



Final Decision

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

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PREAMBLE

The introduction of Full Retail Competition (FRC) in the Queensland gas market on 1 July 2007 placed certain new requirements on gas distributors including APT Allgas.

APT Allgas' approved 2006 access arrangement allows it to seek approval from the Authority to pass through to customers the costs associated with meeting its FRC obligations.

On 5 June 2007, APT Allgas applied for approval to do so. The initial application sought to pass through \$10.7 million of capital expenditure and \$14.2 million of operating costs that APT Allgas claimed to have incurred (or would incur) directly as a result of meeting its FRC obligations.

Following delays in receiving requested data from APT Allgas, the Authority released a Draft Decision in September 2008. At that time, the Authority proposed to approve \$3.2 million of capital expenditure, which was net of \$4.2 million already being recovered under the current access arrangement for FRC related IT costs and \$7.8 million in operating costs.

In response to the Draft Decision, APT Allgas revised some of its cost estimates based on actual outcomes and accepted some of the adjustments proposed by the Authority in its Draft Decision. This reduced the amount APT Allgas was seeking to pass through to \$6.6 million in capital expenditure and \$9.1 million in operating costs.

Following consideration of APT Allgas' revised application, submissions received from stakeholders and a report prepared for the Authority by PB Associates, the Authority's Final Decision is to approve the pass through of costs associated with \$2.91 million of capital expenditure and \$8.37 million of operating costs.

The Authority's Final Decision will allow APT Allgas to raise an additional \$11.09 million in revenue (in nominal 2006 prices). As APT Allgas, had been permitted to raise a provisional amount of \$2.8 million in its pricing for both 2007-08 and 2008-09, APT Allgas will be allowed to raise a further \$2.75 million in pricing over each of the remaining two years of the regulated period. As this amount is slightly less than that already built into APT Allgas' distribution pricing, this Final Decision should not lead to a further increase in prices.

TABLE OF CONTENTS

	PAGE
PREAMBLE	I
1. INTRODUCTION	1
1.1 Regulation of Gas Distribution	1
1.2 Application for Pass Through	1
1.3 The Authority's Assessment Process	1
1.4 Draft Decision	2
2. FINAL ASSESSMENT OF APT ALLGAS' FRC CAPITAL EXPENDITURE	4
2.1 Draft Decision	4
2.2 APT Allgas' response to the Draft Decision	4
2.3 Internal and Other Costs	6
2.4 Overheads	7
2.5 Access Arrangement Allowance	8
2.6 Summary of Final Capital Costs Accepted by the Authority	12
3. FINAL ASSESSMENT OF APT ALLGAS' FRC OPERATING COSTS	13
3.1 Draft Decision	13
3.2 APT Allgas' response to the Draft Decision	13
3.3 FRC Staff Costs	14
3.4 IT Operating Costs	16
3.5 Summary of Final Operating Costs Accepted by the Authority	17
4. REVENUE AND TARIFFS	18
4.1 Total costs	18
4.2 Revenue	18
4.3 APT Allgas' proposed tariffs	19
5. FINAL DECISION	21

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 extending into the northern New South Wales (NSW) area. The implications of FRC for APT Allgas largely related 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 were 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 do not expire until 30 June 2011.

In its 2006 Final Decision on APT Allgas' current access arrangements, 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. Following meetings with the Authority and its consultants, PB Associates (PBA), APT Allgas advised that it would revise its application. However, as a result of the delays in providing revised information, PBA was not able to complete its draft report until 21 April 2008.

To avoid a situation where distribution prices in the first year of full retail competition were held artificially low, the Authority allowed APT Allgas to include a provisional amount (\$2.8 million) in its 2007-08 pricing to reflect potential FRC related costs. 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 have been taken into account in determining the actual amount the Authority has now approved for pass through.

1.3 The Authority's Assessment Process

In considering APT Allgas' cost pass-through application, the Authority has taken into account the requirements of the National Third Party Access Code for Natural Gas Pipeline Systems (the

Code) and the specific provisions covering cost pass through included in APT Allgas' 2006 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.

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 2006 Final Decision on APT Allgas' 2006 revised access arrangement.

The Authority's Terms of Reference required PBA to identify the new responsibilities APT Allgas faced under Queensland FRC requirements and the options available to address FRC objectives. PBA was also required to report on the prudence and efficiency of the proposed costs given the size of the Queensland network and in comparison to the systems used in other States. Further, the proposed costs were required to be incremental in that they were specifically attributed to the FRC event and not include costs already allowed in previous regulatory decisions. Additional matters which PBA analysed included the cost allocation method and the impacts on gas prices as a result of FRC.

In its report of 18 April 2008, PBA found that the introduction of FRC in Queensland had imposed new requirements on APT Allgas to improve its business functions and systems including IT, telemetry and metering functions. PBA accepted the approach adopted by APT Allgas to purchase an off-the-shelf system and acknowledged that it would not have been possible for APT Allgas to construct a tailor-made FRC compliant IT system given the short amount of time between the purchase of its network and when APT Allgas had to be ready for the commencement of FRC (around nine months). PBA also accepted 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.

However, PBA also found that some capital and operating expenditures proposed by APT Allgas did not satisfy key pass-through tests based on prudence and efficiency grounds.

1.4 Draft Decision

In September 2008, the Authority released its Draft Decision. The Authority accepted that APT Allgas had limited time to evaluate, design and implement systems capable of meeting its FRC obligations. Given the time constraints placed on APT Allgas and the options available, the Authority was satisfied that the choice of FRC system adopted by APT Allgas was reasonable. The Authority's Draft Decision was to approve \$7.4 million of capital expenditure and \$7.8 million of operating costs for pass through by APT Allgas during the current access arrangement period. This compared to \$10.7 million of capital expenditure and \$14.3 million of operating costs proposed by APT Allgas.

A particular concern for the Authority in its Draft Decision, was the failure by APT Allgas to recognise any of the IT related expenditure which was already included in its revised access arrangement as providing any offset to the IT cost now sought for pass through. The PEACE system, considered and approved in the earlier access arrangement, was expected to provide billing, network management and data housing for the business similar to the IT systems now being proposed to meet FRC obligations. Consequently, some IT costs which APT Allgas was seeking to pass through as a result of meeting its new FRC requirements, the Authority considered were already embedded in APT Allgas' existing distribution tariffs. The Authority was of the view that 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 2006 approved access arrangement.

Following the release of the Draft Decision, the Authority received submissions from AGL, Origin Energy and APT Allgas in late October/early November 2008.

AGL and Origin generally supported the Authority's Draft Decision. Origin Energy was of the view that APT Allgas' proposed FRC costs should be limited to incremental costs that are directly attributable to, and required for ensuring, the efficient operation of a competitive gas market.

To assist it in its assessment of APT Allgas's response to the Draft Decision, the Authority re-engaged PBA to assess the updated data and information provided by APT Allgas. PBA subsequently requested further information from APT Allgas which was provided on 6 January 2009. The Authority received PBA's final report on 23 January 2009.

In its response to the Draft Decision, APT Allgas accepted several adjustments made by the Authority in the Draft Decision. Consequently, for this Final Decision, the Authority has focused on those cost items for which APT Allgas was required to provide further information and those items for which APT Allgas continues to propose higher amounts.

2. FINAL ASSESSMENT OF APT ALLGAS' FRC CAPITAL EXPENDITURE

2.1 Draft Decision

In its Draft Decision, the Authority proposed approving \$3.2 million of capital expenditure for the upgrade of APT Allgas' core IT and telemetry systems for FRC purposes, compared to the \$10.7 million proposed by APT Allgas in its original cost pass-through application.

The Draft Decision provided a detailed explanation of the proposed capital costs accepted and not accepted by the Authority at that time. Table 1 provides a summary of these costs.

Table 1: Capital costs included in Draft Decision - (\$'000 June 2007)

	<i>2006-07</i>	<i>2007-08</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>	<i>PBA Recommended Costs</i>
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	1,068	289	1,357	0	1,357
Capex Allowance	4,826	2,601	7,427	10,654	7,881
<i>Minus FRC related costs included in approved Access Arrangement</i>	<i>(4,200)</i>	<i>0</i>	<i>(4,200)</i>	<i>0</i>	<i>(4,200)</i>
Total	626	2,601	3,227	10,654	3,681

Note: Totals may not add due to rounding

2.2 APT Allgas' response to the Draft Decision

In its response to the Draft Decision, APT Allgas accepted several of the adjustments to capital costs proposed by the Authority. However, APT Allgas provided additional information to support higher cost recovery in relation to interval meters, internal and other costs, overheads and the access arrangement adjustment.

The following sections set out the Authority's consideration of remaining capital expenditure issues arising from APT Allgas' response to the Draft Decision.

Interval Meter Capital Expenditure

Draft Decision

In its Draft Decision, the Authority included \$828,000 for the installation of interval meters that included installation of data correctors, data collection systems and modifications to its Supervisory Control and Data Acquisition (SCADA) IT system.

These costs included \$352,000 for installing data correctors to 31 sites which consumed greater than 100TJ per annum. However, the Authority required APT Allgas to identify the 31 sites involved and the original asset values for these sites and advised that the Authority would give this matter further consideration in preparing its Final Decision.

APT Allgas' Response to Draft Decision

In its response to the Draft Decision, APT Allgas provided a list of the 31 interval metered sites and the corresponding (confidential) Meter Installation Reference Numbers (MIRNs) and customer names. APT Allgas stated that these sites were fitted with data correcting flow computers prior to 2000 and that given the age of this capital, its book value had been fully depreciated by the start of FRC. Consequently, APT Allgas replaced the flow computers at these sites as part of its FRC project.

APT Allgas also advised that, while the book value of these flow computers was not known, the full replacement value was \$352,000.

Stakeholder Comments

Origin Energy re-iterated its concern that the costs associated with interval meters for customers consuming more than 100TJ per annum should not be included as part of FRC costs for APT Allgas as these costs would have been incurred irrespective of FRC. This is because the requirement to have interval meters for its large customers (>100TJ) had been in place prior to FRC.

AGL noted that APT Allgas was seeking cost pass-throughs for interval meter installations for customers consuming greater than 10 TJ per annum despite not having commenced any installations as required under its FRC obligations by 30 June 2009. AGL was concerned about whether APT Allgas was in a position to meet this requirement given the time remaining.

Consultant's Assessment

PBA noted that the flow computers previously fitted for data correcting at the 31 sites were comprised of computer technology that quickly becomes obsolete. PBA was of the view that it was reasonable to consider the flow computers installed prior to 2000 as having a depreciation period of five years, similar to other telemetry systems. PBA therefore considered APT Allgas' claim to be reasonable that the flow computers were fully depreciated prior to FRC. PBA recommended including the full replacement value of these flow computers in APT Allgas' cost pass-through application based on its understanding that the timing of replacement had been brought forward to coincide with the FRC project.

The Authority's Position

The Authority notes the concerns expressed by Origin Energy's that the requirement for APT Allgas to have appropriate interval meters for its large customers (>100TJ) had been in place prior to FRC and therefore could not form part of its FRC related costs. Based on the additional information submitted by APT Allgas on the installation of data correctors to the 31 interval meter sites, the Authority agrees with Origin that the expenditure on replacing the flow computers at these sites was not attributable to meeting APT Allgas' new FRC obligations.

The sites involved are for customers consuming more than 100TJ per annum. These customers were contestable prior to the commencement of FRC and appropriate meters were already required to be installed at these sites. The existing flow computers were installed at the 31 sites some time prior to 2000, were fully depreciated and were due for replacement. That the

introduction of FRC might have brought forward the timing of replacement of these flow computers over what might otherwise have been the case does not constitute a reason for the cost of replacement (given they were fully depreciated and hence no residual value was lost due to replacement) to be included in this FRC cost pass-through decision. It would appear that the need to replace these flow computers coincided with the introduction of FRC in July 2007 and that it was convenient for these replacements to be carried out as part of the FRC project, thereby minimising costs overall

While the expenditure was incurred, the Authority does not accept the replacement costs to be eligible for FRC cost pass through.

On this basis, for its Final Decision the Authority has not allowed APT Allgas to recover \$352,000 for the replacement of the data correcting flow computers.

2.3 Internal and Other Costs

Draft Decision

The main item in APT Allgas' internal and other costs category related to the upgrading of 205 network billing meters (\$1.01 million). In its Draft Decision, the Authority required APT Allgas to provide information regarding existing metering at each of the 205 inlet points and an explanation as to why these needed to be upgraded.

While the Authority included these costs in its Draft Decision, it noted that it would reconsider this item in preparing its Final Decision once the required details had been received from APT Allgas.

APT Allgas' Response to Draft Decision

In response to the Authority's Draft Decision, APT Allgas reduced its claimed costs for upgrading network billing meters to \$858,000.

APT Allgas advised that it had been able to design alternative and lower cost solutions for 32 of the original 205 sites and that only the remaining 173 sites still required upgrading in order to delineate the network from consumer piping as well as to provide a reconciliation point for any un-metered supply.

Reflecting this reduction in the number of sites requiring upgrading, APT Allgas proposed to reduce its claimed costs proportionally by 15.6% (that is, 32/205), bringing the total amount sought for cost pass-through to approximately \$858,000, compared to the \$1.01 million included in the Draft Decision.

For the remaining 173 sites, APT Allgas provided the Authority with confidential MIRN and corresponding customer details. APT Allgas stated that the 173 network meters were installed at these sites because:

- (a) they were multi-tenanted premises where meters were located at various points around the building with network meters now providing discrete metering points; and
- (b) they were previously un-metered cooker customers.

Stakeholder Comments

No stakeholder comments were received on this cost item.

Consultant's Assessment

PBA accepted the 173 identified sites required upgrades to the network billing meters. PBA therefore recommended that the previously allowed amount of \$1.01 million for network billing meters in the Draft Decision be adjusted to \$853,000 for the Final Decision.

The Authority's Position

In its Draft Decision, the Authority accepted that distributors are required to install interval meters to replace certain existing meters but, at the time of the Draft Decision, was of the view that APT Allgas had not provided sufficient information to demonstrate that all of the 205 inlet points required upgrading. In light of the information subsequently submitted by APT Allgas and PBA's assessment of that material, the Authority accepts APT Allgas' revised estimate of costs associated with upgrading 173 network billing meter sites and has included \$853,000 for pass-through for this item in its Final Decision.

2.4 Overheads

Draft Decision

In its original cost-pass-through application, APT Allgas proposed a 20% allocation (\$1.15 million) to cover overhead costs associated with the introduction of FRC. In its Draft Decision, the Authority was of the view that it would be unlikely that FRC would place a significant burden on shared corporate services that would result in substantive incremental overhead costs. In the Authority's view, the information provided by APT Allgas at that time did not establish that these costs were directly related to FRC. This view was supported by PBA's assessment.

The Authority also noted that, in any event, it would not accept an ad hoc percentage allowance that was not supported by detailed evidence. The Authority was concerned that there was a real likelihood that many of these overhead costs had already been captured in other specific areas and, for these reasons, excluded the majority of overheads claimed by APT Allgas from the Draft Decision. However, the Authority noted that it was open to APT Allgas to provide the necessary detailed information to support these costs in responding to the Draft Decision.

In the Draft Decision, the Authority only included \$200,000 for short term rental space, \$10,000 for telephony costs and \$150,000 for IT equipment, totalling \$360,000 for this cost category, compared to the \$1.15 million proposed by APT Allgas.

APT Allgas' Response to Draft Decision

In response to the Draft Decision, APT Allgas provided details of three separate items of expenditure to it sought to have an additional \$162,816 added to the overhead costs accepted in the Draft Decision. The additional costs were made up of:

- (a) actual external legal costs incurred against Gadens Lawyers for Hansen and Logica contracts, advice on new FRC laws, Energex data separation for FRC etc, totalling \$73,916;
- (b) actual external regulatory costs incurred for network advisory services for tariff development, FRC advice and FRC submission etc) totalling \$71,900; and
- (c) internal regulatory costs made up of costs relating to the activities of the APA Regulatory Manager based in Sydney dedicating 0.5 days a week for 12 months on FRC

implementation and oversight activities. During this period, work functions generally performed by the Regulatory Manager were outsourced to contractors at a total estimated cost of \$17,000.

Stakeholder Comments

No stakeholder comments were received on this cost item.

Consultant's Assessment

PBA was of the view that the additional overhead costs claimed by APT Allgas in its response to the Draft Decision were reasonable. PBA considered that the additional costs proposed were reasonable for the type of advice sought and that such advice would have been necessary in establishing systems for FRC. PBA therefore recommended that the additional costs proposed by APT Allgas be included in the total overhead cost pass-through allowance.

The Authority's Position

In its Draft Decision, the Authority excluded the majority of overhead costs originally claimed by APT Allgas because it considered it unlikely that FRC would place a significant burden on shared corporate services resulting in substantive incremental overheads. The Authority however, also stated that it was open to APT Allgas to identify and provide details of actual overhead expenditures incurred.

The Authority has considered the three additional expenditure items submitted by APT Allgas in its response to the Draft Decision. The Authority is satisfied that these costs have been reasonably incurred by APT Allgas in connection with meeting its FRC obligations. Therefore the Authority has accepted PBA's recommendation to include these additional \$162,816 of costs.

For its Final Decision, the Authority has increased the amount included under overheads to \$523,000.

2.5 Access Arrangement Allowance

Draft Decision

In its Draft Decision, the Authority noted that in constructing its FRC cost pass-through application, APT Allgas had not recognised any of the IT costs previously approved in the 2006 revised access arrangement which were for systems claimed to provide similar capacities to those now being implemented. 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.

The Authority acknowledged that costs accepted at the time the revised access arrangements were approved are no longer 'on the table', including those for PEACE. However, the Authority stated that those costs were accepted for the 2006 revised access arrangement on the basis that they would provide APT Allgas with certain IT capabilities. The Authority further acknowledged that while the current FRC 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. The Authority concluded that APT Allgas' FRC 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 the incremental costing being provided by APT Allgas, the Authority was unable to match components and costs of the systems that APT Allgas proposed in its cost pass-through application with those of the system that already received funding (PEACE) in the 2006 revised access arrangement. Therefore, the Authority adopted the approach, as it did in considering Envestra's FRC cost pass-through application, whereby all costs relating to the PEACE system were subtracted from the cost of the newer Hansen system which was assessed in its entirety.

The Authority therefore included the costs for Maximo for pass through, offset by the later deduction of the \$4.2 million allowance (in the year in which they were included) for the PEACE system provided to APT Allgas as part of its revised 2006 access arrangement.

APT Allgas' Response to Draft Decision

In its response, APT Allgas argued that the Draft Decision was flawed in its approach of taking costs allowed for in the 2006 revised access agreement and deducting them from the allowed costs for FRC systems. APT Allgas stated that some attempt should be made to identify the costs and differences between the two systems (the PEACE and Hansen HUB system).

APT Allgas noted that costs of the new system (the Hansen HUB system) can be approximately allocated to those necessary for FRC and those not related to FRC functionality. APT Allgas proposed that the \$4.2 million of system costs allocated in the 2006 revised access arrangement should be allowed in the FRC cost recovery process and then adjusted for the non-FRC related proportion at the time of the next access arrangement. APT Allgas stated that it would accept an approach where there is recovery of 80% of IT costs (from the deducted \$4.2 million) which it claimed is the percentage of costs that Hansen Technologies has determined are FRC related.

APT Allgas further stated that to the extent that there is double-counting, this should more appropriately be addressed through the next access agreement rather than the FRC cost pass-through approval.

Stakeholder Comments

Both Origin Energy and AGL strongly supported the Authority's Draft Decision assessment to deduct the allowance for the PEACE system from costs associated with Hansen FRC system as part of this cost pass-through application. Origin Energy stated that this was the correct approach given that the PEACE system is now redundant and has been replaced by the newer Hansen HUB system.

AGL stated that the implementation of the PEACE system should be viewed as an overall capital expenditure cost recovery item and therefore netted out of APT Allgas' IT costs relating to the implementation of FRC.

Consultant's Assessment

PBA did not agree with the arguments advanced by APT Allgas. PBA noted that the Authority had made similar access arrangement allowance deductions for IT system upgrades in Envestra's FRC cost pass-through application and saw no reason why similar deductions should not be made for APT Allgas' FRC cost pass-through application.

PBA also considered that if the Authority were to allow an amount in the FRC cost pass through based on the portion of IT costs that relate to FRC and non-FRC functions, the split of costs would need to be determined on a reasonable basis.

PBA suggested that one method that could be considered to apportion costs would be to assume that APT Allgas had already implemented the Hansen system as its meter data and billing system before FRC commenced (rather than the PEACE system proposed at the time of the access arrangement). The cost of implementing the Hansen system could then be estimated and compared with the actual cost incurred by APT Allgas to implement an FRC ready system and, from the difference in the two costs, the portion relating to FRC could be determined.

Another method suggested by PBA was to assume that APT Allgas had already implemented the PEACE system as its meter data and billing system before FRC commenced and then to estimate the cost of modifying the PEACE system to accommodate the required FRC functionality. However, PBA considered that this approach would likely result in minimal costs being approved as the PEACE system is commonly adopted by utilities to manage FRC functionality and should require minimal modification.

PBA stated that APT Allgas did not adopt either of the approaches described above or provide sufficient information to support its proposed cost split between FRC and non-FRC functionality. PBA also did not consider a "one-line email" from Hansen Technologies as a sufficiently robust source of the 80/20 apportionment of FRC costs proposed by APT Allgas.

PBA also noted that APT Allgas had submitted an allocation of the system functions provided by the Hansen HUB modules which allocated approximately 83% of the Hansen system functionality to meet the Queensland gas industry FRC requirements and 17% of functions for additional APT Allgas processes. However, PBA noted that this method of apportionment was not based on costs and PBA therefore had no way of assessing this proposal. PBA concluded that the method proposed by APT Allgas was not an appropriate method of allocating costs between its FRC and non-FRC tasks in the Hansen system.

PBA further noted that APT Allgas had provided no evidence that its implementation of the Hansen system incurred any additional cost to those which would have been incurred had it proceeded to implement a modern IT system such as PEACE following the 2006 access arrangement.

The Authority's Position

Like PBA, the Authority is not persuaded by the arguments from APT Allgas on this issue. In the 2006 access arrangement review process, (APT) Allgas was provided with the financial capacity to introduce an IT system (PEACE) which it claimed would deliver the technical capacity similar to that system subsequently implemented by APT Allgas in the run up to FRC. The costs of the PEACE system are already being captured in APT Allgas' prices. Customers should not now be required to accept the costs associated with another system simply because the ownership of the business changed and a decision was made to implement a different solution.

While APT Allgas, having purchased the business and confronting the requirements of FRC, appear to have made a sensible decision regarding the IT systems they actually introduced, had the PEACE system been already implemented and available, it should have been able to meet the requirements of FRC. Regardless of which system was ultimately implemented, APT Allgas was already being recompensed for the costs of introducing a system that would have met FRC requirements. If the Authority were to accept the arguments being presented and include now the costs of implementing a second system to provide the same or very similar

technical capacity, customers would in effect be paying for two systems to meet the same purpose.

The Authority is not prepared to revisit the decisions made in approving the 2006 access arrangement. That decision accepted the costs of implementing the PEACE system which, at the time, was argued by (APT) Allgas would provide certain functionality and was a necessary upgrade to existing IT systems. However, in considering this current cost pass-through application, the Authority is also not prepared to ignore the arguments that were made at the time of the 2006 decision and the fact that the 2006 decision provided a level of funding considered reasonable to meet a proposed range of capital and operational expenditure in order to provide a certain level of service to customers. This current decision is in relation to the incremental costs, that is, costs above and beyond those already being recovered in existing prices which were incurred by APT Allgas in meeting its FRC obligations.

If it were possible to undertake a line by line, function by function, cost by cost assessment of the components of the PEACE system versus the components of the Hanson system and identify which of these was a necessary addition in order to meet specific FRC requirements (as opposed to providing APT Allgas with different or additional business options), this may have provided a better measure of the incremental costs being incurred by APT Allgas. However, this information has not been provided to the Authority. While APT Allgas have suggested such an assessment should be the basis of deciding what costs to include, it has not undertaken the analysis or provided the necessary information for such analysis. It is not the Authority's role to make APT Allgas' case for it, but rather to assess the case and claims presented by APT Allgas in seeking approval to pass through additional costs to customers.

On the basis of the available information, either the new system cost can be excluded in total, on the basis that the PEACE system already provided for in the 2006 decision should have provided the needed functionality (as was argued at the time) or the cost of the system actually implemented can be offset by the amount already included in the earlier decision. The Authority has chosen the latter approach as this would appear to recognise the additional costs incurred by the new owner of Allgas while also not requiring customers to pay twice for the same or very similar IT system functionality.

2.6 Summary of Final Capital Costs Accepted by the Authority

The capital costs accepted by the Authority for its Final Decision are presented in Table 2.

Table 2: Final Capital Costs accepted by the Authority (\$'000, June 2007)

<i>Capital Cost Categories</i>	<i>2006-07</i>	<i>2007-08</i>	<i>Total Final Decision</i>	<i>APT Allgas Revised</i>	<i>Total Draft Decision</i>	<i>APT Allgas Application</i>
Core system expenditure	1,511	1,503	3,014	3,014	3,014	3,514
Interval meters	176	301	477	829	829	829
Internal & other costs	1,046	112	1,158	1,158	1,316	1,316
Integration costs and GIS	87	316	403	403	403	3,198
Other Items	84	64	148	148	148	647
Overheads	523	0	523	523	360	1,150
Capitalisation of Logica costs	1,068	289	1,357	1,357	1,357	0
Sub-Total	4,495	2,585	7,080	7,432	7,427	10,654
<i>Minus FRC related costs included in 2006 approved Access Arrangement</i>	(4,200)	0	(4,200)	(840)	(4,200)	0
Total Capex	295	2,585	2,880	6,592	3,227	10,654

Note: Figures may not add due to rounding.

3. FINAL ASSESSMENT OF APT ALLGAS' FRC OPERATING COSTS

3.1 Draft Decision

APT Allgas sought approval to pass through \$14.3 million in operating costs incurred to meet its FRC obligations. The operating costs proposed by APT Allgas included core system FRC implementation costs, additional FRC staff, IT operating costs, market participation costs and telemetry system related costs.

In its Draft Decision, the Authority proposed approving only \$7.8 million of operating costs. The Draft Decision provided a detailed explanation of the proposed operating costs accepted and not accepted by the Authority at that time. Table 3 provides a summary of those costs.

Table 3: Operating costs included in Draft Decision - (\$'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>Total PBA</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

3.2 APT Allgas' response to the Draft Decision

In its response to the Draft Decision, APT Allgas accepted most of the adjustments to operating costs proposed by the Authority. However, APT Allgas provided additional information to

support higher cost recovery for two of its operating cost categories: FRC staff costs and IT operating costs.

The following sections set out the Authority's consideration of remaining operating expenditure issues arising from APT Allgas' response to the Draft Decision.

3.3 FRC Staff Costs

Draft Decision

In its Draft Decision, the Authority accepted that APT Allgas' FRC obligations would create extra demand for staff and increase related costs to operate and maintain the FRC IT system. However, the Authority considered that low rates of customer churn evident in the gas market would not warrant the increases in staff that had been proposed by APT Allgas.

Consequently, the Authority accepted PBA's recommendation that an additional 7.5 FTE staff (compared to the 11.5 FTE staff proposed by APT Allgas) represented an efficient resourcing level for APT Allgas to meet its FRC commitments from 2008-09. The Authority also noted that this decision was consistent with the allowance the Authority had approved for Envestra based on similar reasoning.

Overall, the Authority accepted \$3.26 million for additional FRC staff costs over the regulatory period.

Stakeholder Comments

Origin Energy supported the revision of APT Allgas' operating costs for staff required to administer FRC, particularly given that market churn rates have been relatively low. Origin Energy also stated that many of the functions were already carried out by APT Allgas prior to the commencement of FRC.

APT Allgas' Response to Draft Decision

In its response to the Draft Decision, APT Allgas stated that it was not appropriate to benchmark its FRC staff resourcing level with Envestra because:

- (a) Envestra has prior experience in implementing FRC systems and processes and consequently has mature FRC business and IT systems and existing interface with VENCORP;
- (b) Envestra has more, and larger, networks thus benefiting from economies of scale and scope; and
- (c) the APT Allgas FRC IT system is relatively basic and therefore it should be expected to incur relatively higher operating costs.

APT Allgas stated that activity in its consumer connections area has increased since the introduction of FRC requiring additional staff due to a lack of automated systems and higher than expected interaction with retailers and end users. APT Allgas identified that it had employed an additional 11 FTE staff since the introduction of FRC in 2007 to cope with its FRC market services workload. It claimed that the Draft Decision allowance for 7.5 FTE staff falls short of recovering costs for the additional 11 FTE staff that it currently employs. APT Allgas therefore proposed that an additional \$1.04 million (above the costs included in the Draft

Decision) should be included to allow it to recover costs associated with employing an additional 3.5 FTE staff over three years to 2010-11.

In its response to the Draft Decision, APT Allgas also sought approval to include an additional \$50,000 as an FRC general staff contingency cost. While this cost was not proposed in its original application, APT Allgas stated that this expenditure was now necessary due to the Authority's decision not to approve its proposed IT capital expenditure contingency costs of \$488,000. APT Allgas claimed that, as a result of the removal of the IT contingency costs, it will likely require additional contract labour in the future for the Maximo works management interface until full automation is implemented.

Overall, APT Allgas proposed to recover \$4.35 million in FRC staff costs as presented in Table 4.

Table 4: APT Allgas proposed FRC staff costs (\$'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>APT Allgas Revised</i>	<i>Total Draft Decision</i>
Additional FRC Staff	193	841	1,089	1,089	1,089	4,301	3,260
General Staff Contingency	0	0	17	17	17	50	0
Total	193	841	1,106	1,106	1,106	4,351	3,260

Note: Figures may not add due to rounding

Consultant's Assessment

PBA stated that none of the information submitted by APT Allgas had led it to revise its view of the appropriate number of staff required to meet APT Allgas' FRC requirements. Based on the levels of transaction information provided by APT Allgas and benchmarking with other companies, PBA was unable to substantiate APT Allgas' claims for a higher FTE staff allowance.

In response to APT Allgas' suggestion that its FRC staffing level should not be benchmarked against Envestra because APT Allgas has a much smaller network and is new to the FRC environment, PBA reiterated its previous view that there will be a period of bedding down of systems and processes during which there would be a requirement for some additional staff. Whilst PBA considered that two FTE staff for a period of six months was sufficient to cover this requirement, it noted that an allowance for this was already made in the Draft Decision and recommended that no further allowance be made.

Accordingly, PBA maintained its previous view that an additional 7.5 FTE staff to meet FRC requirements represented an efficient resourcing level.

The Authority's Position

The Authority remains of the view that APT Allgas' proposed additional FRC staff level is higher than that of a prudent and efficient provider. The Authority does not consider that APT

Allgas has provided a credible justification as to why its FRC staffing level allowance should be higher than that determined in the Draft Decision.

In its Draft Decision, the Authority noted that low rates of customer churn evident in the gas market do not justify the increases in FRC staff that had been proposed by APT Allgas. The Authority did not receive any new evidence from APT Allgas to indicate that it is or will be experiencing any significantly higher rates of customer churn.

While the Authority accepts that having a smaller network compared to Envestra, and less automated system processes, may result in some differences in operating costs, the information provided by APT Allgas does not support its higher forecast of FRC workload. The Authority agrees with PBA's assessment that the levels of transaction information provided by APT Allgas do not adequately substantiate APT Allgas' claims for higher FTE staff allowance.

The Authority considers that its allowance of 7.5 FTE for additional FRC staff proposed in the Draft Decision remains appropriate.

With respect to the additional \$50,000 in general staff contingency costs proposed by APT Allgas, the Authority is unclear why these costs are likely to be incurred in the future due to the removal of capital expenditure contingency costs. The capital expenditure contingency allowance was not included in the Draft Decision because, given the passage of time, the APT Allgas IT systems should have been completed and major capital expenditure required already undertaken. The Authority also noted that APT Allgas had entered into largely fixed price contracts and that provisions have already been allowed for modifications and change requests to its systems. On this basis, the Authority is not persuaded that general staff contingency costs are necessary to APT Allgas' FRC functions.

3.4 IT Operating Costs

Draft Decision

In its Draft Decision, the Authority could not make an informed decision regarding APT Allgas' proposed third party licensing costs totalling \$327,000 due to inadequate information provided by APT Allgas at that time.

Stakeholder Comments

No stakeholder comments were received on this cost item.

APT Allgas' Response to Draft Decision

In its response to the Draft Decision, APT Allgas revised its third party licensing costs from \$327,000 down to \$257,565. In support of this lower amount, APT Allgas stated that it had incurred \$182,789 (\$166,172 excluding GST) in third party software licensing costs in 2007 from Hansen Technologies and provided an itemised invoice to substantiate this claim. In addition, APT Allgas sought a further \$30,465 per annum for three years in licensing maintenance costs.

Consultant's Assessment

In its review of APT Allgas' response to the Draft Decision, PBA considered that the revised claim for \$257,565 sought for third party software licensing was reasonable and reflected actual costs incurred in 2007-08.

PBA also confirmed that there is an ongoing requirement for APT Allgas to pay third party licensing maintenance fees for its FRC related IT software and that its estimate for the licensing maintenance fees were appropriate.

The Authority's Position

Following receipt of actual invoiced costs for third party software licensing, the Authority is satisfied that these costs were incurred as part of APT Allgas' FRC IT operating costs. The Authority has also accepted PBA's view on the reasonableness of APT Allgas' proposed estimate of licensing maintenance costs and has therefore included an additional \$257,565 sought by APT Allgas in third party licensing costs.

3.5 Summary of Final Operating Costs Accepted by the Authority

The operating costs accepted by the Authority for its Final Decision are presented in Table 5.

Table 5: Final Operating expenditure accepted by the Authority (\$'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 Final Decision</i>	<i>APT Allgas Revised</i>	<i>Total Draft Decision</i>	<i>APT Allgas application</i>
FRC Implementation									
LogicaCMG ^a	0	0	0	0	0	0	0	0	1,357
Project management	485	200	0	0	0	685	685	685	732
Project establishment	0	0	0	0	0	0	0	0	486
AGL Testing	0	184	0	0	0	184	184	184	184
FRC Staff									
Additional FRC staff	193	841	742	742	742	3,260	4,351	3,260	5,341
Increased call centre staff	0	0	0	0	0	0	0	0	576
IT Operating Costs									
Hosting	144	415	415	415	415	1,804	1,804	1,804	1,804
Software Licensing	300	319	185	186	189	1,181	1,181	923	1,250
Brennan IT support & management	0	0	0	0	0	0	0	0	203
New entrant retailers	0	0	0	0	0	0	0	0	182
Interval meters	0	195	197	197	197	786	786	786	1,038
Market Participation									
Promotion and training	0	25	20	20	20	85	85	85	460
Ombudsman Scheme	0	0	0	0	0	0	0	0	550
DME & Vencorp post FRC committee	0	10	10	10	10	40	40	40	107
Total Opex	1,122	2,189	1,569	1,570	1,573	8,025	9,116	7,767	14,273

*Note: Figures may not add due to rounding
a \$1.4 million for the Logica contract capitalised, see Table 3*

4. REVENUE AND TARIFFS

4.1 Total costs

A summary of the total capital and operating costs accepted in this Final Decision is provided in Table 6.

Table 6: Total capital and operating costs accepted by the Authority (\$'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 Final Decision</i>	<i>APT Allgas Revised</i>	<i>Total Draft Decision</i>	<i>APT Allgas application</i>
Total Capex	295	2,585	0	0	0	2,880	6,592	3,227	10,654
Total Opex	1,122	2,189	1,569	1,570	1,573	8,025	9,116	7,767	14,273

4.2 Revenue

Based on the final costs the Authority has accepted 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 Weighted Average Cost of Capital (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 7 presents the breakdown of these component parts of the total revenue requirement resulting from APT Allgas' FRC cost-pass-through application as determined by the Authority.

Table 7: APT Allgas pass-through revenue (\$'000, nominal)

	2006-07	2007-08	2008-09	2009-10	2010-11	Total	NPV
Return on Capital	13	139	234	194	152	732	
Depreciation	15	273	528	542	557	1916	
Operating Costs	1,107	2,219	1,635	1,681	1,731	8,373	
Tax	(74)	(181)	(16)	115	264	108	
Inflationary Gain ^a	4	44	74	61	48	231	
Total	1,057	2,406	2,306	2,471	2,656	10,897	8,313

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 years of the current access arrangement period, while maintaining the overall net present value, requires annual revenue increases as detailed in Table 8.

Table 8: APT Allgas revenue pass-through accepted by the Authority (\$'000, nominal)

	2006-07	2007-08	2008-09	2009-10	2010-11	Total	NPV
FRC Revenue	0	2,800	2,800	2,746	2,746	11,091	8,313

4.3 APT Allgas' proposed tariffs

While the purpose of this Final 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 in its application 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 9.

Table 9: Tariffs proposed by APT Allgas for FRC cost recovery

	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>
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 that the size of the annual FRC cost pass-through amounts determined by the Authority in its Final Decision is slightly less than those already included as provisional amounts in 2007-08 and 2008-09 prices, applying the same pricing approach should not lead to any further price increase for customers (and of itself should produce a small price decrease) as the required amount is already built into the current year's tariffs.

5. FINAL DECISION

The Authority's Final Decision is to approve the pass through of costs by APT Allgas associated with an additional \$2.91 million (nominal) in capital expenditure and \$8.37 million (nominal) in operating expenditure during the current access arrangement period.

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 \$11.09 million in nominal terms over the remaining years of the current access arrangement or \$8.31 million in net present value terms.

The additional revenues to be targeted by APT Allgas for its future tariffs are shown in Table 10.

Table 10: 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>	<i>NPV</i>
FRC Revenue	0	2,800	2,800	2,746	2,746	11,091	8,313