

13 August 2012

John Hall
Chief Executive
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

Supplementary Information and Variations to 2010 Review Event Claim

Dear John,

I am writing to you to provide further information in support of QR Network's proposed Review Event to recover costs associated with restoration of rail infrastructure following the wide spread flooding in the central Queensland coal region in 2010. We are also seeking to amend the proposal to recover those costs through a variation to the 2012-13 Reference Tariffs.

UT3 System Allowable Revenues

QR Network notes that there is some confusion as to what provision was made in the approved UT3 System Allowable Revenues for weather related damage. In particular, the Queensland Resources Council (QRC) noted aspects of the Queensland Competition Authority's (QCA) draft decision on the 2009 Draft Access Undertaking (2009DAU) which indicated that the actuarial assessment of the risk allowance was based on the assumption that QR Network was self insuring weather related damage up to \$8 million.

QR Network acknowledges that the supporting information for the 2009DAU, including the expert report prepared by Finity, did in fact reflect this assumption. QR Network also notes that Finity also qualified its advice that if a different pass-through point were adopted then this would change the results.

The quantum of the allowance determined by Finity for natural disasters for the UT3 period equated to approximately \$1.4 million without escalation.

UT3 – Public Submission (2009 – DAU)

The public submission prepared by QR Network at Attachment K of the 2009DAU included the following:

Notwithstanding the recent rainfall occurring in Central Queensland in January and February of 2008, the previous decade has been relatively benign in regard to rainfall intensity. As a consequence, the recent historical data on flood damage repairs does not provide a robust estimate of severity for normal rainfall patterns for the purpose of undertaking an actuarial assessment. Finity has therefore been limited to providing a premium estimate on the basis of costs associated with recent natural disasters. This premium is summarised in the table below.

Table 6: Estimated Premium for Extreme Weather Events (\$m)

	2009-10	2010-11	2011-12	2012-13
Flood Damage	0.279	0.294	0.306	0.326

QR Network considers this premium does not adequately address the self-insured risks associated with severe weather events and contends that the actuarial analysis needs to be supplemented with an engineering-based assessment of risk exposures to validly assess estimated losses. Therefore, QR Network has submitted the premium on the basis of the Finity analysis but will provide a more robust estimate of losses following further analysis.

The intention of the further analysis was to provide a more robust engineering and probability based model which evaluated the likelihood, frequency, severity and consequential cost impacts of weather related events. However, such an approach was not feasible and QR Network notes that other jurisdictional regulators have raised concerns with accepting allowances based on this type of model due to the impact of low frequency but material consequence events, noting that pass-through would appear to be the most effective approach.

The historical data available with respect to weather related damage for the Central Queensland Coal Network (CQCR) included a maximum loss of approximately \$1 million. QR Network did not consider that historical data provided a reliable or robust basis for estimating losses from future significant weather events. As a consequence QR Network proposed in subsequent engagements with the QCA, to manage this risk through a transfer of all costs for events exceeding \$1 million.

The QCA accepted this proposal in the December 2009 draft decision as noted on page 51 and Decision 1.2:

The Authority therefore approves the creation of a review event for costs greater than \$1 million arising from catastrophes, as the review event provisions give the Authority sufficient discretion in assessing such a claim.

Further Analysis – Finity

In order to improve stakeholder confidence that the amounts proposed to be recovered through this review event are incremental and that QR Network has not otherwise been compensated for those losses, Finity was requested to provide confirmation as to what the quantum of the weather related damage component of the allowance would be. The request was based on an assumption that all costs associated with force majeure events (where the aggregate costs exceed \$1 million) are subject to pass-through arrangements. Finity has advised that under this assumption the component of the allowance would reduce from \$1.4 million to \$0.5 million.

However, weather losses over the UT3 period have totaled \$6.8 million (net of this proposal) which is considerably more than the original estimate of \$1.4 million and the revised calculation based on the historical data set of \$0.5 million. In light of these losses, QR Network also requested Finity to revise the estimate on the assumption that the historical data set used to derive the weather related damage estimate was inclusive of loss data obtained over the UT3 period.

Recasting the UT3 weather loss estimates using data through to 2012 (excluding the \$6.8m included in the Review Event), and assuming a pass-through threshold of \$1 million, results in estimated costs for 2009/10 to 2012/13 of \$2.9 million which is considerably more than the estimates based on data to 2008.

QR Network is not proposing to revise the weather related loss component of the risk premium estimate for UT3 based on the updated estimates. As these losses are not recoverable through subsequent estimates, QR Network considers that the amounts included in this claim are incremental and are not compensated within the approved regulatory allowances.

Details of these losses and the consequential variations to the weather related component of the risk allowance associated with these assumptions is included in correspondence from Finity at Attachment A. Consistent with the approach accepted for the original Finity report, due to the commercially sensitive nature of this information the letter is provided to the QCA for its decision making on this matter and should not be publicly disclosed.

Variation to Reference Tariffs

QR Network's original application of December 2011 sought to recover the costs associated from this review event through a variation to the 2011-12 Moura and Blackwater Reference Tariffs. While QR Network anticipated relying on the application of an Adjustment Charge for this retrospective change to a reference tariff we have acknowledged the concerns of some stakeholders regarding the notice period for that decision. In addition, as any decision on the review event is now likely to follow the calculation and billing of take-or-pay obligations a number of complex contractual issues may arise from any recalculation of take or pay once it has been invoiced.

As discussed with the QCA, we therefore consider it reasonable to amend the claim and recover the proposed costs associated with the review event through a variation of the Moura and Blackwater reference tariffs with effect from 1 September 2012.

The effect date for the review event also avoids the additional administrative burden of retrospective recovery of a variation in a reference tariff.

The QCA was also provided in June 2012 with a copy of the auditors report and details of additional amounts not included in the December 2011 submission relating to the Rolleston branchline of \$1.127 million. As advised in that letter these additional amounts were not recoverable under the commercial arrangements entered into with the mine owner. These additional amounts will be recovered via the System Premium for the Rolleston mine.

As the recovery of the expenses being claimed in this review event application has been deferred, the costs have been escalated by the approved WACC in the same manner with which the revenue cap adjustments are rolled forward. In addition, QR Network has applied the same principles used in the December submission to allocate costs between Minerva, Rolleston and the Blackwater System Tariffs.

The consequential changes to the relevant system allowable revenues and reference tariffs are detailed in the following tables.

Table 1 2012-13 System Allowable Revenues

	Approved System Allowable Revenues	Flood Claim Adjustment	Revised System Allowable Revenue
Blackwater	\$258,920,104	\$6,971,045	\$265,891,149
Moura	\$43,817,275	\$973,974	\$44,791,249

Table 2 Incremental Tariff Adjustments

Tariff Component	Incremental Change (AT3)
Blackwater System Price	\$0.264
Rolleston System Premium	\$0.655
Minerva System Premium	\$0.678
Moura System Price	\$0.515

Table 3 2012-13 Reference Tariffs Effective 1 September 2012

Tariff Component	AT1	AT2	AT3	AT4
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

An electronic copy of the workbook including the additional incremental costs will be forwarded to the relevant staff within the QCA. Should you have any queries in relation to this matter please contact Dean Gannaway, Manager Regulation and Policy on (07) 3235 2055 or via email at dean.gannaway@qrnational.com.au.

Yours sincerely,



Michael Carter
 Chief Executive Officer
 QR Network Pty Ltd