



Submission to the Queensland
Competition Authority on ENERGEX's
Supplementary FRC Cost Pass-through
Application

October 2007

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1. INTRODUCTION

1.1 Purpose

The purpose of this submission is to provide an Origin response to the Queensland Competition Authority ("QCA") in relation to ENERGEX's supplementary application for the pass-through of costs relating to the introduction of full retail competition ("FRC") in Queensland.

1.2 Background

On 7 March 2007, the QCA released a public version of ENERGEX's FRC cost pass-through application ("original application") for consultation with market participants and consumers. ENERGEX submitted this application in response to a decision made by the Queensland Government in September 2005 to introduce FRC for electricity customers from July 2007. In this application, ENERGEX sought the cost pass-through of an additional \$117.1M for FRC costs in the current network regulatory period. \$35.3M related to stage 1 FRC project implementation costs and \$81.8M to stage 1 ongoing FRC operational costs¹.

On 4 October 2007, the QCA released a supplementary FRC cost pass-through application ("supplementary application") by ENERGEX. This was in response to a number of questions that the QCA and relevant stakeholders raised around the robustness of ENERGEX's original application. Origin understands that ENERGEX's supplementary cost pass-through application is seeking to recover approximately:

- \$70.3M in stage 1 operational and implementation costs. This represents a reduction of approximately \$47M from the original application and includes the exclusion of services related to non-DUOS costs; and
- \$15M in stage 2 FRC Implementation Costs. These are only forecast costs and relate largely to system enhancements.

Outlined below are some general comments and concerns that Origin has with ENERGEX's supplementary application.

1.3 General Comments

Origin commends the QCA on conducting a thorough review of the costs submitted by ENERGEX for the pass-through of costs relating to FRC. Origin believes that the consultation process and a forensic review of costs will ensure that only prudent, efficient and incremental costs are passed through to customers as part of the application. The success of FRC is reliant on the benefits that can be realised by consumers.

Further, Origin is pleased that ENERGEX has provided more data and information relating to its FRC costs in its supplementary application. This allows relevant stakeholders to make a more informed judgement on the appropriateness of the costs associated with FRC. Origin supports ENERGEX receiving a reasonable recovery of its FRC expenses and their intent to ensure that adequate investment in FRC systems, people and processes is undertaken to manage market transactions between retailers and consumers.

Although ENERGEX's supplementary application provides more detail about the implementation and operational costs of FRC, Origin notes that there are some significant differences in the costs and reasoning for recovering the FRC expenses. This raises some concerns for Origin with regards to the robustness and capabilities of ENERGEX to

¹ ENERGEX, *FRC Cost Pass-through Application – February 2007*, p1

accurately account for the costs incurred as a result of FRC. As stated in Origin's previous submission, the recovery of FRC costs by ENERGEX should be limited to only those that are:

- directly attributable to the activities and tasks pursuant to FRC; and
- directly attributable to meeting the obligations that arise as a consequence of the legal and regulatory framework for FRC.

The pass-through of costs should not include:

- any costs associated with the sale of Sun Retail Pty Ltd or the separation of the retail business from the network business;
- expenditure that would have been incurred by ENERGEX in any event (ie day to day processes); or
- general business improvement costs.

Origin urges the QCA to further undertake an investigative and forensic analysis of the data submitted by ENERGEX.

1.3.1 Cost Variations

As stated above, there appears to be some substantial differences in the quantum of costs that ENERGEX is seeking to claim as part of the FRC process. Origin found it difficult to match up the differences in the costs sought between the applications and is of the view that the reconciliation provided in Attachment 1 of the supplementary application is inadequate. The cost categories in the table vary with the original application and it does not provide adequate quantitative detail as to the variances between year to year and from the original application. Origin believes that ENERGEX should be required to provide a more detailed reconciliation of the yearly removal of costs.

Origin also notes that the original application stated that the 2006-07 costs were actual costs up to February 2007 and forecast costs for the balance of 2006-07². There is now quite a large variance of \$8.5M in costs for this year. The largest variances appear to come from the operational cost segment. Origin questions such a large variance when more than half of the year's costs were actual?

1.3.2 System Costs

ENERGEX, in its original submission, stated that SPARQ would be paid *for "its services as an annuity over five years from the date the assets became operational"*³. Origin questions whether this is still the case as it does not appear to have been addressed in the supplementary application. Origin seeks clarity over when the annuity period commences and the cost of capital that is being sort for FRC. This will confirm whether the claim is reasonable and whether it is in the order of \$30M or \$50M.

Although ENERGEX is not seeking to claim all of SPARQ's costs through this process, it is noted that they claim costs in the order of \$39M for the 2005-06 and 2006-07 financial years⁴.

1.3.3 Non-DUOS Charges

Origin notes that ENERGEX, in it is supplementary application, proposes to exclude \$32.7M in excluded costs from its FRC cost pass-through application. This means that individual prices will be set for services such as de-energisations, re-energisations and special meter

² ENERGEX, *FRC Cost Pass-through Application – February 2007*, p16

³ ENERGEX, *FRC Cost Pass-through Application – February 2007*, p9

⁴ ENERGEX, *FRC Supplementary Cost Pass-through Submission – October 2007*, p109

reads. Origin supports this approach as it will ensure that cost reflective and transparent prices are set for the various services.

It is not clear however whether ENERGEX has excluded additional revenue from the 2005 Revenue Determination to reflect the removal of non-DUOS services from the revenue cap or whether the \$32.7M reflects the total cost of non-DUOS services. Origin understands the following:

- **ENERGEX EXCLUSION** - In ENERGEX's original application, approximately \$22.3M was being claimed in new non-DUOS services⁵. We understand that these were new costs related to re-energisation and de-energisation that were not included in the 2005 Regulatory Determination. This \$22.3M appears to line up with what ENERGEX has called 'contract labour' in its supplementary application⁶.

The supplementary application claims a further \$10.4M in internal and external labour costs associated with non-DUOS services⁷. Origin can not determine the amount that has been allocated year to year or whether this amount was in the 2005 Revenue Determination that they are seeking to exclude. If this \$10.4M was included in the 2005 Revenue Determination, then it appears that ENERGEX is only seeking to exclude \$10.4M for a three year period - 2007-08 to 2009-10.

- **QCA EXCLUSION** - The QCA has stated that less than 5% of ENERGEX and Ergon's revenue cap was related to non-DUOS services⁸ and removed \$16.2M from their regulated revenue in the 2007-08 Benchmark Retail Cost Index (BRCI)⁹ process.

Origin believes that ENERGEX's supplementary application should clearly show any offset or removals of costs from the 2005 Regulatory Determination. Origin seeks clarity over the quantum of non-DUOS services which is related to the 2005 Revenue Determination and what ENERGEX is claiming to be additional non-DUOS costs.

1.3.4 Service Essentials Costs

Origin notes that Service Essentials costs have been removed from the supplementary application given a business decision to close down the service unit in mid 2008. Given this, Origin questions where the costs related to services such as Spotless will be allocated. It is not clear from the submission whether the functions will be absorbed internally or some functions will be given to external parties such as Metering Dynamics.

1.3.5 Stage 2 Costs

The lack of detail that has been submitted to the QCA in relation to stage 2 costs is of considerable concern to Origin. It is important that only incremental costs are included and costs that are being recouped in stage 1 are not being duplicated. Origin believes that the stage 2 costs require detailed analysis by the QCA. Given this, Origin would encourage the QCA to hold approval of these costs until more detailed data is provided to the QCA and relevant stakeholders.

⁵ ENERGEX, *FRC Cost Pass-through Application – February 2007*, p10

⁶ ENERGEX, *FRC Supplementary Cost Pass-through Submission – October 2007*, p111.

⁷ ENERGEX, *FRC Supplementary Cost Pass-through Submission – October 2007*, p111.

⁸ Queensland Competition Authority, *Electricity Distribution: Review of Excluded Distribution Services – September 2007*, Draft Decision, p3.

⁹ Queensland Competition Authority, *Benchmark Retail Cost Index for Electricity: 2006-07 and 2007-08 Draft Decision – May 2007*, p18