



ENERGEX Response

QCA's Draft Decision Energex's FRC Pass-through Application

May 2008

**ENERGEX LIMITED
ABN 40 078 849 055**

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1. EXECUTIVE SUMMARY

ENERGEX acknowledges the release of the Queensland Competition Authority's (QCA) Draft Decision on ENERGEX's application to pass-through costs in relation to the Queensland Government's decision to introduce full retail competition (FRC) in the state's retail electricity market from 1 July 2007. ENERGEX is concerned with the outcome of the QCA's Draft Decision to allow a cost pass-through amount of only \$44.2 million - \$38.5 million less than ENERGEX sought. ENERGEX believes that these costs represent legitimate network expenditure in response to network regulatory and statutory obligations relating to the implementation of FRC.

Furthermore, ENERGEX disagrees with the basis on which the QCA has made this Draft Decision. Matters of concern in regard to the QCA's Draft Decision are set out below.

New information submitted

The QCA's Draft Decision (and the advice from its independent consultant, PB Associates (PBA)) rejects a number of ENERGEX's cost claims on the basis that ENERGEX has not provided sufficient supporting information, namely 05/06 costs and FRC Stage 2. ENERGEX notes that it has now submitted the additional information in support of these claims for consideration by the QCA as part of the consultation process for this Draft Decision. This information is provided in an attachment to this response and further detail in an accompanying confidential document.

Force and FACOM expenditure

The Draft Decision rejects ENERGEX's costs of upgrading Force and FACOM when the QCA's independent consultant (PBA) has accepted these costs as necessary and prudent. ENERGEX believes that there is no evidence or other material to justify this position of the Draft Decision. ENERGEX emphasises that it used FACOM to provide its distribution FRC services until April 2008 when FACOM was replaced by PEACE. Further information to substantiate ENERGEX's two staged strategy to system development is provided in this response which includes a description of the nature of the network functional upgrades to FACOM.

ENERGEX notes that the decision for a phased approach to IT architecture, where FACOM would run for a significant period of time in parallel to the new PEACE system was made before the Queensland Government's announcement to sell the retail businesses. This strategy was pursued to limit risks associated with a single phase approach to IT development which would have involved a mass migration of customer data and the provision of full transaction volume capability from market start. ENERGEX was responding to expert advice in this area to ensure stable systems were in place for market start. Any suggestion that this two staged strategy was pursued to provide transitional services to retailers can be readily disproved by reviewing documents within ENERGEX which can be provided to the QCA.

Overhead and labour escalation rates

ENERGEX considers that the QCA should reassess and approve ENERGEX's overhead rates. This is because overhead rates cannot be benchmarked with any reliability. Albeit, market evidence indicates that these rates are consistent with rates for other companies, which range from 20–30% of overall operating expenditure. ENERGEX also considers that the QCA should re-assess and approve ENERGEX's

labour rate escalator of 4.5% per annum. This escalation rate is consistent with forecasts published by a range of expert advisors, including the QCA's consultant, PBA, in a report for the Australian Energy Regulator (AER) in December 2006.

1% materiality threshold

ENERGEX considers that the materiality of ENERGEX's FRC costs should be assessed on the basis of the materiality of the event rather than the actual annual revenue impact. Such an approach recognises the magnitude of the event in an aggregate context rather than a year by year assessment. ENERGEX believes that this approach is consistent with the intent of the materiality threshold in the 2005 Final Determination and is consistent with that recently proposed by the (AER). Where there is clearly one event, in this case the introduction of FRC, ENERGEX considers that it is illogical to disallow some expenditure where it just happens to fall in a different financial year, when if it hadn't, it would have been allowed.

Asset lives

While PBA has accepted ENERGEX's proposal to adopt a five year life for SPARQ assets, the QCA has rejected PBA's recommendation and increased the asset lives to ten years. ENERGEX believes that the QCA has failed to publish full and reasonable details of the basis and rationale of the decision, and requests that the QCA adopt ENERGEX's proposal as being in the reasonable range of asset lives set out in the PBA report.

Other matters

PBA has indicated that ENERGEX's costs in the areas of Architecture and Design, and the 2006/07 Accenture Costs were inefficient, a position which ENERGEX considers is unfounded and unsubstantiated. ENERGEX believes that there is no evidence or other material provided by PBA to justify this decision. ENERGEX was required to utilise scarce specialist resources on the FRC project. Because of the competing demands on IT resources there was no incentive to use more resources than necessary to complete these tasks.

In other matters, ENERGEX seeks to clarify issues pertaining to the CVU-IVR costs and ENERGEX staffing levels. In regard to the CVU-IVR costs ENERGEX seeks confirmation that these costs have been approved. In regard to staffing levels ENERGEX confirms that levels do not increase beyond 2007-08 as indicated in the Draft Decision.

Further details on these issues are provided in Section 3 of this submission.

ENERGEX considers that it has provided the QCA with the necessary information for the QCA to make its decision in relation to ENERGEX's cost pass-through application. In the event that the QCA believes that more information is required from ENERGEX to support this application, ENERGEX will provide upon request.

ENERGEX considers that the additional information and explanations provided in this response will clarify the QCA's understanding of the issues and provide them with a more informed and reasonable basis to reassess their Draft Decision. ENERGEX believes it has provided the QCA with the evidence and material to justify making a Final Decision in accordance with this response.

2. INTRODUCTION

ENERGEX acknowledges the release of the QCA Draft Decision in relation to ENERGEX's application for the pass-through of costs associated with the introduction of FRC in the Queensland retail electricity market from 1 July 2007.

ENERGEX is concerned with the outcome of the QCA's Draft Decision to allow a cost pass-through amount of only \$44.2 million - \$38.5 million less than ENERGEX sought. ENERGEX believes that the \$82.7 million represents legitimate network expenditure relating to the implementation of FRC in the Queensland retail electricity market. As noted by the QCA, FRC was "implemented through changes to the Electricity Act 1994, regulations, licences, and the introduction of a new Electricity Industry Code"¹. ENERGEX had no option but to comply with these obligations and to ensure delivery of effective network systems to enable the transfer of customers and the facilitation of competition.

ENERGEX disagrees with the basis on which the QCA has made its Draft Decision. Of particular concern, ENERGEX considers that the QCA has:

- In some cases failed in its duty to "publish full and reasonable details of the basis and rationale of the decision" as is required under 6.2.7 of NER. In a number of instances the QCA's Draft Decision provides no evidence or other material to justify the QCA's decisions that ENERGEX's costs are imprudent and inefficient; and
- Clearly sought to identify and approve the lowest costs possible by assessing ENERGEX's cost claim against a notional benchmarked prudent and efficient entity and then:
 - Where ENERGEX's costs were lower than the "reasonable range", the QCA accepted ENERGEX's costs; but
 - Where ENERGEX's costs were higher than the "reasonable range", the QCA accepted the lower costs.

ENERGEX has identified a number of matters of concern outlined in this response under the following headings.

- Areas where ENERGEX has provided new information;
- Force and FACOM expenditure;
- Overhead and labour escalation rates;
- 1% materiality threshold;
- Asset lives; and
- Other matters.

A detailed discussion of these issues is outlined in section 3 of this submission.

ENERGEX considers that it has provided the QCA with all of the necessary information for the QCA to make its decision in relation to ENERGEX's cost pass-through application. In the event that the QCA believes that more specific information is required to support this application, ENERGEX will provide this specific information upon request.

¹ Energex's FRC Pass-through Application Draft Decision April 2008 p1.

3. MATTERS OF CONCERN

3.1 New Information Submitted

The QCA's Draft Decision (and the advice from its independent consultant, PBA) rejects a number of ENERGEX's cost claims on the basis that ENERGEX has not provided sufficient information to support these claims. In particular, the Draft Decision rejects ENERGEX's:

- Corporate communications costs;
- 2005-06 SPARQ capitalised labour costs;
- 2005-06 ENERGEX capitalised labour costs;
- 2005-06 Accenture costs; and
- "Stage 2" costs.

ENERGEX considers that it has now submitted the additional detailed information for these costs required for the QCA to make a further assessment. ENERGEX considers that this additional information supports the claim for FRC expenditure relating to these items and submits this information for consideration by the QCA as part of the consultation process for this Draft Decision.

Each of the cost claims is discussed below.

3.1.1 Corporate Communications

ENERGEX understands that the recommendation from PBA was to reject ENERGEX's claim to include \$227,000 for corporate communications, on the basis that the DVD "FRC, the Way Forward" was required to meet safety and ring-fencing obligations, and was not consequent to FRC (page 69 of the PBA report). The QCA accepted PBA's recommendation, without providing any analysis for rejecting ENERGEX's claim, and has not included the cost in Table 8² of the Draft Decision.

ENERGEX believes there is no evidence or other material to justify the QCA making this decision. ENERGEX notes that the DVD is titled "FRC, the Way Forward" and is entirely focussed on informing stakeholders about FRC. It would not have been produced if the FRC decision had not been made by Government. A copy of the DVD is attached to this submission to substantiate that the content is directly related to the introduction of FRC. (Attachment 1)

ENERGEX believes that this issue should be reconsidered by the QCA and approve these legitimate FRC costs for pass-through.

ENERGEX considers that the QCA should allow the costs associated with corporate communications on the basis that these costs are prudent, efficient, incremental, and directly related to FRC.

² This refers to Table 8 of the Draft Decision "QCA FRC Project Implementation Costs – Stage 1"

3.1.2 2005-06 SPARQ capitalised labour costs

ENERGEX understands that:

- The recommendation from PBA was to exclude 2005-06 SPARQ labour costs because ENERGETEX could not provide requested detail below the headline data (page 43 of PBA report); and
- The QCA accepted PBA's recommendation on the basis that ENERGETEX should have the ability to provide detailed information to the QCA to support the cost claim (page 17 of QCA Draft Decision).

ENERGEX was unable to provide this information at the time required due to system limitations, and for that reason ENERGETEX subsequently extracted the data manually and provided it to the QCA on 5 February 2008. These costs are now provided again to the QCA on a commercial and in confidence basis as the data contains sensitive material pertaining to labour rates. ENERGETEX seeks that the QCA now consider the additional detail in making its decision.

ENERGEX considers that the QCA should allow recovery of the 2005-06 SPARQ labour costs because:

- These 2005-06 costs were incurred by SPARQ and are reflected in its audited statutory accounts for 2005-06;
- The QCA has allowed SPARQ's labour costs for the same functions to be passed through in subsequent years, thereby implicitly approving these functions; and
- The QCA has not explained the legislative or regulatory basis for rejecting ENERGETEX's costs that have been proven to have been incurred but for which further detail could not be provided at the time of PBA's initial request due to system limitations.

Consistent with the additional information provided, ENERGETEX seeks that the QCA allows the SPARQ capitalised labour costs to be recovered under the cost pass-through on the basis that these costs are prudent and efficient.

3.1.3 2005-06 Accenture costs

ENERGEX understands that:

- The recommendation from PBA was to exclude 2005-06 Accenture costs of \$2.61 million because ENERGETEX could not provide requested detail below the headline data (page 44 of PBA report); and
- The QCA accepted PBA's recommendation on the basis that ENERGETEX should have the ability to provide detailed information to the regulator to support the cost claim (page 17 of QCA Draft Decision).

Additional details to support these costs which were manually extracted were provided to the QCA on 5 February 2008. These details are now resubmitted to the QCA on a commercial and in confidence basis, for consideration in making its decision.

Accordingly, the QCA should allow ENERGETEX to recover the 2005-06 Accenture costs because:

- As with the 2005-06 capitalised labour costs, the Accenture costs were legitimately incurred by SPARQ and are reflected in its audited statutory accounts for 2005-06;
- The QCA has allowed Accenture costs (albeit at reduced amounts) in subsequent years, which indicates the QCA's acceptance of the underlying need for the costs to be incurred; and
- The QCA has not explained the legislative or regulatory basis for rejecting costs that have been proven to have been incurred.

Consistent with the additional information provided, ENERGETEX submits that the QCA should reconsider the pass-through of these costs and allow the full 2005-06 Accenture costs to be recovered on the basis that these costs are prudent and efficient.

3.1.4 2005-06 ENERGETEX capitalised labour costs

ENERGETEX understands that:

- The recommendation from PBA was to exclude 2005-06 ENERGETEX capitalised labour costs of \$212,960 because ENERGETEX could not provide requested detail below headline data (page 49 of PBA report); and
- The QCA accepted PBA's recommendation on the basis that ENERGETEX should have the ability to provide detailed information to the QCA to support the cost claim (page 17 of QCA Draft Decision).

Additional details about these costs which were manually extracted were provided to the QCA on 5 February 2008. These details are provided again with this response on a commercial and in confidence basis. ENERGETEX considers this additional cost information justifies the cost claim and should be considered by the QCA in its decision.

The 2005-06 costs were incurred by ENERGETEX and are reflected in its audited statutory accounts for 2005-06 and in its regulatory accounts for 2005-06. The QCA has allowed ENERGETEX capitalised labour costs for the same functions in subsequent years.

The QCA has not explained the legislative or regulatory basis for rejecting costs that have been proven to have been incurred but for which further detail could not be provided at the time of PBA's initial request due to system limitations.

Consistent with the additional information provided, ENERGETEX considers that the QCA should allow the full ENERGETEX capitalised labour costs to be recovered on the basis that these costs are prudent and efficient.

3.1.5 Stage 2 costs

ENERGETEX has now substantially completed Stage 2 of the FRC project. As such, Stage 2 costs are not forecast expenditure and are now known with certainty.

ENERGETEX understands that:

- The recommendation from PBA was that, based on the information provided in earlier submissions, PBA was unable to assess whether the costs for

ENERGEX's proposed Stage 2 are prudent, efficient and incremental to FRC; and

- The QCA decided that ENERGEX's Stage 2 costs were not to be allowed because its forecast costs were unreliable, although the QCA indicated that it would consider further information provided by ENERGEX on its Stage 2 costs as part of the consultation on the Draft Decision.

The QCA's Draft Decision rejects the entire Stage 2 cost claim on the basis that:

- Stage 2 was in some way optional and that ENERGEX could, in PBA's view, have taken a business decision on whether to proceed with it;
- ENERGEX had admitted in its Supplementary Submission that "...the costs were *unreliable*". ENERGEX notes that this statement was intended only to differentiate between actual and forecast costs in order to propose a "true up" mechanism, and has been taken somewhat out of context; and
- The forecasts had not been made with "*absolute certainty*".

In support of the ENERGEX position, ENERGEX notes that:

- ENERGEX's decision to install PEACE has been determined by PBA to be prudent. This is therefore not in question;
- The decision to run parallel systems (PEACE and FACOM) has been determined by PBA to be prudent and has been discussed elsewhere in this submission;
- Stage 2 costs include integration costs that are necessary in order to fully migrate customer information to PEACE and to cease using FACOM;
- Stage 2 costs were the only costs in the Supplementary Submission that were forecasts. All of the Stage 1 costs were known with certainty; and
- Stage 2 costs are now known with certainty and are comparable to forecasts.

In order to ensure that ENERGEX had the best possible chance of recouping its Stage 2 costs and with the understanding that costs were required to be known with absolute certainty, ENERGEX met with the QCA to discuss a "two stage" submission process.

There was discussion on the option of ENERGEX waiting until Stage 2 was finished before submitting a cost pass through claim so that only "actual" costs would be passed through. However, ENERGEX was advised that the QCA would only consider one pass-through application for FRC. Hence, Stage 2 costs would need to be submitted as forecasts and would therefore involve some judgement on ENERGEX's part.

In the Supplementary Submission to the QCA, ENERGEX made very clear the difference between Stage 1 actuals and Stage 2 forecasts, going so far as to request that the QCA approve not the costs but a mechanism to "true up" the pass-through application once Stage 2 was completed. This was in order to ensure that no more was passed through to customers than was warranted.

In the time taken between ENERGEX's Supplementary Submission (October 2007) and the Draft Decision (May 2008), ENERGEX has finalised the costs for Stage 2.

ENERGEX sought to submit these Stage 2 outcomes to the QCA in February 2008, and notes that the Draft Decision indicates that any additional information provided by ENERGEX regarding its Stage 2 costs will be considered as part of the consultation process for this Draft Decision.

ENERGEX submits the finalised costs for FRC Stage 2 which are now known with certainty (Attachment 2). In addition to Attachment 2 ENERGEX provides further detail on the breakdown of costs on a commercial and in-confidence basis due to the sensitivity of contract and labour data. In the light of this information ENERGEX therefore requests that the QCA consider the detailed information to support the FRC Stage 2 implementation.

In particular, ENERGEX emphasises that Stage 2 was an integral part of providing ENERGEX with full FRC capability by:

- enhancing PEACE and further integrating it into the final systems architecture to address identified Stage 1 gaps;
- delivering an effective IT system architecture to support the desired business outcomes after the removal of FACOM;
- further automating and increasing integration between PEACE and the existing network systems to support the FRC business processes for increased volumes of market transactions; and
- developing business processes and systems to ensure compliance with the regulatory and market obligations to support street lighting contestability, which commences on 1 July 2008.

ENERGEX looks forward to the QCA's assessment of this additional information.

ENERGEX considers that it has provided the QCA with all of the necessary information for the QCA to make its decision. If the QCA believe further information is required ENERGEX will provide on request.

ENERGEX considers that:

- Stage 2 costs represent prudent network expenditure to close the gaps of stage 1 of the FRC project to reach end state.
- The Stage 2 forecasts as provided in the Supplementary Submission are now known with certainty and are eligible for pass-through (additional information has been provided with this submission to substantiate this expenditure); and
- The PBA analysis of Stage 2 costs, which assumed that Stage 2 had not started and a business decision needed to be taken on whether to commence, is no longer relevant.

3.2 Force and FACOM Expenditure

ENERGEX considers that the Draft Decision inappropriately rejects costs that have been accepted by the QCA's independent consultant. In particular, the Draft Decision rejects ENERGEX's costs of upgrading Force and FACOM when PBA, the independent expert engaged by the QCA to review ENERGEX's FRC expenditure, accepted that it was necessary and prudent to have FACOM and PEACE operating in parallel for a period of time before switching fully to PEACE. Therefore, upgrades to Force and FACOM were required for FRC. Further detailed information which outlines the nature of the functional upgrades to FACOM is provided in Attachment 3.

ENERGEX understands that:

- The recommendation from PBA was to accept that operating FACOM and PEACE in parallel was prudent, and therefore to allow the majority of ENERGEX's costs as being efficient (pages 30 and 57 of PBA report); and
- The QCA did not accept PBA's recommendation on the basis that ENERGEX's systems in place at the time of the 2005 Final Determination should have been capable of meeting ENERGEX's obligations in relation to customer transfer (page 18 of QCA Draft Decision). The QCA therefore removed all costs associated with upgrading FACOM from the cost pass-through amounts.

ENERGEX understands that the majority of PBA's time was spent reviewing ENERGEX's decision to replace FACOM with PEACE, and accordingly, ENERGEX devoted a large portion of its October 2007 Supplementary Submission to this issue. Information provided by ENERGEX led to PBA's finding that ENERGEX's decision to implement PEACE was a prudent decision.

PBA noted that running a parallel system represents a prudent decision in terms of testing the new system and the project time constraints faced by ENERGEX. PBA accepted that the two stage strategy was the most viable option open to ENERGEX (as opposed to the "big-bang" approach), and PBA indicated that the current system required augmentation to provide the functions of a parallel system (page 42 of the PBA report).

The QCA clearly disagreed with PBA's advice, as it has decided that FACOM costs cannot be passed through. However it has:

- not set out whether it agrees with PBA that the decision to install PEACE was prudent, or in the event that it does not agree, the basis on which it does not agree;
- not provided detailed reasons for disallowing the FACOM costs other than to note that ENERGEX's existing systems should have been capable of meeting FRC customer transfer capabilities; and
- not proposed how ENERGEX's existing systems could have possibly met the capability gap imposed by FRC, and, therefore, how in a practical sense, ENERGEX could have avoided this expenditure.

Contestability in Queensland prior to FRC was open to customers consuming greater than 100MWh per annum. With the opening of the market for FRC the number of customers eligible for contestability increased exponentially.

The QCA's Draft Decision suggests that ENERGEX would not have retained FACOM and instead would have migrated fully to PEACE by 1 July 2007 if the Government had not announced plans to sell the Government owned retailers. The Draft Decision also suggests that the Transition Services Agreements established between ENERGEX and the purchasers of these retailers required the use of FACOM and that this was the underlying rationale for ENERGEX's FACOM expenditure. For clarity, ENERGEX categorically states that this was not the reason for the retention of FACOM.

In the lead up to FRC and following the announcement of the Sale of the Retail businesses by the Government, ENERGEX established two distinct projects to manage both FRC implementation and the Retail sale process independently. Costs associated with each project were quarantined and recorded separately. ENERGEX's costs in its FRC claim represent the legitimate costs associated with the network preparation and implementation of FRC. Services provided to retailers were funded via the Transition Services Agreements with the retailers. Other costs were addressed as part of the overall sale process.

ENERGEX set out a number of relevant matters in its October 2007 Supplementary Submission for retaining FACOM, including the fact that there would be a need to apply a two stage process to making the necessary modifications to PEACE to enable it to service ENERGEX's network requirements and also to facilitate the cut-over from FACOM. This need arose because:

- FACOM's capability had been tailored to ENERGEX's integrated network and retail requirements over a period of 25 years and needed to be progressively separated in a co-ordinated manner.
- There was not sufficient time available between May 2006 and the start of FRC to fully replicate FACOM's network functionality into PEACE. The decision to use FACOM and PEACE in parallel was required to mitigate the risk of a "big bang" approach for market start.
- In other jurisdictions, staged approaches were adopted to the migration of data and ENERGEX considered it prudent to adopt a similar approach.

Research indicates that 70% of software implementation projects fail or do not meet their required implementation date. Given the advice of the ENERGEX consultants experienced in FRC system implementation, and the requirement to meet the market start of 1 July 2007, ENERGEX pursued a risk mitigating strategy by adopting an approach of minimal compliance for market opening and then transitioning to full capability post Go Live.

ENERGEX emphasizes that the decision to run parallel systems for network functionality was not a result of the decision by Government to sell the retail business and had nothing to do with the Transition Services Agreements (TSA). It was recognized that there would be a need to reinforce and close out gaps in PEACE in Stage 2 after 1 July 2007. This incremental strategy was decided early in the development phase on advice from experienced FRC consultants.

ENERGEX made clear to the QCA in its Supplementary Submission that the Government's decision to undertake the trade sale cemented the decision to manage the franchise customer base in FACOM and market contract customers in PEACE, However, the decision to use a two stage process was not driven by the Transition

Services Agreements as suggested in the Draft Decision. Rather, it was driven by the need to achieve FRC readiness for ENERGETEX's distribution business.

The decision to avoid a "big bang" approach was therefore prudent. For the QCA to suggest otherwise is to suggest that ENERGETEX should have taken a sub-optimal approach that would clearly not have been best for customers.

ENERGETEX therefore believes that there is no evidence or other material to justify the QCA's decision to reject FACOM and Force costs.

ENERGETEX supports PBA's analysis that it was necessary to have FACOM and PEACE in parallel for a period of time, before switching fully to PEACE, and therefore that upgrades to Force and FACOM were required for FRC.

ENERGETEX considers that the QCA in its Final Decision should:

- recognise that the decision to retain FACOM was not consequent to the TSAs;
- make clear whether it agrees with PBA's advice that the decision to install PEACE was prudent; and
- allow the costs of upgrading Force and FACOM as part of a prudent two stage approach to system implementation.

3.3 Overhead and Labour Escalation Rates

ENERGETEX does not agree with the QCA's Draft Decision in relation to overhead rates or labour escalation rates. The complexities and conflicting information associated with the assessment of these issues is highlighted in the discussion below.

3.3.1 SPARQ overhead costs

ENERGETEX understands that:

- The recommendation from PBA was that an overhead rate of 18% should be adopted for all vendors based on its knowledge of overhead rates for other IT vendors and the absence of any reason why NEMLink and SPARQ rates should be higher (pages 34-35 of PBA report); and
- The QCA accepted PBA's recommendation on the basis that 18% is consistent with the rates generally applicable in the market and has reduced ENERGETEX's allowance accordingly (page 17 of the QCA's Draft Decision).

ENERGETEX considers that the QCA and PBA's reliance on benchmarking of overhead rates is not appropriate. This is because overhead rates cannot be benchmarked with any reliability. For example in the case of distribution network service providers (DNSPs) different approaches and definitions are adopted, particularly in relation to the definition of direct versus overhead expenditure. In some cases, a direct cost for one DNSP may be an indirect cost for another. This is particularly relevant for some of the complex ownership arrangements in the southern States, which involve multiple asset owners being serviced by one asset manager.

Further, the same DNSP may take a different approach to the definition of direct versus overhead expenditure from one year to the next. This could be a result of changes to its organisational structure or the methodology of the cost accounting processes adopted, although ENERGEX notes that it is not able to make such changes under the QCA's existing cost allocation arrangements.

ENERGEX also notes that the method of "recovery" is inextricably linked with the nature of an "overhead rate". While one DNSP might establish a rate that is applied to operations and capital expenditure, another might simply allocate a bucket of costs to a project that is not "rate based". Yet another DNSP might establish a rate that is applied only to capital expenditure.

Finally as with all benchmarking studies, the individual geographic characteristics of DNSPs, which in-turn impact on the nature, type and relative size of costs incurred, make data, particularly expenditure based data, difficult to meaningfully compare.

ENERGEX considers that these factors make any benchmarking of overhead rates highly contentious, and for that reason believes that PBA should be required to provide more detail as to why it believes that 15-20% is a reasonable range of overheads.

ENERGEX notes that Western Power's expenditure submission to the Western Australian Economic Regulation Authority (ERA) as part its current access arrangement included a benchmarking study. This study compared corporate overhead costs as a percentage of total operating expenditure. It found that:

- Western Power's overhead rate was around 25%;
- Country Energy's overhead rate was around 49.4%;
- Energy Australia's overhead rate was around 26.7%; and
- Westar, MultiNet and Stratus gas distribution businesses overhead rates in Victoria ranged from 20% to 30%.

Western Power's report notes that *"The above figures would appear to indicate that corporate cost allocations of between 20% and 30% of overall operating and maintenance costs would be an indication of industry expectations. Country Energy's levels appear to be inconsistent although it has not been possible to fully ascertain the reasons behind its high levels"*.³

Furthermore, ENERGEX queries on what basis the QCA believes that its rate is outside of a reasonable range when its 2004 review of ENERGEX's expenditure submission found that ENERGEX's overall overhead rate was around 30% of total operating and capital expenditure. BRW, which provided expert advice to the QCA during that process, commented that in its experience:

"ENERGEX's overhead rate is in the mid range for electricity distributors and appears to be reasonable on that basis".⁴

³ Western Power's Capital and Operating Expenditure Program For The South West Interconnected Networks, March 2007, page 44

⁴ Burns and Roe Worley, *Capital and Operating Expenditure Study for Distribution Network Service Providers in Queensland – ENERGEX, Final Report*, 14 December 2004, page 50. Found at http://www.qca.org.au/files/Consultantreport_BRW_Energex_draftdetermination.pdf

ENERGEX considers that the QCA should allow the proposed SPARQ overhead rate to be used because it relates to prudent and efficient costs and is consistent with the overhead rate accepted by the QCA as part of its 2005 Final Determination.

3.3.2 On-going labour costs

ENERGEX understands that:

- The recommendation from PBA was that labour rates should not be escalated by 4.5% per annum because such increases in wages should be offset by productivity improvements. Rather, the QCA's Final Determination inflation rate of 2.76% should be used (page 76 of PBA report); and
- The QCA accepted PBA's advice regarding the escalation of labour cost components being limited to CPI, rather than the higher rate included in ENERGEX's enterprise bargaining agreement, in light of productivity gains that could reasonably be expected. The QCA stated that the CPI rate in its 2005 Final Determination is 2.5% (refer page 22 of QCA's Draft Decision).

ENERGEX considers that the proposed labour escalation rate of 4.5% per annum is in line with ENERGEX's expiring enterprise bargaining agreement. It is therefore only seeking to include costs that will actually be incurred. ENERGEX's proposed labour escalation rate is net of productivity improvements which are factored into the numbers of personnel required for FRC. This is the most direct way of taking productivity improvements into account as ENERGEX has only included labour that it believes it will need to provide the necessary functionality. It should be noted that ENERGEX's wage costs will rise by significantly more than CPI in 2007-08 to 2009-10.

ENERGEX notes that the QCA wrongly state that the CPI rate in its 2005 Final Determination was 2.5% per annum - rather it is 2.76% per annum.

In any event, the actual inflation rate in Queensland has exceeded 2.76% per annum in recent years and is forecast to exceed this amount in the coming years. PBA provided advice to the AER in December 2006 in relation to Powerlink's operating expenditure that indicated:

- Statistics released by the ABS in March 2006 indicate a 5.9% annual increase for electricity, gas and water supply workers in the short term;
- Average weekly earning (AWE) deflators of between 3.75% and 4% are being used by actuaries to predict longer term wage impacts;
- PBA has examined AWE historical data for Queensland full-time adult workers total earnings and found that the average compound increase has been 4.6% over the last 10 years; and
- PBA recommended to the AER that labour costs increase by 5.82% in 2007-08 and 5.6% in 2008-09 and 2009-10.⁵

A report prepared by EconTech on labour costs growth forecasts for the AER in August 2007 also compared wage growth forecasts for Queensland and Australia

⁵ Refer page 155 - <http://www.aer.gov.au/content/index.phtml/itemId/707570>

from EconTech, BIS and Access Economics. All of these organisations' forecasts are considerably higher than the QCA's Draft Decision and indicate that ENERGEX's proposed labour escalation rate is well within the reasonable range.⁶

Against this background, ENERGEX believes that the QCA should reassess the decision on this issue.

ENERGEX considers that the QCA should apply a 4.5% annual labour escalation rate because it is market supported and consistent with a prudent and efficient service provider.

3.4 1% Materiality Threshold

While PBA recommended that all of ENERGEX's prudent and efficient 2005-06 and 2006-07 costs be accepted, the QCA rejected PBA's recommendation on the basis that ENERGEX's 2005-06 and 2006-07 costs do not satisfy the QCA's materiality threshold on a pass-through event of 1% of aggregate annual regulated revenue.

The QCA's 2005 Final Determination indicates that the purpose of providing a general cost pass-through mechanism is to allow costs associated with major unforeseen events beyond the distributors' control to be passed to customers immediately. It has been clearly established that FRC qualifies as such an event.

The QCA's 2005 Final Determination also established a materiality threshold to apply to pass-through events. That materiality threshold was set at 1% of aggregate annual regulated revenue per event, based on the regulated revenue in the year of the event. The QCA's 2005 Final Determination suggests that the materiality threshold was introduced to limit the number of small pass-through claims (where the regulatory costs of administering the pass-through arrangements may be higher than the value of the claim). Specifically, the 2005 Final Determination notes that "(t)he Authority does not consider relatively minor events should be considered for pass-through"⁷.

ENERGEX considers that the QCA's rationale for the application of a materiality threshold (i.e. limiting pass-through applications for minor events) does not apply in the case of ENERGEX's FRC cost pass-through application. ENERGEX's FRC cost pass-through application represents a single large event (presented in a single pass-through application) whose proposed costs are significant (i.e. not "minor" and considerably higher than the costs associated with administering the pass-through arrangements).

Further, ENERGEX believes that the QCA's decision to apply a 1% materiality threshold to each year's aggregate annual regulated revenue is unreasonable. For example, the application of the QCA's materiality threshold could lead to a situation whereby an entire pass-through claim is rejected as immaterial simply because its costs are spread over 4 years, while a claim of similar total magnitude is assessed as material because its cost and revenue impacts are concentrated in 2 years. It is entirely arbitrary, because whether costs fall before or after 30 June in a year has very little to do with the materiality of those costs.

⁶ Refer page 44 and 36-37 - [http://www.econtech.com.au/information/Forecast/Econtech_-_Labour_costs_growth_forecasts_\(13_August_2007\).pdf](http://www.econtech.com.au/information/Forecast/Econtech_-_Labour_costs_growth_forecasts_(13_August_2007).pdf)

⁷ QCA *Final Determination: Regulation of Electricity Distribution* (May 2005), page 49.

ENERGEX believes that the QCA's materiality threshold has been inappropriately applied to ENERGEX's FRC costs. The materiality threshold was originally intended to prevent the QCA from having to assess a very small pass-through application for a very small event, not used to block one year of a multi-year cost consequent to a major unforeseen event (i.e. FRC).

Accordingly, ENERGEX believes that it is unreasonable for the QCA to reject ENERGEX's prudent 2005-06 and 2006-07 costs on the basis of the materiality threshold adopted by the QCA.

ENERGEX considers that the materiality of ENERGEX's FRC costs should be assessed on the basis of the materiality of the event rather than the annual revenue impact. This approach recognises the magnitude of the event in an aggregate context rather than a year by year assessment. ENERGEX believes that this approach is consistent with the intent of the materiality threshold in the 2005 Determination and is consistent with that recently proposed by the AER.

As part of its process for determining materiality for possible pass-through events for ACT and NSW DNSP's, the AER's preliminary position was to deem a pass-through event material if the revenue from the event exceeds 1% in any one of the remaining years of the regulatory period. The AER noted that the adoption of this threshold allows events to be passed through which have a "spike" in expenditure in any year⁸.

ENERGEX considers that:

- It is unreasonable for the QCA to reject ENERGEX's prudent 2005-06 and 2006-07 costs on the basis of the materiality threshold adopted by the QCA. ENERGEX considers this to be inconsistent with the intent of the materiality threshold in the 2005 Final Determination; and
- The materiality of ENERGEX's FRC costs should be assessed on the basis of the materiality of the event rather than the annual revenue impact.

3.5 Asset lives

While PBA has accepted ENERGEX's proposal to adopt a five year life for SPARQ assets, the QCA has rejected PBA's recommendation and increased the asset lives to ten years.

ENERGEX understands that:

- The recommendation from PBA was to accept a five year asset life for SPARQ assets as being in the reasonable range of asset lives (pages 66-68 of PBA report); and
- The QCA rejected PBA's recommendation and increased the lives for SPARQ assets from five to ten years because it considered:
 - An assumed asset life of five years is insufficient;

⁸ AER *Preliminary Positions: Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014 - Approach to determining materiality for possible pass through events* (December 2007).

- Five years is not in line with asset lives attributed to major IT assets in other contexts; and
- Five years is not in line with the assets lives for major IT assets already in ENERGEN's regulatory asset base (page 18 of QCA Draft Decision).

ENERGEN does not agree with the QCA's Draft Decision and considers that:

- There is no evidence or other material to justify the QCA's decision. Rather, it has simply made an assertion about IT asset lives based on those that have been applied in its FRC cost pass-through assessment of Envestra's gas network;
- PBA's report indicated that a five year asset life for IT assets is within the reasonable range. By choosing ten years, the QCA has chosen to adopt an asset life at the top of PBA's range and has failed to provide a defensible justification for doing so; and
- In any event, a ten year asset life is inconsistent with that used in ENERGEN's regulatory asset base (as approved by the QCA) for IT assets.

As such, ENERGEN believes that it is unreasonable for the QCA to reach the conclusion set out in the Draft Decision.

In addition, ENERGEN considers that the Draft Decision should address the QCA's understanding with regard to the treatment of approved cost pass-through amounts which extend into the next regulatory period. This is particularly relevant given the transfer of regulatory responsibilities from the QCA to the AER at the next regulatory reset. At the moment, the QCA has assumed that ENERGEN will be allowed to recover its legitimate pass-through allowance in subsequent regulatory periods on the same basis as it is recouped in the current regulatory period. While it is possible that the AER may accept the roll-forward of IT assets on a ten year life in the roll-forward model (including potentially not recognising these amounts), there is no guarantee that this will occur and indeed evidence to date is that an amount less than this would be applied.

The QCA cannot bind the AER under the NER and it therefore cannot simply assume that ENERGEN will receive a revenue allowance in the next regulatory period for FRC-related costs. In particular, by increasing the IT asset lives from 5 to 10 years, the QCA should make clear how it believes that ENERGEN will recover the full cost of the asset in NPV terms – in particular why it believes that the AER would allow these assets to be rolled into the asset base using a ten year life in the absence of any specific guidance to do so from the QCA.

ENERGEN requests that the QCA reconsider its treatment of SPARQ's IT assets in its Final Decision and:

- Apply a five year asset life to these assets on that basis that it is within the reasonable range identified by PBA, is consistent with its recommendation, and there is no clear justification for applying a longer period; and
- Make clear how it believes that ENERGEN will recover the full cost of its asset in NPV terms so that financial capital maintenance will be preserved in relation to these assets between regulatory control periods.

ENERGEX considers that the QCA should apply a five year asset life for SPARQ's IT assets, rather than the ten year asset life that it used in the Draft Decision, because it is within the reasonable range accepted by PBA for IT assets.

3.6 Other matters

ENERGEX has identified a range of other matters associated with the QCA's Draft Decision. These are addressed below.

3.6.1 Architecture and design

ENERGEX understands that:

- The recommendation from PBA was that, without a detailed explanation of costs, only two senior SPARQ personnel and two senior Accenture personnel should have been required to perform architecture and design tasks rather than four Accenture and four SPARQ personnel as submitted by ENERGEX (page 66 of PBA report); and
- The QCA accepted PBA's recommendation, despite not referencing it in its Draft Decision or providing any analysis, and has not included the cost in Table 8 of the Draft Decision.

ENERGEX does not agree with PBA's assessment or with the QCA's Draft Decision on this matter. ENERGEX holds this view because:

- ENERGEX and SPARQ did the work required for FRC with scarce resources and outsourced work where it did not have the resources or, alternatively, the specialist skills. Accenture provided specialist skills that were required by ENERGEX and SPARQ for FRC; and
- PBA assessed the decision to engage Accenture on page 30 of its Report. They noted that Accenture was retained under a competitive process and their use was "a prudent decision" that was part of the selection of a "solution that can be delivered on time".

PBA's assessment that the work could have been delivered by a cheaper configuration of staff and resources ignores the reality that these tasks were delivered in "real time" in an environment of competing demands for internal resources. If the task could have been delivered on time by fewer resources, given all other competing demands, ENERGEX and SPARQ would have done this. There was no incentive to apply more resources to the architecture and design work than was prudent and efficient.

ENERGEX believes that there is no evidence or other material to justify the making of this decision. In particular, PBA has not considered what internal resources were available at the time that this work was being undertaken, and whether there were the types of SPARQ resources available that PBA believes could have delivered these tasks.

Furthermore, ENERGEX notes that the QCA has not made clear the basis on which it has accepted PBA's recommendation and rejected ENERGEX's costs.

ENERGEX believes that the QCA should allow ENERGEX's full architecture and design costs. There was no incentive to apply more resources to the architecture and design work than was prudent and efficient and specialist skills were required.

3.6.2 2006-07 Accenture costs

ENERGEX understands that:

- The recommendation from PBA was to apply a 50% reduction in 2006-07 Accenture business delivery costs because it considered that one rather than two consultants should have been used for each project stream (pages 45-46 of PBA report); and
- The QCA accepted PBA's recommendation to reduce 2006-07 Accenture costs by \$2.6 million (refer page 18 of QCA Draft Decision).

ENERGEX considers that the QCA should allow it to recover the full 2006-07 Accenture costs. In particular:

- ENERGETEX and SPARQ did the work required for FRC with scarce resources, using its most valuable in-house management and resources for its most valuable tasks and workstream, and outsourced work where it did not have the resources or alternatively the specialist skills. Accenture provided specialist skills that were required by ENERGETEX and SPARQ for FRC;
- PBA assessed the decision to engage Accenture on page 30 of its Report. They noted that Accenture was retained under a competitive process and their use was "a prudent decision" that was part of the selection of a "solution that can be delivered on time"; and
- The PBA analysis assumes that if fewer Accenture staff were employed to undertake these tasks, then the same quality product could have been produced without impacting on other aspects of the FRC preparation process. This is an assumption which simply should not be made and cannot be proven on an *ex-post* basis. If the task could have been delivered on time by fewer resources, given all other competing demands, ENERGETEX would have done this – ENERGETEX had no incentive to apply more resources to the work than was prudent and efficient.
- ENERGETEX believes that there is no evidence or other material to justify the making of this decision. In particular, PBA has not considered what internal resources were available at the time that this work was being undertaken, and whether there were the types of SPARQ resources available that PBA believes could have delivered these tasks.

Furthermore, ENERGETEX notes that the QCA stated on page 18 of its Draft Decision that

"Given the extensive use of IT consultants from numerous external sources, including from ENERGETEX's half owned specialist IT provider SPARQ, the Authority agrees with the advice from PBA that these costs are excessive and do not represent prudent and efficient costs".

ENERGETEX considers that the reasons provided by the QCA for accepting PBA's recommendation are not relevant to the prudence or efficiency of ENERGETEX's claim to recover legitimately incurred Accenture costs.

ENERGEX considers that the QCA should allow the full ENERGETEX 2006-07 Accenture costs to be recovered on the basis that these costs are prudent and efficient. There was no incentive to apply more resources than necessary and Accenture provided specialist skills that were required by ENERGETEX and SPARQ for FRC.

3.6.3 CVU-IVR

ENERGEX understands that the recommendation from PBA was to accept ENERGETEX's cost claim in relation to the CVU-IVR (page 64 PBA report), and notes that the QCA appears not to have included an allowance for the recovery of 2007/08 CVU-IVR costs in its Draft Decision.

ENERGEX considers that there has been an oversight in the Draft Decision in that it has not specifically addressed the matter of ENERGETEX's CVU-IVR costs and, as a consequence, these costs have been left out in the calculation of the pass-through amounts.

ENERGEX considers that the QCA should allow the full CVU-IVR costs to be recovered on the basis that these costs are prudent and efficient.

3.6.4 Staff levels

ENERGEX understands that the recommendation from PBA was that ENERGETEX should constrain its labour costs for 2008-09 and 2009-10 to 2007-08 levels (page 76 of PBA report). The QCA provided no discussion in its Draft Decision about the issues of whether labour costs for 2008-09 and 2009-10 should be constrained to 2007-08 levels but has reflected these cost reductions in table 12 (refer page 23 of QCA's Draft Decision).

ENERGEX notes that the information in its Supplementary Submission about staff levels relates to full-time equivalents (FTEs), which represent the annual equivalent of an employee. Due to ENERGETEX continuing to recruit staff through the first half of 2007-08, these statistics would not reflect the same FTE count as in 2008-09 and 2009-10, which relate to employment for the full year. Consequently, the cost of staff will increase in 2008-09 and 2009-10, simply due to all staff being employed for the full year rather than part of the year.

As a consequence, in its Supplementary Submission, ENERGETEX's headcount at the end of June 2008 is carried forward in subsequent years. The information ENERGETEX supplied does not escalate staff numbers beyond 2007-08 – rather, the 2007-08 headcount is maintained in future years.

ENERGEX considers that information provided on this matter requires clarification. ENERGETEX definitely has not increased staff levels beyond 2007-08. ENERGETEX considers the QCA should allow the on-going labour costs as claimed because these costs are prudent and efficient and are based on carrying forward the 2007-08 staff levels, not increasing them.

4. ATTACHMENT 1 – DVD TITLED “FRC, THE WAY FORWARD”

DVD Attached

5. ATTACHMENT 2 – FINALISED STAGE 2 COSTS

The FRC Stage 2 Project was required in order to deliver enhanced systems and process capability to support changes in business processes as a result of the full migration of premises and standing data from FACOM to PEACE. The phased approach to system upgrades was decided as a risk mitigating strategy to ensure network capability for market start. PEACE was enhanced and further integrated into the final systems architecture to address the identified Stage 1 gaps, reducing duplication of effort and delivering an effective IT system architecture to support the desired business outcomes after the removal of FACOM.

Further automation and increased integration between PEACE and the existing network systems was required to support the FRC business processes. SPARQ is the key supplier and was responsible for the design, build and implementation of required information systems.

Key tasks that were undertaken in Stage 2 included:

- **Street Lighting Contestability** - The development of business processes and systems to ensure compliance with the regulatory and market obligations to support street lighting contestability, which commences on 1 July 2008 and the subsequent development of inventory management processes for streetlights and unmetered supplies.
- **Market Transactions** - The development of business processes and systems to allow for the increased volumes of market transactions resulting from customer churn; and
- **Full Data Migration** - The full migration of premises and network customer data from FACOM to PEACE;

This required ENERGEX to:

- Upgrade PEACE, ArcFM, TOHT and Advantex to support system functionality previously delivered in a limited capacity by FACOM;
- Define and implement the upgrade to the next version of PEACE (V8.09);
- Increase the integration between PEACE and existing network systems; and
- Modify business processes and people capability.

ENERGEX has now substantially completed Stage 2 of its FRC capability implementation, and the associated costs for this work are finalised. The following tables provide more detailed information for Stage 2 costs similar to that provided in ENERGEX's Supplementary Submission for Stage 1.

Table 1 - Final Cost Summary for FRC Stage 2

Project Implementation (Stage 2)		2007/08	2008/09	2009/10	Total
Project Management & Implementation Costs					
Labour - Internal	Table 3	583	-	-	583
Labour - Contract	Table 3	600	-	-	600
Other Project Administration Costs	Table 3	70	-	-	70
		1,253	-	-	1,253
IT & Business Systems					
SPARQ (ICT) - Asset Service Charge	Table 5	876	5,072	4,752	10,700
Operating Costs					
IT & Business Systems Maintenance					
Peace Post Production Support Contract	Table 4	470			470
Annual Hardware / Software Support Licence	Table 4	245	245	245	735
Data Extraction and Migration capability - FACOM	Table 4	480			480
Post Go Live Enhancements & Design error rectification	Table 4	594			594
		1,789	245	245	2,279
Total FRC Costs Stage 2		3,919	5,317	4,997	14,232

Table 2 - Final IT Systems Capital Expenditure (including Stage 2)

Asset	2005/06 - Actual	2006/07 - Actual	Stage 1 Total	2007/08 - Actual (Stage 2)	Total FRC CAPEX
FDU - Peace	\$2,215,300	\$13,213,798	\$15,429,098	\$9,488,137	\$24,917,235
Labour					
Peace	\$792,878	\$5,681,898	\$6,474,776	\$5,430,108	\$11,904,884
Accenture	\$1,303,496	\$4,880,503	\$6,183,999	\$943,007	\$7,127,007
ENERGEX	\$106,480	\$1,132,620	\$1,239,100	\$1,296,345	\$2,535,445
SPARQ	\$12,446	\$1,398,242	\$1,410,688	\$1,569,927	\$2,980,615
Software	-	\$120,535	\$120,535	\$248,750	\$369,285
Hardware	-	\$862,737	\$862,737	\$642,456	\$1,505,193
TOHT	\$662,803	\$3,630,674	\$4,293,477	\$1,727,941	\$6,021,418
Labour					
Datec	\$97,014	\$763,695	\$860,709	\$612,420	\$1,473,129
Accenture	\$521,398	\$1,338,751	\$1,860,150	\$345,850	\$2,206,000
ENERGEX	\$31,944	\$258,991	\$290,935	\$260,282	\$551,217
SPARQ	\$12,446	\$1,269,237	\$1,281,683	\$501,389	\$1,783,072
Software	-	-	-	\$8,000	\$8,000
Hardware	-	\$202,448	\$202,448	\$53,538	\$255,986
NEMLink	\$91,804	\$797,380	\$889,184	-	\$889,184
Labour					
Accenture	\$65,175	\$97,536	\$162,711	-	\$162,711
BEA	\$9,758	-	\$9,758	-	\$9,758
ENERGEX	\$10,648	-	\$10,648	-	\$10,648
SPARQ	\$6,223	\$699,843	\$706,066	-	\$706,066
Force	\$92,694	\$276,152	\$368,845	-	\$368,845
Labour					
Accenture	\$65,175	\$54,412	\$119,587	-	\$119,587
ENERGEX	\$21,296	\$69,089	\$90,385	-	\$90,385
SPARQ	\$6,223	\$152,650	\$158,873	-	\$158,873
Facom	\$470,482	\$4,363,120	\$4,833,602	-	\$4,833,602
Labour					
Accenture	\$260,699	\$225,846	\$486,545	-	\$486,545
ENERGEX	\$10,648	\$289,959	\$300,607	-	\$300,607
SPARQ	\$199,135	\$3,847,315	\$4,046,450	-	\$4,046,450
Software	-	-	-	-	-
Hardware	-	\$49,700	\$49,700	-	\$49,700



Asset	2005/06 - Actual	2006/07 - Actual	Stage 1 Total	2007/08 - Actual (Stage 2)	Total FRC CAPEX
FFA-FRC	-	\$1,982,810	\$1,982,810	\$956,754	\$2,939,564
Labour					
TUSC	-	\$1,038,400	\$1,038,400	\$46,374	\$1,084,774
Accenture	-	\$24,096	\$24,096	\$85,245	\$109,341
ENERGEX	-	\$86,814	\$86,814	\$115,645	\$202,459
SPARQ	-	\$775,900	\$775,900	\$667,190	\$1,443,091
Software	-	\$57,600	\$57,600	\$42,300	\$99,900
Hardware	-	\$8,600	\$8,600	\$107,076	\$115,676
ArcFM	-	\$2,537,620	\$2,537,620	\$1,687,913	\$4,225,533
Labour					
ESRI	-	\$802,076	\$802,076	\$222,312	\$1,024,388
Accenture	-	\$433,491	\$433,491	\$226,921	\$660,412
ENERGEX	-	\$367,665	\$367,665	\$515,610	\$883,275
SPARQ	-	\$710,567	\$710,567	\$723,071	\$1,433,638
Software	-	\$223,820	\$223,820	-	\$223,820
Hardware	-	\$76,996	\$76,996	\$107,076	\$184,072
Integration	\$620,850	\$5,159,517	\$5,780,367	\$1,840,535	\$7,620,902
Labour					
BEA	\$185,411	\$1,576,681	\$1,762,092	-	\$1,762,092
Accenture	\$391,049	\$2,912,374	\$3,303,423	\$537,008	\$3,840,431
ENERGEX	\$31,944	\$29,227	\$61,171	\$133,366	\$194,537
SPARQ	\$12,446	\$472,072	\$484,518	\$950,848	\$1,435,366
Software	-	\$169,164	\$169,164	\$219,313	\$388,477
Hardware	-	\$114,521	\$114,521	\$107,076	\$221,597
Reporting	-	\$533,600	\$533,600	\$89,008	\$622,608
Labour					
Accenture	-	\$24,096	\$24,096	-	\$24,096
ENERGEX	-	\$349,849	\$349,849	-	\$349,849
SPARQ	-	\$158,672	\$158,672	\$89,008	\$247,679
Software	-	\$984	\$984	-	\$984
TCE	-	\$508,054	\$508,054	-	\$508,054
Labour					
ENERGEX	-	\$70,753	\$70,753	-	\$70,753
SPARQ	-	\$425,891	\$425,891	-	\$425,891
Software	-	\$11,410	\$11,410	-	\$11,410
Hardware	-	\$71,545	\$71,545	-	\$71,545
GUS	-	\$291,653	\$291,653	-	\$291,653
Labour					
ENERGEX	-	-	-	-	-
SPARQ	-	\$291,653	\$291,653	-	\$291,653
EMAS	-	\$188,396	\$188,396	\$65,018	\$253,415
Labour					
ENERGEX	-	-	-	-	-
SPARQ	-	\$188,396	\$188,396	\$65,018	\$253,415
SLIM	-	-	-	\$1,163,433	\$1,163,433
Labour					
Accenture	-	-	-	\$248,262	\$248,262
ENERGEX	-	-	-	\$346,076	\$346,076
SPARQ	-	-	-	\$569,095	\$569,095
Software	-	-	-	-	-
Hardware	-	-	-	\$53,538	\$53,538
Total	\$4,153,933	\$34,869,320	\$39,023,253	\$18,089,500	\$57,112,752

Streetlight Inventory Manager (SLIM) – receives a detailed inventory from NFM (Detailed Inventory Source) for all lights and sundry devices. Each device is processed on ‘add’, ‘change’, or ‘delete’ to determine if it is contestable or not, what NMI it should be allocated to and other PEACE related attribute values. The system provides an updated inventory to PEACE and TOHT on a monthly basis to enable Network billing and also for the purpose of publishing final reading information to the market via TOHT to meet MDP obligations.

Table 3 - Stage 2 Project Management and Implementation Costs

Labour – Internal	FRC Project management and administrative team labour costs, including key ENERGEX staff with specialist knowledge of ENERGEX's business and processes impacted by FRC. Where these staff were sourced internally, backfilling of their previous role was a requirement for recognition as an incremental FRC expense. Further detail is provided in Table 6 of the confidential data pack.
Labour - Contract	External contractors with FRC knowledge and experience in the management of significant and complex implementation projects. Further detail is provided in Table 6 of the confidential data pack.
Project Administration Costs	Project expenses incurred for staff amenities, travel, training and stationery. Further detail is provided in Table 7 of the confidential data pack.

Table 4 – IT & Business Systems Maintenance Costs

Expense	Description
PEACE Post Production Support	This is the warranty period for the implementation and also provides a two month window to enable the transition of the solution from the project into SPARQ for ongoing support. Under this arrangement the PEACE project team will close out the majority of P3/P4 defects identified prior to go live, and rectify any P1/P2 that may have arisen post go live. Subsequent to this period, defects will be raised via the standard PEACE Support arrangements. Further detail is provided in the confidential data pack.
Annual Hardware / Software Support Licences	Hardware and Software support licences required to support Stage 2 IT Assets Further detail is provided in Table 3 of the confidential data pack.
Data Extraction and Migration - FACOM	This represents the effort expended in the full migration of Network information from FACOM to PEACE. The work included the creation of a range of extract and conversion routines, leveraging some of the trickle feed logic from stage 1. The extracts covered the full set of NMIs remaining in FACOM which had not transferred to PEACE via the trickle feed mechanism as a consequence of a market transfer. Some 1,035,167 NMIs and their associated data were successfully transferred to PEACE via this mechanism. Further detail is provided in Table 4 of the confidential data pack.
Post Go-Live Enhancements and Error rectification	Subsequent to the go live of the day 1 FRC solution on 1 July 2007, there were a number of issues causing the trickle of NMIs from FACOM to PEACE to fail. These were generally associated with complex metering at a site or other permutations of site and metering information that the trickle feed mechanism had not been specifically designed to handle. From 1 July 2007 a wide range of data analysis and consequential fixes were applied to FACOM to enable NMIs to successfully trickle to PEACE. Further detail is provided in Table 5 of the confidential data pack.



Table 5 - SPARQ (ICT) – Asset Service Charge Stage 2

	07/08			08/09			09/10		
	Depreciation	Return On Asset	Total	Depreciation	Return On Asset	Total	Depreciation	Return On Asset	Total
PEACE	316,271	131,055	447,326	1,897,627	692,239	2,589,866	1,897,627	530,940	2,428,568
TOHT	57,598	23,867	81,465	345,588	126,068	471,656	345,588	96,693	442,281
FFA-FRC	31,892	13,215	45,107	191,351	69,803	261,154	191,351	53,538	244,889
ArcFM	56,264	23,314	79,578	337,583	123,147	460,730	337,583	94,453	432,035
Integration	61,351	25,422	86,774	368,107	134,282	502,389	368,107	102,993	471,100
Reporting	2,959	1,226	4,185	17,755	6,477	24,231	17,755	4,968	22,722
EMAS	2,167	898	3,065	13,004	4,744	17,747	13,004	3,638	16,642
SLIM	38,781	16,070	54,851	232,687	84,882	317,569	232,687	65,104	297,790
Hardware	59,487	14,537	74,024	356,920	69,525	426,445	356,920	39,187	396,107
Total	626,770	249,605	876,375	3,760,621	1,311,167	5,071,788	3,760,621	991,514	4,752,135

6. ATTACHMENT 3 – FACOM UPGRADES FOR NETWORK CAPABILITY

Prior to the introduction of FRC the FACOM system was a vertically integrated Network/Retail solution underpinned by a single shared data repository. Given its history, it provided little support for the Network's market obligations under FRC, rather it provided:

- Limited support for NEMMCO MDP requirements
- Limited support for NEMMCO MPB requirements
- No market connectivity capability
- No XML capability
- No concept of customer transfer
- No concept of market participant or associated roles
- No support for the publication of standing data

In order to support FRC, a split FACOM/PEACE architecture was implemented. This strategy was chosen independently of the Trade Sale process, and prior to the Queensland Governments announcement of the trade sale. This enabled the Network business to:

- meet its market obligations for the market opening, minimising risk of system failure;
- continue to leverage FACOM under low churn volumes, with updated business processes and system components;
- transition to the PEACE system over an extended period
 - lessening the change impact across the business
 - allowing PEACE time to develop system changes for full NMI volumes and other functional gaps in the then current version 8.05; and
- prepare separately for Streetlight contestability.

Consequently, a range of changes were made to FACOM to support this Network strategy for 1 July 2007.

Functionality	Description
Standing Data Load, Maintenance and Publication	The market is underpinned by standing data that is provided and maintained by the network business. The FACOM system, as the predominant repository of this data, was enhanced to provide an initial data load to populate the NEMMCO system, via the PEACE NMI Master Repository (NMR). This included the initial assignment of participant information which was not required pre-FRC and capability to maintain this ongoing. Change capability was also developed in the FACOM to detect standing data changes made as part of normal business operations (eg. Meter installs / replacements, service energisation / de-energisation). These changes were provided to the PEACE NMR to enable subsequent publishing to the market.

Functionality	Description
	With the NMIs split across FACOM and PEACE changes were also required to stop FACOM providing churned NMI information across external interfaces as this information would be coming from PEACE (eg. CMS/CVU).
B2B - New Connection Processing	While NMIs remained in FACOM, the service order processing capability remained largely unchanged with the exception of the introduction of Network Product codes for network billing purposes, and changes required for the new connection process as these would all come via the Market. Capability was developed in FACOM to process the new connection requests forwarded from PEACE and subsequently transfer the newly created NMI and associated standing data into PEACE for publication to the market.
CATS – Transfers	The concept of market transfers required the development of capability in FACOM to record a pending transfer and action this through cancellation or completion of the transfer based on notification from the market after a physical meter read. From a network perspective this triggered the transfer of the NMI and associated standing data information to the PEACE system (trickle feed), which would manage all aspects of market interactions for that NMI moving forward.
Route and Reading Management	<p>There was a significant gap between the existing FACOM capability and that of the PEACE route and reading management functionality. While these changes were being made to PEACE 8.09, FACOM remained the master of route and reading management. This required changes to the FACOM to enable it to:</p> <ul style="list-style-type: none"> • generate NMI suffixes as a component of NEMMCO standing data. • manage routes and reading sequences including NMIs that had gone to market and hence transferred to PEACE. • generate a master MV-RS download reading file with appropriate slots for PEACE based NMIs. This file would be merged with the MV-RS file from PEACE to provide the composite MV-RS file, and split into separate files on upload. • modify the meter reading and statistics reporting
NMI Billing for uniform tariff	The FACOM system prior to FRC was fundamentally a retail billing engine. Consequently, an independent network billing capability (Force) was developed to cater for the billing of multiple retailers in FACOM. Changes were made to FACOM to include network product codes and network tariff codes, and a monthly extract functionality was developed to enable network billing of NMIs through FORCE. This billing information was combined within the PEACE solution to issue a single set of NMI invoices per retailer.