

Revised Regulatory Proposal ICT Capex Summary



Part of the Energy Queensland Group

Executive Summary

The AER's ICT capex assessment method considered the forecast expenditure within two sub-categories:

- Recurrent ICT capex; and
- Non-recurrent ICT capex.

Through the Draft Decisions (DDs), the AER included reduced substitute amounts for each of the sub-categories.

Energex and Ergon Energy appreciate the feedback and perspectives provided by the AER, EMCA and our customers through the DD process. In the Revised Regulatory Proposals (RRPs) we therefore accept the AER's substitute ICT capex positions as follows:

- We accept the AER's substitute position on recurrent ICT capex with a small exception regarding the calculation of the substitute value for "other minor application upgrades and updates"; and
- We accept the AER's substitute position on non-recurrent ICT capex without further amendment.

Contents

Executive Summary.....	i
1 Introduction	1
2 AER Draft Decisions.....	1
2.1 Overview	1
2.2 Recurrent ICT capex.....	1
2.3 Non-recurrent ICT capex.....	1
3 Energex and Ergon Energy RRP.....	2
3.1 Overview	2
3.2 Recurrent ICT capex.....	2
3.3 Non-recurrent ICT capex.....	3
Removal of “contingency” from investment estimates	3
Reduction due to deliverability concerns.....	3
Benefits traceability.....	4

1 Introduction

This document summarises the changes Energex and Ergon Energy have made from the Regulatory Proposals (RPs) to the Revised Regulatory Proposals (RRPs) for ICT capex in response to feedback received from the AER and our customers.

2 AER Draft Decisions

2.1 Overview

The AER's ICT capex assessment method considered ICT capex within two sub-categories. I.e. Recurrent ICT capex and Non-recurrent ICT capex. Through the Draft Decisions (DDs), the AER included reduced substitute amounts for each of these two sub-categories as summarised below.

2.2 Recurrent ICT capex

Recurrent ICT capex includes the following capex forecast elements:

1. Shared Energy Queensland infrastructure;
2. Video Conferencing (VC) equipment renewal;
3. End user devices;
4. Infrastructure storage;
5. Servers;
6. Minor applications change & compliance; and
7. Other minor application upgrades and updates.

Through the DDs, the AER noted that based on “top-down assessment” the total forecast recurrent ICT expenditure would appear to be a reasonable forecast of prudent costs¹. EMCa also considered most elements of the recurrent ICT program to be reasonable, with the exception of the proposed “other minor application upgrades and updates” capex where the RP forecast was higher than the current regulatory control period (RCP)².

On this basis, the AER substituted recurrent ICT capex amounts for Energex and Ergon Energy reflecting 100% of cost elements 1 to 6 (above) and 50% of item 7 (i.e. “other minor application upgrades and updates”).

2.3 Non-recurrent ICT capex

Energex and Ergon Energy's RP forecast for non-recurrent ICT capex comprises a program of 18 planned investments to consolidate and replace existing capability for sustainability, operational security and efficiency.

Through the DDs, the AER endorsed the overall objectives of the non-recurrent ICT program but determined the non-recurrent ICT capex forecast is not a reasonable forecast of prudent and efficient costs. The AER also determined that for prudence and efficiency, the portfolio of work would be undertaken over a longer timeframe to reduce delivery and resourcing risk³.

Particular concerns identified in the DDs included:

- Each business case included an additional cost element based on the estimation accuracy of each cost forecast. The DDs identified these amounts as a form of “contingency” which has

¹ AER Draft decision – Energex 2020–25, Attachment 5: Capital expenditure, Page 5-50

AER Draft decision – Ergon Energy 2020–25, Attachment 5: Capital expenditure, Page 5-51 - 5-52

² EMCa Report - Review of aspects of Ergon Energy and Energex's proposed 2020-25 capex, Pages 82 - 87

³ AER Draft decision – Energex 2020–25, Attachment 5: Capital expenditure, Page 5-51

AER Draft decision – Ergon Energy 2020–25, Attachment 5: Capital expenditure, Page 5-52

been removed in the substitute amounts.

- The AER has expressed concern regarding the deliverability of the complex and interdependent ICT program.
- The AER also questions the tangible contribution of the identified ICT investment benefits towards Energex and Ergon Energy's productivity improvement.

In assessing the non-recurrent ICT program, EMCa identified that:

- The elements of Energy Queensland's governance and management framework for ICT are generally consistent with good industry practice⁴.
- The inclusion of an estimation accuracy allowance within each business case forecast is equivalent to a "contingency" which should not be included⁵.
- The complexity of the forecast program and the interdependencies across RCP boundaries may lead to delivery delays⁶.
- It is operationally and commercially prudent to replace the nominated systems in the next RCP or shortly thereafter, but it is likely there will be some slippage in the program⁷.
- A reasonably detailed explanation of the source of assumed savings and benefits realisation assumptions was provided. Given the stage of each project in its lifecycle they considered the approach to be reasonable and the claimed benefits to be a reasonable approximation⁸.

On the above basis, through the DDs the AER substituted non-recurrent ICT capex amounts reflecting removal of the estimation accuracy allowances within each business case (i.e. "contingency") and a further reduction of 15% to reflect the potential for delivery delays due to the complexity of the program and lack of confidence in the contribution of the ICT benefits towards Energex and Ergon Energy's productivity improvement.

3 Energex and Ergon Energy RRP

3.1 Overview

Energex and Ergon Energy appreciate the feedback and perspectives provided by the AER, EMCa and our customers through the DD process. With our RRP, we accept the substitute ICT capex positions described in the DDs in most regards (with a small exception in recurrent ICT capex as described in the next section).

3.2 Recurrent ICT capex

As noted in section 2.2 (above) the AER and EMCa supported most of the cost elements within Energex and Ergon Energy's recurrent ICT cost forecast. The one exception related to the forecast for "other minor application upgrades and updates" where the AER substituted an amount of 50% "to align the forecast to current period actual levels"⁹.

We agree it is reasonable that the forecast should be reduced to align with current period actuals, however we believe this would require the Energex and Ergon Energy forecasts for this cost element to reduce by 45.0% and 25.5% respectively, rather than 50% as indicated in the DDs. Our reasoning for this interpretation is provided in the paragraph below. However, if the AER determines this

⁴ EMCa Report - Review of aspects of Ergon Energy and Energex's proposed 2020-25 capex, Paragraph 344

⁵ EMCa Report, Paragraph 345

⁶ EMCa Report, Pages 81-82

⁷ EMCa Report, Pages 87-95, Paragraphs 394, 403-404, 411-413, 417-418, 425-426

⁸ EMCa Report, Paragraph 436

⁹ AER Draft decision – Energex 2020–25, Attachment 5: Capital expenditure, Page 5-50 - 5-51

AER Draft decision – Ergon Energy 2020–25, Attachment 5: Capital expenditure, Page 5-51 - 5-52

reasoning to be invalid, we are satisfied in accepting the 50% DD amounts through the AER's Final Decisions.

Within the EMCa report¹⁰, the combined Energy Queensland forecast for "other minor application upgrades and updates" was identified as being 56%¹¹ higher than the current period (Energex is 81.7%¹² higher and Ergon Energy is 34.1%¹³ higher). Therefore, to align with current period levels, the combined Energy Queensland forecast for "other minor application upgrades and updates" would reduce by 35.9%¹⁴ (the Energex forecast should reduce by 45.0%¹⁵ and the Ergon Energy forecast should reduce by 25.5%¹⁶). This is the only ICT capex cost element where Energex and Ergon Energy's RRP's differ from the AER's DDs.

3.3 Non-recurrent ICT capex

Energex and Ergon Energy recognise and accept the perspectives provided by the AER, EMCa and our customers regarding non-recurrent ICT capex. Our RRP therefore reflects the AER's substitute amounts for this ICT capex sub-category without amendment. In accepting this position, we provide the following response to the key items raised.

Removal of "contingency" from investment estimates

The business cases provided with the RP were preliminary in nature, incorporating a 6-7 year outlook for planned investment. With long range planning such as this, there is inherent uncertainty associated with initiative scopes, delivery methods and timing. As such, an estimation accuracy allowance was included to reflect Energex and Ergon Energy's confidence in each respective estimate.

We believe this allowance for estimation uncertainty differs from contingency allowances employed as a project management tool following approval of a detailed business case. Nonetheless, we acknowledge the AER's position that such uncertainties may have positive impacts on total costs for some investments which may offset negative impacts for other investments.

Reduction due to deliverability concerns

We acknowledge the complexity of our ICT works program and plans for the coming period. Across our ICT program, we have embedded several key actions to manage delivery risks and maintain solution quality. These include:

1. Consolidation of strategic transformation initiatives within an integrated delivery portfolio.
2. The strategic portfolio is under the leadership of a highly experienced external Program Director, with an Executive steering committee and Board oversight.
3. We make use of external solution providers and vendors to provide required delivery capacity and expertise.
4. We continue to plan and manage the program interdependencies and sequencing, along with the required vendor services, resourcing and business change impacts.

Nonetheless, we recognise the concerns as expressed by the AER, EMCa and our customers. While accepting the AER's substitute values for non-recurrent ICT capex, Energex and Ergon Energy will continue to manage program delivery within the reduced forecast, maximising delivery efficiency with

¹⁰ EMCa Report - Review of aspects of Ergon Energy and Energex's proposed 2020-25 capex, Page 85 Paragraphs 373-374 and Figure 46

¹¹ 56% is $(\$35.4M / \$22.7M) - 1$

¹² 81.7% is $(\$18.9M / \$10.4M) - 1$

¹³ 34.1% is $(\$16.5M / \$12.3M) - 1$

¹⁴ 35.9% is $1 - (1 / 1.56)$

¹⁵ 45.0% is $1 - (1 / 1.817)$

¹⁶ 25.5% is $1 - (1 / 1.341)$

priority on risk mitigation, sustainability, security and productivity enablement.

Benefits traceability

Through the RPs and subsequent information requests, Energex and Ergon Energy provided available detail regarding the forecast benefits for each planned initiative. In accepting the AER's substitute values for non-recurrent ICT capex, we are recognising the AER's concern regarding the contribution of ICT benefits towards Energex and Ergon Energy's productivity improvement.

Energex and Ergon Energy remain committed to realisation of forecast ICT program benefits as enablers of the companies' productivity improvement.