

Draft Decision

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## Aurizon Network's 2013 Review Event Application

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May 2014

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## THE ROLE OF THE QCA

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The Queensland Competition Authority (QCA) is an independent statutory authority to promote 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.

In 2012, that role was expanded to allow the QCA to be directed to investigate, and report on, any matter relating to competition, industry, productivity or best practice regulation; and review and report on existing legislation.

Submissions on this draft decision are requested from stakeholders by 20 June 2014.

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# 1 INTRODUCTION

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## 1.1 Background

On 25 and 26 January 2013, the Central Queensland Coal Region was subject to wide spread flooding as a result of ex-tropical cyclone Oswald. The flooding caused substantial damage to rail infrastructure in Aurizon Network's Blackwater and Moura rail systems. Aurizon Network said recovery would require full replacement of all track and earthworks in the affected locations.<sup>12</sup>

On the Blackwater system, the east track was damaged in a number of locations, most significantly between Edungalba and Duaringa. Approximately two kilometres of track was submerged between these two locations. On the Moura system, track damage occurred in a variety of locations, with approximately three kilometres of full earthworks formation washout between Stirrat-Clarke and Earlsfield.

On 30 July 2013, Aurizon Network submitted a cost pass through application to the QCA (original application) to recover costs associated with the repair and restoration of the affected infrastructure. As a result, a force majeure was declared by Aurizon Network, triggering the Review Event provision within Schedule F, Clause 2.2.1 of the Aurizon Network 2010 access undertaking (UT3). This application did not include all costs associated with Review Event as, at the time, outstanding work remained to be completed.

## 1.2 Process

In August 2013, we engaged Jacobs Sinclair Knight Merz (SKM) to review and comment on the reasonableness of the costs included in Aurizon Network's Submission. We invited stakeholders to comment on both the Aurizon Network application and the SKM report.

Five submissions were received in response to the application and the SKM report. On 13 September 2013, Aurizon Network wrote to us to provide supplementary information to support its original application. On 6 November 2013, Aurizon Network provided a response to industry submissions.

On 4 March 2014, Aurizon Network provided a revised application that included details on final costs. By this time, all costs related to the event had been incurred. One submission (from Anglo American) was received in response to this revised application.

Separately, on 7 April 2014, Aurizon Network submitted a draft amending access undertaking (the 2014 Extension DAAU) proposing to, among other things, further extend the term of UT3. It also included proposed transitional reference tariffs for 2014-15, which included \$21.3 million related to the 2013 flood review event claim in the Blackwater and Moura systems.

We are considering the 2014 Extension DAAU in accordance with the provisions of the *Queensland Competition Authority Act 1997* (QCA Act).

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<sup>1</sup> Aurizon Media Release, 4 April 2013, "Aurizon continues flood recovery works."

<sup>2</sup> In February 2013, further rain events and subsequent flooding occurred, however this impact was significantly smaller than the January flooding. Aurizon Network did not seek to recover costs associated with the February floods through its customers.

## 2 AURIZON NETWORK PROPOSAL

### 2.1 Aurizon Network's original application

On 30 July 2013, Aurizon Network submitted a cost pass through application, seeking to recover \$17.16 million<sup>3</sup> of costs incurred in the Blackwater and Moura Systems. The amounts claimed by Aurizon Network for the Blackwater and Moura systems are contained in Table 1 below.

**Table 1: Aurizon Network's total costs claim (\$ 2012-13, 'm)**

<i>Total Flood Claim</i>	<i>2012-13</i>
Blackwater	8.5
Moura	6.2
North Coast Line ( included in Blackwater system tariff)	2.5
Total	17.2

Aurizon Network proposed this amount be recovered from customers through a variation to reference tariffs for 2013-14. Aurizon Network said the adjustment amount should be recovered from the AT3 reference tariff component of the Blackwater and Moura systems from 1 July 2013.<sup>4</sup>

When Aurizon Network submitted its original application, it had completed repair works for 177 of the 242 sites and 65 sites were uncompleted.

The proposed pass through amount was comprised of:

- \$12.91 million actual costs incurred in the period between January 2013 and June 2013
- \$4.25 million in estimated costs not yet incurred but part of the repair works activity plan for the flood event.<sup>5</sup>

Aurizon Network said its claim:

- excluded all asset renewal costs
- applied a 5.75% margin on direct labour costs associated with the flood event, which was included to be consistent with the approved UT3 cost allowances
- is based on incremental costs associated with operational and maintenance activities incurred as a result of the flood event. Costs that were otherwise provided for in the build-up of reference tariffs was not included in the claimed amount
- flood-related costs were captured at the work order level, which were linked to the Aurizon Network finance system based on the location of the works completed.<sup>6</sup>

<sup>3</sup> Unless otherwise indicated, all estimates are in \$2012-13.

<sup>4</sup> Aurizon Network 2013: 15.

<sup>5</sup> Aurizon Network 2013: 1.

<sup>6</sup> Aurizon Network 2013: 1; 10.

On 13 September 2013, Aurizon Network wrote to us to provide supplementary information to support its original application. It provided further information on the inclusion of ordinary labour costs in its application. This letter clarified that the Maintenance Cost Submission, Volume G of UT3 made no provision in the Maintenance Cost Allowance for the recovery of costs associated with flood damage. It was contemplated at the time that such costs would be recovered via a Review Event Submission, which is triggered by a declaration of a Force Majeure Event.<sup>7</sup>

On 6 November 2013, Aurizon Network provided us with further information in response to the industry submissions. Aurizon Network said:

- it has exhausted its insurance allowance for compensation of flood rectification costs, including any potential liability by a third-party
- no double counting of allowances was made as part of developing its cost estimates related to the pass through application
- due to the combination of the types of corrective works and the nature of the assets, there is minimal opportunity to realise any reductions in future maintenance or capital expenditure.<sup>8</sup>

Aurizon Network said, as non-coal customers make up a very small percentage of overall usage of the Central Queensland Coal Network (CQCN), their impact on the network should be excluded from the normal revenue and tariff modelling process.<sup>9</sup>

Aurizon Network said as costs were incurred during the 2010 regulatory period, it should be recovered under the 2010 approved tariff mechanism and not under the 2013 access undertaking (UT4) provisions.<sup>10</sup>

## 2.2 Aurizon Network's revised application

On 4 March 2014, Aurizon Network submitted a revised cost pass through application relating to the 2013 flood event. This application included a proposed pass through amount of \$18.60 million. Aurizon Network said this amount represented all outstanding flood related works on the Blackwater (including the North Coast Line) and Moura systems.<sup>11</sup>

The revised claim of \$18.60 million consisted of:

- consumables and inventory costs, which accounted for 58 % of the total cost claim
- labour costs which accounted for 15% of the total cost claim (ordinary labour costs accounted for 14% and overtime labour costs accounted for 1% of total labour costs).
- ballast, resurfacing costs and overhead costs accounted for 7 %, 12 % and 8 % of total costs respectively.

In light of the timing of events, Aurizon Network considered the claim should be recovered in the UT4 period. Costs could be recovered from customers via an adjustment to the System Allowable Revenue for 2014-15, conditional upon the approval of UT4. Aurizon Network

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<sup>7</sup> Aurizon Network 13 September 2013: 1.

<sup>8</sup> Aurizon Network 6 November 2013: 1-5.

<sup>9</sup> Aurizon Network 6 November 2013: 4-5.

<sup>10</sup> Aurizon Network 6 November 2013: 1-5.

<sup>11</sup> Aurizon Network 2014: 1.

considered this would be the most efficient method to recover the cost, as it would avoid significant retrospective adjustment charging.

Aurizon Network said the most efficient means of recovering costs would be to split the recovery of flood claim costs on a 50:50 basis between the AT3 and AT4 approved Reference Tariffs. This approach is consistent with the application of previous revenue adjustment amounts. Table 2 shows the proposed tariff impacts, which Aurizon Network said was modelled using the 2014-15 reference tariffs provided as part of the UT4 proposal.<sup>12</sup>

**Table 2: Proposed AT3 and AT4 tariff impacts**

<i>System</i>	<i>AT3</i>			<i>AT4</i>		
	<i>Excl Flood</i>	<i>Inc Flood</i>	<i>% increase</i>	<i>Excl Flood</i>	<i>Inc Flood</i>	<i>% increase</i>
Blackwater	5.81	6.09	4.9%	1.97	2.07	5.1%
Moura	10.85	12.83	18.2%	1.85	2.18	18.2%

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<sup>12</sup> Aurizon Network 2014:2.

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## 3 STAKEHOLDER COMMENTS

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### 3.1 Comments on original application

Five submissions were received in response to Aurizon Network's original pass through application, and SKM's report, from the Queensland Resources Council (QRC), BMA, Wesfarmers, Anglo American and Sojitz.

Stakeholders expressed general support for Aurizon Network's proposal to pass through costs associated with the flood event. However, concerns were raised about Aurizon Network's proposed method for recovering costs associated with the claim and whether these costs can be independently verified.

A submission from Anglo American was received in response to Aurizon Network's revised claim. Anglo American reiterated the majority of its views made in its first submission (dated September 2013) as it considered Aurizon Network still did not adequately address concerns raised by stakeholders (including itself).<sup>13</sup>

Anglo American was concerned Aurizon Network did not provide a detailed explanation of the rise in cost estimates between the original and revised application.<sup>14</sup>

Furthermore, Anglo American considered that, in calculating the pass through amount, Aurizon Network should not be entitled to escalation of costs based on the Weighted Average Cost of Capital (WACC). Anglo American said this is not representative of the true risk borne by Aurizon Network. Instead an escalation at a rate equivalent to its cost of holding the amount payable (the Holding Cost) should be used to reflect the delay in repayment.<sup>15</sup>

#### Estimation of incremental costs

Stakeholders generally indicated concerns about whether all costs claimed by Aurizon Network were in fact incremental costs. Specifically, they indicated concerns that:

- to the extent the work which was deferred in favour of the flood recovery work was subsequently able to be completed in ordinary time; or was deferred, such that it will find its way into UT4 cost allowances, then the ordinary time labour costs are not incremental<sup>16</sup>
- much of the labour applied to the flood recovery task involved existing employees or contractors of Aurizon, who were reallocated from other tasks<sup>17</sup>
- not all of the costs in Aurizon Network's overhead claim are incremental to its UT3 maintenance or operating expenditure allowances. The only overhead costs BMA considered relevant to this claim are overtime, specific plant hire, contracted services and other out of pocket expenses, such as travel specifically required for the flood recovery

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<sup>13</sup> Anglo American 2014: 1.

<sup>14</sup> Anglo American 2014: 1.

<sup>15</sup> Anglo American 2014: 1.

<sup>16</sup> QRC 2013: 2.

<sup>17</sup> QRC 2013: 1-2; BMA 2013:1-2; QRC 2013: 3; Wesfarmers 2013: 2; Anglo American 2013: 4; Anglo American 2014:2.



work. Some of the labour, resurfacing and work protection costs are provided for in the UT3 maintenance allowance.<sup>18</sup>

Stakeholders generally supported SKM's finding of excluding \$2.3 million in ordinary labour costs from the proposed pass through amount. This amount should be covered by the UT3 maintenance allowance. However Anglo American is not sure whether this amount relates to all systems and, if so, what proportion relates to the Moura system.<sup>19</sup>

### Insurance (and self insurance)

Similar to the Aurizon Network flood claim for 2011, stakeholders expressed concern about the extent to which flood costs should be covered by self insurance arrangements. Specifically, stakeholders said that:

- the QCA should not make a decision on the proposed pass through amount until it is satisfied Aurizon Network has exhausted all insurance claims available to it.<sup>20</sup>
- coal producers fund certain insurance coverage through reference tariffs, yet have no visibility of the coverage obtained. The level of certainty that could have been provided around the self-insurance arrangements has been, and continues to be, "lacking".<sup>21</sup>

### Moura system issues

Anglo American was concerned the quantum of costs for the repair of the Moura System is high<sup>22</sup> and a significant proportion of the Moura System costs have been attributed to overtime labour costs as compared to the Blackwater System. While only approximately 4% of the Blackwater System costs are attributed to overtime labour, almost 20% of the Moura System costs are this component. Anglo American noted Aurizon Network is still yet to produce any evidence of why this is so.<sup>23</sup>

### Other matters

Stakeholders also commented on a number of other matters concerning the 2014 Extension DAAU, including:

- Aurizon Network should not obtain a margin of 5.75% on labour costs, as costs recovered for a Review Event should be based on costs prudently incurred only<sup>24</sup>
- to the extent any track was restored to a better condition than its pre-flood condition, then there will be future maintenance cost savings. To the extent these savings relate to the UT3 period, they should be deducted from the incremental cost<sup>25</sup>
- as the claim includes a material cost(\$2.50m) incurred on the North Coast line, where non-coal traffic is significant, consideration should be given to allocating some costs to non-coal traffic.<sup>26</sup>

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<sup>18</sup> BMA 2013: 2.

<sup>19</sup> Anglo American 2013: 4; BMA 2013: 1; Anglo American 2014: 2.

<sup>20</sup> QRC 2013: 3; Wesfarmers 2013: 1; Anglo American 2013: 1; Anglo American 2014, 2.

<sup>21</sup> BMA 2013:2.

<sup>22</sup> Anglo American 2014: 2.

<sup>23</sup> Anglo American 2013: 1-2.

<sup>24</sup> QRC 2013: 2; Wesfarmers 2013: 2.; Anglo American 2013: 1-2; Anglo American 2014: 2.

<sup>25</sup> QRC 2013: 2.

<sup>26</sup> QRC 2013: 3; BMA 2013: 1.

### Timing and means of flood claim cost recovery

Stakeholders raised a number of matters in respect of the period of time and way in which they considered Aurizon Network should recover the costs of the 2013 flood. We also received a number of submission on this matter in response to our consideration of the 2014 Extension DAAU.

The key concerns raised were:

- the QRC and Wesfarmers said the flood recovery cost should be included in the UT4 cost allowances and recovered over the term of UT4<sup>27</sup>
- to seek recovery of the final determined amount over the balance of the 2013-14 period would unfairly prejudice producers in an environment where unprecedented efforts are being made to reduce cash costs in order to stay competitive in the international export market<sup>28</sup>
- Aurizon Network should recover any approved pass through cost through the adjustment charges under UT3<sup>29</sup>
- the recovery of the pass through amount should be adjusted on an AT4 reference tariff (net tonne basis) to lessen the impact on mines situated at a substantial distance from the main Blackwater system.<sup>30</sup>

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<sup>27</sup> QRC 2013: 3-4; Wesfarmers 2013: 2.

<sup>28</sup> Wesfarmers 2013: 2.

<sup>29</sup> Anglo American 2014: 4.

<sup>30</sup> Sojitz 2013: 1.

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## 4 QCA ANALYSIS AND POSITION

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We considered Aurizon Network's revised cost pass through application in accordance with the requirements of Schedule F, Clause 2.2.1 of UT3. This provision provides for Aurizon Network to seek approval from us to vary reference tariffs in response to a review event, which can include a force majeure event caused by, among other things, a flood, and with an impact of greater than \$1 million. The mechanism for varying reference tariffs is detailed in Schedule F of the undertaking.

As part of making our assessment on the revised pass through application, we:

- engaged SKM to conduct an engineering assessment of Aurizon Network's flood event cost pass through claim
- took into account the matters raised by stakeholders in submissions.

### 4.1 SKM assessment

SKM was asked to complete the following activities:

- investigate whether Aurizon Network included normal labour hours into their estimate or only overtime and contractors' time
- provide high level commentary on differences between SKM's preliminary cost estimates per system and Aurizon Network's final claim
- provide a high level review of the Neerkol Creek bridge<sup>31</sup> component of the claim to appraise reasonableness.<sup>32</sup>

SKM found \$10.60 million of Aurizon Network's original claim for \$17.16 million to be reasonable. It recommended the Authority omit \$6.55 million from the claimed amount comprising of the following:

- (a) \$2.30 million in ordinary labour costs (excluding estimated costs). SKM considered this amount is already provided for in the UT3 maintenance allowance
- (b) \$4.25 million in estimated costs for rectification works not yet completed.<sup>33</sup>

SKM found Aurizon Network's cost estimates for each system for repair activities as reasonable.<sup>34</sup>

SKM found the claimed costs for completed works at Neerkol Creek Bridge (in the Blackwater System) reasonable.<sup>35</sup>

**Appendix A** of this draft decision has further information on the methodology used by SKM as part of its assessment of Aurizon Network's original pass through application.

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<sup>31</sup> Which belongs to the Blackwater System.

<sup>32</sup> SKM 2013: 12.

<sup>33</sup> SKM 2013: 23.

<sup>34</sup> SKM 2013: 19-20.

<sup>35</sup> SKM 2013: 20-21.

## 4.2 QCA analysis

### 4.2.1 Estimation of incremental costs

We are not satisfied Aurizon Network's pass through application reasonably reflects incremental costs associated with ordinary labour costs.

SKM identified that Aurizon Network included normal and overtime labour hours in its original application<sup>36</sup> and requested information on why Aurizon Network included these costs in its claim. Aurizon Network's response was that UT3 did not provide for costs associated with flood recovery works, therefore Aurizon Network treated these costs as incremental costs, consistent with the 2011 Flood Review Event application.<sup>37</sup>

SKM noted that Aurizon Network used internal labour to undertake a significant portion of the flood repair works. Some of this labour was temporarily relocated to the flood affected area from the Goonyella and GAPE systems. However, SKM considered the costs for ordinary labour stationed in the Blackwater and Moura systems and labour from other areas would have been accounted for when developing the tariffs for UT3. As a result, SKM did not consider sufficient justification was provided to explain why ordinary labour costs of \$2.30 million (excluding \$788,500 of Aurizon Network's estimated costs that had not been completed) should be included in the flood claim when they should be covered by the UT3 cost build-up.<sup>38</sup>

We note that, between the original and revised applications, Aurizon Network made significant amendments to its ordinary labour cost estimates, with a significant reduction in the Blackwater costs, but increases in ordinary labour costs for Moura and North Coast Line. This means the revised ordinary labour costs are \$2.54 million compared to the \$3.09 million originally forecast.

We have considered Aurizon Network's position that UT3 did not provide for costs associated with flood recovery works and that its ordinary labour should be treated as an incremental cost. However, based on the material we have available, we are of the view the ordinary labour costs incurred in flood recovery had already been allowed for in the UT3 maintenance allowance and we have not seen evidence that Aurizon Network increased its ordinary labour elsewhere which would suggest these costs should be treated as incremental costs.

We consider it reasonable to exclude Aurizon Network's claim of \$2.54 million for ordinary labour costs from the flood claim as we are not satisfied they reflect incremental costs.

We have reviewed, as has SMK, the overhead allowances proposed by Aurizon Network and are of the view that they are incremental to the normal operations of Aurizon Network.

We maintain our position as determined in our decision on the 2011 flood review event to accept Aurizon Network's 5.75% standard margin applied on labour costs. On the basis that we understand this margin to be applied only to internal labourers from Aurizon Holdings, to carry out the works, we are satisfied that there is no double counting of corporate overheads.

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<sup>36</sup> SKM 2013: 12-13.

<sup>37</sup> SKM 2013: 12 (Aurizon Network response to SKM RFI009).

<sup>38</sup> SKM 2013: 12-13.

### 4.2.2 Insurance and self insurance

We accept the flood review event damage costs are not covered by Aurizon Network's existing self-insurance arrangements.

We acknowledge the arguments made by Aurizon Network in its original application that the UT3 operating allowance for self insurance was materially exceeded by weather-related infrastructure repairs (not related to this flood event), over the course of UT3. Furthermore, we accept the arguments made by Aurizon Network in its response to stakeholder comments<sup>39</sup> declaring it has exhausted all avenues for compensation, including any potential liability by a third party.

Our 2012 decision on the central Queensland flooding referred to work done by Aurizon Network's consultant, Finity. Finity provided actuarial assessment of Aurizon Network's insurance allowance for weather related damage up to a value of \$8 million. Finity's analysis indicated weather losses over the current undertaking period had been significantly greater than in previous periods, even without the consideration of the December 2010/January 2011 severe flooding event. Finity concluded that the most recent historical data suggest that a self insurance premium to cover all weather related events would be significantly greater than the allowance provided for in UT3.

We continue to have concerns about Aurizon Network's approach to demonstrating the adequacy or otherwise of its self-insurance arrangements. We maintain the same view as discussed in our 2012 decision on the central Queensland flooding.<sup>40</sup> We are concerned significant uncertainty regarding the coverage and nature of the self-insurance arrangements continues to exist. We agree with the QRC's comments that coal producers fund certain insurance coverage through reference tariffs, but have no visibility of the coverage obtained.<sup>41</sup>

We note the definition of review event in the 2010 undertaking specifically provided for Aurizon Network to recover the costs of developing and implementing a self-insurance function, providing it was to be in place by no later than 31 December 2010.

Despite the opportunity to recover the costs of implementing a self-insurance function, Aurizon Network chose not to do this. We consider this means that the level of certainty that could have been provided around the self-insurance arrangements has been, and continues to be, lacking.

We note that Aurizon Network has proposed similar self-insurance arrangements for UT4. We will outline our concerns in respect of transparency in more detail as part of our assessment of UT4.

### 4.2.3 Moura system issues

Anglo American noted that a significant proportion of the Moura System costs were attributed to overtime labour costs, as compared to the Blackwater System.

Aurizon Network advised us the reason for this is because there are no depot stations situated at Moura. As a result higher overtime hours were incurred, reflecting the additional travel time incurred by Aurizon Network staff and contractors to the affected sites. We accept Aurizon Network's explanation.

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<sup>39</sup> Aurizon Network, 6 November 2013: 1.

<sup>40</sup> QCA October 2012 Decision - QR Network's Review Event Submission - Central Queensland Flooding.

<sup>41</sup> QRC 2013: 3.

#### 4.2.4 Tariff Adjustments to AT3 and AT4

We do not agree with Sojitz's proposal that the recovery of the pass through amount should be adjusted on an AT4 reference tariff (net tonne basis) only, to lessen the impact on mines situated at a substantial distance from the mainline on the Blackwater system.

The AT4 reference tariff takes into consideration distance travelled (by kilometres) when railing coal (measured by net tonnes) from the mine to the port. The AT3 reference tariff only factors the net tonne railed and distance travelled is not a factor.

We note the Sojitz mine is located further away from the port, however we consider it is reasonable from an in-principle perspective that users should pay for a system tariff if they use the system. In particular, we consider:

- all customers who use the system should contribute for the repair costs
- if the AT4 reference tariff incorporated the flood repair costs only, then this would disadvantage customers whose mines are closer to the Blackwater and Moura System mainlines, but advantage customers who are situated further away.

To balance the interests of all customers, we consider the approved pass through amount should be incorporated into both the AT3 and AT4 reference tariffs as proposed by Aurizon Network.

#### 4.2.5 Cost allocation - coal versus non-coal users

We acknowledge the QRC and BMA's view that the revised application includes a material cost incurred on the North Coast line (\$2.50 million) where non-coal traffic is significant. It would be reasonable from an in-principle perspective for some of the repair works to be allocated to the non-coal customers, however we note the repair works were carried out in a timely manner on infrastructure built for coal users in the CQCN, to ultimately meet coal users' needs.

Consistent with our decision on the 2011 flood review event, we do not propose to share the approved pass through amount between coal and non-coal customers. We note the proportion of revenue on the Blackwater system 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.

#### 4.2.6 Other matters

In relation to other matters raised by stakeholders:

- we note the QRC's view there should be future maintenance cost savings where track was restored to a better condition than its pre-flood condition. However, we do not consider a savings offset is warranted as part of this pass through application. We note Aurizon Network's view that:

*The primary intention of Aurizon Network's flood response was to restore track to its pre-flood standard not to a higher standard. As a result, there are no expected changes, and in particular, reductions in the scope of the existing programs over the remainder of UT3. As a result, there are no expected cost savings in these programs as a result of the flood response.<sup>42</sup>*

- we note Anglo American's view that the holding cost (the cost of holding the amount to be paid at a suitable borrowing rate, currently circa 5.0%) should be used to represent the time

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<sup>42</sup> Aurizon Network 2013: 10.

cost of money as part of calculating the pass through amount. However, consistent with the principle of NPV=0, we consider the WACC should be used as proposed by Aurizon Network in its revised Review Event Submission, updated to reflect the WACC approved as part of the UT4 process for 2013-14 and subsequent years.

#### 4.2.7 Timing of flood claim recovery

We acknowledge the concerns of stakeholders that the impact of the adjustments to tariffs due to the 2013 flood review event claim is likely to be very significant in the case of the Moura system.

With regard to the question of whether any approved flood review event claim should be recovered within 2014-15 or smoothed over the remainder of the UT4 regulatory period, our preliminary view is it should be recovered in 2014-15 (at least for the Blackwater system), noting the event itself occurred in early 2013.

However, given the potentially significant proportional impact on Moura system reference tariffs, we will give further consideration to this matter in the UT4 approval process, in the context of the overall movements in the UT4 Moura tariffs.

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## 5 QCA DRAFT DECISION

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For the reasons outlined in this decision document, we have decided not to approve Aurizon Network's 2013 flood claim of \$18.60 million.

We consider it reasonable to exclude Aurizon Network's claim of \$2.54 million for ordinary labour costs from the flood claim as we are not satisfied they reflect incremental costs. We consider this amount has already been provided in the UT3 cost allowances.

The approved pass through amount of \$16.10 million should be incorporated into the AT3 and AT4 reference tariffs, and the period of time over which costs are to be recovered will be considered as part of the UT4 process.

Stakeholders are invited to provide submissions on this draft decision by 20 June 2014.



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## APPENDIX A: ENGINEERING ASSESSMENT OF THE APPLICATION

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We appointed SKM to assist in assessing Aurizon Network's flood event cost pass through application. SKM was asked to develop a preliminary estimate of the likely cost of repairing the damage to Aurizon Network's below-rail infrastructure due to the flood event.<sup>43</sup> As part of this exercise, SKM was asked to complete the following activities:

- investigate whether Aurizon Network included normal labour hours into their estimate or only overtime and contractors' time
- provide high level commentary on differences between SKM's preliminary estimates per system and Aurizon Network's final claim
- provide a high level review of the Neerkol Creek bridge component of the claim to appraise reasonableness.<sup>44</sup>

### Methodology

SKM derived its cost estimate by completing the following tasks.

SKM undertook a site visit on 19 and 20 February 2013 to gain an understanding of the magnitude of the scale of repair works and the typical repair methodologies used by Aurizon Network to reinstate the rail infrastructure. SKM visited 20 of the 242 affected sites in the Moura and Blackwater systems (including the North Coast Line) (see Table 3).

The selected sites were used as benchmarks and the repair information was used to extrapolate across the full list of affected sites. SKM derived its cost estimates based on a typical scope of works and a bill of quantities was developed for each site.<sup>45</sup> Additional information was required by SKM and this was requested through a request for information (RFI) process.<sup>46</sup>

Aurizon Network provided SKM with the '2013 Flood Recovery Plan' as at 18 February 2013 and an updated version dated 7 March 2013 which detailed the sites affected and the type of repair works to be conducted to the railway infrastructure.

From these tools, SKM derived a cost estimate based on the following:

- photographs and video footage supplied by Aurizon Network
- Aurizon Network flood recovery plan on 7 March 2013
- material and plant hire costs for the Central Queensland Coal Region.<sup>47</sup>

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<sup>43</sup> SKM 2013: 3.

<sup>44</sup> SKM 2013: 12.

<sup>45</sup> SKM 2013: 7.

<sup>46</sup> SKM 2013: 7.

<sup>47</sup> SKM 2013: 15.

**Table 3: List of sites visited by SKM<sup>48</sup>**

<i>Site</i>	<i>Location</i>
1	Blackwater - 2 x LOC's underwater
2	Blackwater - Both tracks washed out
3	Blackwater - Scour at bridge east and west abutments
4	Blackwater - Track washed out
5	Blackwater - Up track washed out
6	Blackwater - Track stability undermined
7	Blackwater - 2 x Points motors under water and series of LOC's underwater
8	Blackwater - Scour at culvert with minor formation slips along embankment, points machines underwater
9	Blackwater - Debris on bridge, both tracks washed out, points machines underwater, rock armour washed away
10	Blackwater - Scour at bridge abutment
11	Moura - Track washout (single line) including formation, culvert scoured at both ends
12	Moura - Land slips where cutting has slid onto track, culverts scoured out and requires replacement, creek has been silted up due to embankment slip, will need clearing out
13	Moura - Landslip on to access road
14	Moura - Landslip covering access road
15	Moura - Mt Rainbow - Major landslip where the edge of the slip stopped at the toe of ballast along original track alignment. Currently being repaired by Abigroup Contractors
16	Moura - Mt Rainbow - Trackslew by 1m to the Northern side to allow for landslip repairs (associated with Site 15)
17	Moura - Clarke - Scour at culvert and washed out ballast
18	North Coast - Epala - Washout of formation
19	North Coast - Oaky Creek - Culvert damage and formation repairs
20	North Coast - Ambrose - Ballast washed out from under truck

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<sup>48</sup> SKM 2013: 8-9.

### Inclusion of ordinary labour costs and contractor expenses

A total of \$6.55 million relating to ordinary labour costs and contractors' expenses was recommended by SKM to be excluded from the Aurizon Network's original claimed amount.<sup>49</sup>

SKM recommended that \$2.30 million in ordinary labour costs<sup>50</sup> (excluding \$788,5000 of Aurizon Network's estimated costs that had not yet been completed) should be omitted from Aurizon Network's claim since this amount was already provided for in the UT3 operating allowance.<sup>51</sup>

SKM recommended un-incurred costs of \$4.25 million should be excluded from the claimed amount. SKM considered these costs should be recovered from customers once they have been incurred and can be substantiated by Aurizon Network.<sup>52</sup>

Aside from this, SKM considered Aurizon Network's costings for the following elements were reasonable:

- claimed overheads amount of \$1.50 million
- claimed consumables amount of \$5.27 million.<sup>53</sup>

### Differences between SKM's and Aurizon Network's estimates at the system level

SKM found Aurizon Network's cost estimates for each system (the Blackwater System, the North Coast Line and the Moura system) for repair activities reasonable.<sup>54</sup>

SKM noted that after it developed its preliminary cost estimate, Aurizon Network increased the scope of works significantly along the Moura System. However, SKM still found overall costs relating to this system reasonable, taking into consideration the change in scope.<sup>55</sup>

### Review of the Neerkol Creek Bridge claim component

SKM found the claimed costs for completed works at Neerkol Creek Bridge on the Blackwater System reasonable, based on a high level review.<sup>56</sup> SKM recommended we accept the claimed amount of \$938,634 relating to remediation works for the Neerkol Creek Bridge.<sup>57</sup>

SKM noted Aurizon Network stated in its application that the amount included in the UT3 operating costs for self-insurance has been materially exceeded. As a result, costs associated with the remediation works for Neerkol Creek Bridge cannot be claimed under the self-insurance allowance. SKM noted this was the same response provided by Aurizon Network in its response to a RFI request from SKM on 30 August 2013, requesting clarification on how Aurizon Network's self insurance allowance has been expended over the course of UT3.<sup>58</sup>

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<sup>49</sup> SKM 2013: 12-13.

<sup>50</sup> SKM found that Aurizon Network had included normal and overtime labour hours in the claimed amount. SKM considered these costs are already provided for in the UT3 (SKM 2013: 13).

<sup>51</sup> SKM 2013: 12-13.

<sup>52</sup> SKM 2013: 12.

<sup>53</sup> SKM 2013: 16-19.

<sup>54</sup> SKM 2013: 19-20.

<sup>55</sup> SKM 2014: 20.

<sup>56</sup> SKM 2013: 21.

<sup>57</sup> SKM 2014: 21.

<sup>58</sup> SKM 2013: 22.

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