



Draft Decision

**APT Allgas FRC Cost Pass-through
Application**

September 2008

SUBMISSIONS

The Queensland Competition Authority considers public involvement to be an important element of its decision making process. It therefore invites submissions from interested parties on its Draft Decision regarding the application by APT Allgas for additional capital and operating expenditure related to the introduction of Full Retail Competition (FRC) to be included in the 2007-08 to 2010-11 regulatory periods.

To facilitate the publication of submissions on the Authority's website, it is preferred that submissions be provided electronically. Where this is not possible, written submissions will be accepted and should be sent to the address below:

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Submissions are due by no later than **29 October 2008**

Confidentiality

In the interests of transparency and to promote informed discussion, the Authority would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would be appreciated if two copies of the submission (a complete version and second version excising confidential information for public release) could be provided. Where it is unclear why a submission has been marked "confidential", the status of the submission will be discussed with the person making the submission.

While the Authority will endeavour to identify and protect material claimed as confidential as well as exempt documents (within the meaning of the *Freedom of Information (FOI) Act 1989*), it cannot guarantee that submissions will not be made publicly available. As stated in s187 of the *Queensland Competition Authority Act 1997* (the QCA Act), the Authority must take all reasonable steps to ensure the information is not disclosed without the person's consent, provided the Authority is satisfied that the person's belief is justified and that the disclosure of the information would not be in the public interest. Notwithstanding this, there is a possibility that the Authority may be required to reveal confidential information as a result of an FOI request.

Public access to submissions

Subject to any confidentiality constraints, submissions will be available for public inspection at the Brisbane office of the Authority, or on its website at www.qca.org.au. If you experience any difficulty gaining access to documents please contact the office (07) 3222 0555.

Information about the role and current activities of the Authority, including copies of reports, papers and submissions can also be found on the Authority's website.

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1. INTRODUCTION

On 28 September 2005, the Queensland Government announced its intention to introduce Full Retail Competition (FRC) into the Queensland retail gas market from 1 July 2007.

Under FRC, the operation of the gas retail market is governed by the gas retail market rules. These rules impose certain requirements on entities operating in the market, including gas distribution businesses, to facilitate the effective operation of the market. The rules were developed by the Queensland Government in consultation with stakeholders.

APT Allgas owns a gas distribution network on the south side of Brisbane and in the northern New South Wales (NSW) area. The implications of FRC for APT Allgas largely relate to the need to improve information technology systems and metering equipment to accommodate the requirements of the gas retail market rules.

The prices that APT Allgas can charge for access to its pipelines are set out in APT Allgas' approved access arrangement. The regulatory arrangements applying to APT Allgas are not affected by the introduction of competition to the retail segment of the gas market.

1.1 Regulation of Gas Distribution

The Authority approved APT Allgas' current access arrangement in May 2006. These arrangements are not due to expire until 30 June 2011.

In its 2006 Final Decision, the Authority accepted that costs relating to the implementation of FRC could be passed through to customers at a later date, rather than being included as forecast costs at the time, as these costs could not be estimated with any certainty until the gas retail market rules were finalised.

The potential costs of FRC related to new activities that APT Allgas would have to perform due to the introduction of FRC and/or an increase in the volume of existing tasks required solely as a result of the introduction of FRC.

1.2 Application for Pass Through

On 5 June 2007, APT Allgas submitted an application to the Authority for approval to pass through costs relating to the introduction of FRC in Queensland.

To better understand APT Allgas' application, the Authority and its consultant, PB Associates (PBA), held a workshop with APT Allgas on 24 and 25 August 2007. Following an extensive delay, APT Allgas provided its final responses to questions raised at that workshop on 29 January 2008. APT Allgas also provided updated and revised expenditure data at this time.

As a result of the delays in providing information, PBA was not able to complete its draft report until 21 April 2008.

For 2007-08 pricing, the Authority allowed a provisional amount (\$2.8 million) to be included in APT Allgas' pricing to reflect potential FRC related costs. The Authority took this step so that distribution prices in the first year of full retail competition were not held artificially low.

Consistent with the approach undertaken for 2007-08, the Authority again included a further provisional amount of \$2.8 million in APT Allgas' 2008-09 prices. Both these provisional amounts are to be taken into account in determining the actual amount the Authority approves for pass through.

1.3 Submissions

The Authority invited submissions on APT Allgas' cost pass-through application on 22 June 2007. In response, submissions were received from AGL and Origin Energy. Both submissions raised a number of concerns regarding APT Allgas' application and, in particular, questioned the prudence of the proposed costs and whether amounts already included in the access arrangement were being double counted in the cost pass-through application. AGL also suggested that APT Allgas' cost pass-through application lacked sufficient detail in terms of the break down and allocation of costs.

The Authority was also concerned about this aspect of APT Allgas' cost pass-through application and also the possibility that some expenditure approved in the access arrangement (for example, expenditure on a new billing system that had been accepted as part of APT Allgas' revised access arrangement) may be superseded by expenditure on seemingly unrelated items in relation to FRC. As a result, considerable attention has been focussed on the extent to which FRC related expenditure proposals put forward by APT Allgas have been demonstrated to be incremental to, and directly related to, the pass-through event.

1.4 Independent Technical Analysis

The Authority engaged PBA to provide an independent technical assessment of whether the capital and operating expenditure proposed by APT Allgas were consistent with the pass-through conditions set out in the Authority's Final Decision. The terms of reference for the consultancy required PBA to:

- (a) identify the scope of APT Allgas' additional responsibilities under FRC in Queensland;
- (b) review APT Allgas' existing IT and other systems and identify the options available to either augment or replace existing systems and processes needed to meet FRC obligations;
- (c) determine whether the options and costs proposed by APT Allgas were prudent given the size of APT Allgas' Queensland network and costs incurred in other states. In this regard, compatibility with APT Allgas' systems in other states was not a sufficient justification of itself to select any particular option unless it also resulted in lower costs to APT Allgas in Queensland than would be the case for a stand alone operation;
- (d) identify the extent to which costs are incremental, with incremental costs being those costs that:
 - (i) can be specifically attributed to the introduction of FRC; and
 - (ii) have not previously been allowed for in the capital and/or operating expenditure included in the Authority's Final Decision of May 2006 on APT Allgas' revised access arrangement (including any expansion/replacement of related systems previously approved);
- (e) identify any efficiencies/synergies from the new systems (for example, APT Allgas' overall operating costs may be lower than previously allowed by the Authority due to the new system) and replacement of old systems (for example, old systems may no longer need to be enhanced/maintained or old systems may be able to be sold or redeployed in other areas of APT Allgas' operation);
- (f) identify the level of prudent and efficient incremental FRC costs (for both capital and operating expenditure), having considered all the matters above; and

- (g) consider whether the proposed allocation of FRC costs between customer groups and the manner of recovery (for example, fixed or variable charge adjustments) is reasonable.

1.5 Criteria for Assessment

In considering APT Allgas' cost pass-through application, the Authority has taken into account the requirements of the Code and the specific provisions covering cost pass through included in APT Allgas' approved access arrangement.

Sections 8.16 and 8.37 of the Code require that capital and operating expenditure must, amongst other things, be consistent with a prudent service provider acting efficiently, in accordance with accepted good industry practice, to achieve the lowest sustainable cost of providing the reference service.

In normal circumstances, a cost pass-through application would be subject to materiality criteria. However, in its 2006 Final Decision on APT Allgas' revised access arrangement, the Authority indicated that a materiality test would not be applied to FRC costs. This provision was included because, at the time, while the Government had announced its intention to open the gas market to retail competition, the obligations that might flow from this decision were not clear. The Authority took the view that it was preferable to allow APT Allgas to make an as-of-right cost pass-through application at a later date than to attempt to include uncertain forecast costs in the arrangement at the time.

2. APT ALLGAS APPLICATION

The APA Group purchased the Allgas distribution network from Energex in November 2006. The Allgas distribution business was sold as FRC non-compliant as the existing IT system would not support the operation of FRC.

Following the acquisition of Allgas by the APA Group, APT Allgas initiated a project to replace the existing IT system (ACIS) with a new system capable of meeting the business’s FRC obligations. Having completed this project, and with less than a month before the commencement of FRC, APT Allgas submitted a cost pass-through application to the Authority on 5 June 2007.

The initial application sought to pass through \$23.1 million in costs associated with APT Allgas’ FRC obligations. However, following a workshop with the Authority’s consultants in August 2007, APT Allgas provided updated and revised capital and operating expenditure data of \$24.9 million in total. The assessment of the APT Allgas cost pass-through application presented in this Draft Decision is based on these revised cost estimates that were provided on 29 January 2008. These costs are summarised in Table 1.

Table 1: APT Allgas revised cost pass-through – (\$’000 June 2007)

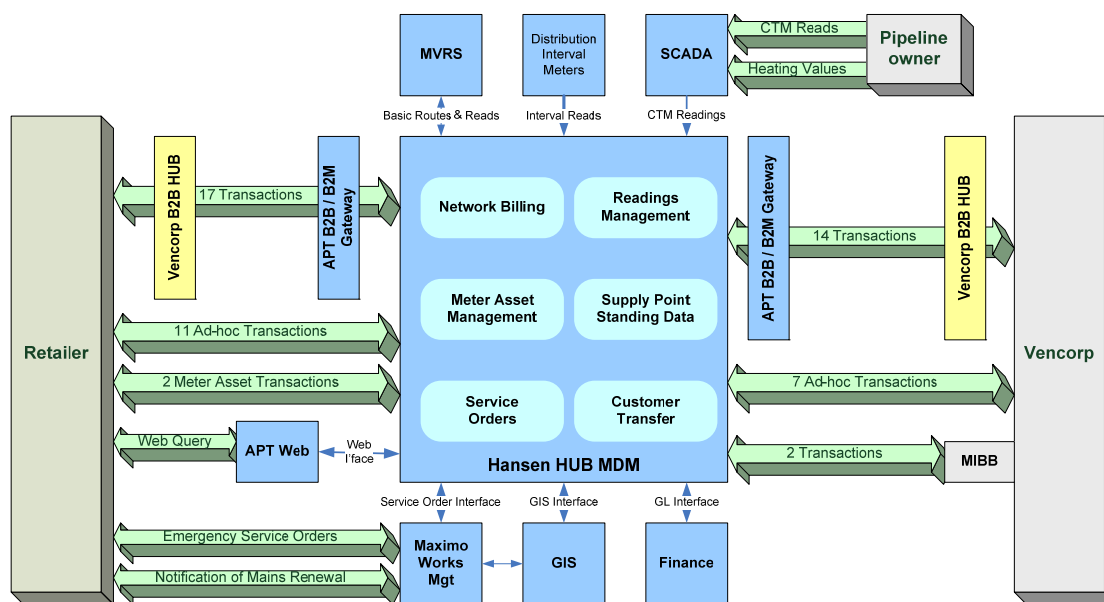
	2006-07	2007-08	2008-09	2009-10	2010-11	Total Cost
Capital Expenditure	4,206	6,448	0	0	0	10,654
Operating Expenditure	2,771	3,296	2,634	2,735	2,836	14,273
Total	6,977	9,744	2,634	2,735	2,836	24,927

Note: Totals may not add due to rounding

2.1 APT Allgas’ Proposed FRC System

The system implemented by APT Allgas on 1 July 2007, or “FRC day”, is shown in Figure 1.

Figure 1: APT Allgas’ Proposed FRC System



Source: APT Allgas

The main component of the IT solution is the Hansen HUB Meter Data Management (MDM) system. The Hansen HUB system was an off-the-shelf IT package. This system stores consumption and network related information and provides an interface to VENCORP (the gas retail market operator) as well as providing management of meter data, service orders and customer transfers from gas retail businesses.

The APT Allgas system also provides for an interface into other APT Allgas back office functions such as its works management, finance and geographic information systems (GIS).

In its cost pass-through application, APT Allgas suggested that, once implemented, the IT systems it had proposed would ensure compliance with the gas retail market rules and associated requirements.

Consultant's Assessment

Given the short amount of time between the purchase of the Allgas network and when APT Allgas had to be ready for the commencement of FRC (around nine months), PBA considered that it would not have been possible for APT Allgas to construct a tailor-made FRC compliant IT system. Once the sale of Allgas had been announced, the previous owner (Energen) ceased all preparatory work for FRC. For this reason, PBA accepted the approach adopted by APT Allgas to purchase an off-the-shelf system and acknowledged that APT Allgas had adequately considered the main solution alternatives available to provide a system that would comply with its obligations under FRC in the time available.

In terms of the cost efficiency of the FRC system selected by APT Allgas, PBA was satisfied that APT Allgas had undertaken a comprehensive competitive tender process in order to identify the most suitable solution and service provider. In summary, PBA considered that Allgas had:

- (a) considered the appropriate range of solution options;
- (b) sensibly automated processes and interfaces where manual processing would not work well; and
- (c) selected a solution that could be implemented in the available time.

Stakeholder Comments

While both Origin Energy and AGL supported the introduction of FRC, both stressed the importance of achieving the lowest cost FRC solution due to the relatively small number of gas customers that would ultimately be required to bear the associated costs.

Origin Energy highlighted the parent company of APT Allgas had recently acquired a significant share of the ownership of Envestra and had also acquired the business that provided asset management services for Envestra's Queensland gas distribution network. As a result, Origin Energy suggested that both companies now had the same single operator. Given that APT Allgas had already been allowed to raise a provisional amount of revenue, thereby removing timing issues in assessing its application, Origin Energy suggested that it would be reasonable for APT Allgas to re-submit its FRC operating costs reflecting synergies that would accrue from having a single operator for both networks.

Origin Energy acknowledged that FRC commencing at around the same time as the sale of Allgas was not ideal for the planning and implementation of an FRC solution by APT Allgas. However, Origin Energy noted the early participation of APA Group representatives in the industry retail rule development process assisted in a rapid assembly of the APT Allgas project

team. Consequently, Origin Energy considered the sale of the network should not have adversely affected the cost of achieving FRC compliance.

AGL considered that the APT Allgas cost pass-through application lacked sufficient detail to allow a full assessment of the amounts claimed.

Both Origin Energy and AGL Sales (AGL) suggested that \$4.2 million included in APT Allgas' approved access arrangement in relation to the PEACE billing system should be offset against the cost of new IT systems required to meet FRC requirements.

The Authority's Position

The Authority acknowledges that APT Allgas had limited time to evaluate, design and implement systems capable of meeting its obligations under FRC.

The Authority is satisfied that APT Allgas examined a reasonable range of options to meet its FRC requirements. Given the constraints placed on APT Allgas and the options available, the Authority is satisfied that the choice of FRC system adopted by APT Allgas is reasonable.

While the Authority accepts that APT Allgas was required to incur additional IT spending to meet its FRC obligations over and above the amount allowed for in its approved access arrangement, the Authority will only approve costs to upgrade facilities or systems that are directly related to this pass-through event.

A detailed analysis of each component of APT Allgas' proposed FRC systems is presented in the following sections.

3. CAPITAL EXPENDITURE

APT Allgas proposed that \$10.7 million in capital expenditure was required for an IT system that it considered necessary to meet its obligations under FRC. APT Allgas also identified additional expenditure required for metering, systems integration, contingencies and overheads. APT Allgas' proposed capital costs are summarised in Table 2.

Table 2: APT Allgas proposed capital expenditure proposal by category - (\$'000 June 2007)

<i>Cost Category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total</i>
Core system expenditure	1,511	2,003	3,514
Interval meters	527	301	828
Internal & other costs	1,188	128	1,316
Integration and GIS costs	233	2,965	3,198
Other Items	84	563	647
Overheads	662	488	1,150
Total	4,206	6,448	10,654

Note: Figures may not add due to rounding

3.1 Core Systems Expenditure

Core systems capital expenditure includes the costs of purchasing new hardware and software as well as the costs associated with tailoring the system to meet APT Allgas' requirements. Consultancy fees, labour and administrative costs associated with the design and implementation of the new systems have been capitalised by APT Allgas under this cost category.

A summary of APT Allgas' proposed core systems capital costs is provided in Table 3.

Table 3: APT Allgas proposed core system expenditure - (\$'000 June 2007)

<i>Cost Category</i>	<i>2006-07 Actual</i>	<i>2007-08 Forecast</i>	<i>Total</i>
Fixed deployment costs	935	265	1,200
Allowance deployment costs	360	540	900
Optional deployment costs	147	500	647
Modification allowance recommended by Hansen	0	400	400
Travel allowance	50	5	55
Change requests	19	30	49
Hansen related	0	263	263
Total	1,511	2,003	3,514

Note: Figures may not add due to rounding

In its cost pass-through application, APT Allgas advised that the majority of its core system expenditure related to fixed deployment costs. These costs were part of the fixed-price contract between APT Allgas and Hansen Technologies and covered costs relating to project management provided by Hansen Technologies, configuration of the HUB system and gateway and pre- and post-implementation support.

In addition to the fixed deployment costs, the contract between APT Allgas and Hansen Technologies allowed for variable costs (allowance deployment costs) costs for Hansen

Technologies to customise the HUB system to meet APT Allgas' business requirements and testing the system to ensure it functioned as intended.

The third major item of core system expenditure related to optional deployment costs which covered activities that APT Allgas considered necessary for FRC but could be provided separately to the Hansen Technologies system work. The optional deployment costs related to its Maximo interface which permit electronic interaction between APT Allgas' other business processes and its FRC system.

APT Allgas also proposed costs for post implementation changes. These costs related to change requests and modifications that were additional to the fixed-price contract APT Allgas entered into with Hansen.

The remaining costs cover other items such as travel expenditure and Hansen related costs such as hosting, data recovery provisions and maintenance support costs.

Consultant's Assessment

PBA considered that the overall implementation costs for an IT system of this nature would be in the range of \$3 million to \$6 million depending on the level of customisation required. PBA also indicated that, because APT Allgas had limited the need for system re-design and required a minimal level of customisation, APT Allgas' costs would be at the lower end of this range.

PBA identified that the fixed deployment costs over 2006-07 and 2007-08 were made up of:

- (a) project management (\$670,000);
- (b) configuration of the HUB system and gateway (\$300,000);
- (c) documentation and training (\$35,000); and
- (d) pre- and post-implementation support and handover (\$195,000).

PBA advised that these costs were part of a fixed-price contract provided by Hansen Technologies which did not include detailed labour rates.

With respect to project management, PBA considered that 160 days of effort per resource for four resources would be a reasonable level of labour for an activity of this nature. The amount of \$670,000 claimed across 640 resource days equates to \$1,047 per day. PBA considered that an average cost for vendor support of this nature would be around \$1,500 per day and therefore PBA considered that the project management costs provided by Hansen Technologies were efficient.

PBA also considered that the decision to configure an off-the-shelf HUB system and gateway rather than develop a system from scratch allowed APT Allgas the flexibility to then customise its solution to its preferred method of operation. This would allow APT Allgas to adapt the system to any changes in the way APT Allgas may operate in the future. PBA applied the labour per day cost of \$1,047 to the proposed costs of \$300,000 to derive days of effort (287 days) to customise the HUB system. PBA considered that this level of effort was appropriate.

Similarly, applying a daily resource cost of \$1,047 to APT Allgas' proposed training costs translated into 33 days of training. For a system of this nature, PBA suggested the proposed training costs were reasonable.

PBA applied the derived daily resource cost to the proposed pre- and post-implementation support costs. On this basis, the claimed \$195,000 equated to 186 resource days. PBA

considered that it was usual for support to be provided for the duration of the project and typically one month after implementation. On the basis of a project length of eight months plus one month post implementation, or 180 resource days, PBA considered that the proposed costs were reasonable.

Overall, PBA recommended that the costs for fixed deployment proposed by APT Allgas be accepted.

With respect to the variable (deployment allowance) costs for Hansen Technologies to customise the HUB system, PBA applied its derived resource rate of \$1,047 to APT Allgas' proposed costs of \$900,000 to calculate an implementation effort at 860 days. PBA considered that this represented an appropriate effort considering the compressed nature of the project compared to other system implementations PBA had reviewed or been associated with.

PBA noted that APT Allgas was still considering whether to undertake a project to install an interface between its existing systems and the Maximo works management system as part of its optional deployment at a cost of \$500,000. This upgrade would occur subject to a cost/benefit analysis. As there was no certainty that this project would take place (and has not been undertaken to date), PBA did not recommend approving this cost for pass through. However, PBA did recommend including \$147,000 proposed by APT Allgas to cover a market trial of the interface.

Given the complexity of the system required for FRC, PBA considered a provision for post-implementation modification to be necessary as full knowledge of the effectiveness of the system can only be determined once it is in operation in the FRC environment.

PBA considered that, for a project of this complexity, allowing for two large change requests (requiring 50 resource days each), 10 medium change requests (requiring 10 resource days each) and 50 small change requests (requiring two resource days each) was reasonable. At a resource rate of \$1,500 per day, PBA concluded that the \$400,000 proposed by APT Allgas was a reasonable estimate of expected costs.

PBA considered that APT Allgas' proposed travel costs of \$55,000, which represented a total of 0.5% of total proposed costs, were reasonable.

With respect to change requests, PBA stated that, given the scale and complexity of the project, it would expect a certain amount of additional work to result outside of the contracted amount as a result of inaccurate customisation requests. PBA assessed the change request amount of \$49,000 by applying a resource cost of \$1,500 per day. On this basis, PBA considered that 33 resource days was reasonable.

PBA considered that the proposed Hansen related costs associated with hosting and disaster recovery of software and hardware were consistent with typical costs for production and disaster recovery and accepted APT Allgas' proposed costs.

A summary of core systems expenditure recommended by PBA are detailed in Table 4.

Table 4: PBA recommended APT Allgas core system expenditure - (\$'000 June 2007)

<i>Cost Category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total</i>	<i>APT Allgas Application</i>
Fixed deployment costs	935	265	1,200	1,200
Allowance deployment costs	360	540	900	900
Optional deployment costs	147	0	147	647
Modification allowance recommended by Hansen	0	400	400	400
Travel allowance	50	5	55	55
Change requests	19	30	49	49
Hansen related	0	263	263	263
Total	1,511	1,503	3,014	3,514

Note: Totals may not add due to rounding

The Authority's Position

The Authority notes that PBA has considered in some detail each of the component costs of APT Allgas' core system costs. PBA recommended that the costs associated with the optional deployment of the Maximo interface not be included as there was no certainty it would occur.

While the Authority accepts the recommendations from PBA, it notes that costs to deploy a system (the PEACE system), that included the functionality of Maximo, was included in APT Allgas' IT costs when the Authority approved the (APT) Allgas revised access arrangement in 2006. The PEACE system was expected to provide billing, network management and data housing capabilities necessary to meet the FRC requirements of each of the businesses. Consequently, costs associated with PEACE are now embedded APT Allgas distribution tariffs.

In constructing its FRC cost pass-through application, APT Allgas has not recognised any of the PEACE costs previously accepted by the Authority. The Authority acknowledges that costs accepted at the time the revised access arrangements were approved are no longer 'on the table', including those for PEACE. However, those costs were accepted by the Authority on the basis that they would provide APT Allgas with certain IT capabilities. While the current cost pass-through application may be centred on different "brands" of software, much of the capability is the same. For example, the capabilities of the Maximo works management system that APT Allgas is seeking approval for now would have been provided by PEACE. APT Allgas' cost pass-through application should only be for the additional cost of providing any further capability that was not in the original proposal accepted as part of the access arrangement approval.

In the absence of that incremental costing being provided by APT Allgas, it is not possible to match components and costs of the systems that APT Allgas has proposed in its cost pass-through application with those of the system that already received funding (PEACE) in (APT) Allgas access arrangement. Therefore, the Authority has adopted an approach, as it did in considering the Envestra's FRC cost pass-through application, whereby all costs relating to the PEACE system have been subtracted (see section 3.7) from the cost of the newer Hansen system which has been assessed in its entirety. While this may be a second best approach compared to a purely incremental assessment, this approach is the only practical means by which the Authority can identify approximate incremental costs.

The Authority has therefore included the costs for Maximo for pass through, offset by the later deduction of the allowance for the PEACE system provided to (APT) Allgas as part of its revised 2006 access arrangement (see Table 10).

The resulting core system capital expenditure costs accepted by the Authority are presented in Table 5.

Table 5: Core system expenditure accepted by the QCA - (\$'000 June 2007)

<i>Cost Category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommendation</i>
Fixed deployment costs	935	265	1,200	1,200	1,200
Allowance deployment costs	360	540	900	900	900
Optional deployment costs	147	0	147	647	147
Modification allowance recommended by Hansen	0	400	400	400	400
Travel allowance	50	5	55	55	55
Change requests	19	30	49	49	49
Hansen related	0	263	263	263	263
Total	1,511	1,503	3014	3,514	3,014

Note: Figures may not add up due to rounding

3.2 Interval Meter Capital Expenditure

APT Allgas stated that, under FRC, it is required to provide sites consuming more than 10 tera joule (TJ) per year with an interval meter within two years of the commencement of FRC. This involves installation of the meter, correctors, data collection systems and modifications to its Supervisory Control and Data Acquisition (SCADA) IT system.

APT Allgas included the cost of installing interval meters at 84 sites at a cost of \$2,833 per site. In addition, APT Allgas included five spare meters and 10 meters for additional sites over the next five years at \$2,833 each and \$20,500 for operating spares, giving a total cost of \$301,000. APT Allgas also included the cost of installing correctors to 31 sites consuming greater than 100TJ per annum and at seven sub-gate sites at a cost of \$352,000.

A two-stage SCADA communications system upgrade at a cost of \$123,000 was also proposed by APT Allgas. The first stage involved a minor upgrade to the City gate and Heating Value calculations while stage 2 involved an upgraded communications system, development of procedures and the purchase of computer hardware.

APT Allgas proposed costs of \$28,000 to provide a system to collect interval meter data and project management costs associated with the installation of interval meter reading equipment and systems of \$25,000.

Overall, interval meter costs proposed by APT Allgas total \$828,000.

Stakeholder Comments

Origin noted that APT Allgas already had remotely read interval meters for its large customers (>100TJ) but this system was considered unsuitable for FRC. Origin considered that costs to correct the system were business enhancement costs and not costs required solely due to the introduction of FRC. To the extent that these costs are approved by the Authority, Origin considered that any allowance previously made for this enhancement should be netted out of total approved costs.

Consultant's Assessment

PBA noted that Envestra's cost of installing an interval meter was \$2,500 per site compared to APT Allgas' costs of \$2,833 per site. However, PBA also noted that this difference on meter costs was more than offset by APT Allgas' lower telecommunications operating costs. On this basis, PBA recommended that APT Allgas' interval meter costs of \$2,833 per meter be accepted.

In addition to the installation of interval meters, PBA considered that the installation of correctors was necessary as the existing telemetry system was deemed unsuitable for FRC due to poor performance and reliability.

The cost per site for correctors installed by APT Allgas was \$7,742. PBA considered that the costs proposed by APT Allgas compared well to the costs of \$9,450 per corrector proposed by Envestra.

The cost to upgrade the SCADA system was not considered material by PBA in the context of the total proposed capital expenditure, nor were the proposed costs of \$28,000 to provide a system to collect interval meter data. PBA considered that both costs should be accepted.

PBA considered that project management costs associated with the installation of interval meter reading equipment and systems were typically around 10% of capital costs. PBA calculated APT Allgas' proposed costs at 5% and on this basis considered the proposed costs acceptable.

In total, PBA recommended the Authority accept the full \$828,000 of interval meter costs proposed by APT Allgas.

The Authority's Position

The Authority notes the comments of PBA regarding the differing meter costs compared to those approved for Envestra being offset by lower operating costs and on this basis accepts the higher capital costs recommended by PBA.

The Authority notes Origin Energy's concerns regarding the existing interval meters for large customers. While the Authority has accepted PBA's advice on this matter and included the costs of installing interval meter data correctors to 31 sites, it requires APT Allgas to identify the 31 sites involved and the original asset values for these sites. The Authority will give further consideration to these costs, based on the information to be provided by APT Allgas, in preparing its Final Decision.

Total meter costs accepted by the Authority are detailed in Table 6.

Table 6: Interval metering expenditure accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommended Costs</i>
Interval meters	0	301	301	301	301
Interval meter data correctors	352	0	352	352	352
SCADA system works	123	0	123	123	123
Interval meter data collection	28	0	28	28	28
Project management costs	25	0	25	25	25
Total	528	301	829	829	829

Note: Totals may not add due to rounding

3.3 Internal and Other Costs

The main item in APT Allgas' internal and other costs relates to network billing meters. These refer to the installation of network meters to delineate between the distribution network and embedded networks. APT Allgas proposed installing 205 network meters at a cost of \$1.0 million.

APT Allgas also proposed costs of \$177,000 for travel to and from Brisbane for its staff and contractors, vendor evaluation costs of \$125,000 and IT access code costs of \$3,000.

Stakeholder Comments

No stakeholder comments were received on this cost item.

Consultant's Assessment

The costs per meter proposed by APT Allgas (\$4,932 per meter) were somewhat higher than a cost of \$3,153 per meter for industrial and commercial customers supplied by AGLGN in NSW. However, PBA noted that the costs in NSW were associated with a new site as opposed to an existing site (as is the case for APT Allgas) where costs are typically higher reflecting the need for the distributor to negotiate with property owners, modify pipe work and in some cases construct a chamber for the meter. PBA considered that this would account for the difference in cost between AGLGN and APT Allgas and that the costs proposed by APT Allgas were therefore reasonable and recommended that they be approved for pass through.

PBA considered that vendor evaluation should require between 50 and 150 resource days. PBA estimated that the costs of \$125,000 proposed by APT Allgas represented around 100 days and, on that basis, should be accepted.

PBA noted that a number of resources allocated to the FRC project were not located in Brisbane. PBA recommended that the costs associated with travel for APT Allgas staff and its direct hire contractors was reasonable and should be included for pass through. PBA considered that the cost of \$3,000 for the IT access code was minimal and should be accepted for pass through.

The Authority's Position

While the Authority accepts that distributors are required to install an interval meter to replace certain existing meters, APT Allgas has not provided sufficient information to demonstrate that

all of the 205 inlet points require upgrading. The Authority requires APT Allgas to provide information regarding existing metering at each of the 205 inlet points and an explanation as to why these need to be upgraded. However, on the assumption that most (if not all) of these meters will need replacing, the Authority has included the full amount proposed by APT Allgas and supported by PBA. If APT Allgas is unable to justify the upgrade of all these meters in its response to this Draft Decision, an appropriate adjustment will be made in the Authority's Final Decision.

With respect to vendor evaluation (\$125,000), travel allowance (\$177,000) and the IT access code (\$3,000), the Authority accepts the \$305,000 costs proposed by APT Allgas on the basis that those costs appear reasonable.

Total internal and other costs accepted by the Authority are detailed in Table 7.

Table 7: Internal and other costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommended Costs</i>
Network Billing Meters	911	100	1,011	1,011	1,011
Travel	152	25	177	177	177
Vendor evaluation, system design	125	0	125	125	125
ESCROW agreement for Hansen Code	0	3	3	3	3
Total	1,188	128	1,316	1,316	1,316

3.4 Integration and GIS Costs

The integration costs proposed by APT Allgas are associated with the costs of deploying the new IT systems within its business.

APT Allgas proposed \$232,898 of actual IT integration costs for 2006-07. Of these costs, \$192,000 was attributable to the deployment of the new IT system to existing staff. These costs included the costs of a new server as well as desktop/laptop computers for existing staff.

APT Allgas included costs associated with the introduction of an interface with the Maximo asset management system as a complement to the Hansen Technologies system. APT Allgas proposed total Maximo costs of \$1.1 million.

In addition to a proposed upgrade to its GIS system, APT Allgas proposed a new spatial GIS system at a cost of \$1.9 million for year 2007/08.

Stakeholders' Comments

AGL considered that the detail provided by APT Allgas was inadequate. In addition, AGL stated that it was unclear which internal interfaces will remain manual and what the associated ongoing costs would be.

While acknowledging the benefits of implementing a GIS system for network businesses, both AGL and Origin Energy questioned the appropriateness of recovering the costs associated with a GIS system as a FRC related cost. Both submissions suggested that GIS costs are more appropriately addressed as part of the access arrangement process.

Consultant's Assessment

PBA noted that \$232,898 of actual IT integration costs were reported by APT Allgas for 2006-07. However, PBA could only identify that \$86,842 of this amount related to a specific category, being the Maximo system. PBA assessed remaining costs as if they were to be incurred in the 2007-08 financial year.

Based on the assumption that a new desktop/laptop would cost between \$3,000 to \$4,000 for each of APT Allgas' 20 existing staff and that a new server typically costs within a range of \$30,000 to \$60,000, PBA considered that costs of \$144,000 for servers and laptops/desktops should be included in the pass-through amount.

With respect to the provision of IT hardware equipment such as cabling and software licenses to the 11.5 new FTE staff hired for FRC, PBA considered the proposed cost per FTE of \$4,350 to be high but within a range it considered to be acceptable.

PBA noted that APT Allgas had double counted \$500,000 of costs for a Maximo interface already included in APT Allgas' integration costs (see section 3.1). APT had also included costs of \$170,000 associated with the integration of the Maximo interface with the Hansen system. As that project had been rejected, PBA also recommended that these costs should be removed.

PBA supported the inclusion of \$142,000 for programming and testing associated with system changes for the implementation of Maximo. While PBA also identified that \$55,196 had been double counted by APT Allgas, it was unable to explain the remaining balance of the \$221,000 claimed by APT Allgas.

With respect to the proposed purchase of a new GIS system, PBA did not accept the costs proposed by APT Allgas. PBA considered that the business and system requirements for a GIS system would not be materially impacted by the introduction of FRC. Instead, PBA considered that only modification of the existing GIS system would be required to ensure that it was capable of interacting with the new system and new system data such as metering data or retailer identifiers. On this basis, PBA considered the costs associated with an upgrade should be moderate and recommended that only the costs proposed by APT Allgas of \$62,000 for GIS modifications should be approved.

The Authority's Position

While the Authority accepts that IT assets are required to upgrade servers and provide necessary software licences, it is not clear why existing staff require new laptop/desktop computers and software solely to meet FRC requirements. While the Authority accepts those costs proposed for additional servers, it does not accept costs (\$80,000) relating to new desktop/laptops for existing staff.

The Authority accepts that new equipment will be required for new staff and accepts costs associated with 7.5 new FTEs (see Section 4.2 regarding reduction from 11.5 to 7.5 FTEs) at the rate of \$4,350 per FTE, which PBA considered at the higher end of an acceptable range. As a result, integration costs for additional FRC staff have been reduced from \$50,000 to \$33,000.

The Authority has accepted the advice of PBA regarding the Maximo system upgrade costs (approving \$142,000) and notes that PBA was unable to identify all costs claimed by APT Allgas for this item.

The Authority has accepted PBA's advice regarding the exclusion of costs associated with the Maximo Hansen interface project (section 3.1 - \$500,000) and PBA's advice that these costs

had been double counted in this current section as well. The Authority also accepts PBA's advice that the additional \$170,000 of integration costs associated with that excluded project (making \$670,000 in total) must also be excluded.

It was unclear whether the \$20,000 claimed for Maximo project management costs related to the interface or the Maximo upgrade. As they could not be clearly attributed to a project, these costs have not been included.

The Authority has also accepted PBA's advice and included \$102,000 of costs associated with a range of small projects grouped together as "other integration costs".

The Authority accepts that APT Allgas may need to upgrade its GIS to allow for an effective interaction with its other systems. However, the Authority agrees with PBA that there is insufficient information to support the argument that a GIS system is required solely to meet FRC obligations placed on APT Allgas. New GIS system costs have not been accepted for cost pass-through.

Total integration and GIS costs accepted by the Authority are detailed in Table 8.

Table 8: Integration and GIS costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommended Costs</i>
Integration costs – servers	0	42	42	42	42
Integration costs laptops, desktops etc	0	22	22	102	102
Integration costs for additional FRC staff	0	33	33	50	50
ARC FM GIS system	0	62	62	62	62
Maximo system upgrade	87	55	142	221	142
Maximo Hansen interface estimate	0	0	0	670	0
Maximo project manager	0	0	0	20	0
Other Integration Costs	0	102	102	123	102
GIS	0	0	0	1,908	0
Total	87	316	403	3,198	500

Note: Totals may not add due to rounding

3.5 Other Items

APT Allgas proposed a number of additional supporting capital expenditure items including:

- (a) enhancement to its PABX telephone network functionality (\$90,000);
- (b) additional user acceptance testing not foreseen at the time of its original application (\$69,000); and
- (c) a 20% contingency on its capital expenditure costs to account for unforeseen expenditure item, project delays and changes in system requirements (\$488,000).

Consultant's Assessment

PBA considered that issues associated with telephone network functionality will arise when implementing new contact management systems.

For the installation of a new PABX, PBA suggested this would typically require the services of a technician at a cost \$1,000 per day, for 30 days of design, 30 days of technical implementation and programming and 30 days of testing. In total, PBA recommended that costs for this activity, including hardware and software, would be in the range of \$50,000 to \$100,000. While APT Allgas' proposed costs were at the top end of the range, PBA recommended these costs be accepted.

PBA considered that the additional user acceptance costs would be only a fraction of the overall system costs and would, therefore, not be material.

With respect to contingency costs, PBA considered that the level of risk associated with unknown variables should be very low. PBA did not consider that there was evidence that any contingency for the remainder of the project was necessary. As a result, PBA recommended not including a contingency allowance and removing contingency already included in integration costs and additional items.

The Authority's Position

So far as the claimed PABX expenditure is concerned, the Authority has accepted PBA's advice that telephone network issues may arise as a result of the introduction of FRC and has included the \$90,000 proposed by both APT Allgas and PBA

The Authority also accepts that costs will be incurred as part of user acceptance testing and has included \$57,600 for pass through.

At the time this Draft Decision is released, the retail gas market will have been open to competition for over one year. APT Allgas' systems, therefore, will have been in place for this period of time and major capital expenditure will have been completed. The Authority also notes that APT Allgas entered into largely fixed price contracts for the roll-out of new systems and that provisions have already been allowed for modifications and change requests. On this basis, the Authority considers that a contingency allowance of \$488,000 is not warranted.

Table 9: Other Items costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommended Costs</i>
PABX Telephone	84	6	90	90	90
UAT	0	58	58	69	58
Contingency	0	0	0	488	0
Total	84	64	148	647	148

3.6 Overheads

APT Allgas proposed a 20% allocation (\$1.1 million) to cover overhead costs associated with the introduction of FRC.

Stakeholder Comments

AGL questioned whether corporate overhead costs had already been allocated to APT's pipelines and network business.

Consultant's Assessment

PBA considered that overhead rates should be recovered only on an incremental basis. PBA noted that APT Allgas had proposed overhead costs by applying an overhead rate of 20% to its Hansen Technologies, interval meters, internal and PABX costs.

PBA also noted that APT Allgas did not provide an incremental breakdown of its costs. As a result, PBA estimated APT Allgas' incremental overhead costs on the following basis:

- (a) legal costs to review contracts with Hansen Technologies, Logica and other suppliers at \$50,000 for five contacts (\$250,000);
- (b) regulatory costs based on a contracted regulatory person at 100 days at a daily rate of \$2,000 (\$200,000);
- (c) rental space for a team of 30 people at a costs of \$300 per square meter for 25 square meters per person for eight months (\$150,000);
- (d) move in and move outs costs of \$50,000;
- (e) telecoms costs of \$50 per person per month for 25 additional FTEs involved in the FRC project (\$10,000); and
- (f) IT to provide desktop, license and access to servers and network for a project team of 30 people for a period of eight months (\$150,000).

PBA stated that the total of these estimated costs amounted to \$810,000. Of this amount, \$92,000 had already been included in integration costs. PBA recommended that the balance of \$717,000 be included in APT Allgas' recovery amount.

The Authority's Position

The Authority considers that it would be unlikely that FRC would place a significant burden on shared corporate services that would result in substantive incremental overheads. The information provided by APT Allgas has not established that these costs were directly related to FRC, which is supported by PBA.

With respect to the legal and other costs suggested by PBA as possibly having been incurred, the Authority is not in a position to guess what APT Allgas' costs were and is not prepared to accept an ad hoc percentage allowance that is not supported by detailed evidence.

The Authority considers that there is a real likelihood that many of these "overhead" costs have already been captured in other specific areas and, for these reasons, has excluded all overheads claimed by APT Allgas for the purposes of this Draft Decision. It is open to APT Allgas to provide the necessary detailed information to support these costs in responding to this Draft Decision.

In relation to the costs associated with the short term engagement of external expert consultants, APT Allgas was able to demonstrate that these costs were additional to its normal activities and were directly a result of its preparations for FRC. On this basis, the Authority accepts the short

term rental, telecom and IT costs incurred to facilitate the short term placement of external providers in Brisbane.

Overall costs accepted by the Authority include \$200,000 for short term rental space, \$10,000 for telephony costs and \$150,000 for IT equipment.

3.7 Access Arrangement Allowance

As noted previously, in approving APT Allgas' 2006 revised access arrangement, the Authority included costs of \$4.2 million to replace APT Allgas' existing (pre-FRC) IT systems with PEACE in 2006-07 to meet suggested FRC IT requirements, as noted in the Authority's 2006 Final Decision on APT Allgas' revised access arrangement. These costs are already being recovered in current prices. The IT systems, now being proposed by APT Allgas to address FRC related purposes, share many of the same functional capabilities of the system upgrades that were already recognised in the current access arrangement, creating the potential for significant costs to be double counted. Consequently, the Authority has deducted these costs (in the year in which they were included) from the cost that have been accepted for pass through.

3.8 Summary of Capital Costs Accepted by the Authority

The capital costs accepted by the Authority are presented in Table 10.

Table 10: Capital costs accepted by the QCA - (\$'000 June 2007)

	2006-07	2007-08	Total Draft Decision	APT Allgas Application	PBA Recommended Costs
Core system expenditure	1,511	1,503	3,014	3,514	3,014
Interval meters	528	301	829	829	829
Internal & other costs	1,188	128	1,316	1,316	1,316
Integration costs and GIS	87	316	403	3,198	500
Other Items	84	64	148	647	148
Overheads	360	0	360	1,150	717
Plus capitalisation of Logica costs ^a	1,068	289	1,357	0	1,357
Capex Allowance	4,826	2,601	7,427	10,654	7,881
Minus FRC related costs included in approved Access Arrangement	(4,200)	0	(4,200)	0	(4,200)
Total	626	2,601	3,227	10,654	3,681

Note: Totals may not add due to rounding

a. See discussion in section 4.1

3.9 Depreciation

APT Allgas proposed a 1.5 year depreciation period for its IT assets. APT Allgas did not propose a depreciation period for its interval meters.

Consultant's Assessment

PBA considered that, in general, assets should be depreciated over a period that reflects the economic life of the assets.

PBA considered that network billing meters are primarily long-lived assets. PBA noted that, in its supporting information, APT Allgas had proposed an asset life of 30 years for commercial/industrial meters. PBA considered this to be an appropriate period over which to depreciate these assets.

With respect to telemetry systems, PBA suggested that ongoing technological change would mean the economic life of modern electronic communications devices would be typically five years or less.

PBA also considered that IT assets are generally short lived and are typically replaced every five to ten years. In its access arrangement, APT Allgas depreciated its assets over five years. On the basis that this depreciation period had already been proposed by APT Allgas previously, PBA recommended that the IT component of APT Allgas' expenditure be depreciated over five years.

The Authority's Position

The economic life for IT assets adopted by APT Allgas in its access arrangement was five years. This is different to the asset lives for similar assets included in Envestra's access arrangement (10 years) and subsequently accepted in the context of Envestra's FRC cost pass-through application. While the reasons for this inconsistency are not entirely clear, the Authority, in considering this application, is more concerned with the internal consistency of the asset base. To be consistent with the current access arrangement and noting the comments by PBA, the Authority considers that an economic life of five years is appropriate for APT Allgas' IT assets.

With respect to meter assets, the Authority has accepted an asset life of 25 years for domestic meters and 30 years for commercial/industrial meters.

4. OPERATING EXPENDITURE

APT Allgas' operating costs include the ongoing additional costs associated with operating its business in an FRC environment. APT Allgas has suggested that, despite the level of automation delivered with its new IT system, there will be an increase in labour costs due to work request "exceptions" that arise when market participants send data outside of required time windows or where this data is not submitted in the correct format requiring APT Allgas to deal with the request manually.

A summary of the costs associated with APT Allgas' proposed core systems operating requirements for FRC are shown at Table 11.

Table 11: APT Allgas operating expenditure proposal by category - (\$'000 June 2007)

<i>Cost Category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total</i>
FRC Implementation						
LogicaCMG	1,068	289	0	0	0	1,357
Project management	485	247	0	0	0	732
Project establishment	486	0	0	0	0	486
AGL Testing	0	184	0	0	0	184
FRC Staff						
Additional FRC staff	193	1,138	1,237	1,336	1,435	5,341
Increased call centre staff	0	144	144	144	144	576
IT Operating Costs						
Hosting	144	415	415	415	415	1,804
Software Licensing	395	211	213	214	217	1,250
Brennan IT support & management	0	29	58	58	58	203
New entrant retailers	0	0	61	61	61	182
Interval meters	0	247	264	264	264	1,041
Market Participation						
Promotion and training	0	250	100	100	100	550
Ombudsman Scheme	0	115	115	115	115	460
DME & Vencorp post FRC committee	0	27	27	27	27	107
Total	2,771	3,297	2,634	2,735	2,836	14,273

Note: Figures may not add due to rounding

Stakeholder Comments

Origin Energy suggested that, when assessing additional operating costs, it is important to understand what were normal operational activities prior to FRC and how new FRC automated systems have impacted on the former manual processes.

4.1 FRC Implementation

APT Allgas engaged Logica to act as system integrator to provide business consultancy, process, mapping, end-to-end business process testing and system integration support.

In its cost pass-through application, APT Allgas proposed Logica costs of \$1.1 million for 2006-07 and \$288,964 for 2007-08.

In addition, APT Allgas has proposed costs associated with project managing the development, planning, resolving issues and determining solutions for FRC matters. These costs total \$732,290 and were made up of program director costs and IT management costs.

PBA stated that APT Allgas had also advised that \$486,000 of project establishment costs, which had already been included in other lines items, had been deducted by APT Allgas in arriving at the above \$732,290 cost to ensure there was no double counting.

APT Allgas stated that it had performed system testing with AGL to determine if its FRC solution operated as intended. APT Allgas stated that it required the assistance of both Hansen and Logica to perform this testing. The costs of retaining Hansen Technologies and Logica for these trials totalled \$184,000.

Consultant's Assessment

In PBA's opinion, APT Allgas did not possess the experience and internal resources necessary to complete the FRC project in time for FRC on 1 July 2007. As a result, PBA considered that it was necessary for APT Allgas to engage an external system manager to achieve this outcome.

PBA considered that a systems integrator would typically charge staff at a labour multiplier of 3-4 times the salary paid. While PBA considered that there are no benchmark guidelines for daily rates, adopting the average salaries published in the Hays Salary Survey for Information Technology provided suitable proxy rates.

PBA considered that the rates per Logica activity were consistent with market rates adopting a labour multiple of 3-4 times against the Hays rates.

With respect to APT Allgas' proposed project management costs, PBA considered that it was unusual that APT Allgas had expensed these costs rather than capitalising them as PBA considered that these costs would generally be classified as capital and depreciated.

The costs for 2006-07 proposed by APT Allgas included:

- (a) Program Director - \$1,978 per day for a total cost of \$309,000;
- (b) Change management manager - \$768 per day for a total cost of \$31,000;
- (c) Ad hoc advice - \$1,500 per day for a total of \$4,000;
- (d) Internal FRC IT Manger - \$792 per day for a total of \$89,000; and
- (e) Brennan IT - \$1,728 per day for a total of \$52,000;

PBA accepted the rates and resource days used by APT Allgas and recommended that costs of \$485,000 be included for cost pass-through for 2006-07.

The costs for 2007-08 proposed by APT Allgas included:

- (a) Project Director - \$1,978 per day for a total cost of \$208,000; and
- (b) IT manager - \$792 per day at a total cost of \$40,000.

PBA noted that APT Allgas only budgeted to incur costs of \$200,000 in 2007-08 for its project director and IT manager.

With respect to retesting the system with AGL, PBA noted that the external costs of engaging Logica for this work were consistent with the rates for its system integration project. PBA recommended accepting these costs.

The Authority's Position

The Authority accepts that APT Allgas did not possess the experience and internal resources necessary to complete the FRC project in time for FRC on 1 July 2007 and that it was prudent to engage an external system integrator to achieve this outcome.

While acknowledging that the Hays Salary Survey is indicative of salaries and not conclusive, the Authority accepts these rates as an acceptable proxy benchmark at this time.

While the Authority accepts costs for Logica of \$1.1 million for 2006-07 and \$288,964 for 2007-08, the Authority also accepts PBA's view that such costs would normally be capitalised and has treated the Logica costs accordingly.

With respect to project management, the Authority accepts that these costs were necessary and has accepted PBA's recommended cost for project director and IT manager of \$200,000 for 2007-08 costs which reduces the total for 2007-08 from \$732,290 to \$685,000.

The Authority accepts that it was necessary for APT Allgas to test the effectiveness of its IT solution functionality with retail businesses and accepts the costs of testing with AGL.

Total FRC implementation costs accepted by the Authority are summarised in Table 12.

Table 12: APT Allgas FRC implementation costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommended</i>
LogicaCMG ^a	0	0	0	1,357	0
Project management	485	200	685	732	685
AGL Testing	0	184	184	184	184
Total	485	384	869	2,759	869

Note: Figures may not add up due to rounding

a. Logica costs capitalised – see Table 10.

4.2 FRC Staff

APT Allgas identified that it required an additional 11.5 FTE staff starting from 2008-09 to deal with new workflows and exceptions management resulting from new FRC requirements. APT Allgas suggested that the increased workload would arise from an additional 7,500 customer transfers per year, 38,375 services orders per year and 6,500 weekly meter data transactions. APT Allgas identified a need for the following staff:

- (a) Manager: 0.5 FTE;
- (b) market service manager: 1.5 FTE;
- (c) inquiries and exceptions manager: 1.5 FTE;
- (d) complaints: 1 FTE;

- (e) HUB administration: 1 FTE;
- (f) meter data management: 2 FTEs;
- (g) new connections: 1 FTE;
- (h) transfers and market requests: 1 FTE;
- (i) business improvement manager: 0.5 FTE;
- (j) support officers: 1 FTE; and
- (k) FRC project: 1 FTE.

APT Allgas also estimated that it would require an additional three call centre staff to manage forecast call increases as a result of the introduction of FRC. The cost of these additional staff was \$144,000 per annum.

Additional staffing costs are detailed in Table 13.

Table 13: APT Allgas FRC staff expenditure proposal - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total</i>
Additional FRC Staff	193	1,138	1,237	1,336	1,435	5,341
Increased call centre staff		144	144	144	144	576
Total	193	1,282	1,381	1,480	1,579	5,917

Note: Totals may not add due to rounding

Stakeholder Comments

Both Origin Energy and AGL sought clarification on APT Allgas' proposed new staffing levels given that:

- (a) the function of new connections, metering, service ordering and billing existed prior to FRC;
- (b) customer numbers are comparatively small; and
- (c) customer churn is expected to be relatively small.

Consultant's Assessment

PBA noted that, in its June 2007 application, APT Allgas proposed 7.5 FTE and then changed this to 11.5 FTE in its revised data without any explanation.

PBA was of the view that 7.5 FTE represented an efficient resourcing level. Given the expectation of increased transaction volumes and the proportion of manual effort that would be required as a result of these transactions, PBA recommended that an additional 7.5 FTE would be reasonable.

PBA also considered that there would be a period of bedding down of systems and processes during which there would be a requirement for some additional staff. PBA considered that an allowance of an additional two FTE for a period of six months following go-live would be a reasonable allowance for this requirement.

In summary, PBA recommended staff costs of \$193,000 for 2006-07, \$841,000 for 2007-08 and \$742,000 for each subsequent year be accepted.

PBA noted that no supporting justification was provided by APT Allgas for increased call centre staff. However, PBA considered that three operators working 200 days per year and answering one call each five minutes would result in 54,000 calls being answered per year. This would equate to 80% of all customers contacting the call centre each year. On this basis, PBA did not believe the additional call centre staff were justified.

The Authority's Position

Based on the recommendation of PBA, the Authority accepts an additional 7.5 FTE staff would be required by APT Allgas. This is also consistent with the additional staffing approved for Envestra. At an effective cost of \$99,000 per FTE, this equates to additional staff costs of \$742,000 per annum.

The Authority accepts that there will be a period of bedding down during which time system issues would need to be resolved and staff become accustomed to the new systems and processes. The Authority therefore accepts the bedding down costs recommended by PBA for inclusion in the pass-through amount.

The Authority accepts PBA's advice regarding call centre staff and has not included these costs.

A summary of the additional staff costs accepted by the Authority are detailed in Table 14.

Table 14: Additional FRC staff costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommendation</i>
Additional FRC Staff	193	841	742	742	742	3,260	5,341	3,260
Call centre staff	0	0	0	0	0	0	576	0
Total	193	841	742	742	742	3,260	5,917	3,260

Note: Totals may not add due to rounding

4.3 IT Operating Costs

APT Allgas stated that it was faced with two options with respect to operating the HUB system. Either it could host the system in-house or, alternatively, it could out-source the responsibility of hosting the system to an external third party.

As it did not possess the in-house expertise or resources to host the HUB internally, APT Allgas opted for external hosting at a cost of \$1.8 million.

APT Allgas proposed costs of \$203,000 for ongoing IT support associated with FRC computers and help desk provided by external provider Brennan IT be included.

With respect to maintaining its IT licenses, APT Allgas proposed the inclusion of license fees with Hansen Technologies, third party software and IT access codes at a cost of \$1.3 million.

APT Allgas estimated it would incur testing costs of \$61,000 for each retail market entry and assumed that from 2008-09 the market would receive one additional entrant each year.

Consultant's Assessment

PBA considered that external hosting is a common business approach for companies with limited IT resources and is generally considered good business practise. In APT Allgas' case, PBA did not consider that APT Allgas possessed the necessary internal resources to host the HUB system internally and that its decision to out-source this function was sound. PBA noted that APT Allgas had considered two options, one from Hansen Technologies and the other from Logica and that the Hansen Technologies option was chosen based on cost.

As the costs for having the HUB system externally hosted were determined as a result of competing quotes, PBA considered that the \$1.8 million hosting costs were efficient and should be accepted for pass through.

PBA considered that the IT support provided by Brennan IT covered generic IT support, as opposed to providing support for its FRC IT solution. PBA noted that APT Allgas had limited internal resources to manage its IT environment and agreed with APT Allgas' decision to utilise external consultants to provide this function.

PBA noted that licensing arrangements with system vendors such as Hansen Technologies are typically based around the number of customers or meters being serviced and are not typically publicly available. However, on the basis that the process for selection of a core IT system was undertaken in a competitive process, the proposed licensing costs were likely to be efficient. As licensing is a necessary part of IT system ownership, PBA recommended that the Hansen licensing fees be accepted.

With respect to third party licensing cost totalling \$327,000, PBA considered that APT Allgas had provided insufficient information regarding the licensing required for it to be able to make an informed assessment of the costs. For this reason, PBA did not recommend inclusion of these costs in the FRC cost pass through.

With respect to ongoing testing, PBA was of the view that APT Allgas staff should have developed the necessary skills and experience with new processes and systems to be able to assist a new retailer with necessary market testing by the time this event occurs. On this basis, PBA did not recommend that these costs (\$0.2 million) be included.

Overall, PBA recommended the inclusion of \$2.9 million of IT operating costs compared to the \$3.4 million requested by APT Allgas.

The Authority's Position

The Authority accepts that, in some instances, it will be prudent for companies with limited IT resources to have IT functions hosted externally. The Authority recognises that multiple tenders were sought by APT Allgas for this function and accepts that this process was appropriate. For these reasons and based on PBA's recommendation, Authority accepts the proposed hosting costs for pass through.

The Authority accepts that licensing is a necessary part of IT system ownership and notes the fact that the process for selecting a supplier for the IT solution was subject to a competitive tender process. On this basis, the Authority accepts APT Allgas' proposed vendor software license costs of \$923,000.

In the absence of adequate information, the Authority cannot make an informed decision regarding other proposed third party licensing costs of \$327,000 and therefore cannot accept these costs for inclusion in the pass-through amount at this time.

It is not clear to the Authority that costs to cover IT support provided by Brennan IT result solely from its FRC obligations. Whether APT Allgas already had the necessary internal resources to manage its IT system is not relevant to this application, rather the costs being claimed must be shown to be incremental and have been incurred as a direct result of the introduction of FRC and the new obligations this placed on APT Allgas. As this is unclear, the Authority has not included any of these costs (\$203,000) at this time and APT Allgas will need to provide additional evidence to support the inclusion of Brennan IT costs in its response to this Draft Decision.

The Authority accepts that there will be a need for APT Allgas to test its FRC IT solution as new retailers enter the market. However, the Authority agrees with PBA that APT Allgas staff should have developed the necessary skills and experience to assist new retailers with market testing by the time this is required. Based on experience to date, the Authority is also of the view that the forecast rate of market expansion appears highly optimistic. For these reasons, the Authority does not propose to accept the \$183,000 proposed by APT Allgas for future testing.

Overall, the Authority proposes to accept \$2.7 million of IT operating costs compared to the \$3.4 million proposed by APT Allgas. These costs are detailed in Table 15.

Table 15: Third party licensing and IT support costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommendation</i>
Hosting	144	415	415	415	415	1,804	1,804	1,804
Software Licensing	300	153	155	156	159	923	1,250	923
Brennan IT	0	0	0	0	0	0	203	203
New Entrant Testing	0	0	0	0	0	0	183	0
Total	444	568	570	571	574	2,727	3,440	2,930

Note: Totals may not add due to rounding

4.4 Interval Meter Operating Costs

APT Allgas stated that, as a result of FRC, it was required to provide resources to maintain the interval metering telemetry system. APT Allgas proposed that employment of a field technician at a cost of \$90,000 per annum be allowed for this function.

In addition, APT Allgas proposed engaging GasNet to administer, support and process interval meter data. Notwithstanding the outsourcing of these activities, APT Allgas indicated that some residual in-house metering administration would be required and proposed costs of \$41,184 in 2007-08 and \$56,909 in subsequent years.

APT Allgas also proposed the inclusion of costs associated with increased use of its commercial mobile phone system to provide communications between the interval meters and the APT Allgas office as well as minor expenditure associated with replacing batteries at the metering sites. In total, APT Allgas proposed costs of \$13,000 per annum for these items.

Consultant's Assessment

PBA considered that the proposed cost for a technician to maintain the interval meter telemetry system (which equates to \$737 per meter) was a significant amount for maintenance. PBA was of the view that a reasonable estimate of these costs would lie somewhere between an upper

limit of \$950 per site each year (based on the cost of maintaining on-site data and communication equipment in NSW) and a lower limit of \$250 per site each year (representing roughly 10 per cent of the \$2500 cost of an interval meter). PBA considered that around \$600 per site per year would be a reasonable allowance for the cost of maintaining interval meter telemetry systems and was also consistent with what PBA had recommended for Envestra.

The costs proposed by APT Allgas to outsource administration and processing of interval meter data to GasNet equated to \$708 per meter per year. PBA considered that the costs of processing interval meter data would be quite sensitive to meter volumes and that the annual costs proposed by APT Allgas were reasonable given the volume of meters.

PBA considered that the proposed administration expenditure of \$42,000 in 2007-08 and \$57,000 for 2008-09 was excessive considering these costs reflected an allowance for two hours of work per day. PBA considered that applying a labour rate of \$50 per hour was a more reasonable cost and this would translate to an annual cost of \$25,000.

PBA noted that the system used by APT Allgas to read interval meters utilises a commercial mobile phone system to provide communications between the meter and APT Allgas' offices. PBA noted that the nominal increase in these costs reflected recovery of costs for additional interval meters installed over the future regulatory period and considered that these costs be accepted on the basis that they were consistent with mobile communications costs experienced by other utilities utilising mobile phone systems.

The costs associated with the replacement of batteries at meter sites was considered minor by PBA and recommended that they be accepted.

Overall, PBA recommended the inclusion \$786,000 for interval meter operating costs compared to \$1.0 million proposed by APT Allgas.

The Authority's Position

The Authority accepts PBA's estimate of a reasonable cost for the maintenance of a meter of \$600 per site per year on the basis that it is within a reasonable range of costs and is consistent with what the Authority had approved for Envestra for this function.

The Authority acknowledges that costs relating to processing interval meter data are likely to be linked to the scale of the task and accepts PBA's recommendation of approving \$86,000 per annum for pass through against this item.

With respect to administration costs, the Authority accepts PBA's recommendation to approve \$25,000 per annum for cost pass through.

The Authority notes that the nominal increase in costs for utilising APT Allgas' commercial mobile phone system reflects the recovery of reasonable costs and accepts APT Allgas' proposed cost of \$11,000 per annum plus \$1,000 per annum for battery replacements.

In summary, the Authority proposes to accept interval meter operating costs of \$195,000 in 2007-08 and \$197,000 per annum thereafter for pass through . This equates to \$786,000 over the regulatory period.

These costs are detailed in Table 16.

Table 16: Interval metering operating costs accepted by the QCA - - (\$'000 June 2007)

<i>Cost category</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommendation</i>
Field Technician	73	73	73	73	292	432	292
GasNet	86	86	86	86	344	344	344
Administration	25	25	25	25	100	212	100
Telephone Costs	11	12	12	12	47	47	47
Battery Changes	0	1	1	1	3	3	3
<i>Total</i>	195	197	197	197	786	1,040	786

Note: Totals may not add due to rounding

4.5 Market Participation

APT Allgas identified a number of new market participation commitments associated with the introduction of FRC. These included participation in the Energy Ombudsman Queensland (EOQ) scheme (\$115,000 per annum), promotion and training of FRC procedures and processes for customers and industry (\$550,000), attending meetings of market participants and industry stakeholders with the Department of Mines and Energy (DME) on the monitoring of FRC and with VENCORP on market rule changes (\$27,000 per annum).

Stakeholder Comments

Origin Energy suggested that APT Allgas already incurred similar costs from its involvement with the Energy Consumer Protection Office (ECPO) to manage disputes. Origin Energy considered that it was unclear how these costs have been separately accounted for given that the Ombudsman would replace ECPO from 1 July 2007. In addition, given that the Ombudsman would commence from that date, Origin Energy considered that it was unclear why costs were being recovered for 2006-07.

Consultant's Assessment

PBA noted that the Ombudsman participation costs proposed by APT Allgas were 24% higher than the costs proposed by Envestra. PBA could see no reason for APT Allgas to be incurring the higher amount and therefore proposed that the amount of \$93,000 per annum be accepted plus \$5,000 in 2007-08 for the EOQ joining fee.

PBA was not aware of any obligation on APT Allgas to provide industry training on FRC and recommended that these costs not be included. However, PAB considered the costs of attending industry meetings with DME and VENCORP were minor but reasonable and recommended that these be approved.

The Authority's Position

The Authority has confirmed with the EOQ that the fixed cost of the EOQ scheme includes a \$5,000 joining fee and a variable levy to meet EOQ's costs which are allocated across participating businesses based on the ratio of investigations concerning each business. EOQ indicated that APT Allgas had a very low ratio of investigations and APT Allgas' contributions to the EOQ would be closer to \$10,000 per annum than the \$115,000 per annum APT Allgas proposed. While some investigations made against the activities of retailers may indirectly involve APT Allgas, it is difficult to accept that these would increase the level of costs to those

suggested by APT Allgas. For this reason, the Authority proposes to accept Ombudsman scheme participation costs of \$20,000 per annum plus a \$5,000 registration fee.

The Authority agrees with PBA that there do not appear to be obligations on APT Allgas to provide industry training on FRC and does not propose to include these costs.

DME has indicated to the Authority that it is not aware of any cost obligations imposed on APT Allgas by DME with respect to participation in FRC performance meetings.

Nevertheless, the Authority accepts that these meetings did not occur prior to FRC and that APT Allgas may incur some incremental costs from its participation in these meetings. The Authority has included an allowance of \$10,000.

Total market participation costs accepted by the Authority are presented in Table 17.

Table 17: Market participation costs accepted by the QCA - (\$'000 June 2007)

<i>Cost category</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommendation</i>
EOQ Scheme	25	20	20	20	85	460	377
Promotion and Training	0	0	0	0	0	550	0
DME & Vencorp post FRC committee	10	10	10	10	40	107	107
<i>Total</i>	35	30	30	30	125	1,117	484

Note: Totals may not add due to rounding

4.6 System Operating Cost Summary

In summary, the system operating costs the Authority proposes to approve are presented in Table 18.

Table 18: Operating costs accepted by the QCA - (\$'000 June 2007)

<i>Cost Category</i>	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommendation</i>
FRC Implementation								
LogicaCMG ^(a)	0	0	0	0		0	1,357	0
Project management	485	200	0	0		685	732	685
Project establishment	0	0	0	0	0	0	486	0
AGL Testing	0	184	0	0	0	184	184	184
FRC Staff								
Additional FRC staff	193	841	742	742	742	3,260	5,341	3,260
Increased call centre staff	0	0	0	0	0	0	576	0
IT Operating Costs								
Hosting	144	415	415	415	415	1,804	1,804	1,804
Software Licensing	300	153	155	156	159	923	1,250	923
Brennan IT support & management	0	0	0	0	0	0	203	203
New entrant retailers	0	0	0	0	0	0	183	0
Interval meters	0	195	197	197	197	786	1,040	786
Market Participation								
Promotion and training	0	0	0	0	0	0	550	0
Ombudsman Scheme	0	25	20	20	20	85	460	377
DME & Vencorp post FRC committee	0	10	10	10	10	40	107	107
Total	1,122	2,023	1,539	1,540	1,543	7,767	14,273	8,329

Note: Figures may not add due to rounding

(a) Logica costs capitalised and included in approved capital expenditure

5. COST PASS THROUGH SUMMARY

Table 19 provides a summary of the combined capital and operating costs proposed by APT Allgas and the corresponding costs the Authority proposes to approve.

Table 19: Pass-through costs accepted by the QCA - (\$'000 June 2007)

	2006-07	2007-08	2008-09	2009-10	2010-11	Total
APT Proposed						
IT Capex	3,678	6,147	0	0	0	9,825
Interval meters	528	301	0	0	0	829
Total Capex	4,206	6,448	0	0	0	10,654
IT Opex	2,771	3,049	2,370	2,470	2,572	13,232
Telemetry Opex	0	247	264	264	264	1,040
Total Opex	2,771	3,295	2,634	2,734	2,836	14,273
TOTAL	6,977	9,743	2,634	2,734	2,836	24,927
QCA Accepted						
IT Capex	4,298	2,300	0	0	0	6,598
Less Access Arrangement	(4,200)	0	0	0	0	(4,200)
Interval meters	528	301	0	0	0	829
Total Capex	626	2,601	0	0	0	3,227
IT Opex	1,122	1,828	1,342	1,343	1,346	6,981
Telemetry Opex	0	195	197	197	197	789
Total Opex	1,122	2,023	1,539	1,540	1,543	7,767
TOTAL	1,748	4,624	1,539	1,540	1,543	10,994

Note: Totals may not add due to rounding

5.1 Revenue

Based on these costs the Authority is proposing to approve for pass through to customers due to the introduction of FRC, the Authority has calculated the corresponding revenue requirement consistent with the approach used in its 2006 Final Decision on APT Allgas' revised access arrangement. Revenue required is as the sum of:

- (a) operating costs; plus
- (b) tax
- (c) depreciation on new capital expenditure; plus
- (d) a return on new assets.

The allowance for tax comprises the additional tax payable on revenue after operating costs and depreciation have been deducted.

Consistent with the current access arrangement, depreciation has been calculated based on a straight line basis using asset lives as discussed in earlier sections.

A return on new assets has been calculated using the WACC of 8.75 % included in APT Allgas' current access arrangement, applied to new FRC related capital costs.

The cost data provided by APT Allgas was reported in values as at June 2007. For the purpose of calculating the revenue requirement, all figures have been converted to nominal amounts using the same inflation rate of 2.77% used in APT Allgas' revised access arrangement.

Table 20 presents the breakdown of these component parts of the total revenue requirement resulting from APT Allgas' FRC cost-pass-through application as currently proposed for pass through by the Authority.

Table 20: APT Allgas pass-through revenue (\$'000, nominal)

	2006-07	2007-08	2008-09	2009-10	2010-11	Total	NPV
Return on Capital	(27)	168	264	223	180	863	
Depreciation	20	285	542	557	572	1,975	
Operating Costs	1,107	2,051	1,603	1,649	1,698	8,108	
Tax	(77)	(162)	(19)	110	258	110	
Inflationary Gain ^A	8	53	83	71	57	273	
Total	1,069	2,289	2,306	2,469	2,651	10,784	8,220

Note: Totals may not add due to rounding

^A Represents the returns received from the inflation on APT Allgas' asset base.

As previously noted, the Authority allowed APT Allgas to raise a provisional amount of \$2.8 million in its 2007-08 and 2008-09 prices. Raising the remaining revenue requirement over the remaining three years of the current access arrangement period, while maintaining the overall net present value, requires annual revenue increases as detailed in Table 21.

Table 21: QCA accepted APT Allgas revenue pass-through (\$'000, nominal)

	2006-07	2007-08	2008-09	2009-10	2010-11	Total	NPV
FRC Revenue	0	2,800	2,800	2,678	2,678	10,955	8,220

5.2 APT Allgas' proposed tariffs

While the purpose of this Draft Decision is to consider the appropriate level of costs associated with the introduction of FRC to be passed through to customers, rather than to approve resulting prices, APT Allgas has proposed to recover approved FRC costs through charges to be levied in addition to the existing tariffs for use of the gas distribution system.

In determining its pricing proposal, APT Allgas recognised that retail competition was not a new initiative for the largest customers on its network who had been able to choose their retailer for a number of years. In its cost pass-through application, APT Allgas proposed charges as detailed in Table 22.

Table 22: Tariffs proposed by APT Allgas for FRC cost recovery

	2007-08	2008-09	2009-10	2010-11
Volume customers \$ per year	119.02	141.83	25.77	24.84
Demand customers \$ per year	6,899	7,495	3,160	3,160

To raise the provisional amounts allowed by the Authority for 2007-08 and 2008-09, APT Allgas introduced one fixed daily charge for volume customers consuming 0 to 1.7 GJ per day and a second fixed daily charge for demand customers (customers that consume greater than

10TJ per year and are charged on the basis of maximum daily gas deliveries rather than the actual volume of gas consumed).

For 2008-09 these charges were \$0.09 per day (\$32.85 per year excluding GST) for volume customers consuming 0 to 1.7 GJ per day (expected to recover of \$2.3 million) and \$10.79 per day (\$3,938.35 per year excluding GST) for demand customers (expected to recover the remaining \$0.5 million).

Given the similar size of the annual cost pass-through amounts proposed in this Draft Decision to those already included as a provisional amount in 2007-08 and 2008-09 prices, applying the same pricing approach for future years as applied in 2008-09 should not lead to any further price increase for customers as the required amount is already built into the current year's prices.

6. DRAFT DECISION

The Authority's Draft Decision is to approve the pass through of costs by APT Allgas associated with an additional \$7.4 million (nominal) in capital expenditure and \$7.8 million (nominal) in operating expenditure during the current access arrangement period. The Draft Decision is to also remove the allowance of \$4.2 million associated with significant upgrades to APT Allgas' existing (pre-FRC) IT systems included in its current access arrangement.

Based on the same parameters used in the 2006 Final Decision, the Authority has determined the total revenue impact or the cost pass through to be \$10.9 million (in nominal terms) over the remaining years of the current access arrangement.

The additional revenues to be targeted by APT Allgas for its future tariffs are shown in Table 23.

Table 23: Target revenue for future APT Allgas tariffs (\$'000, nominal)

	<i>2006-07</i>	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>Total</i>
FRC Revenue	0	2,800	2,800	2,678	2,678	10,955

Subject to any changes that may be made in the Authority's Final Decision, APT Allgas will be able to recover these additional revenue amounts through the price approval process in the relevant year.