Rolleston costs and escalation to allow recovery via 2012-13 reference tariffs) is small relative to the magnitude of the weather event;
- (c) QR Network's view that the work conducted was necessarily highly labour intensive appears justifiable given the extent of flooding and the need to resume operations on the network as quickly as possible;
- (d) QR Network has excluded all internal margins in the claim, apart from the standard 5.75% margin applied to direct labour costs;
- (e) QR Network's response to the flood event was governed by its established policies and procedures for dealing with threats or incidents that materially impact its network, especially the Network Operations Crisis Response Plan (NOCRCP);



- (f) the response to the event was overseen by a specially established flood recovery taskforce, based in Brisbane, and an associated flood recovery management team, based in Rockhampton; and
- (g) a detailed flood recovery resource plan was developed and implemented for each impacted system.

Given this, the Authority accepts that the costs claimed by QR Network in its flood review application have been prudently incurred.

### **Cost allocation**

The Authority accepts that, from an in-principle perspective, it would be reasonable for some of the rectification costs to be allocated to the non-coal customers. However, the Authority notes that the proportion of revenue on the Blackwater system presently sourced from non-coal customers is relatively small (less than 0.1%), meaning that a pro-rata allocation of the flood recovery costs to these customers is a non-material value.

As a result, the Authority considers that QR Network's proposal that costs associated with the flood review event be recovered solely from coal customers is reasonable.

### **Aggregation of events**

Xstrata argued that QR Network's flood review event may in fact be constituted by a number of discrete force majeure events, some or all of which may not individually trigger the \$1 million threshold for such events contained in QR Network's 2010 access undertaking.

While understanding the rationale for this position, given the several different parts of the network impacted by the December 2010 / January 2011 floods and the several different rivers or waterways involved, the Authority nonetheless considers that the common sense position is to view the central Queensland floods in this period as a single force majeure event. This is because the flooding in the region during this period was caused by a sustained and widespread heavy rainfall event that caused sequential overflows of a number of rivers and waterways that in turn led to significant damage to rail infrastructure in the Blackwater and Moura systems.

The QRC separately argued that the \$0.9 million claimed for recovery of costs incurred on the Moura system should be considered to have not reached the trigger for a review event. In that context, the Authority notes that the definition of review event contained in QR Network's 2010 access undertaking includes 'a Force Majeure Event affecting QR Network to the extent that QR Network has incurred or will incur additional incremental costs of greater than \$1 million that have not previously resulted in a variation of the relevant Reference Tariff.'

As indicated above, the Authority considers that the common sense view of the impact of the December 2010 / January 2011 central Queensland floods on QR Network's rail infrastructure is to consider it as the result of a single force majeure event. This means that the first part of the relevant sub-clause of the undertaking's definition of review event is satisfied – i.e. a force majeure event (impacting on both the Blackwater and Moura systems) causing QR Network to incur costs of greater than \$1 million (\$5.9 million in total in the original claim, with \$5.0 million in Blackwater and \$0.9 million in Moura).

The Authority accepts that the second part of the undertaking definition, referring to a variation of the relevant Reference Tariff, could suggest that, for the trigger to be met, the cost impact needs to be \$1 million for each system (which would not be the case for Moura).

However, there is some doubt about this interpretation given the reference to ‘a (single) force majeure event.’ The likelihood is that the definition was drafted without envisaging a circumstance where a single force majeure event could impact on more than one coal system – which is not surprising given the historically unusual nature of a weather event of the size that impacted central Queensland in December 2010 / January 2011.

In the circumstances, and with the knowledge that the cost impact on the Moura system of \$0.9 million was relatively close to the \$1 million trigger in its own right, the Authority accepted QR Network's proposal to aggregate the damage costs for the two systems in order to meet the review event trigger for variations to the reference tariffs for both systems.

### **Rolleston line**

Given the significant value of reconstruction work on the Rolleston branch-line conducted at Xstrata's expense under its separate agreement with QR Network, the Authority understands Xstrata's wish to be assured that the present flood review event claim does not include any double-counting of costs associated with this work.

This issue was specifically considered as part of the external audit commissioned by QR Network. The factual finding by the auditor was that no work orders included in the flood review event claim and forming part of the Rolleston branch-line are included in the listing of work orders that formed part of the separate flood costs to be claimed for reimbursement from Xstrata. The Authority considers that this should provide comfort to Xstrata that the flood review event claim does not include any costs double-counted with the work performed under the separate agreement between QR Network and Xstrata.

## **1.5 Conclusion**

For the reasons discussed above, the Authority has decided to approve QR Network's proposed flood review event claim for the costs associated with the impact of the December 2010 / January 2011 central Queensland flooding event on the Blackwater and Moura systems.

The approved reference tariffs for 2012-13, the incremental adjustments to tariffs caused by the flood review event, and the new tariffs that will apply from 1 September 2012 are shown in the Tables contained in Attachment A.

The new reference tariffs for 2012-13 are as proposed by QR Network in its August 2012 addendum to its original flood review event claim. The Authority is satisfied that the calculation of these tariffs is consistent with provisions contained in Part B of Schedule F of QR Network's 2010 access undertaking.

**Attachment A****Table A.1: Approved Reference Tariffs for 2012-13**

<i>System</i>	<i>AT<sub>1</sub></i>	<i>AT<sub>2</sub></i>	<i>AT<sub>3</sub>*</i>	<i>AT<sub>4</sub>*</i>	<i>AT<sub>5</sub></i>	<i>EC</i>
Blackwater	0.84	1,970.11	5.54	1.88	5.39	0.88
Goonyella	0.58	1,248.18	5.47	1.17	2.85	0.88
Moura	1.56	590.12	10.17	1.27		
Newlands	1.63	263.85	7.43	1.05		
Vermont	0.78	3,218.29	5.96	1.83	4.82	0.88
GVG	0.60	1,248.18	5.51	1.68	2.99	0.88
<b>Discounts / Premiums</b>						
Stanwell			(1.74)			
Rolleston			2.63			
Minerva			1.15			
Lake Vermont via Gladstone			0.49			

**Table A.2: QR Networks Proposed Incremental Tariff Adjustments**

<i>Tariff Component</i>	<i>Incremental Change (AT<sub>3</sub>)</i>
Blackwater System Price	0.264
Rolleston System Premium	0.655
Minerva System Premium	0.678
Moura System Price	0.515

**Table A.3: QR Networks Proposed Reference Tariffs Effective 1 September 2012**

<i>System</i>	<i>AT<sub>1</sub></i>	<i>AT<sub>2</sub></i>	<i>AT<sub>3</sub>*</i>	<i>AT<sub>4</sub>*</i>
Blackwater System Price	0.84	1,970.11	5.80	1.88
Rolleston System Premium			3.29	
Minerva System Premium			1.83	
Moura System Price	1.56	590.12	10.69	1.27